

# THE FRANCHISE RESALE DISCLOSURE EXEMPTION: FRANCHISORS “WING IT” AT THEIR OWN PERIL

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In *Jayasena Management Corp. et al. v Savannah Wells Holdings Inc. et al.* (“*Jayasena v Savannah*”)[<sup>1</sup>] the Ontario Superior Court held that the sale of an existing franchise was effected by or through the franchisor, making the resale disclosure exemption in s. 5(7)(a)(iv) of the *Arthur Wishart Act (Franchise Disclosure), 2000* (the “AWA”) inapplicable. The Court went on to find that the franchisor’s failure to provide the purchasers with the disclosure document mandated by the AWA entitled them to rescind the franchise agreement and to damages of almost \$700,000 plus costs of \$250,000.

The decision follows prior jurisprudence and confirms that courts will interpret disclosure exemptions very narrowly. Generally speaking, the resale disclosure exemption in s. 5(7)(a)(iv) of the AWA will only apply when the franchisor is not an active participant in bringing about the sale and does nothing more than “passively” exercise its right to consent to the transfer.

## The Facts

The plaintiffs, Kaushalya and Chathura Jayasena, were interested in becoming Wild Wing franchisees and accordingly contacted Wild Wing’s head office. A representative of Wild Wing, Mr. Chandio, met with the plaintiffs, encouraged them to purchase a franchise from an existing franchisee (as opposed to opening a new location), took them on a tour of that location and provided them with some of the vendor franchisee’s financial information (but no disclosure document). The plaintiffs bought the existing Wild Wing franchise and claimed they entered into a franchise agreement with Wild Wing that all parties signed.

After unsuccessfully running the business at a loss for 18 months, the plaintiff franchisees served a notice of rescission on Wild Wing. They subsequently brought a claim against Wild Wing and others (the “Franchisor Defendants”) for a declaration rescinding the franchise agreement and damages from Wild Wing and the Franchisor Defendants jointly and severally as “franchisor’s associate[s]” (as defined in the AWA).[<sup>2</sup>]

## Legislative Background under the AWA - The Resale Exemption

Section 5(7)(a)(iv) of the AWA provides an exemption from the franchisor’s disclosure obligations if the grant of

a franchise by a franchisee is “not effected by or through the franchisor.” Section 5(8) of the AWA provides that “a grant is not effected by or through a franchisor merely because, (a) the franchisor has a right, exercisable on reasonable grounds, to approve or disapprove the grant; or (b) a transfer fee must be paid to the franchisor in an amount set out in the franchise agreement or in an amount that does not exceed the reasonable actual costs incurred by the franchisor to process the grant.”

Pursuant to Section 12 of the AWA, franchisors bear the burden of proving this exemption applies (which is often difficult to do, given the remedial nature of franchise legislation that is aimed at leveling the imbalance of power between franchisors and franchisees).

### **Key Issues**

One of the key issues in this decision was whether the grant of the franchise was “effected by or through the franchisor” (in which case, the resale disclosure exemption would not apply) or if the franchisor merely passively consented to the transfer of the franchise. For the reasons described below, the Court held that the resale was “effected by or through the franchisor” and, consequently, found that the resale disclosure exemption was not available to Wild Wing.

Additionally, the Court considered: (1) whether the franchise agreement was valid (the Court determined that it was, even though the copy in evidence was only signed by Wild Wing), (2) whether the disclosure provided was sufficient to discharge the franchisor’s statutory obligations under the AWA (it was not), (3) whether the plaintiffs are entitled to rescind the franchise agreement (they are), and (4) whether the Franchisor Defendants are “franchisor’s associate[s]” and therefore also responsible for rescission damages (they are).<sup>[3]</sup>

### **The Decision – The Resale Exemption Does Not Apply**

In determining whether Wild Wing could rely on the resale disclosure exemption in s. 5(7)(a)(iv) of the AWA, the Court began by referring to two prior decisions of the Ontario Court of Appeal on the subject, specifically noting that:

- “a franchisor that does not simply play a passive role in the resale limited to the specific requirements mandated for its consent under the franchise agreement will be unable to avail themselves of the exemption” (citing *2189205 Ontario Inc. v Springdale Pizza Depot Ltd.*, 2011 ONCA 467 (“*Springdale*”) at para 41). In *Springdale*, the franchisor went beyond “passive” involvement as it directed the purchaser to the particular franchise and had some involvement in the negotiations. Moreover, the agreement of purchase and sale obliged the purchaser to obtain the franchisor’s consent to the sale, thereby requiring the purchaser to deal with the franchisor directly, and the franchisor required the purchaser to sign additional documents that had not been

- signed by the vendor; and
- “[h]aving chosen to require a franchise agreement with the [franchisees], the [franchisor] cannot now argue that a franchise agreement was already in place with them, such that they are exempted from the disclosure requirement by s. 5(7)(a)(iv)” (citing 2256306 *Ontario Inc. v Dakin News Systems Inc.*, 2016 ONCA 74 (“*Dakin 2016*”) at para 8). In *Dakin 2016*, after the plaintiffs purchased a franchise from another franchisee and operated it for about two years, the franchisor required them to sign a franchise agreement (containing slightly different terms than those in the vendor franchisee’s agreement) that applied both retrospectively and into the future.<sup>[4]</sup>

The Court held that the reasoning in *Dakin 2016* applied here and found that “[b]y requiring the plaintiffs to sign a new franchise agreement, the franchise defendants cannot now argue that a franchise agreement was already in place between the plaintiffs and the franchisor”.<sup>[5]</sup> In other words, according to *Jayasena v Savannah*, the mere fact that a franchisor requires a purchaser to sign a new franchise agreement (instead of the existing agreement simply being assigned to the purchaser) is sufficient to make the resale disclosure exemption inapplicable.

The Court went on to note that, even if it is wrong that the mere signing of a new franchise agreement is insufficient for the grant of the franchise to have been “effected by or through the franchisor”, it would have gone on to conclude the franchisor did not play a “merely passive role” in the transfer. Mr. Chandiok steered the plaintiffs to a franchise that was for sale (as in *Springdale*) and provided them with information about the franchise.<sup>[6]</sup>

Accordingly, the Court concluded that the grant of the franchise was “effected by or through the franchisor” and that the resale disclosure exemption in s. 5(7)(a)(iv) did not apply. The Court went on to find that Wild Wing’s failure to provide a compliant disclosure document entitled the plaintiffs to rescind the franchise agreement under Section 6(2) of the AWA (and to damages and a significant costs award).

### **Takeaways**

This decision is a reminder that franchisors should exercise a high degree of caution (and not just “wing it”) before relying on an exemption from the requirement to deliver a compliant disclosure document under the AWA. As the Court in *Jayasena v Savannah* re-affirmed, courts will construe disclosure exemptions narrowly and the onus to demonstrate that one applies is on the franchisor.

With respect to the resale disclosure exemption in s. 5(7)(a)(iv) of the AWA, there are generally two circumstances where a court may find that a franchisor has “effected” the transfer: (1) where it requires the purchaser to sign a franchise document (or other documents with the franchisor) or agree to additional conditions that were not imposed on the vendor; and (2) where it actively participates or is involved in the

transaction in some way.

For example, the resale disclosure exemption will likely not apply (and a compliant disclosure document must be provided) where:

- The franchisor directs a purchaser to an existing franchisee looking to sell and has some involvement in putting the parties together, providing the purchaser with information about the vendor's business and/or in their negotiations;
- The franchisor requires a personal guarantee from the purchaser's spouse as a condition of approving the sale;
- The franchisor requires the purchaser to execute a new franchise agreement (instead of merely taking an assignment of the existing franchise agreement) as a condition of approving the sale;
- The franchisor, as a condition of approving the sale, requires the vendor to provide it with a copy of the purchase and sale agreement, contact information for the parties' lawyers, financial information on the purchaser; and/or
- The franchisor requires the purchaser to pay it an inventory fee to be put towards initial orders for inventory post-closing.

Where more than one of the above circumstances are present, a court is more likely to find that the franchisor has "effected" the transfer.

The message to franchisors is that, when dealing with a sale of a franchise by one of their existing franchisees to another person, the resale disclosure exemption in s. 5(7)(a)(iv) will be of limited availability in many cases. Franchisors who do nothing more than provide their consent or approval to a franchise resale will likely be able to rely on the exemption.

In circumstances where there is any doubt about the extent of the franchisor's involvement in a resale, counsel of prudence would suggest that the franchisor should provide a compliant disclosure document to the prospective purchaser in accordance with the AWA.

[1] 2023 ONSC 1008 [*Jayasena v Savannah*].

[2] *Ibid*, at para 3.

[3] *Ibid*, at para 8.

[4] Although the Court did not reference another more recent resale exemption decision involving Dakin News (being *1901709 Ontario Inc. et al. v. Dakin News Systems Inc.*, 2022 ONSC 6008), as we noted in our [2022 Franchise Year in Review](#), the Court in that case similarly found that the resale exemption does not apply if the franchisor's involvement in the transfer goes beyond simply exercising a right to consent to the sale.

[5] *Jayasena v Savannah*, *supra*, at para 45.

[6] *Ibid*, at para 46.

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### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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