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"Not Just Pious Passages": The Disclosure Requirements of the Franchises Act

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Cases Considered:

Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc., 2008 ABCA 276

In this Court of Appeal decision, three of Alberta's most experienced justices determined that the disclosure requirements of the *Franchises Act*, R.S.A. 2000, c. F-23 were indeed required and that "must" meant "must." The *Franchises Act* gives franchisees a right to accurate and complete information about franchisors and franchises and backs up that right with the remedy of rescission. The reserved reasons for judgment of Madam Justice Elizabeth McFadyen, concurred in by Madam Justice Carole Conrad, are a restrained seventeen paragraphs long (including statements of the relevant facts and applicable statutory provisions). The much lengthier reserved reasons for judgment of Mr. Justice Jean Côté are a *tour de force*, providing a thorough review of the policies behind the laws requiring disclosure in the franchising context and thus much fodder for arguments by counsel in future cases. In the end, both sets of reasons recognize the exclusively statutory nature of franchisors' obligations and franchisees' remedies.

Hi Hotel Limited Partnership, the franchisee, bought a hotel that had been operated as a Holiday Inn and entered into negotiations to acquire a new franchise from Holiday Inn, the franchisor. Holiday Inn provided a disclosure package, but the trial judge found that package was missing the signatures of the franchisor's officers or directors and a date on a certificate, as required by the *Franchises Act* and the *Franchises Regulation*, Alberta Regulation 240/1995. The required certificate was there, but it was not signed and it was not dated.

Nevertheless, Hi Hotel and Holiday Inn subsequently entered into a franchise agreement and operated under that agreement for a few months until a dispute arose about the franchisee's obligations to renovate the hotel. The franchisee sought legal advice and their lawyer noted the absence of the signatures and a date on the certificate. The franchisee then sent a notice of rescission of the franchise agreement to Holiday Inn and sued for a declaration of rescission. The franchisor counterclaimed for an additional $1,125,000 in fees and penalties allegedly due under the franchise agreement.

The franchisee stood on its legal rights under the *Franchises Act* and its regulations. In the Act, section 4(3)(a) states that a disclosure document "must" comply with the requirements of

the regulations. Section 2(3)(a) of the *Franchises Regulations* provides that "a disclosure document … must include a certificate . . . that must be dated and must be signed by at least 2 officers or directors of the franchisor . . . " and section 2(5) provides that the date of the disclosure document is the date set out in the certificate. The regulations also specify the form of certificate, requiring the franchisor's officers or directors to certify that the disclosure document contains no untrue information and does not omit material facts. Section 13 of the Act gives a franchisee a right to rescind if a franchisor fails to deliver the disclosure document in a timely fashion. The franchisee has to give notice they are rescinding within 60 days of receiving the disclosure document or within two years of the franchise being granted, whichever comes first.

Section 13 of the Act provides a franchisor with a bit of leeway from these strict requirements, setting out that disclosure is properly given if the disclosure document is "substantially complete." The franchisor in this case argued that the absence of signatures and a date on the certificate were merely technical defects and compliance was substantial.

The franchisor also tried to rely on the fact that the disclosure documentation did not in fact mislead the franchisee. The franchisee admitted that it had not relied on the disclosure document in entering into the franchise agreement and admitted that the dispute arose entirely from dealings after the franchise agreement was signed and not from any problems with disclosure. Holiday Inn therefore argued the franchisee was merely using the absence of signatures and a date as an excuse to get out of the franchise.

The matter was initially heard by a Master of the Court of Queen's Bench in the fall of 2006 as an application for summary judgment by the franchisee. The Master dismissed the application and the franchisee appealed to the Court of Queen's Bench. Mr. Justice Paul Chrumka concluded that the signature and dating requirements were mandatory and that the franchisor had not substantially complied with the disclosure requirements because the certificate was an essential part of the disclosure document. He therefore found that the franchise agreement had been effectively rescinded by the franchisee. See *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*, 2007 ABQB 686.

Holiday Inn's appeal to the Court of Appeal was dismissed. Justice McFadyen indicated that, while she generally agreed with the lengthy and detailed reasons of Justice Côté, she preferred to limit the scope of her decision to three issues (at para. 121):

> (a) whether the trial judge erred in finding that Holiday Hospitality Franchising Inc. ("Holiday") never provided a signed and dated certificate;
> (b) whether legislation requiring that the franchisor provide a certificate signed by two officers or directors as part of the disclosure is mandatory; and
> (c) whether the failure to provide the required certificate is sufficient to justify the grant of the remedy of rescission where the dispute between the parties does not relate to any misrepresentation or any misleading disclosure and does not result from any defect in the disclosure.

On the first issue, Justice McFadyen found that the chambers judge was right to conclude that Holiday Inn had not provided a signed and dated certificate as part of the disclosure document. The evidence of the franchisee on this point was not contradicted.

She also concluded the chambers judge was correct to hold that there is no disclosure as required by the Act unless a signed and dated certificate is included in the disclosure document. Justice McFayden held that the "must" language of the disclosure provisions, as well as the legislative intent to provide protection for prospective franchisees, supported the chambers judge's conclusion that the omissions of signatures and a date were fatal errors.

In connection with legislative intent, I would note that the original Alberta franchise legislation - the first of its type in Canada - came into effect in 1971. However, in 1995, Alberta made a major change in the way it regulated franchising, switching from a registration approach to a disclosure approach. The basic principle behind the current approach is the disclosure of necessary information to franchisees to allow them to make an informed decision about entering into the franchise agreement. As Justice Côté notes (at para. 12), "[t]he common law and equity give a number of types of relief to someone who has contracted because of misrepresentation. But the *Franchises Act* goes far beyond franchisors who misstate facts." See also Edward N. Levitt, "New Directions in Canadian Franchise Legislation" (1998) 15 Franchise Law Journal 83 and Chad E. Coleman, "The Alberta Franchises Act, a Change in Approach for the First Provincial Regulation of the Franchising Industry in Canada" (1998) 11 Transnational Lawyer 135.

On the third issue, Justice McFayden simply looked to section 13 of the *Franchises Act* and noted it entitles a prospective franchisee to "rescind all franchise agreements" if the franchisor fails to provide the disclosure document. She indicated that it was irrelevant whether the disclosure document was misleading or not, irrelevant that the franchisee did not rely on the disclosure document, and irrelevant that the franchisee suffered no detriment due to the defective disclosure. Although she does not say so explicitly, the arguments of the franchisor on this issue are the type of arguments that would be properly made if the remedy was the equitable remedy of rescission. In the context of a statutory remedy of rescission, however, those types of arguments are out of place. The statute itself states the pre-conditions for the remedy. They were satisfied here.

On the question of whether the franchisor's certificate was in substantial compliance, Justice McFayden merely notes (at para. 136) that "[t]he certificate, signed and dated as required by the Regulations, is a mandatory part of the disclosure. Until there is substantial compliance, there is no disclosure." All we know about substantial compliance from this decision for the majority of the Court of Appeal is that, whatever it is, it is not an undated, unsigned certificate. No reasons are offered for this finding.

Justice Côté's concurring opinion is to be preferred on this aspect of the case. If Justice McFadyen's judgment is a model of judicial restraint, Justice Côté's judgment is a thorough, albeit somewhat rambling, look at why the disclosure requirements are mandatory, why there

was no substantial compliance on the facts, the analogies between the franchise legislation and the legislation requiring disclosure in the securities context, how to interpret protective legislation - and more.

One of the most interesting aspects of Justice Côté's judgment is the way that he positions the court's decision as one that promotes freedom of contract and produces certainty for business people. On the first point, he acknowledges (at para. 19) that the principle of freedom of contract generally yields to that of consumer protection, often because of the disparity of knowledge about goods and services being sold to consumers. But the *Franchises Act*, he notes, only interferes with franchisor's contractual rights in a certain sense. The legislation calls for disclosure before any franchise agreement is entered into. At most, it is "a restriction on future contracts, in a way known ahead of time to both parties" (at para. 21). He might have also noted that the free enterprise marketplace in which freedom of contract reigns supreme is a marketplace with perfect information. The *Franchises Act*, by seeking to redress the information imbalance between franchisors and prospective franchisees merely seeks to improve the marketplace.

The certainty point is made in connection with the franchisor's arguments that the franchisee was a sophisticated investor not in need of the Act's protection and it was unfair for the franchisee to rely on the technicalities of the Act when they had nothing to do with why the franchisee wanted out of its bargain. Justice Côté notes that the court has two choices when confronted with these types of unfairness arguments in the context of statutory duties and remedies. The court could interpret the Act as laying down hard and fast rules that apply to all franchisees and franchisors in the province regardless of their sophistication or motives. Alternatively, they could interpret the Act as leaving the application of rules with fuzzy boundaries up to the discretion of individual judges deciding what would be fair in each case. Hard and fast rules create certainty. If all certificates accompanying disclosure documents under the *Franchises Act* must have the required signatures and must be dated - no exceptions - then franchisors will soon adapt their business practices to comply with the rules.

Justice Côté's points parallel the classic points made about the role of equity in our legal system. In the context of rules laid down in legislation rather than by the common law, however, there is no room for equitable arguments unless a particular statute allows for them. Thus, when the franchisor argued that the franchisee simply rescinded because it was financially advantageous to it to do so, Justice Côté's apt reply was: "With respect, that is no answer . . . Only a malcontent or crank would do so if the transaction was profitable for him or her" (at para. 108).

In this statutory context, the franchisor's argument that there had been substantial compliance is the closest to an argument about fairness that is allowed by the *Franchises Act*. All other complaints about inequities are irrelevant.

Justice Côté's reasons for finding that a certificate with a complete absence of signatures cannot be in substantial compliance are set out in a section entitled "Do These Omissions Matter?" (at paras. 45 - 99). He addresses the wording of the provisions requiring signatures on the certificate,

noting not only their mandatory nature but also the fact the certificate is the only overall statement about the disclosure and therefore "the linchpin of the substance of the disclosure" (at para. 61). He notes that section 9(1) of the *Franchises Act* gives franchisees a new statutory right to sue for damages and that the persons who can be sued include not just the franchisor but also "every person who signed the disclosure document." The only signature required on the disclosure document is the signature on the certificate. Why can they be sued? A person who signs the certificate has a duty (when the consequences of sections 1(q), 9 and 10 are combined) to "conduct an investigation sufficient to provide reasonable grounds for believing" that the facts stated are accurate and complete (at para. 73). Requiring personal verification by an officer or director ensures corporate officers are accountable for the quality and accuracy of the disclosures. As the Ontario Securities Commission said of similar requirements for prospectuses in the securities context, the statements ". . . are not just pious passages that appear as a matter of form at the end of every prospectus": *Re A.E. Ames & Co.*, 1972 O.S.C.B. 98 at 112. Justice Côté also analogizes to other aspects of securities legislation and trends and addresses the franchisor's argument that the franchisee did not need the disclosure.

Justice Côté deals with the absence of a date on the certificate much more quickly, having concluded the absence of any signature is fatal. He merely notes that many of the disclosure requirements are geared towards the date on the certificate, including the scope of the information and deadlines for rescinding.

In the end, all three judges affirm the Court of Queen's Bench declaration of effective rescission by the franchisee. The judgments serve notice that Alberta's *Franchises Act* disclosure requirements will be strictly construed in favour of franchisees, the party the legislature intended to protect.

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