

# FIRST REPORTED DECISION UNDER NEW BRUNSWICK'S FRANCHISES ACT ON DISCLOSURE DOCUMENT FATAL FLAWS

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In the first reported decision under New Brunswick's *Franchises Act*, R-SNB 2014, c. 111 (the "Act"), *Alphataho Inc., et al v Maaco Canada Partnership LP, et al* ("*Alphataho v Maaco*"),<sup>[1]</sup> the Court of Queen's Bench of New Brunswick held that the failure to include statute-compliant financial statements in a franchise disclosure document ("FDD") entitled the franchisee to avail itself of the 2-year rescission remedy available under the Act. The Court relied heavily on jurisprudence from Ontario in reaching its decision that this deficiency rose to the level of a "fatal flaw" in terms of franchise disclosure under the Act.

## Background

The principal issue in this summary judgment was whether the FDD provided by the franchisor defendants (collectively "Maaco") was compliant with section 5 of the Act and the Disclosure Document Regulation, NB Reg 2010-92 (the "Regulation"). More particularly, to what extent did the deficiency with respect to the financial statements constitute a lack of disclosure entitling the franchisee to rescind the franchise agreement.<sup>[2]</sup>

By way of general background, the well known brand, Maaco, grants franchises for the establishment and operation of automotive painting and collision repair shops. Mr. Hussain was interested in investing in a Maaco franchise and was provided with an FDD on February 12, 2017. Mr. Hussain entered into a franchise agreement with Maaco in April 2017, and subsequently incorporated, and assigned the franchise agreement to, AlphaTaho Inc. (collectively, the "plaintiffs").

The plaintiffs sent a notice of rescission on October 19, 2018. While the plaintiffs alleged several deficiencies in the franchisor's FDD, the principal issue the Court considered was the lack of statute-compliant financial statements.

## New Brunswick's Franchises Act

The Court noted that the Act is comparable to Ontario's *Arthur Wishart Act (Franchise Disclosure), 2000* ("AWA").

Section 5 of the Act sets out a franchisor's disclosure obligations, which include a requirement to include a

copy of the franchisor's financial statements in the FDD. More specifically, subsection 7(4) of the Regulation requires the financial statements to be for the most recent fiscal year. However, if the relevant disclosure is within 180 days of the most recently completed fiscal year, subsection 7(5) requires disclosure of the financial statements from the year prior to that.

While Maaco provided the FDD to Mr. Hussain within 180 days of the 2016 fiscal year end, it included its 2014 financial statements. The analysis in this case turned on whether the failure to provide the 2015 financial statements, as required by section 5 of the Act and subsection 7(5) of the Regulation, amounted to "no disclosure at all," thereby entitling the franchisee to rescind the franchise agreement at any time up to two years from the date of the franchise agreement pursuant to subsection 6(2) of the Act.<sup>[3]</sup>

### **The Decision**

Relying heavily on Ontario-based franchise cases, the Court concluded that the failure to provide statute-compliant financial statements constituted a fatal defect in disclosure entitling the plaintiffs to rescind the franchise agreement.

While Maaco acknowledged its failure to disclose the 2015 financial statements, relying on the Ontario authority *Raibex Canada Ltd v ASWR Franchising Corp.*,<sup>[4]</sup> Maaco argued the position that this "imperfect disclosure" did not "effectively deprive Mr. Hussain of the opportunity to make an informed investment decision."<sup>[5]</sup> The Court rejected both of Maaco's arguments advanced in support of this position.

First, Maaco argued that had the 2015 financial statements been disclosed, such statements would have served to demonstrate its improved financial position (which would have provided Mr. Hussain additional assurance, not less). The Court relied on *Mendoza v Active Tire & Auto Inc.*,<sup>[6]</sup> and *2611707 Ontario Inc., et al v Freshly Squeezed Franchise Juice Corporation, et al*,<sup>[7]</sup> to reject this argument. Reference was specifically made to *Mendoza*, which states that the remedy of rescission depends only on the franchisor's failure to disclose.<sup>[8]</sup>

Second, Maaco argued the seriousness of not including statute-compliant financial statements in the FDD was mitigated by the undisputed fact that it qualified for an exemption from such disclosure requirement under s. 8(1)(b)(vi) of the Regulation. Maaco further submitted that it was a mere technical flaw to omit the prescribed statement in the FDD that advises the franchisee that it is not providing financial statements due to meeting the requirements of the exemption. Agreeing with the plaintiffs, the Court held that the failure to claim the exemption is "not a mere technical defect"<sup>[9]</sup> and the requirement to give the required notice by inclusion of the prescribed statement that the franchisor is claiming such exemption is substantive. Furthermore, the Court agreed with the plaintiffs' submission that to permit retroactive exercise of the exemption would undermine the intent of the legislation and encourage poor behaviour by franchisors. Notably, the Court referenced several Ontario decisions that recognize the failure to include the requisite financial statements as a fatal flaw

or complete failure of disclosure.<sup>[10]</sup>

## Takeaways

While the conclusion reached by the Court in *Alphataho v Maaco* is not surprising given the jurisprudence from other Canadian provinces, the decision is valuable in that it sets a precedent for New Brunswick, which is consistent with the approach taken in other provinces that have enacted franchise legislation. Furthermore, franchisors that qualify for an exemption from financial statement disclosure requirements should exercise caution before automatically including financial statements in their FDD. Particularly, where franchisors can or wish to rely on an exemption from that disclosure requirement.

[1][ps2id id='1' target=''] 2022 NBQB 25 [*Alphataho v Maaco*].

[2][ps2id id='2' target=''] *Ibid* at para 2.

[3][ps2id id='3' target=''] *Ibid* at para 44.

[4][ps2id id='4' target=''] 2018 ONCA 62.

[5][ps2id id='5' target=''] *Alphataho v Maaco*, *supra* note 1 at para 46.

[6][ps2id id='6' target=''] 2017 ONCA 471 [*Mendoza*].

[7][ps2id id='7' target=''] 2021 ONSC 2323.

[8][ps2id id='8' target=''] *Alphataho v Maaco*, *supra* note 1 at para 48, citing *Mendoza*, *supra* note 6 at para 38.

[9][ps2id id='9' target=''] *Alphataho v Maaco*, *supra* note 1 at para 52.

[10][ps2id id='10' target=''] The Court noted *Sovereignty Investment Holdings Inc. v 9127-6907 Quebec Inc.*, 2008 CarswellOnt 6547 (ONSC), 792341 *Canada Inc. v Dollar It Ltd.*, 2009 ONCA 385, and 2619506 *Ontario Inc. v 2082100 Ontario Inc. et al*, 2020 ONSC 6817.

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## A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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