

Franchising - Canada

Failure to Comply with Disclosure Requirements Leads to Rescission

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In a recent Alberta Court of Appeal decision it was unanimously held that a franchisor's failure to comply with a technical disclosure requirement gave way to rescission of the franchise agreement.

Facts

In *Hi Hotel Limited Partnership v Holiday Hospitality Franchising Inc* the franchisee, Hi Hotel Limited Partnership, purchased a hotel that was previously run as a Holiday Inn.

(1) The franchisee decided to continue running the hotel under the Holiday Inn chain and entered into negotiations with Holiday Hospitality Franchising Inc.

The franchisor sent the franchisee a disclosure package as required under the (Alberta) Franchises Act and the parties signed a franchise agreement. However, the franchisee did not renovate the hotel as agreed between the parties and as a consequence the franchisor threatened contractual penalties. The franchisee subsequently tried to cancel the franchise agreement on the grounds that the franchisor had not provided a signed and dated certificate as required under the Franchises Act. As such, the franchisee served a notice of rescission and sued for a declaration of same. The franchisor counterclaimed for heavy contractual penalties.

Evidence submitted at trial confirmed that no signed or dated certificate was ever provided to the franchisee, nor was any of the disclosure material signed or dated. In such circumstances, the Franchises Act provides a franchisee with a right of rescission.

At trial the franchisee was awarded a summary judgment for an amount to be determined and the franchisee's rescission of the franchise agreement was maintained. The franchisor appealed the trial decision before the Alberta Court of Appeal.

Issue

The main issue at the heart of the dispute was whether the franchisor's breach of franchise legislation through its failure to provide the franchisee with a signed and dated certificate of completeness and accuracy was material enough to allow the franchisee to rescind the franchise agreement.

Decision

The Alberta Court of Appeal commenced its analysis by reiterating the principal objectives of the Franchises Act, which are to ensure that franchisors provide accurate and complete information to franchisees and to provide franchisees with appropriate remedies in case of a franchisor's breach of its disclosure requirements. The Alberta Court of Appeal also reviewed the rules of interpretation with respect to consumer and investor protection legislation and concluded that such legislation should not be narrowly construed, but rather interpreted broadly and consistently in favour of the franchisee.

One of the franchisor's principal allegations was that it was dealing with a sophisticated franchisee that was trying to get out of a franchise agreement by using

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unimportant technical defects as an excuse. Conversely, the franchisee's rebuttal was that it was neither sophisticated nor experienced and that the franchisor was a much larger and more sophisticated corporation.

In response to these allegations the court of appeal noted the dangers of holding a 'trial of fairness' every time there is a breach of franchise legislation and indicated that the issue was one of statutory interpretation rather than common law. Accordingly, the franchisor breached franchise legislation by failing to sign and date disclosure documents and provide the necessary certification of completeness and accuracy. Contrary to the franchisor's allegations, this was not a harmless deviation of mere form, but rather a defect of significant importance. In fact, the wording of the Franchises Act emphasizes that disclosure documentation must comply with franchise regulations; in turn, the relevant regulations indicate that disclosure documents must include the necessary certificate and such certificate must be signed and dated.

Furthermore, the Alberta Court of Appeal drew an interesting parallel between franchise and securities legislation by stressing the importance associated with ensuring that a prospectus is signed and certified by the directors or promoters of the issuer. The court of appeal deemed an unsigned prospectus as "almost useless". As such, it concluded that legislation calling for the signature of two officers or directors cannot be regarded as a mere technicality, irrespective of whether a franchisee relies on same. Moreover, the Franchises Act does not exempt large or sophisticated franchisees. Even the most experienced hotel operators in Canada require the type of information that the franchisor was obligated to disclose and certify under the act.

The Alberta Court of Appeal noted that an erroneous or incomplete date alone on a signed certificate may not necessarily be fatal, depending on the circumstances. However, the combined effect of an absent signature and date was fatal.

Finally, the Alberta Court of Appeal also rejected the franchisor's other principal argument that the franchisee was too late in requesting rescission. Accordingly, the time limit should have started to run from the date on which the franchisee received the disclosure documentation. However, under the circumstances and given the breach, the disclosure documentation was never deemed to have been received and therefore the time limitation could not be deemed to have lapsed.

In view of the foregoing, the Alberta Court of Appeal affirmed the Court of Queen's Bench's declaration of effective rescission. Since the franchise agreement had been rescinded, the franchisor's counterclaim was dismissed.

Comment

This unanimous decision from the Alberta Court of Appeal highlights the importance for franchisors of ensuring compliance with technical requirements under franchise legislation. Non-compliance can render franchise agreements void.

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Endnotes

(1) 2008 ABCA 276.

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