

Litigation Bulletin

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Ontario Court Sends Message to Franchisors and Franchisees

In July 2006, the Ontario Superior Court released a significant decision that provides guidance to both franchisors and franchisees on the meaning of three provisions of the *Arthur Wishart (Franchise Disclosure) 2000 Act* (the “Act”). The Court considered the Act’s provisions regarding when a franchisor is exempt from providing disclosure, whether using an American disclosure package is sufficient in Ontario and the effect of a release given by a franchisee. The Court’s message is important to both franchisors and franchisees.

The Facts

The plaintiffs in *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC* purchased a daycare franchise from an existing franchisee. As part of the deal, the plaintiffs paid a transfer fee to the American franchisor and signed a personal guaranty. Before the transfer closed, the franchisor gave the plaintiffs a Uniform Franchise Offering Circular (“UFOC”) – a disclosure document prepared in accordance with US laws. The franchisor told the plaintiffs that it was preparing, and would send to them, a disclosure package designed to meet the Act’s requirements. The franchisor never, however, did so.

When the operation failed several months later, the plaintiffs sued the franchisor. The plaintiffs moved for summary judgment seeking damages and rescission of the franchise agreement because the franchisor failed to provide the disclosure required by the Act. The Court dismissed the motion.

Franchisors Not Exempt from Disclosure Because Franchisee Buys Franchise from Another Franchisee

In defence to the claim for rescission, the franchisor first argued that the Act did not apply because the plaintiffs purchased the franchise from a third party, a previous franchisee. Subsection 5(7) of the Act states that a franchisor is exempt from disclosure obligations if the grant of the franchise is not “effected by or through” the franchisor.

The Court decided this section did not apply because the franchisor was involved in the transfer of the franchise (as it requested payment of a fee for the transfer and imposed additional obligations on the plaintiffs, including a personal guaranty). These actions were enough for the Court to find that the grant of the franchise was “effected by or through” the franchisor.

American Disclosure Not Adequate

The franchisor next argued that it provided adequate disclosure by supplying an American UFOC. The Court again sided with the franchisee, finding that while the UFOC was adequate in the US, it was not adequate disclosure in Ontario. The Act requires the disclosure document to be “evergreen” and updated to reflect all material facts as they exist when it is delivered to the franchisee. The UFOC did not comply with these requirements. Moreover, although the franchisor told the plaintiffs it would provide disclosure documents under Ontario law, it never did so. Accordingly, the Court found that no disclosure under the Act had been made at all.

Franchisee May Release its Rights under the *Franchise Act*

Shortly after the plaintiffs began operating the franchise, a dispute arose about the payment of royalties and other fees. Ultimately, the parties entered into a settlement agreement in which the franchisor waived certain fees and the parties released each other from “all claims” arising from the “franchise relationship”. At the time this release was signed, the plaintiffs had legal counsel and were aware that the franchisor had violated its disclosure obligations under the Act.

The franchisor argued that the release barred the plaintiffs’ claims. The plaintiffs responded by arguing that section 11 of the Act makes any “purported waiver or release” by a franchisee of a right given under the Act “void” and unenforceable. The Court disagreed. The Court found that s. 11 does not apply to a release given by a franchisee in the settlement of a dispute involving known breaches of the Act’s disclosure obligations. In other words, the settlement of a claim *arising from* an existing statutory right of rescission is not itself a “waiver or release” of the statutory right.

Accordingly, the Court dismissed the plaintiffs’ motion for summary judgment in spite of having found that the franchisor violated the Act’s disclosure obligations. This is the first case in which s. 11 of the Act has been judicially considered.

Written by Brad Hanna and Erin Cowling

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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*For more information please contact your McMillan Binch Mendelsohn lawyer or one
of the lawyers listed below:*

Erin Cowling	416.865.7868	erin.cowling@mcmbm.com
W. Brad Hanna	416.865.7276	brad.hanna@mcmbm.com

McMILLAN BINCH MENDELSON

TORONTO | TEL: 416.865.7000 | FAX: 416.865.7048

MONTRÉAL | TEL: 514.987.5000 | FAX: 514.987.1213

www.mcmbm.com