

Franchisees can't have their cake and eat it too: statutory disclosure exemptions have consequences

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Introduction

In recent years, many Canadian provinces have adopted franchise-specific disclosure laws with a view to remedying the inequality of bargaining power between franchisors and franchisees. Subject to certain limited exemptions, franchisors must provide prospective franchisees with full and accurate information in respect of all material facts relating to the franchise business before entering into a franchise agreement, failing which, franchisees may bring a claim for rescission and damages against the franchisor.⁽¹⁾

Case

In *2101516 Ontario Inc v Radisson Hotels Canada Inc*, the Ontario Superior Court of Justice confirmed that franchisees are precluded from exercising their statutory right to compensation for losses incurred as a result of deficient franchise disclosure documents in situations where franchisors could rely on an exemption from such disclosure obligations pursuant to Section 5(7) of the Ontario Arthur Wishart Act. The court opined that these legislative exemptions apply in situations involving knowledgeable and sophisticated franchisees that, given their equal bargaining power, are not entitled to benefit from the statutory protections provided under Section 5 of the act.

Facts

In 2016, 2101516 Ontario Inc (the franchisee) acquired a hotel operating under licence from Radisson Hotels (the franchisor) for C\$8.35 million. As part of the acquisition process, the franchisor disclosed to the franchisee what the court characterised as a 'financial disclosure document'.

In 2017 the franchisee ceased paying the required monthly royalty fees to the franchisor and rescinded its franchise agreement, alleging deficient disclosure by the franchisor. The franchisee then instituted arbitration proceedings against the franchisor in accordance with the franchise agreement, seeking (among other things):

- rescission of the franchise agreement pursuant to Section 6 of the act; and
- damages for misrepresentation pursuant to Section 7 of the act.

In its various arbitration awards, the arbitrator found that the franchisor was exempt from providing statutory disclosure documents to the franchisee pursuant to Section 5(7) of the act because the franchisee had made a total annual investment of more than C\$5 million for the acquisition and operation of its Radisson franchise. As such, the arbitrator concluded that the franchisee could not claim rescission under Section 6 of the act. The arbitrator also rejected the franchisee's misrepresentation claim, finding that claims made pursuant to Section 7 of the act are warranted in circumstances where deficiencies are contained only in mandatory disclosure documents and not in documents which are voluntarily disclosed.

Following the arbitrator's decision, the franchisee sought leave to appeal from the Ontario Superior Court of Justice to set aside the arbitration awards on the basis that Section 7 of the act applies to all

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disclosure documents provided by a franchisor, irrespective of whether the disclosure of such documents is legally required.(2)

Decision

The Ontario Superior Court of Justice agreed with the arbitrator's interpretation of Section 7 of the act, dismissing the franchisee's application for appeal and enforcing the arbitration awards.(3)

In assessing the franchisee's claim for damages due to deficient disclosure, the court confirmed that the act's purpose is to redress the inherent inequality in bargaining power between franchisors and franchisees by implementing certain corrective mechanisms, such as a franchisee's right to damages resulting from a franchisor's misrepresentation or insufficient disclosure that is statutorily required. As the arbitrator established, the court determined that the circumstances in this case fit squarely within the exemptions established at Section 5(7) of the act for the application of such heightened protective measures. The court also noted that these exemptions aim to exclude the disclosure requirement where the disclosure obligation under Section 5 of the act is not required to correct the inequality of bargaining power in the relationship between a franchisor and a franchisee given the fact that such legislative exemptions apply in situations involving commercially sophisticated prospective franchisees.(4)

Further, in adopting a plain language approach to statutory interpretation, the court concurred with the arbitrator that Section 7 of the act affords a right to damages only for injury suffered due to misrepresentation contained in disclosure documents, which are statutorily required to be provided to franchisees pursuant to Section 5 of the act. The court noted that the act's definition of 'disclosure document' expressly references disclosure documents that must be provided pursuant to Section 5 of the act, and the fact that such disclosure documents benefitted from the presumption of reliance thereon by the franchisee pursuant to Section 7(2) of the act.

According to the court, broadening the scope of these provisions to encompass all disclosure documents given to a franchisee would not only defeat the purpose of the protective measures provided in Section 5 of the act, but would also make the remedies at Section 7 of the act available to "commercially sophisticated franchisees who neither require, nor are entitled, to" such statutory protections.(5)

On another interesting note, in addressing whether the franchisee's motion for leave to appeal was valid, the court held that the "final, conclusive and binding" wording of the arbitration clause contained in the franchise agreement between the franchisor and the franchisee in any event prohibited the franchisee to appeal from the arbitration awards.(6)

Comment

This decision provides some relief to Ontario franchisors by confirming that deficiencies in franchisor's voluntary disclosures made in good faith do not warrant the presumption of reliance or the severe remedies of rescission or damages contained in the Arthur Wishart Act. These additional disclosures remain subject to the common law regime requiring evidence of reliance by the franchisee and the damages suffered remain subject to the usual common law principles of causation.

This decision also serves as a reminder that, in keeping with the basic tenets of contract law, commercially sophisticated franchisees should:

- be bound by the terms of their franchise agreement; and
- not be entitled to benefit from statutory safeguards enacted specifically for the purposes of protecting their more vulnerable counterparts.

Moreover, with this ruling, the court asserts that a franchisee's statutory claim for damages resulting from misrepresentation is precluded in cases where an exemption applies in respect of the franchisor's disclosure obligations prescribed by the act. There exist other limited scope exemptions to the franchisor's disclosure obligations to which the court's reasoning should hold, by extension.(7)

Notably, despite a franchisor's reliance on an exemption from its disclosure obligations, a franchisee may still substantiate a claim based on alleged misrepresentations in any of the documents delivered to it by a franchisor in connection with the franchise agreement's execution. However, in this instance, the franchisee would have to establish that it relied, to its detriment, on the alleged misrepresentations in such documents (ie, without the benefit of the presumption of reliance in Section 7(2) of the act that exists for disclosure documents required under Section 5 of the act).

Despite the court's conclusion, in negotiating franchise agreements particularly in provinces with

franchise disclosure legislation, franchisors should exercise caution before voluntarily disclosing information to prospective franchisees that need not be disclosed. Therefore, franchisors are strongly advised to seek guidance from counsel through all steps of the franchise transaction, particularly during pre-contractual negotiations in order to establish whether an exemption to disclosure applies and:

- if so, whether it would nonetheless be prudent for the franchisor to disclose certain information to a prospective franchisee; or
- if not, the specific disclosure documents that must be submitted.

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Endnotes

(1) See, for example, Arthur Wishart Act (Franchise Disclosure) 2000, SO 2000, c 3, Sections 5, 6 and 7.

(2) *2101516 Ontario Inc v Radisson Hotels Canada Inc*, 2019 ONSC 3302, Paragraphs 3-15.

(3) *Ibid*, Paragraphs 40-41.

(4) *Ibid*, Paragraphs 32-35.

(5) *Ibid*, Paragraphs 36-37.

(6) *Ibid*, Paragraphs 16-23.

(7) Arthur Wishart Act *supra* note 1, Section 5 (7); Ontario Regulation 581/00.

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