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Caught by Release: Franchisees Can't Have Their Cake and Eat It Too

The recent decision in *New Vision Renaissance MX Ltd. v. The Symposium Café Inc.*¹ confirms that Ontario courts will uphold the terms of appropriately crafted releases in the context of the *Arthur Wishart Act (Franchise Disclosure), 2000* (the "**AWA**"). Moreover, the Court rejected the argument that the *Tutor Time* exception is limited to the release of claims that are specifically the subject of the dispute or to releases given at the end of a franchise relationship. Releases will be effective if given as part of a settlement of a dispute or potential dispute where the franchisee has knowledge of the matters being released and has legal advice in respect of the settlement.

Beyond finding that the release in this case was valid and enforceable, the Court also went on to state by way of *obiter* that the "piecemeal" disclosure by the franchisor did not prevent the franchisee from making an informed investment decision. The *New Vision* case supports the recent string of decisions that assess rescission claims based on the impact of a disclosure deficiency to a franchisee's investment decision.

Background

The franchisor provided the franchisee with two separate disclosure documents on two occasions. Neither disclosure document contained certificates signed by the appropriate directors or officers on behalf

¹ *New Vision Renaissance MX Ltd. v. The Symposium Café Inc.*, 2020 ONSC 1119.

of the franchisor as required by the AWA. The franchisee later alleged that the disclosure documents contained additional, allegedly material, deficiencies.

Notwithstanding the deficiencies, the franchisee agreed to proceed with the proposed franchise arrangement and executed a franchise agreement dated February 2015 (the "**Franchise Agreement**"). When the time came to finalize the franchise transaction, the franchisee did not have the funds necessary to do so. The franchisor agreed to advance a short-term loan in exchange for the franchisee releasing any claims for rescission and misrepresentation relating to the franchisor's disclosure obligations pursuant to the AWA. The financing arrangement (including the requirement that rescission claims be released) was memorialized in a franchise amending agreement dated June 2015 (the "**Franchise Amending Agreement**").

The Rescission Claim

Less than a year after opening the franchised business, the franchisee purported to rescind the franchise agreement on the basis that the franchisor failed to deliver a disclosure document in compliance with the AWA. Among other deficiencies, the franchisee alleged that the disclosure document:

- did not contain a certificate signed by the appropriate directors and officers on behalf of the franchisor;
- was not delivered as one document at one time; and
- did not contain all material facts.

In response, the franchisor argued that the release provided by the franchisee (pursuant to the Franchise Amending Agreement) constituted a complete defence to the franchisee's rescission claim.

The Release Held Enforceable

The Court found that the release provided by the franchisee was enforceable and stood as a complete bar to the franchisee's rescission claim. In reaching this decision, the court acknowledged

that section 11 of the AWA contains a general prohibition against a waiver of a franchisee's statutory rights and release of a franchisor's statutory obligations. However, the court found that the release in this case was within the common law exception set out in *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC*² and adopted by the Ontario Court of Appeal in *Trillium Motor World Ltd. v. General Motors of Canada Limited*.³

Adopting the reasoning in *Tutor Time*, the Ontario Court of Appeal in *Trillium* found that section 11 of the AWA does not bar a voluntarily negotiated settlement of existing statutory claims if the release:

- (a) is entered into with the benefit of legal advice;
- (b) is done in settlement of a dispute; and
- (c) it relates to existing and known breaches of the AWA.

The franchisee entered into the release with the benefit of independent legal advice

In this case, the franchisee retained a lawyer to review the both the Franchise Agreement and the Franchise Amending Agreement, and to assist it throughout the transaction.

The Court specifically rejected the notion that an ILA certificate was necessary to establish that the franchisee received independent legal advice. In doing so, the Court stated that an ILA certificate is only one means of demonstrating that a franchisee obtained independent legal advice, and that it can be evidenced in other ways, including through the direct involvement of the franchisee's counsel in the transaction.

² *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC*, 2006 CanLII 25276.

³ *Trillium Motor World Ltd. v. General Motors of Canada Limited*, 2017 ONCA 545.

The release was given in settlement of a dispute

In *Trillium*, the Ontario Court of Appeal found that a settlement is a voluntary arrangement that brings a dispute or potential dispute to an end without a final adjudication of the issues between the parties.

In this case, the Court found that a potential dispute existed between the parties at the time the Franchise Amending Agreement was entered into, namely, the franchisee's inability to pay the transaction costs was an anticipatory breach of its obligations under the Franchise Agreement. The franchisee faced the prospect of the termination of its franchise as a result of the stated inability to pay the funds due. The Court held that this potential dispute was resolved or "settled" through the provision of a loan to the franchisee by the franchisor. The settlement enabled the franchisee to complete the franchise transaction. As part of the consideration associated with the settlement, the franchisee provided a release of its statutory rights arising from, among other things, any disclosure deficiencies under the AWA.

The Court rejected the franchisee's argument that in order to fall within the *Tutor Time* exception the rights being released had to relate to the specific dispute being settled (which the franchisee argued were the disclosure obligations associated with the loan that resolved the dispute). In this case, the Court found that it would be inequitable to permit the franchisee to have the benefit of the loan, but to then resile from its part of the bargain.

The release was in respect of "known" breaches of the AWA

Because the release was drafted broadly (it included all claims whether presently known or unknown which the franchisee has or may hereinafter have), the franchisee argued that it released future unknown claims and was therefore outside the *Tutor Time* exception. The Court dismissed this argument and found that, when read in context, it related only to the disclosure that had been made prior to the Franchise Amending Agreement and was only being relied upon in respect of alleged deficiencies arising from facts and circumstances that existed at the time of the Franchise Amending Agreement.

Given that the franchisee had legal counsel at all material times, the Court found that it either knew or ought to have known about the alleged disclosure deficiencies (which it raised in support of its rescission claim) at the time that the settlement was entered into. In fact, there was evidence that the franchisee's lawyer attempted to carve these claims out of the scope of the released claims in the course of the negotiation of the release language. The Court inferred from this that the franchisee knew or was capable of knowing about these deficiencies at the time it executed the release (as part of the settlement).

Finally, the Court rejected the franchisee's arguments that the release was invalid because it was unconscionable, they were under duress when they signed it and due to a failure of consideration. Importantly, the Court noted that the franchisee failed to discharge its evidentiary burden to establish each of the above.

The Alleged Disclosure Deficiencies

Having decided that the release is a full answer to the franchisee's claims in the litigation, the Court nonetheless proceeded to comment on the alleged disclosure document deficiencies. While the Court noted that a franchisor's failure to deliver an appropriately signed directors and officer's certificate is a fatal disclosure deficiency, it found that the failure to deliver the franchise disclosure document as one document at one time did not impact the franchisee's decision to invest in the franchise. The Court's latter finding departs from prior case law that regards "piecemeal" disclosure as being a "fatal flaw."

Section 5(3) of the *AWA* requires a disclosure document to be delivered as one document, at one time. The Court acknowledged earlier case law supporting the proposition that piecemeal disclosure is sufficient to vitiate the disclosure because it interferes with the other significant policy objective of the *AWA* to allow franchisees to make informed investment decisions. The reasoning for such draconian measures is that piecemeal disclosure is difficult for franchisees to process and assess.

However, the Court interpreted the Ontario Court of Appeal's recent decision in *Raibex Canada Ltd. v. ASWR Franchising Corp*⁴ as imposing a requirement on a franchisee seeking rescission to demonstrate that the alleged disclosure deficiency did in fact interfere with that ability. In this case, the Court was not satisfied on the record that the ability of the franchisee to make an informed investment decision was affected by the piecemeal disclosure.

The Court also noted that the franchisee failed to establish on evidence they were unable to make an informed investment decision because the disclosure document lacked all material facts, was not accurate, clear and concise and failed to include a list of costs associated with the establishment of the franchise.

Key takeaways

First, the *Symposium Café* decision offers guidance for franchisors seeking to obtain appropriately crafted releases as part of a broader settlement of disputes with franchisees. The case clarifies that releases under the AWA do not have to relate only to the specific dispute that is being settled. Releases will be effective if given as part of a settlement of a dispute or potential dispute where the franchisee has knowledge of the matters being released and has legal advice in respect of the settlement.

Releases can be effective in disclaiming franchisees' rights and claims under the AWA. To insulate releases from attack under s. 11 of the AWA franchisors must ensure that:

- (a) their franchisees obtain independent legal advice in connection with the settlement and release (while ILA certificates will be helpful in establishing this in some situations, they are not required in all circumstances, particularly where the evidence confirms legal advice was obtained);

⁴ *Raibex Canada Ltd. v. ASWR Franchising Corp.*, 2018 ONCA 62.

- (b) the releases are structured as part of a settlement of a dispute associated with the franchise arrangement; and
- (c) the claims being released are known or capable of being known by the franchisee at the time the settlement is consummated.

It would also be helpful to expressly state in the release that it constitutes a full and final settlement and resolution of all disputes as contemplated by *Tutor Time*, as the release in this case did (the Court held that such a reference, while not determinative, corroborates that the parties intended to settle a dispute).

Second, for certain types of disclosure deficiencies (such as “piecemeal” disclosure, a failure to disclose all material facts, a failure to be accurate, clear and concise or a failure to include a list of costs associated with the establishment of the franchise), franchisees will need to establish, on actual evidence, that their ability to make an informed investment decision was actually impaired as a result. The Court’s finding that a franchisee must demonstrate that its ability to make an informed investment decision was in fact negatively affected by a deficient disclosure document supports the post-*Raibex* trend of considering the actual impact of the disclosure deficiencies

Finally, however, the case confirms that non-compliance with the certification requirements imposed by the *AWA* and related regulations continues to constitute a fatal disclosure flaw and is, on its own, grounds for rescission.

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a cautionary note

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