

Franchising - Canada

New application of franchise disclosure remedies?

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Introduction

In the recent case of *Caffé Demetre Franchising Corp v 2249027 Ontario Inc.*⁽¹⁾ the Ontario Superior Court of Justice found that certain disclosure deficiencies alleged by a franchisee were not tantamount to "no disclosure at all" and did not give rise to the franchisee's right to rescind the franchise agreement on that basis.

While the court found that a material fact had been omitted from the franchisor's disclosure, this is one of the first cases in which an Ontario court has found that a franchisee could not exercise its rescission right resulting from deficient disclosure following the expiry of the 60-day period during which claims for rescission on that basis must typically be initiated. It is also one of the first cases to apply the new principles regarding the broad interpretation of summary judgment rules by Canadian courts, in particular with respect to a rescission claim in a franchise case.

Facts

Following a series of defaults by the franchisee over several months during the second year of its operation of the franchised business, the franchisor terminated the franchise agreement. In the meantime, the franchisee had provided the franchisor with a notice of rescission of the franchise agreement and demanded payment of more than C\$900,000 without detailing the basis for its claim.

The franchisor unsuccessfully attempted to take possession of the premises in which the franchisee was operating the franchised business, and then instituted proceedings against the franchisee when it failed to cease operating a competing business in those premises.

The franchisee filed a counterclaim against the franchisor for rescission of the franchise agreement and for misrepresentation, breach of contract and breach of fair dealing on the basis of various alleged deficiencies in the franchisor's disclosure, including the franchisor's involvement in litigation, system policy changes and renovations required in connection with system changes.

Decision

In its application of the new rules with respect to evaluating summary judgment motions,⁽²⁾ the court determined that there was no genuine issue for trial with respect to the franchisee's rescission claim under Section 6(2) of the Arthur Wishart Act.⁽³⁾ This provision allows a franchisee in the Province of Ontario to claim rescission within two years of entering into a franchise agreement where the franchisor has failed to provide the requisite disclosure.⁽⁴⁾

The court concluded that the franchisor's failure to disclose the following was not a failure to disclose material facts at the time of disclosure:

- modification of the franchisor's general policy with respect to 'tip outs';
- modification of the franchisor's system-wide policy with respect to ice cream manufacturing; and
- the franchisor's intention to implement a more expensive menu throughout all locations, which would require that the defendant remodel and renovate its franchise location.

In the court's view, these changes were not material facts which the franchisor should have disclosed at the time of disclosure (ie, at the beginning of the franchise relationship). The court noted that each of these developments occurred more than one year after the franchisee had entered into the franchise agreement with the franchisor. The court also emphasised that the franchisee had refused to implement the new policies and had never performed the remodelling and renovation work, such

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that the franchisee had incurred no costs or expenses as a result of the alleged deficiencies in disclosure.

However, the court did consider that the franchisor's involvement in litigation with a former franchisee was a material fact that should have been disclosed to the franchisee, as it was known to the franchisor at the time of disclosure that the litigation was forthcoming. Nevertheless, the court further stated that the failure to disclose this information did not constitute a failure by the franchisor to make any disclosure whatsoever. As a result, the franchisee could not rely on the two-year rescission right under Section 6(2) of the Arthur Wishart Act.

The franchisee's counterclaim for rescission was ultimately dismissed on summary judgment, while its claims for damages on the basis of misrepresentation, breach of contract and breach of fair dealing were not dealt with at the summary judgment stage.

Comment

The facts in this case were largely undisputed. This facilitated the court's analysis of the legal questions associated with the franchisee's rescission claim. Courts may be less inclined to adjudicate claims on summary judgment in circumstances where the facts underlying a motion are in dispute.

This decision may constitute an important turning point in the interpretation of disclosure obligations incumbent upon franchisors under the Arthur Wishart Act.⁽⁵⁾ The court strongly stated that a franchisee's right to claim rescission for deficient disclosure expires 60 days after having received the disclosure:

"The defendants' complaint about the disclosure document is that it is deficient in content. On the plain wording of the Act, a right of rescission for a deficiency in content is only available within 60 days after receiving the disclosure document. That period would have expired on August 24, 2011, long before the notice of rescission was delivered. A right to claim rescission under s. 6(2) [of the Arthur Wishart Act] only arises where the franchisor never provided the disclosure document. That is clearly not the case."⁽⁶⁾

It also cited with approval certain passages of an Ontario Court of Appeal case which "cautioned against blurring the distinction between the two remedies",⁽⁷⁾ and recalled that the "sweeping remedy of rescission" is limited to cases where no disclosure at all is provided.⁽⁸⁾

The Ontario courts had previously determined that where there were "stark and material deficiencies"⁽⁹⁾ in disclosure, or where disclosure was essentially insufficient and provided in "bits and pieces",⁽¹⁰⁾ a franchisor could be considered to have provided no disclosure at all. This determination suggested in turn that a "failure to provide disclosure" would be interpreted broadly and, even if disclosure was provided, certain significant deficiencies could allow a court to determine that no useful disclosure had ever been provided. This approach has increased uncertainty for franchisors with respect to two-year rescission claims.

However, in this case the court did not consider the franchisor's failure to disclose its upcoming litigation with a former franchisee to be an omission so egregious as to constitute no disclosure at all. The court emphasised the fact that the litigation was being prosecuted by the franchisor in order to protect its brand and in order to benefit its franchise system generally, and was unable to conclude that the existence of the litigation would have a negative impact on the franchisee. The court further stated that the failure to disclose this litigation could have allowed the franchisee to avail itself of its right to rescission within 60 days of receiving the disclosure document, but it could not serve as the foundation for a rescission claim brought on the basis of a general failure to provide disclosure.

The court's decision indicates that where a material fact is omitted from otherwise compliant franchise disclosure, the two-year rescission claim should be unavailable to a franchisee – at least in circumstances where the omission would not have demonstrably affected the price paid for the franchise or otherwise had a financial impact on the franchisee.

Despite this decision restricting the availability of the two-year rescission remedy, it is arguable that the nature of the deficiency in this particular case or the franchisee's competitive actions and opportunistic claim were determining factors that may not be of universal application.

However, this interesting decision may be seen as grounds to support arguments in future cases pertaining to franchise disclosure obligations and may lead to a new trend in seeking summary judgment with respect to rescission claims.

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Endnotes

(1) 2014 ONSC 2133

(2) The Supreme Court of Canada recently established the test in *Hyrniak v Mauldin*, 2014 SCJ No 7.

(3) SO 2000, c3

- (4) Similar franchise legislation exists in a number of other Canadian provinces.
- (5) *Supra*, note 3 Section 5(4)
- (6) *Caffé Demetre Franchising Corp v 2249027 Ontario Inc*, *supra*, note 1, at para 19.
- (7) *Ibid*, at para 20.
- (8) *Ibid*, at para 41.
- (9) *6791241 Canada Inc v Dollar It Ltd*, 2009, 95 OR (3d) 291 (CA)
- (10) *1490664 Ontario Ltd v Dig This Garden*, 2005, OJ No 3040 (CA)

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