

Disclosure: what affects a franchisee's decision to invest?

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- › Introduction
- › Developments
- › Comment

Introduction

Franchise disclosure law in Canada has been recognised as requiring disclosure by a franchisor, in accordance with the applicable laws, in a manner that allows a potential franchisee to "make a properly informed decision about whether or not to invest in a franchise".⁽¹⁾

In recent years, the well-known *Raibex* matter,⁽²⁾ as considered under the Arthur Wishart Act (Ontario),⁽³⁾ has drawn specific attention to the types of disclosure failures or shortcomings that may give rise to rescission claims for franchisees, based on an appreciation of whether the prospective franchisee was in a position to make an informed investment decision. More particularly, *Raibex* raised questions about the parameters for disclosing information that is not yet available, such as site-specific details where a lease for premises has not been secured.

This article explores the developments that have emerged in this area since *Raibex* was examined by the courts.

Developments

As indicated by the findings in *Raibex*, a franchise agreement can itself provide points of reference for assessing the parties' expectations, including the level of risk assumed by the franchisee upon entering into the franchise agreement. For example, the franchise agreement considered in *Raibex* contemplated that the franchisee was meant to participate in the location selection and it contained restrictions on the franchisor's ability to enter into a lease without considering the franchisee's interest. A specific opt-out clause was also provided, which bolstered these protections in favour of the franchisee.⁽⁴⁾ Ultimately, the Ontario Court of Appeal decision in *Raibex* determined that the franchisee should be entitled to rescind the franchise agreement, given that the effect of the franchisor's non-disclosure was found to be significant and affected the franchisee's ability to properly consider its decision to invest.⁽⁵⁾

Freshly Squeezed decision

Since the final *Raibex* decision was rendered, the Ontario Superior Court has further considered the criteria for determining whether certain disclosure deficiencies sufficiently affect a franchisee's decision to invest, so as to give rise to a rescission right. For example, in a decision involving a Freshly Squeezed franchise, where location-specific information also had yet to become available at the time of disclosure, the Court held that an objective standard must be used to perform the assessment, in line with case law developed prior to *Raibex*, and stated that:

the objective standard must take into account the particular facts of each case, including the terms of the franchise agreement, in determining whether the alleged deficiencies reasonably impaired the ability of a prospective franchisee from having the opportunity to make an informed investment decision.⁽⁶⁾

As such, there may remain a certain level of flexibility as concerns a franchisee's ability to present a rescission claim, given that this decision suggests that a franchisee may not be required to present evidence that its own ability to make an informed investment decision was affected by delinquent disclosure, provided that missing disclosure elements are significant enough to constitute fatal flaws. In the *Freshly Squeezed* decision, deficiencies in the franchisor's financial statement disclosure and franchise-specific location information were considered to be sufficiently material to allow rescission by the franchisee, without evidence that the franchisee's investment decision was specifically affected by these deficiencies.

Yogurtworld decision

Similarly, in the recent *Yogurtworld* decision, the Ontario Superior Court emphasised the importance of adopting an objective standard when assessing whether the absence of any particular disclosure information would give rise to a rescission claim; however, it indicated that "the circumstances of the case and the particular franchisee/franchisor provide the context for the analysis".⁽⁷⁾

Following the Court's rejection of the franchisee's rescission claims, this decision further clarifies the legal framework applicable when analysing rescission claims, given that it suggests a contextual approach to an objective analysis will inform whether a franchisee's ability to make its investment decision was impaired.⁽⁸⁾

Further, the *Yogurtworld* decision suggests that it remains possible for franchisors and franchisees to enter into franchise agreements even where certain information remains unknown, including location details.

Fit for Life decision

The Ontario Superior Court has also emphasised the risks for franchisors in failing to deliver a compliant certificate with a franchise disclosure document, and held that an unsigned certificate constitutes a fatal flaw that entitles a franchisee to rescind its franchise agreement.

In this decision, which involved a Fit for Life gym franchise,⁽⁹⁾ the franchisee argued that the franchisor's failure to provide a signed and dated certificate with its disclosure document, as required by the applicable regulation,⁽¹⁰⁾ amounted to effective non-disclosure and prevented the franchisee from making an informed investment decision.

In considering the franchisee's rescission claim, the Court rejected the franchisor's argument that the lack of a compliant certificate was



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not sufficient to affect the franchisee's decision to invest in the franchise – a position that was argued on the basis of the findings in *Raibex*. Conversely, the Court emphasised that a franchisee's rescission right resulting from a complete lack of disclosure can be informed by an analysis of whether the franchisee was in a position to make an informed investment decision, but also by the importance for those signing a franchise disclosure certificate, to ensure the document is complete and accurate.

The Court held that there is no need for a franchisee to demonstrate that it was unable to make an informed investment decision where rescission occurs as a result of a deficient franchise disclosure certificate. This decision is consistent with previous case law that has established that a non-compliant disclosure certificate is tantamount to non-disclosure, allowing rescission under Ontario's franchise disclosure statute.

Comment

While the backdrop of franchise disclosure law has recognised the need for franchisees to have the ability to make an adequate assessment of their willingness to invest in a given franchise, certain disclosure flaws still allow franchisees to claim rescission even where they are not specifically prevented from making an informed investment decision.

This can lead to puzzling results for franchisors, and the decisions discussed above serve as useful reminders for franchisors to take measures to ensure continued compliance with the strict requirements of franchise disclosure legislation, with a view to limiting the risks of unexpected rescission claims. In particular, it is essential to provide adequate disclosure in respect of each individual franchise opportunity, as and when required by and in strict accordance with applicable law, considering particularly that facts considered "material" for a specific location may be unique. Each franchise grant and related disclosure should be given detailed consideration in this context.

For further information on this topic please contact Bruno Floriani or Marissa Carnevale at Lapointe Rosenstein Marchand Melançon LLP by telephone (+1 514 925 6300) or email (bruno.floriani@lrmm.com or marissa.carnevale@lrmm.com). The Lapointe Rosenstein Marchand Melançon LLP website can be accessed at www.lrmm.com.

Endnotes

(1) *Raibex Canada Ltd v ASWR Franchising Corp*, 2018 ONCA 62 (CanLII), paragraph 49, quoting from 1490664 *Ontario Ltd v Dig This Garden Retailers Ltd*, 256 DLR (4th) 451 (Ont CA, at paragraph 16).

(2) *Supra*, note 1.

(3) *Arthur Wishart Act (Franchise Disclosure)*, 2000, SO 2000, c 3.

(4) *Supra*, note 1, at paragraph 53.

(5) *Supra*, note 1.

(6) 2611707 *Ontario Inc v Freshly Squeezed Franchise Juice Corporation*, 2021 ONSC 2323 (under appeal).

(7) 2364562 *Ontario Ltd v Yogurtworld Enterprises Inc*, 2021 ONSC 5112, paragraph 36.

(8) *Id* at paragraph 38.

(9) 2483038 *Ontario Inc v 2082100 Ontario Inc*, 2020 ONSC 475.

(10) Section 7(2) of the General Regulation to the Wishart Act, O Reg 581/00.