

"Dakin" A Closer Look at the Resale Exemption and Franchisor's Associates in Statutory Rescission Cases

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A recent decision from the Ontario Superior Court of Justice, *1901709 Ontario Inc. et al. v. Dakin News Systems Inc. (Dakin)*,¹ contains both good news and bad news for franchisors in respect of dealing with rescission claims under Ontario's franchise legislation, the *Arthur Wishart Act (Franchise Disclosure), 2000* (the Wishart Act). On the good news side, *Dakin* provides helpful clarification to the statutory definition of franchisor's associates, confirming that mere employees of the franchisor will not meet the definition and thereby become exposed to personal liability. However, on the bad news side, *Dakin* highlights the pitfalls involved with relying on the "resale" disclosure exemption for transfers between franchisees. *Dakin* confirms that the exemption to statutory disclosure obligations will be construed narrowly, such that nearly any degree of involvement by the franchisor in the transfer may preclude the exemption's applicability.

Background

The plaintiffs purchased an operating "International News" franchise in Toronto from an existing franchisee who was looking to sell the business. An agreement of purchase and sale was entered into in November 2013 between the plaintiffs and the selling franchisee. The selling franchisee was required by their franchise agreement to seek the approval of the franchisor, Dakin News, to the sale.

The franchisor required as a condition of its approval that the selling franchisee follow a six-step transfer process. In addition to the six steps, Dakin News also required the plaintiffs to provide a \$20,000 inventory fee prior to closing over and above the amount paid to the seller for inventory on hand, which would be put toward the new franchisee's initial orders for inventory post-closing. The franchisor had no direct contact with the plaintiffs throughout this process and did not provide a disclosure document, relying on section 5(7)(a)(iv) of the Wishart Act, which provides that disclosure is not required where "the grant of the franchise is not effected by or through the franchisor."

The transfer was completed in January 2014 and the plaintiffs assumed operation of the franchise in March 2014. In July 2014, Dakin News advised the plaintiffs that it would be requiring a refurbishment and rebranding of the franchise at a cost of \$75,000 to be paid in three instalments as a condition of renewal with the franchise agreement and sublease set to expire in May 2015.

A dispute arose regarding these requirements and the plaintiffs delivered a Notice of Rescission, seeking

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damages against Dakin News, its affiliated sub-landlord entity, and two individuals alleged to be franchisor's associates.

Resale Exemption Not Applicable

Dakin News argued that no disclosure was required due to the application of the "resale exemption" to disclosure pursuant to section 5(7)(a)(iv) of the Wishart Act. Section 5(8) further confirms that a grant will not be "effected by or through the franchisor" merely due to the franchisor exercising a right to approve of the grant on reasonable grounds or levy a reasonable transfer fee in an amount set out in the franchise agreement not exceeding the reasonable actual costs incurred by the franchisor in processing the grant. Dakin News argued that its participation in the transfer did not exceed this permitted scope and that the transfer was between franchisees.

The Court rejected this argument, noting that the sale was "not a franchisee-franchisee transaction; rather, it was a franchisor-franchisee transaction in disguise." The six-step transfer process mandated by the franchisor, the requirement that the buyer enter into a new franchise agreement and sublease, and the \$20,000 inventory fee were found to go beyond the franchisor's right to approve the transfer and levy a reasonable transfer fee. Despite distancing itself from direct contact with the buyer, the Court found that Dakin News nevertheless controlled "every aspect" of the transfer through its imposition of a "guided process" intended to "cloak what in pith and substance was a transfer effected by Dakin News."

In light of the non-applicability of the resale exemption, the plaintiffs' claim for rescission was granted and various damages were ordered payable by Dakin News and certain alleged franchisor's associates.

Interestingly, this is the second case involving Dakin News that interprets the resale exemption under section 5(7)(a)(iv) of the Wishart Act. In a prior decision from 2015, the Court found that the resale exemption was inapplicable because the franchisor had required the purchasing franchisee to enter into a new franchise agreement.²

Franchisor's Employees Not Franchisor's Associates

While the court found that the franchisor's leasing affiliate and sole officer and director easily met the statutory definition of franchisor's associates, the plaintiffs were unsuccessful in establishing that one of Dakin News' employees was a franchisor's associate. In dismissing this claim, the court provided helpful guidance regarding the statutory definition of franchisor's associates and its applicability to non-officer employees of the franchisor.

The court held that the employee at issue, who was neither an officer, director, nor shareholder of the

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franchisor, was not “controlled” by Dakin News in the sense intended by the Wishart Act. The Court further noted that the Wishart Act was “not intended to include employees of the franchisor whose very job description it is to approve franchisees for its employer franchisor. [...] It cannot be that employees of a franchisor company are liable simply because their job is to implement the franchisor’s process for granting franchises. Otherwise, no one would work for a franchisor company without the company indemnifying them for any such liability.”

This is a helpful clarification of the statutory definition of franchisor’s associates which will hopefully avoid unnecessary claims being brought against mere employees of the franchisor with the prospect of personal liability attached.

Key Takeaways

This decision reaffirms the view that the “resale” exemption to disclosure continues to be construed extremely narrowly. Requiring compliance with a “guided” transfer process or any payment beyond a nominal transfer fee may preclude its application. Franchisors should proceed cautiously in resale scenarios and consider carefully with their legal counsel whether disclosure is required. However, franchisors can be reassured that their employees whose role is confined to franchisee recruitment and approval may not be exposed to joint and several liability as franchisor’s associates.

A copy of the decision can be found [here](#).

¹ 1901709 Ontario Inc. et al. v. Dakin News Systems Inc, 2022 ONSC 6008.

² 2256306 Ontario Inc. v Dakin News Systems Inc., 2015 ONSC 566, <<https://canlii.ca/t/gg3js>>, aff’d 2016 ONCA 74, <<https://canlii.ca/t/gn36d>>.