Franchising - Canada

Will important clarifications to disclosure document exemptions stand?

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March 08 2011

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The recent decision in *TA & K Enterprises Inc v Suncor Energy Products Inc* has shed new light on the application of one of the disclosure exemptions for franchisors under the Arthur Wishart Act. This is the first decision which interprets the disclosure exception for franchise agreements that are not valid for more than one year.

Facts

Franchisee TA & K Enterprises Inc argued that franchisor Suncor Energy Products and its associate Suncor Energy Inc contravened the act by failing to deliver the disclosure document required under Section 5(1) of the act, and sought the rescission remedy and damages. However, the court, by way of summary judgment, held that a disclosure document was not required as "the franchise agreement [was] not valid for longer than one year and [did] not involve the payment of a non-refundable franchise fee".

The parties entered into a retailer franchise agreement on November 11 2008, which followed earlier successive agreements of a similar nature. On the expiry of each previous agreement, the parties "reviewed and discussed a new business plan" and signed a new agreement. The franchisor later merged with Petro-Canada and, as a result, relied on the overholding provision of the agreement in order to extend the term of each agreement on a month-to-month basis until January 2010, when it advised the franchisee that the agreement would terminate in August 2010. The franchisee commenced a proposed class action and claimed the right to rescind the agreement under the act.

The key issue in this case was whether the requirements to benefit from the disclosure exception set forth in Section 5(g)(ii) of the act were met - namely, that the franchisee had not paid a 'franchise fee', and that the franchise agreement was 'valid' for less than one year.

Proceedings

The court began by considering the meaning of 'franchise fee', a term which is undefined in the act. Justice Perell turned instead to the Alberta Franchises Act, which defines a 'franchise fee' as a "direct or indirect payment to purchase a franchise or operate a franchised business". The court ultimately held that the Ontario legislature did not intend that every payment by a franchisee to a franchisor would constitute a franchise fee. In Perell's opinion, the following payments do not constitute a franchise fee for the purposes of the act:

- a payment for goods or services; or
- a payment for royalties or similar fees payable under the franchise agreement.

Rather, he likened a franchise fee to a fee that one disburses in order to be part of a country club - an 'initiation fee' of sorts.
The court then turned to the meaning of the term 'validity', which is also undefined in the act. Perell assessed the intention of the legislature in drafting this provision and concluded that the legislation refers to franchise agreements with terms which are enforceable for less than one year. Therefore, the rights and obligations in the agreement must be conferred for less than one year in order for this exception requirement to be met. In this case the agreement was signed on November 11 2008, while the term was stipulated to commence on November 15 2008 and to expire on

November 14 2009. However, the month-to-month overholding resulted in the agreement remaining in effect until January 18 2010, when the franchiseee exercised its right of rescission under the act.

Nevertheless, the court determined that the requirement as to the term was met. In Perell's opinion, the "legislature did not intend to make a prospective obligation to provide a disclosure document to operate retroactively, and thereby, make conduct illegal that was proper at the time when it occurred". When the agreement was signed, the parties could not have know whether any overholding would occur at the expiry of the stated term, and thus the franchisee could not use facts arising after signing to argue that disclosure was required at the time of signing.

Decision

As both requirements of the exemption found in Section 5(g)(ii) were met, the court held that the franchisor was not required to deliver a new disclosure document at the time of entering into the franchise agreement.

A subsidiary facet of this decision is the analysis of the exception whereby a disclosure document is not required when a franchise agreement is renewed/extended and there has been no interruption in the operation of the franchisee's business and no material change since the franchise agreement or latest renewal/extension was entered into (Section 5(7)(f) of the act). This was the alternative defence put forth by the franchisor. Perell found that this exception may also have been available to the franchisor. The franchisee argued that the agreement was not a renewal or extension, but rather a new agreement altogether. The basis for this argument was that, under the prior agreement, both parties were permitted to end the relationship on the expiry of its term. While the court agreed that each agreement was new, it maintained that a new agreement could nevertheless constitute a renewal or extension of a prior agreement.

The court held that the availability of the exception found in Section 5(7)(f) would depend on three factors being satisfied:

- there being a pre-existing franchise agreement;
- there being no interruption of the operation of the franchise business; and
- there having been no material change comparing the old franchise agreement with the new one.

The court found that while the first two factors were clearly met in this case, the third could not be treated by a summary judgment.

In assessing the distinction between 'renewals' and 'extensions', the court reasoned that a renewal revives an agreement with a term that has come to a close or expired, whereas an extension permits an agreement which is still in existence to continue. In the court's opinion, the legislature intended that if the parties had already entered into a franchisor-franchisee relationship, a subsequent disclosure would not be required unless the previous relationship had been interrupted or materially changed.

Comment

The franchisee has appealed and this case is sure to be followed with great interest by the Canadian franchise community. Given that the Ontario Court of Appeal has generally taken a very broad view of the rescission remedy available under the act, it remains to be seen whether it will be inclined to let this interpretation of the disclosure exemption to stand.

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