

# A Deep Dive into Disclosure Dilemmas

*Franchise Law*

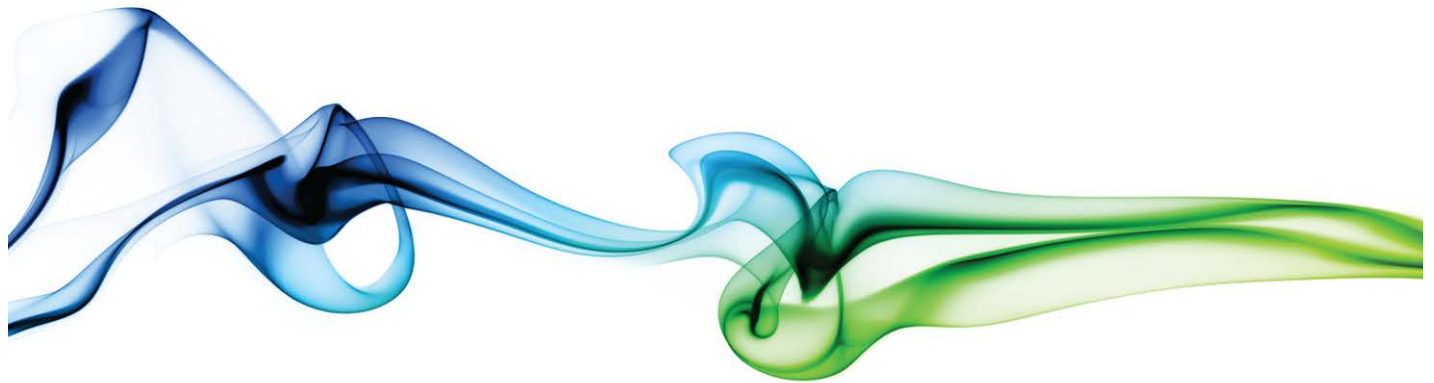
Wednesday, March 25, 2015  
5:30pm - 8:00pm

## **PROGRAM CHAIR**

Larry Weinberg, Cassels Brock & Blackwell LLP  
Jordan Druxerman, Garfinkle Biderman LLP

## **SPEAKERS**

Andrae Marrocco, Dickson Wright LLP  
Kathy Steffan, Welch LLP  
Mark Jackson, Welch LLP  
Dominic Mochrie, Osler, Hoskin & Harcourt LLP  
Dixie Ho, Morrison Brown Sosnovitch LLP



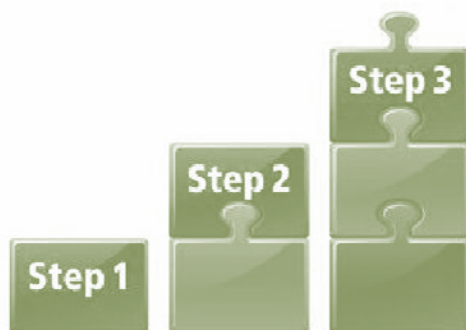
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# US Financial Statements in a Canadian Franchise Disclosure Document



## Wishart Act Requirement

3. (1) Every disclosure document shall include,
- an **audited financial statement** for the most recently completed fiscal year of the franchisor's operations, **prepared in accordance with generally accepted auditing standards that are at least equivalent to those set out in the *Canadian Institute of Chartered Accountants Handbook***;
  - a financial statement for the most recently completed fiscal year of the franchisor's operations, **prepared in accordance with generally accepted accounting principles that are at least equivalent to the review and reporting standards applicable to review engagements set out in the *Canadian Institute of Chartered Accountants Handbook***; or
  - if a regulation has been made under subsection 13 (2) of the Act in respect of the franchisor, a declaration that the franchisor is exempt from the requirement to provide the financial statement described in clause (a) or (b), and that the franchisor meets the criteria prescribed for the purpose of that exemption. [O. Reg. 581/00, s. 3 \(1\)](#); O. Reg. 69/04, s. 3; O. Reg. 199/05, s. 1.

## Subject to Interpretation

- What does “at least equivalent” mean?
  - Is there a ranking system to standards?
  - Does the other standard have to have all of the requirements of the Canadian standards (plus possibly additional standards)?
- Different standard for audited statements vs reviewed statements
  - Audited statements make no reference to the reporting standards used



## Audit Standards

- Canadian Auditing Standards based on International Auditing Standards (IAS)
  - Some paragraphs added to provide additional clarity
- Since 2007, the US auditing standards have been converging with IAS

## Audit Standards

- There are no significant differences between Canadian Auditing Standards and US generally accepted audit standards
  - Terminology differences
  - Removal of non-applicable material from US standards
  - Items presented in a different order
  - Some US rules slightly more prescriptive



## Review Standards

- Similarly, the review standards in Canada and the US are nearly identical.
- These standards focus primarily on inquiry and analytical procedures
- Negative assurance provided
  - Nothing has come to our attention that causes us to believe that the financial statements are materially misstated.

## Accounting Standards

- Canadian generally accepted accounting standards consist of four parts:
  - International Financial Reporting Standards (IFRS)
  - Accounting Standards for Private Enterprises (ASPE)
  - Accounting Standards for Not-for-Profit Organizations (ASNFPPO)
  - Accounting Standards for Pension Plans (ASPP)



## Accounting Standards

- US generally accepted accounting standards take a one size fits all approach
  - Most closely aligns with IFRS
  - However there are differences that could have a material impact on the financial statements

## US GAAP vs Canadian GAAP

- These differences apply to both ASPE and IFRS
- Common examples (not a comprehensive list)
- Inventory
  - Last-in-first-out permitted in US, not in Canada
  - Write-downs can be reversed in Canada, not US

## US GAAP vs Canadian GAAP

- Intangible Assets
  - Purchased intangibles – more likely recognized in US than in Canada
  - Capitalization of development costs – not permitted in US, may be permitted in Canada
- Factored receivables with recourse – can derecognize asset in US, not in Canada



## US GAAP vs Canadian GAAP

- Revenue recognition
  - Many differences
  - Key is to look for complex revenue arrangements (e.g. multiple deliverables)

## Impact on Your Clients

- Safest approach – consult with a Canadian CPA prior to issuing the financial statements
- Look out for indicators discussed previously
  - Complex financial statements more likely to have differences
- Basic financial statements
  - Consider attaching comfort letter to the statements, signed by a Canadian CPA





## Questions?

## Contact Us!

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## OSLER

“What hath the *Pet Valu* decision wrought? Is there now going to be a continuing disclosure obligation of all material facts during the term of the franchise agreement?”

OBA Franchise Law Dinner Program  
March 25, 2015

Dominic Mochrie

Osler, Hoskin & Harcourt LLP

## OSLER

### History of the Case

- 2014 Summary Judgment
  - 7 common issues. Gist: “*the defendant said it had substantial purchasing power; it was contractually obliged to share the volume-related pricing benefits with the franchisees; it did not do so.*” [2].
  - During proceedings, focus shifted to suggestion by the court to add 8<sup>th</sup> common issue, focussing on volume discounts
  - Motion to amend by plaintiff to add 8<sup>th</sup> common issue
  - Findings for Pet Valu in common issues 1 – 5
  - Common Issues 6 – 7 reserved pending resolution of 8<sup>th</sup> common issue
- 2015 Motion to Amend
  - Proposal of 8<sup>th</sup> common issue
  - Motion dismissed due to prejudice against Pet Valu
  - Decision on common issue 6
  - Deferral of common issue 7

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## Common Issues

Common issues:

- 1. Has the defendant breached its contractual duty to the Class Members at any time during the Class Period by failing to share Volume Rebates with them? [2014: No.]
- 2. If the answer to common issue # 1 is yes, has the defendant breached its contractual duty to the Class Members at any time during the Class Period by: [2014: N/A]
  - (a) charging a mark-up on private label products without giving Class Members credit for their proportionate share of Volume Rebates in respect of such products?
  - (b) imposing a distribution charge on the price of products without giving Class Members credit for their proportionate share of Volume rebates in respect of such products?
- 3. Has the defendant breached the duty of fair dealing to the Ontario Class Members under [section 3](#) of the [Arthur Wishart Act \(Franchise Disclosure\) 2000, S.O. 2000, c. 3](#) (the "A.W.A.") by any of the conduct described in common issues 1 and 2 above, if so found? [2014: N/A]
- 4. If the conduct described in common issues 1 and 2 above did not constitute a breach of the Franchise Agreement, has the defendant been unjustly enriched by such conduct, if so found? [2014: No.]
- 5. What is the aggregate amount of damages for the breaches of any of the duties referred to in common issues 1, 2 and 3 above, or the aggregate amount of compensation for unjust enrichment, if so found? [2014: N/A]

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## Common Issues

- 6. Did the defendant have a duty at common law to the Class Members or under [section 3](#) of the [A.W.A.](#) to the Ontario Class Members to disclose the following information to the Class Members or to some of them, and if so, did it breach such duty:
  - (i) whether the defendant or its affiliates receives Volume Rebates in respect of purchases which are made by the defendant or its affiliates for wholesale to the Class Members; [2014: Reserved. 2015: Yes.]
  - (ii) the defendant's policy in respect of the allocation of Volume Rebates to Class Members and, in particular, whether the defendant complied with sections 22(e) and (f) and 23(c) of the Franchise Agreement; [2014: Reserved. 2015: No.]
  - (iii) the amount of Volume Rebates received by the defendant or its affiliates during the Class Period; [2014: Reserved. 2015: Yes.]
  - (iv) the amount of Volume Rebates retained by the defendant or its affiliates and the amount, if any, that was shared with Class Members; [2014: Reserved. 2015: Yes.]
  - (v) the criteria that were used by the defendant to determine how much of the Volume Rebates were retained and how much, if any, were shared with the Class Members? [2014: Reserved. 2015: No.]

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### Common Issues

- 7. If the answer to common issue 6 is yes, is the plaintiff entitled to an order requiring the defendant to disclose such information forthwith and what damages, if any, is the defendant required to pay for the breach of such duty? [2014: Reserved. 2015: Reserved.]
- 8. Did the defendant have a duty at common law or pursuant to s. 3 or s. 5 of the *Arthur Wishart Act* to truthfully disclose to franchisees, in the disclosure document, the franchise agreement or otherwise during the course of the relationship of the parties, whether it possessed substantial or significant purchasing power and whether it received significant volume discounts offered by suppliers?
  - If yes, did it breach its duty or duties?
  - If yes, what damages or remedies are the class members entitled to, if any? [2015: Not certified]

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### Representations re: Volume Discounts

- Disclosure Document: *By virtue of its significant purchasing power, Peton Distributors Inc. is able to take advantage of volume discounts offered by suppliers.* [24]
- *The purchasing power/pricing benefits theme is continued in the body of the Agreement itself. In s. 27(a) of the Agreement, the franchisee acknowledges that “a fundamental component of the Pet Valu System” is “the ability of PVCI to coordinate and consolidate buying activities and to obtain lower prices for the benefit of all Pet Valu stores by purchasing in larger quantities on a centralized basis.”* [26]
- *The franchise agreement also provides in s. 22(f) that “volume allowances granted to [Pet Valu] by a supplier or manufacturer based on [Pet Valu’s] annual purchasing volume shall be allocated as more particularly set forth in the Pet Valu Franchise Business System.” This provision reinforces the representation in the disclosure statement by noting that volume allowances granted by suppliers and based on Pet Valu’s “annual purchasing power” can be expected and will be allocated or shared in some fashion with the franchisees.* [27]

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### Good faith = failure to correct?

- Failing to correct previous disclosure?
  - *“Pet Valu said one thing in the disclosure document ... and then failed to advise its franchisees that this was actually not the case.” [9(7)].*
  - *“The point is that Pet Valu, contrary to its representations in the disclosure document and franchise agreement, was never able to generate a meaningful amount as was promises and expected and never told its franchisees the truth.” [47].*

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### Good Faith = disclosure obligation?

- Cites Salah, Country Style & Cuts Fitness
- SCC in Bhasin: Not a duty of disclosure
- Shoppers v. Spina
- Is GF&FD a codification of common law, or something more?
  - *“It is generally accepted that section 3(1) is a codification of the common law.” [41]*
  - On Bhasin: *“...one must remember that the Court was making this comment in the context of good faith in the common law and was not dealing with franchise relationships...” [58]*


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## Good faith = Misrepresentation = Rescission?

- Good faith or misrepresentation?
  - “powerful representation” [25]
  - “disclosure of all material facts” [57]
  - Informed decision [51, 52]
- Good faith or rescission?
  - Re: plaintiff’s positions on common issue 8:
    - *If the claim is damages for losing the opportunity to rescind had timely disclosure been made, then the appropriate remedial vehicles are ss. 7 or 3. [36]*
    - *The plaintiff alleges that it lost the opportunity to rescind and recover damages had timely (and truthful) disclosure been provided. In my view, the s. 7 claim is at least tenable and worthy of trial. [37]*

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## Questions?

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# Material Fact “Yes it is...No it isn’t...”

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March 25, 2015

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BARRISTERS AND SOLICITORS

What to do when a client does  
not want to include in their  
FDD what the lawyer believes  
is a material fact?

## Assumptions

- Client is an organization
- Franchise is in Ontario
- It is a material fact
- You are preparing and sending out the disclosure document

## Considerations

- Advising your client
- Your professional duties and obligations
- Other considerations

## Advising the client

Ensuring that the client understands:

- The purpose of the *Arthur Wishart Act (Franchise Disclosure), 2000 (Ontario)*
- The statutory definition of material fact
- The approach of the courts in interpreting *Wishart* and the definition of “material fact”
- The consequences of deficient disclosure and, in particular, the *personal liability* of the directors/officers who sign the FDD
- The consequences of a claim for damages for rescission and/or misrepresentation

## Advising the client

### Documenting your advice to the client

- Memo to client
  - WHO does that include?
- Your covering letter when delivering the FDD
- Marking documents as privileged and confidential
  - Memos, draft FDDs, client correspondence, description of services in client invoices
- Ensuring that documents remain protected by solicitor-client privilege

## Professional Duties and Obligations

### Who is your client?

- Commentary in definition of “client” in the Rules
  - *For greater clarity, a client does not include a near-client, such as a... director, shareholder, employee... unless there is objective evidence to demonstrate that such an individual had a reasonable expectation that a lawyer-client relationship would be established.*



## Professional Duties and Obligations

Who is your client?

- Rule 3.2-3- When the client is an organization
  - Who are you getting instructions from?
  - Who is signing the disclosure certificate?
- Commentary: *In addition to acting for the organization, the lawyer may also accept a joint retainer and act for a person associated with the organization. An example might be a lawyer advising about liability insurance for an officer of an organization. In such cases the lawyer acting for an organization should be alert to the prospects of conflicts of interest and should comply with the rules about the avoidance of conflicts of interest*

## Professional Duties and Obligations

Who is your client?

- Section 7 of Wishart imposes joint liability against the franchisor, its agent, broker, associate and every person who signed the FDD
  - Do you have any duties to each of them?
  - Should they be advised of their obligations/rights?
    - E.g. Consider the statutory defence in subsection 7(5) of Wishart available to persons who are jointly liable in a misrepresentation claim

## Professional Duties and Obligations

*Is preparing a deficient FDD “assisting” in “dishonest” or “illegal conduct”?*

- Rule 3.2-7 Dishonesty, Fraud, etc. by Client or Others
  - *A lawyer shall not knowingly assist in or encourage any dishonesty, fraud, crime, or illegal conduct or instruct a client or any other person on how to violate the law...*
  - *3.2-7.1 A lawyer shall not act or do anything or omit to do anything in circumstances where he or she ought to know that, by acting, doing the thing or omitting to do the thing, he or she is being used by a client, by a person associated with a client or by any other person to facilitate dishonesty, fraud, crime or illegal conduct.*

## Professional Duties and Obligations

*Acting for an organization that intends to act “dishonestly” or “illegally”?*

- Rule 3.2-8 Dishonesty, Fraud, etc. when Client an Organization
  - *When retained by an organization to act in a matter in which the lawyer knows that the organization... intends to act dishonestly, fraudulently, criminally or illegally*
- Going “up the ladder”

## Professional Duties and Obligations

### *Going "Up the Ladder":*

- *(a) advise the person from whom the lawyer takes instructions and the chief legal officer and/or the chief executive officer, that the conduct is dishonest and should be stopped;*
- *(b) if such person(s) refuse to cause the conduct to be stopped, advise progressively the next highest persons (board of directors, trustees, etc.) that the conduct is dishonest; and*
- *(c) if the organization, despite the lawyer's advice, intends to pursue the wrongful conduct, withdraw from acting in the matter in accordance with rules in Section 3.7*

## Professional Duties and Obligations

### *Loss of Confidence*

- *Rule 3.7-2: Optional Withdrawal: Subject to the rules about criminal proceedings and the direction of the tribunal, where there has been a serious loss of confidence between the lawyer and the client, the lawyer may withdraw.*
- *Commentary: A lawyer may have a justifiable cause for withdrawal in circumstances indicating a loss of confidence, for example, if ...the client refuses to accept and act upon the lawyer's advice on a significant point ...*

## Professional Duties and Obligations

What if your client acts contrary to your advice that a material fact should be included in the FDD and the issue becomes the subject of a rescission claim:

- Are you conflicted and prevented from acting for the client in the defence of the rescission claim?
- Should your client be advised of this potential conflict at the outset when you deliver the FDD to them?

## Other Considerations

- Consider how your client's refusal to follow your advice affects your professional risk generally
- Confidence in future dealings with client
- Reputation
- Representing client in the event that the franchisee rescinds

# Material Fact “Yes it is... No it isn’t...”

S. Dixie Ho  
OBA Franchise Law Section  
March 25, 2015

**MORRISON BROWN SOSNOVITCH** LLP  
BARRISTERS AND SOLICITORS

## OBA's Franchise Law Section: A Deep Dive into Franchise Disclosure Dilemmas

Who is an “*officer*” for the purposes of preparing a Franchise Disclosure Document (“**FDD**”) under the Arthur Wishart Act (Franchise Disclosure), 2000 (“**Act**”) and Regulations (“**Regulations**”).

- The role of an “officer” under the Act.
- The potential consequences for an “officer” under the Act.
- Why does this matter to the franchisor.
- Who is an “officer?”
- *Danforth-Woodbine Theatre Ltd vs Loblaws Inc.*
- Ordinary dictionary meaning, legal dictionary meaning and commentary.
- *Ontario Business Corporations Act* perspective.
- Considerations in light of the *Securities Act*.
- Conclusions.

Presented by:

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# Who is an “officer” for the purposes of preparing a Franchise Disclosure Document under the *Arthur Wishart Act and Regulations*

Presented by  
Andrae Marrocco | Dickinson Wright LLP

## The role of an “officer” under the Act

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[If selected by the franchisor] sign the certificate certifying the veracity and completeness of the Franchise Disclosure Document

Section 7 of the Regulations

## The potential consequences for an “officer” under the Act

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The franchisee has a statutory right of action for damages against officers who signed the certificate where it suffers loss because of: (a) misrepresentation in the FDD, or (b) noncompliance with FDD requirements

Section 7 of the Act

## Why does this matter to the franchisor

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1. FDD must set out particular information pertaining to the officers



## Why does this matter to the franchisor

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The business background of the directors, the general partners and the officers of the franchisor, including,

- the name and current position of each person,
- a brief description of the prior relevant business experience of each person,
- the length of time each person has engaged in the line of business associated with the franchise, and
- the principal occupation and the employers of each person during the five years immediately preceding the date of the disclosure document.

Section 2. 2. of the Regulations

## Why does this matter to the franchisor

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1. FDD must set out particular information pertaining to the officers.
2. Franchisor may decide to have officers sign the certificate.

Who is an “officer?”

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*Danforth-Woodbine Theatre Ltd vs Loblaws Inc.*

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Ordinary dictionary meaning

vs

*Ontario Business Corporations Act* definition

## Ordinary dictionary meaning, legal dictionary meaning and commentary

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- A holder of a senior post in a society, company, or other organization: 'a chief executive officer' – Oxford Dictionary
- A person appointed by the board of directors of a firm, such as a president, CEO, vice president, etc., to manage the day-to-day business of the firm and to carry out the policies set down by the board – BusinessDictionary.com
- A person appointed or elected to some position of responsibility or authority in the government, a corporation, a society, etc. – Dictionary.com

## Ordinary dictionary meaning, legal dictionary meaning and commentary

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- A person employed in connection with the administration and management of a department.
- The chairman and any vice-chairman of the board of directors, the president, any vice-president, the secretary, any assistant secretary, the treasurer, any assistant treasurer, the general manager and any other person designated an officer by by-law or by resolution of the directors, and any other individual who performs functions for a company similar to those normally performed by an individual occupying any of those offices.
- The chairperson of the board of directors, the president, a vice-president, the secretary, the treasurer, the comptroller, the general counsel, the general manager, a managing director, of an entity, or any other individual who performs functions for an entity similar to those normally performed by an individual occupying any of those offices.

Daphne Dukelow, eds, *Dictionary of Canadian Law*, 4<sup>th</sup> ed (Toronto: Carswell 2011) *sub verbo* "officer";

## *Ontario Business Corporations Act perspective*

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**Subsection 1(1) of the OBCA**, “officer” means an officer designated under section 133 and includes the chair of the board of directors, a vice-chair of the board of directors, the president, a vice-president, the secretary, an assistant secretary, the treasurer, an assistant treasurer and the general manager of a corporation, and any other individual designated an officer of a corporation by by-law or by resolution of the directors or any other individual who performs functions for a corporation similar to those normally performed by an individual occupying any such office

## Considerations in light of the *Securities Act*

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## Conclusion

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- Senior position or a position of responsibility or authority within a corporation.
- An individual who is part of the management team that oversees the management and administration of the corporation's affairs.
- An individual appointed or designated by the board of directors or the bylaws.
- Chairman or vice-chairman of the board, president, vice-president, chief executive officer, secretary, treasurer, general manager, managing director, controller, general counsel.
- OPEN ENDED...