Cassels

Proper Disclosure is "Paramount": The Ontario Court of Appeal Weighs in on a Complex Franchise Rescission Case

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In *Royal Bank of Canada v. Everest Group Inc.*, 2024 ONCA 577 (*Paramount*), the Ontario Court of Appeal upheld the trial decision made by Madam Justice Vermette of the Ontario Superior Court of Justice (*Premium Host Inc. v. Paramount Franchise Group*, 2023 ONSC 1507). In the trial decision, Justice Vermette had tackled a complex set of franchisee rescission claims from three different franchisees against Paramount, a restaurant franchisor, and a collection of franchisor-related defendants. Among other issues, Justice Vermette explored whether the franchisees were entitled to rescind their franchise agreements under the *Arthur Wishart Act (Franchise Disclosure), 2000* (the *"Wishart Act"*), the nature of the disclosure provided by the franchisor, the availability of disclosure exemptions to the franchisor, and the extent to which the franchisor-related defendants were "franchisor's associates" and liable under the *Wishart Act.*

In the trial decision, Justice Vermette concluded that only one franchisee (Premium Host) was entitled to rescind its franchise agreement under the *Wishart Act*, while the two others (Versatile and Everest) did not make their case for rescission. The Court of Appeal was "not persuaded that the trial judge made any reversible error" and dismissed the franchisees' appeal and the defendants' cross-appeal. The key findings by the Court of Appeal that impact Ontario (and Canadian) franchising law are outlined below.

- **The Onus of Proving Inadequate Disclosure or Non-Disclosure is on the Franchisee**: Both the franchisor and franchisees had significant issues in respect of their credibility and their documentation surrounding required disclosure under the *Wishart Act.* The trial judge ultimately held that some form of franchise disclosure document was provided to all three franchisees, although the trial judge found that it could not establish that any of the *specific* FDDs relied upon by the franchisor were provided to the franchisees.

An issue on appeal was whether the onus is on the franchisor to prove there was actual disclosure to a potential franchisee in accordance with the disclosure requirements of the *Wishart Act*. The Court of Appeal agreed with the trial judge and clarified that the onus is on the franchisee to prove that they are entitled to rescission and statutory compensation, hence it is the burden of the franchisee to prove there was no disclosure or inadequate disclosure under the *Wishart Act.*

- **Two of the Franchisees Did Not Meet Their Burden to Prove No Disclosure or Inadequate Disclosure:** The Court of Appeal gave deference to the trial judge's interpretation of the evidence tendered at trial in respect of her finding that two of the franchisees – Versatile and Everest – had not

met the burden of proving that they received no franchise disclosure or inadequate franchise disclosure. The Court of Appeal held that, "[i]t was open to the trial judge to reject the franchisees' evidence that the documents on which they relied were not the last documents that they received from the franchisor and that the franchisor had produced further documents to the franchisees, which the franchisees failed to produce." This finding underlines the importance of franchise parties maintaining disclosure-related records in order to bolster their positions in potential future franchise litigation.

- **Some of the Defendants Were Found to be Franchisor's Associates:** The franchisees' claims included allegations that various franchisor-adjacent parties were "franchisor's associates" and therefore liable for the rescission claims under the *Wishart Act.* The trial judge found that the franchisor's wholesale company and construction company were not associates because they had no role in the grant of the franchises and did not exercise significant operational control over the franchises. This finding was upheld by the Court of Appeal, which commented that the trial judge "properly applied the statutory definitions and her findings that neither was involved in the review or approval of the franchise nor exercised significant operational control were open to her on the record to which she referred." The Court of Appeal affirmed that a related leasing company was a franchisor's associate due to the "significant operational control" exercised by the company over the franchisees. The Court of Appeal specifically noted that the related leasing company had the power to terminate the franchisee's lease for breach of the franchise agreement. The Court of Appeal further agreed with the trial judge that an employee, the Manager of Franchising, was a franchisor's associate because of her "significant role in the process of reviewing [franchise] applications, exercising professional judgment, and advising the ultimate decision makers." This latter finding, although potentially confined to the specific facts of this case, may prove controversial as it arguably broadens the risk of lower-level employees being liable for rescission claims.

- **The Narrow Interpretation of Disclosure Exemptions**: At trial, the franchisor sought to defend against the rescission claims through a variety of *Wishart Act* disclosure exemptions. These attempts were rejected by the trial judge and the Court of Appeal adopted her reasoning, driving home that Ontario courts are unlikely to accept creative attempts to escape from disclosure obligations. Specifically:
    - The franchisor attempted to argue that the three franchises were a single grant of a franchise due to connections between the franchisees' principals, and therefore claimed that Paramount was entitled to an exemption based on the fact that the franchises collectively cost more than $5 million (section 5(7)(h) of the *Wishart Act*). The trial judge rejected this argument, holding that there were three different grants at three different times through three different franchise agreements in different territories.
    - The franchisor argued that it was entitled to an exemption because there was a grant of an additional franchise to an existing franchisee (section 5(7)(c) of the *Wishart Act)*. Although there were some connections between the new franchise and an existing franchisee (in respect of shareholders, directors, officers), the trial judge rejected this claim because the

franchisees were separate corporations and there were some differences in the principals of the franchises.

- The franchisor claimed that it was entitled to rely on the franchisee-to-franchisee resale exemption under section 5(7)(a) of the *Wishart Act*. The trial judge rejected this claim because the former franchisee had been terminated by Paramount and fresh agreements were entered into by Paramount with the new franchisee. There was no "grant by a franchisee" in this case. Further, the franchisor's involvement in the sale meant that it was not permitted to rely on this exemption.

- **A Terminated Franchise Agreement May Still Be Rescinded**: At trial, Paramount argued that a terminated franchise agreement could not be rescinded as it was no longer operative. This was rejected by the trial judge, who held that rescission was a statutory right and that parties cannot contract out of the *Wishart Act*. The Court of Appeal agreed and added that the lawful termination of a contract for breach absolves the non-breaching party from performing future surviving obligations under the contract, but it does not render the contract void *ab initio*. The Court of Appeal concluded that "[t]he franchisor cannot negate the franchisee's statutory right to rescind by pre-emptively terminating the agreement, even where there has been a breach by the franchisee."

- **The Franchise Disclosure Documents Were Sufficient for Two of the Three Franchisees**: In examining the contents of the FDDs notionally or likely given to the three franchisees, the trial judge rejected certain alleged minor deficiencies (such as the adequate listing of directors and officers and the failure to include a material construction management agreement) as insufficient to give rise to a valid rescission claim. The trial judge further held that it was not satisfied that the franchisor failed to produce financial statements, head leases, and signed and dated certificates. However, for one of the franchisees (Premium Host), the trial judge held that the franchisor had committed the fatal error of disclosure on a piecemeal basis. Specifically, Paramount provided late, separate disclosure of material financial performance information. That was sufficient to support Premium Host's rescission claim. The Court of Appeal upheld this finding as the finding was informed by the trial judge's credibility assessments and the decision on the materiality of the erroneous disclosure was entitled to deference.

Paramount touches on a wide variety of issues concerning disclosure and rescission under the *Wishart Act* and other Canadian franchise legislation and should be reviewed by franchisors to ensure that their disclosure policies comply with the standards set out in the decision. A further and more subtle lesson from this decision, which arises from the conflicting evidence concerning what was actually disclosed, is that properly organized and documented disclosure processes will go a long way in resisting (or at least managing) litigation disputes arising from rescission claims.

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