FIVE KEY TAKEAWAYS FROM THE 18TH ANNUAL FRANCHISE LAW CONFERENCE

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Several lawyers from McMillan's Franchise Law and Distribution Group presented at the 18th Annual Franchise Law Conference held on October 18, 2018 in Toronto, Ontario. The following are five key takeaways from the event:

1. Reconciling *Raibex* and *Mendoza* Tests for Availability of 2-year Rescission Remedy

There appears to be tension between the Ontario Court of Appeal decisions in *Raibex*[1] and *Mendoza* [2]regarding the availability of rescission remedies under section 6(2) of Ontario's *Arthur Wishart Act (Franchise Disclosure)*, 2000 SO 2000, c 3 (the "**Act**"). The Court of Appeal decision in *Raibex* came as a relief to franchisors because it held that, so long as a prospective franchisee is provided with all material facts sufficient to make an informed investment decision, the franchisee does not have a claim for rescission for a 2-year period under section 6(2) of the Act. As part of its reasoning, the Court of Appeal took into account the provisions of the franchise agreement relating to site selection. *Raibex* departed from the previous "fatal flaw" standard articulated in *Mendoza* that if a disclosure document does not include certain prescribed content, the franchisee may rescind its franchise agreement under section 6(2) of the Act. Despite this discrepancy, the Court of Appeal in *Raibex* did not distinguish its judgement from *Mendoza* and actually cited *Mendoza* in its decision.[3] The crucial question for franchisors following *Raibex* is how the courts will reconcile the two tests for when the rescission remedy under section 6(2) is available, as currently both are valid. Although this tension is still in its infancy, the courts have applied the *Raibex* standard in recent decisions.[4] This departure from the stricter Mendoza approach and the shift towards the business-friendly and subjective *Raibex* standard for evaluating franchisee rescission claims is highly favourable to franchisors.

2. Rescission as a Counterclaim to Termination of Franchise Agreements

Franchisees are increasingly responding to notices of termination by advancing counterclaims for rescission.[5] Accordingly, franchisors should carefully consider the timing of the issuance of a notice of termination, and if a notice of termination is to be given within the 2-year rescission window, evaluate the quality of disclosure provided to franchisees. If the franchisor cannot wait for the 2-year rescission window to expire before

terminating a franchise agreement, it should be prepared to respond to a rescission claim. Termination may not be in the best interests of the franchisor if there is a possibility that the rescission claim has merit and franchisors should consider alternative corrective actions, such as a buyout or negotiated sale to a third party.

3. Addressing Privacy Concerns

One of the most significant technological advancements in recent history has been the proliferation of data analysis. Franchisors are in the perfect position to aggregate and analyze consumer information. Large franchise networks can collect information on the behaviour of customers across a wide geographic area. While this data can lead to substantial customer insights, its collection also raises privacy concerns. Franchisors should ensure that franchisees comply with privacy legislation when collecting customer data. Further, franchisors should consider limiting the ways in which franchisees can use collected customer data. Allowing franchisees to store customer data or engage third parties to process such data can lead to complications on termination or non-renewal. Franchisors should analyze the implications of privacy legislation when reviewing their franchise agreement.

4. Granting Franchisees Limited Freedom

Traditional franchise agreements are generally restrictive when it comes to what a franchisee can and cannot do. This is by design. Franchisors often use restrictions to ensure uniformity across their franchise system and to derive benefits from achieving economies of scale. Today, an overly strict approach has become problematic for a number of reasons.

First, overly restrictive franchise agreements limit a franchisor's ability to take advantage of the knowledge of their franchise network. Franchisees are becoming more sophisticated. In certain areas, such as procurement, certain franchisees may have expertise that rivals or surpasses that of the franchisor. Granting franchisees a limited amount of freedom allows a franchise network to take advantage of this experience to become more efficient.

Restrictions are also problematic from an employment perspective. Franchisors that exercise too much control over franchisee employment matters risk being found to be "common employers" of franchisee employees. Being labelled a “common employer” is problematic as it may lead to liability under the *Labour Relations Act, Employment Standards Act* or similar legislation.

By granting franchisees a greater degree of freedom, franchisors can both increase efficiency and reduce exposure to liability across their franchise system. When re-examining their franchise agreement, franchisors should consider how much autonomy to grant franchisees.

5. The Appropriate Use of a Statement of Material Change

A Statement of Material Change ("**SMC**") is intended to inform a franchisee of any material adverse change following delivery of the disclosure document but before the franchise agreement is signed or any money is paid by the franchisee. It is well accepted thae bet a SMC is not a tool whereby the franchisor can correct errors in a defective disclosure document. The best method for correcting such errors is to deliver a new and complete disclosure document to avoid violating the "one document at a time" principle.[6] However, post-*Raibex*, and as a mechanism for mitigating the risk of failing to provide a franchisee with all material information needed to make an informed investment decision, SMCs are increasingly being used as a vehicle to disclose new information. A common example of this is disclosure of site-specific information that, while arguably not adverse, was not known at the time the disclosure document was delivered. The courts have not yet considered whether it is proper for a franchisor to disclose in a SMC new information that is not adverse to the franchisee – franchisors should be mindful of the uncertainty related to this practice if adopted.

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[1] *Raibex Canada Ltd. v. ASWR Franchising Corp.*, 2018 ONCA 62 [Raibex].[ps2id id='1' target='/]
[2] *Mendoza v Active Tire & Auto Inc.*, 2017 ONCA 471.[ps2id id='2' target='/]
[3] *Raibex supra* note 1 at para 48.[ps2id id='3' target='/]
[4] See: *1680960 Ontario Inc. v. Print Three Franchising Corporation, 2018* ONSC 1192.[ps2id id='4' target='/]
[5] For example see: *Caffé Demetre Franchising Corp. v. 2249027 Ontario Inc.,* 2015 ONCA 258.[ps2id id='5' target='/]
[6] Act, *supra* note 1, s 5(3).[ps2id id='6' target='/]

A Cautionary Note