



# Courts Clarify Rescission Rights Under Ontario's Franchise Law

Debi M. Sutin

Franchise legislation in each of the provinces of Alberta, Ontario and Prince Edward Island require franchisors to provide a disclosure document to prospective franchisees for the purposes of allowing these prospective franchisees to make an informed investment decision regarding their purchase of, and investment in, a franchised business. The disclosure document required by the legislation in each of these provinces must contain, among other prescribed information and documents, information regarding the franchisor, the business to be franchised, and certain particulars regarding the franchise system. Although substantially similar, the disclosure requirements of these provinces do have some significant differences. This article will focus on Ontario's franchise law, the *Arthur Wishart Act (Franchise Disclosure), 2000* (the "Act")<sup>1</sup> and recent Court decisions made under the Act.

Failure to comply with the disclosure requirements gives rise to a statutory right of rescission in favour of the franchisee. Upon rescission, the franchisor is obliged to repay all monies paid to it by the franchisee, to buy back all of the franchisee's equipment, supplies and inventory and compensate the franchisee for any losses that the franchisee has incurred in establishing and operating the franchised business. The consequences of

a franchisor not complying with its disclosure obligation are therefore significant. Nonetheless, until recently, the availability to a franchisee of this statutory remedy has not been so clear. In fact, soon after the passage of the Act, lawyers began to debate the distinction between the two statutory remedies available to a franchisee when there has been non-compliance with the disclosure requirements under the Act.

Recent Ontario court decisions have now clarified a franchisee's right to rescind under the Act where the franchisor has provided a deficient disclosure document. The decisions demonstrate the necessity of strict compliance with the disclosure obligations imposed upon franchisors under the Act so as to enable prospective franchisees to make an informed investment decision.

The Act provides a franchisee with a right of rescission in two separate and distinct scenarios: section 6(1) of the Act allows a franchisee to rescind the franchise agreement no later than 60 days following its receipt of the disclosure document if the franchisor failed to provide the disclosure document within the time required under the Act, or if a disclosure document did not meet the requirements of the Act. Under section 6(2) of the Act, the franchisee has two years from the date of entering into the franchise

agreement if a franchisor fails to provide a disclosure document. These two provisions have raised the question as to whether a disclosure document that is deficient in the information provided is in fact a disclosure document, for purposes of the Act.

Eight years following passage of the Act, the Court of Appeal for Ontario has now affirmed that a materially deficient disclosure document is not a disclosure document at all, thus entitling a franchisee the right to rescind within two years following the execution of the franchise agreement.

In *6792341 Canada Inc. v. Dollar It Limited*<sup>2</sup>, a franchisee attempted to rescind its franchise agreement pursuant to section 6(2) of the Act and made application to the Superior Court for declaratory relief. The Court dismissed the application on the grounds that, as the franchisee had received a disclosure document, it was entitled only to the right of rescission under section 6(1) of the Act. The franchisee's notice of rescission was delivered well after the expiry of the 60-day period following its receipt of the disclosure document. The franchisee's appeal to the Court of Appeal was granted and in his reasons, MacFarland J.A. held that the deficiencies in the disclosure document were so material that "the only reasonable conclusion is that the franchisor never provided the disclosure document within the meaning of section 6(2)".

The respondent franchisor acknowledged that the disclosure document was missing required information required under the Act and its regulations (the "Regulations")<sup>3</sup> but took the position that a disclosure document having been provided, the franchisee was entitled to rescind only within the

60-day period provided by Section 6(1) of the Act.

The Court, in its reasons, looked to the purpose and intent of the Act, being to protect the interests of franchisees and to permit a prospective franchisee to make an informed decision about whether to make the investment. Among the deficiencies noted by the Court, the disclosure document provided by Dollar It Limited did not include, among other information:

- (1) a signed and dated Certificate of disclosure;
- (2) financial statements or an opening balance sheet;
- (3) a copy of the lease for the premises under which the franchisee was the subtenant;
- (4) information about the franchisor's affiliate which was the tenant and sublandlord of the premises;
- (5) prescribed information pertaining to the franchisor's advertising program; and
- (6) a description of the exclusive territory to be granted and the franchisor's policy on proximity between franchised locations.

The Court held that the provisions of sections 6(1) and 6(2) must be read and interpreted broadly in light of the intended purposes of the Act and that to interpret those provisions strictly would "lead to absurdity". Taken together, the deficiencies were substantial enough to preclude the franchisee from making an informed decision and thus concluded that a disclosure document was never provided within the meaning of section

6(2) of the Act. An order was granted declaring that the franchisee had the right to rescind the franchise agreement within the 2-year period following execution of the franchise agreement.

In its decision, the Court acknowledged that each case must be considered on its own facts and accordingly, it is not clear whether any of these deficiencies alone would have been sufficient to constitute a failure to provide disclosure within the meaning of the Act or whether the Court relied on the fact of a number of deficiencies. Of particular significance is the Court's inclusion in the noted deficiencies the failure to provide a copy of the lease for the premises and information regarding the franchisor's affiliate, both of which the Court held to be "material facts" to be disclosed pursuant to section 5 of the Act in addition to the information prescribed by the regulations.

In rendering its decision, the Court relied on the recent decision of the Alberta Court of Appeal in *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*,<sup>4</sup> which held that the absence of a signed and dated Certificate alone was sufficient to establish that there was no disclosure provided and accordingly the franchisee was entitled to the two-year rescission period. The Court rejected the franchisor's argument that, as the franchisee was a sophisticated purchaser, it should not be able to get out of the deal on a technical defect. The Court strictly construed the requirements of Alberta's *Franchises Act* that the disclosure document must include a certificate that must be dated and must be signed. The Court held that neither the level of sophistication of the franchisee nor whether the franchisee relied upon the absence of the signa-

ture and date on the certificate (the franchisee candidly admitted that they did not) was relevant to its determination of the case. The case simply turned on whether the franchisor complied with the statute.

A similar decision was rendered by the Superior Court of Ontario in which a franchisee of the Houston Steaks & Ribs franchise system was permitted to rescind a franchise agreement approximately 14 months after its restaurant opened for business<sup>6</sup>. The Court held that the document delivered to the franchisee candidate was not a "disclosure document" for a number of reasons including that it did not contain a certificate of disclosure. The lack of a signed certificate was one of at least four deficiencies that the Court held was alone sufficient to render the disclosure document non-compliant with the Act's requirements. In his decision, Mr. Justice Wilton-Siegel stated:

The certificate is an important means of implementing the policy of the Act of ensuring complete and accurate disclosure of all material facts pertaining to a proposed franchise investment. It is also the mechanism for imposing liability for misrepresentations in the disclosure document on certain parties as contemplated by paragraph 7(1)(e) of the Act.<sup>7</sup>

The other deficiencies which alone rendered the disclosure document non-compliant included i) the failure to include financial statements, ii) the failure to provide the basis for, or assumptions underlying, the earnings projections and iii) the failure to deliver a disclosure document as single document at one time.

Of equal consequence in this case, the franchise system had been sold and the franchise agreement assigned to a new franchisor between the date that the disclosure document was delivered and the date that the franchisee delivered its notice of rescission. The Court held both the original franchisor and the assignee liable to the franchisee for the post-rescission compensation that the franchisee was entitled to under the Act. The original franchisor and the new franchisor were ordered to pay to the franchisee in excess of \$1 million which was the cost of establishing the restaurant as well as a further amount to compensate the franchisee for its operating losses. In view of these decisions, it is imperative that franchisors in Ontario comply strictly with the disclosure requirements of the Act and its regulations including the disclosure of material information particular to the specific location at which the franchised business will be operated. A generic, “standard form” disclosure document will not suffice to protect a franchisor from the severe penalties imposed under the Act for non-compliance.

*Group and is named in the 2008 and 2009 editions of **The Best Lawyers in Canada** in the specialty of Franchise Law and as ‘Repeatedly Recommended’ in **The Canadian Legal Lexpert Directory**.*

<sup>1</sup> S.O. 2000 c.3

<sup>2</sup> 2009 ONCA 385

<sup>3</sup> O.Reg. 581/00

<sup>4</sup> [2008] A.J. No. 892

<sup>5</sup> R.S.A. 2000 c. F-23

<sup>6</sup> *Sovereignty Investment Holdings, Inc. v. 9127-6907 Quebec Inc.*, [2008] O.J. No. 4450 (S.C.J.)

<sup>7</sup> *Ibid.* paragraph 19 ■

*Debi Sutin is a Partner in the Hamilton office of Gowling Lafleur Henderson LLP where her practice is focused on general corporate/commercial law and all matters relating to franchising, licensing and distribution law. She is a member of Gowlings’ Franchise and Distribution Law National Practice*