STRICT LIABILITY AND STATUTORY RESCISSION OF FRANCHISE AGREEMENTS IN THE ONTARIO COURT OF APPEAL

Ontario's Arthur Wishart (Franchise Disclosure) Act[1] has fundamentally affected franchise purchase transactions in Ontario by imposing extensive pre-contractual disclosure obligations on franchisors. Franchisees have the statutory right to receive detailed disclosure statements before committing to the franchise relationship, which is enforced through a powerful rescission remedy where disclosure is not properly made. The public policy goal of the disclosure regime and its rescission remedy is to provide prospective franchisees with opportunities to make informed investment decisions.[2] Mandatory, pre-contractual disclosure and rights of rescission are becoming cornerstones in franchise law in Canada, with similar legislation in force in Alberta, New Brunswick and Prince Edward Island, and with Manitoba soon to follow.[3]

The Ontario Court of Appeal has now delivered nine decisions in which it has considered the Act's disclosure obligations and related rescission remedy.[4] As will be explored in this comment, in my view, the court has affirmed a disclosure regime in which most kinds of errors or omissions in a disclosure statement will effectively entitle the franchisee to an indemnity for all the losses it has incurred up to the second anniversary of the franchise. This effective indemnity flows from the financial obligation imposed on the franchisor by the statutory rescission remedy to put the

1. Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3 ("the Act").
2. *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.* (2005), 256 D.L.R. (4th) 451 (C.A.), at para. 18; *6792341 Canada Inc. v. Dollar It Ltd.* (2009), 310 D.L.R. (4th) 683 (C.A.), at paras. 16-20.
3. Franchises Act, R.S.A. 2000, c. F-23; Franchises Act, S.N.B. 2007, c. F-23.5; Franchises Act, R.S.P.E.I. 1988, c. F-14.1; The Franchises Act, S.M. 2010, c. 13 (CCSM c. F156) [Not yet in force].
4. *1368741 Ontario Inc. v. Triple Pizza (Holdings) Inc.*, [2004] O.J. No. 3562 (C.A.); *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*, *supra*, footnote 2; *Personal Service Coffee Corp. v. Beer* (2005), 256 D.L.R. (4th) 466 (C.A.); *MDG Kingston Inc. v. MDG Canada Inc.* (2008), 299 D.L.R. (4th) 497 (Ont. C.A.), leave to appeal to S.C.C. refused 317 D.L.R. (4th) vii; *4287975 Canada Inc. v. Imvescor Restaurants Inc.* (2009), 305 D.L.R. (4th) 193 (Ont. C.A.), leave to appeal to S.C.C. refused 308 D.L.R. (4th) vi; *6792341 Canada Inc. v. Dollar It Ltd.*, *supra*, footnote 2; *Trade Secrets International Ltd. v. Jalaly*, 2009 ONCA 748; *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.* (2011), 336 D.L.R. (4th) 234 (Ont. C.A.); *TA & K Enterprises Inc. v. Suncor Energy Products Inc.*, [2011] O.J. No. 4242 (C.A.).

franchisee back in the position it was in prior to the purchase of the franchise.[5] None of the defences that are traditionally available in similar areas of the law are available under the statutory rescission remedy.[6] Franchisees, accordingly, have strong incentives to look carefully at disclosure statements for any material deficiencies in order to trigger their right to an effective indemnity for any business losses and poor financial performance in the first two years of operations.

This comment will consider these themes and is divided into four parts. Part 1 will provide an overview of the franchise disclosure regime in Ontario with reference to the governing statutory provisions and controlling case law. Part 2 will describe and critically analyze the two leading cases of the Ontario Court of Appeal, which arguably establish a regime of strict liability in Ontario. Part 3 will provide a more policy-oriented discussion in an attempt to make sense of the current state of the law. Both the principles of statutory interpretation and the policy goals of the Act can accommodate a disclosure regime that is better grounded in the reasonable expectations of the parties. With U.S.-based franchisors now looking to expand into Canada,[7] it is a convenient time to rethink the statutory consequences for trivial deficiencies under the Act.

1. Overview of Franchise Disclosure Regime in Ontario

In Ontario, a franchisor is obliged to deliver a disclosure document to a prospective franchisee at least 14 days prior to the date on which the franchisee executes an "agreement relating to the franchise,"or the date on which the franchisee pays consideration to the franchisor, whichever comes first.[8] As discussed, the purpose of the disclosure requirements are to ensure that franchisees are sufficiently informed before undertaking the significant financial risks of acquiring a franchise.[9]

5. See Section 1 below.
6. See Section 3 below.
7. Jeff Gray, "Canada serves up a surprise for U.S. fast-food franchises," *Globe and Mail*, December 20, 2011.
8. Arthur Wishart Act, s. 5(1). The provision also deals with the concept of a "franchisor's associate;" which will not be explored in this article. A franchisee has paid "consideration" where it has provided the franchisor with a "deposit and [a] debt instrument that secure[s] the balance": *1368741 Ontario Inc. v. Triple Pizza (Holdings) Inc.*, *supra*, footnote 4, at para. 2.
9. *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*, *supra*, footnote 2, at para. 18; *6792341 Canada Inc. v. Dollar It Ltd.*, *supra*, footnote 2, at paras. 16-20.

The form and content of a disclosure statement are prescribed in the Act, which includes, among other things, an obligation to include all "agreements relating to the franchise," a general obligation to disclose "all material facts," and an obligation to disclose "material facts as prescribed" in the Regulation.[10] In its present iteration, the Regulation prescribes over 25 different subject areas that must be addressed in a disclosure document.[11] Some of the key subject areas include: detailed background information about the franchisor and its directors and officers;[12] financial documents relevant to the franchisor and the subject franchise location;[13] upfront and recurring costs to the franchisee;[14] information concerning the closure of other franchisees in the franchise system;[15] and information about specific policies of the franchisor, including those imposing restrictions on goods and services to be sold,[16] those relating to volume rebates for purchases of goods, policies on network-wide advertising funds, and those dealing with exclusive territories.[17]

In terms of formal requirements, the Act provides that the disclosure statement be "one document" delivered at "one time,"[18] and the Regulation requires that it include a certificate, signed by an officer or director of the franchisor,[19] certifying that there are no errors or omissions. Each disclosure document must be specific to the franchise location at issue in the transaction;[20] in other words, "it must be localized."[21] The Act is also clear that the parties to a franchise agreement cannot contract out of the disclosure requirements.[22]

10. Act, s. 5(4).
11. Regulation, General, O Reg 581/00, ss. 2-7; in *6792341 Canada Inc. v. Dollar It Ltd.*, *supra*, footnote 2, at paras. 61-62, the Ontario Court of Appeal noted that a franchisor is required to expressly note in the disclosure document if one of these subject areas does not apply to its franchise system.
12. Regulation, General, s. 2.
13. Act, s. 5(4)(b); Regulation, General, ss. 3 and 6(3).
14. Regulation, General, s. 6(1), (2) and (6).
15. *Ibid.*, s. 6(16).
16. *Ibid.*, s. 6(7).
17. See Regulation, General, *ibid.*, s. 6(6), (8) and (13).
18. Act, s. 5(3).
19. The Regulation contains specific rules about who needs to sign the certificate depending on the governance structure of the franchisor: see s. 7(2).
20. See, for example, the requirement in s. 6(12) of the Regulation to specifically describe any exclusive territory that would be granted to the franchisee.
21. See, for example, *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC*, 2006 CanLII 25276 (Ont. S.C.J.), at para. 62, where the franchisor's failure to disclose material information specific to the location at issue was held to be deficient under the Act.

The Act provides two specific remedies to franchisees where the disclosure requirements are not met. The first and primary remedy is statutory rescission, an extraordinary form of relief that effectively allocates the business risks and financial consequences for the operation of the franchise to the franchisor. The rescission remedy is available to a franchisee in the event of late disclosure, deficient disclosure or absent disclosure, and allows the franchisee to "rescind the franchise agreement, without penalty or obligation," and imposes significant financial obligations on the franchisor to effectively indemnify the franchisee for any and all costs incurred to date. The financial obligations include the refund of all monies received, the purchase by the franchisor of any inventory, supplies or equipment that the franchisee had purchased pursuant to the arrangement, and the payment of compensation to the franchisee for any losses incurred in "acquiring, setting up and operating" the franchise.[23] Where the franchisee purchased the franchise from a previous franchisee, "losses incurred" includes any payment by the new franchisee to the former franchisee's lenders.[24]

The rescission remedy is *sui generis* in the sense that it does not contain the same indicia as rescission at common law or in equity.[25] Moreover, there is no requirement for the franchisee to have relied upon or even to have noticed the deficiency which triggers the remedy, nor is there any obligation to establish a nexus between the disclosure statement, or the deficiency therein, and the financial loss for which the franchisee may seek compensation.[26] It is no defence for the franchisor to prove that the franchisee knew about the deficiency in the disclosure statement at the time of contract formation.[27] A franchisor must discharge its financial obligations under the rescission remedy within 60 days from the effective date of the rescission, even where the franchisor has a valid counterclaim against the franchisee for breach of contract, or in tort, which will take some time to be disposed of.[28]

22. The Act, s. 11; see also, *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*, *supra*, footnote 2, at paras. 33-34.
23. Act, s. 6(6).
24. *Trade Secrets International Ltd. v. Jalaly*, *supra*, footnote 4.
25. *MDG Kingston Inc. v. MDG Canada Inc.*, *supra*, footnote 4, at para. 25.
26. By contrast, under s. 7 of the Act, a franchisee may claim damages for a misrepresentation in a disclosure document where it suffers a loss "because of" that misrepresentation. There is no similar language in the rescission clauses under the Act.
27. This is clear from s. 7(4), which applies only to the statutory damages remedy (not rescission) and which expressly provides the franchisor with such a defence.

The rescission remedy is subject to two potential limitations periods. Where the "contents of the disclosure document did not meet the [statutory] requirement," or where the disclosure statement was not delivered "within the [prescribed] time," the Act provides that the right of rescission must be exercised by the franchisee "no later than 60 days after receiving the disclosure document." By contrast, "if the franchisor never provided the disclosure document," the franchisee has "two years after entering into the franchise agreement" to exercise the right of rescission.[29] Obviously, the financial consequences of rescission are far greater to the franchisor the longer the franchisee has been in business. We shall see that two decisions of the Ontario Court of Appeal have now established that most forms of deficiency — even arguably trivial ones — will constitute "absent disclosure" triggering the two-year limitations period.[30]

The second statutory remedy for inadequacies in disclosure is damages, which shares many similarities with the counterpart provision in the Ontario Securities Act for prospectus misrepresentation.[31] Statutory damages under the Act is only available where the franchisee establishes a link between its financial loss and a misrepresentation or other deficiency in the disclosure document.[32] Unlike with respect to statutory rescission, the franchisor can avoid paying statutory damages by proving that the franchisee acquired the franchise with knowledge of the misrepresentation.[33] The franchisee may assert the damages remedy against a wider class of defendant, including any officer or director of the franchisor who executed the certificate accompanying the franchise document,[34] and there are special defences available to this wider class, similar to the prospectus misrepresentation provisions of the Securities Act.[35]

While the Act provides a list of scenarios in which the franchisor is exempt from the obligation to deliver a disclosure document, the Ontario Court of Appeal has held that the exemptions are to be "narrowly construed."[36] Generally speaking, the exemptions are

28. *Personal Service Coffee Corp. v. Beer*, *supra*, footnote 4, at paras. 30-32.
29. Act, s. 6(1) and (2).
30. See Section 2 below.
31. Securities Act, R.S.O. 1990, c. S.5, s. 130.
32. Act, s. 7.
33. Act, s. 7(4).
34. Act, s. 7(1)(e).
35. See Securities Act, s. 130(3).
36. *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*, *supra*, footnote 4, at para. 32.

limited to situations where the franchisee already has intimate knowledge of the franchise system,[37] where the financial risk to and investment by the franchisee are relatively small,[38] or where the franchisee acquires the franchise from a third party without the active involvement of the franchisor.[39]

2. Court of Appeal Establishes General, Two-Year Limitation Period for Rescission

(a) Breach of the Formal Statutory Requirements

The Ontario Court of Appeal has made clear that a franchisor's failure to comply with the two key formal requirements under the Act will be held to constitute absent disclosure, triggering the two-year limitations period. In the first key decision of the court, *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*,[40] MacFarland J.A., writing for the court, held that the provision of "piecemeal" disclosure over a period of time — in contravention of the "one document" at "one time" provision of the Act — constituted absent disclosure. Like with most of the franchise disclosure decisions that have come before the court, it is noteworthy that in *Dig This Garden* the franchisor *conceded* that it had failed to make adequate disclosure under the Act. The franchisor provided an initial disclosure document that contained very general information about it and the franchise system,[41] and then proceeded to provide successive, additional disclosure over time, including financial documents, a draft franchise agreement, and verbal information. The franchisor conceded that it was only upon receipt of the last piece of information that the franchisee

37. Act, s. 5(7)(b), (c) and (f). Clause 5(7)(h) (supplemented by s. 10 of the Regulation) may also be thought of as falling into this group, as the prospective franchisee would surely have conducted significant due diligence to invest $5 million in the first 12 months of business.
38. Act, s. 5(7)(e) and (g). In *TA & K Enterprises Inc. v. Suncor Energy Products Inc.*, *supra*, footnote 4, at para. 18, the Court of Appeal implicitly suggested that this was the purpose of the exemption found in s. 5(7)(g).
39. Act, s. 5(7)(a) and (d). In *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*, *supra*, footnote 4, the Ontario Court of Appeal held that the exemption in s. 5(7)(a) (which applies where "the grant of the franchise is not effected by or through the franchisor") requires that the franchisor be but a passive participant in the transaction.
40. *Supra*, footnote 2.
41. *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*, [2004] O.J. No. 3008 (S.C.J.), at para. 4.

had finally obtained 70% of the informational content prescribed in the Act and the Regulation.[42]

The principal issue before the Court of Appeal was whether the 60-day or two-year limitation period applied to the franchisee's claim for statutory rescission, as the franchisee was past the 60-day period. According to MacFarland J.A., the 60-day limitation period "presupposes the existence of a single 'disclosure document,'" which had not been provided. Instead, the two-year period applied to the franchisee's claim for rescission. The Court of Appeal expressly rejected the franchisor's attempt to frame the deficiency as one of procedure over substance. According to MacFarland J.A.:

> There is no issue of "substantive" versus "procedural" compliance . . . The legislature clearly envisioned that the purpose of the legislation — *i.e.*, ensuring that a decision to enter into a franchise agreement is an informed one — would best be fulfilled by . . . a single document . . . so that all the information is before them at the same time.[43]

One of the difficulties with *Dig This Garden* is that it does not provide clear guidance in future cases regarding the dividing line between inadequate disclosure and absent disclosure. On the one hand, a more restrictive reading of the decision would focus on the factual record from which MacFarland J.A.'s comments emanated, including that:

- The initial disclosure document contained less than half the prescribed information.[44]
- The franchisor never intended to meet its full disclosure obligations.[45]
- It was impossible for the franchisee to know which piece of information received by the franchiser actually triggered the right to seek rescission.[46]

On the other hand, MacFarland J.A. did not mention any of these facts in the principal passages of her judgment, which on their face are open to the interpretation that any form of "piecemeal" disclosure will *per se* be held to constitute absent disclosure triggering the two-year limitations period. In this context, there is a

42. *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.* (C.A), *supra*, footnote 2, at para. 9.
43. *Ibid.*, at para. 18.
44. *Ibid.*, at para. 9.
45. *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.* (S.C.J.), *supra*, footnote 41, at paras. 24-26.
46. *Ibid.*, at paras. 24-26.

real risk to franchisors of providing prospective franchisees with *any* material information outside the four corners of the disclosure document.[47]

MacFarland J.A. had the opportunity to clarify her analysis in the 2009 decision in *6792341 Canada Inc. v. Dollar It Ltd.*,[48] now the leading authority on franchise disclosure obligations in Ontario. Again, the franchisor conceded before the court that the disclosure statement it delivered to the franchisee had multiple deficiencies under the Act.[49] MacFarland J.A., again writing for the court, held that the deficiencies amounted to absent disclosure attracting the two-year limitations period under the Act. In terms of formal deficiencies, MacFarland J.A. held that the franchisor's failure to have an officer or director sign the prescribed certificate which forms a part of the disclosure document was in and of itself fatal to the disclosure document.[50] MacFarland J.A. cited with approval the Alberta decision in *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*,[51] in which the Alberta Court of Appeal held that an unsigned certificate in a franchise disclosure statement rendered the disclosure "substantially" incomplete, thus providing the franchisee with a two-year rescission right under the Alberta franchise statute. MacFarland J.A. also held that the franchisor had breached the formal obligation to provide "one document" by separating the draft franchise agreement from the remainder of the disclosure document which presumably would too have been sufficient to attract the two-year limitations period. Therefore, *Dollar It* further affirms the strict nature of the formal requirements under the Act and the broad reading that the Court of Appeal accorded to the two-year period in *Dig this Garden*.[52]

(b) Content-Based Deficiencies

In the course of considering the many deficiencies in the disclosure statement at issue in *Dollar It*, MacFarland J.A. made a number of inconsistent statements regarding the legal framework that would thereafter demarcate the line between deficient and absent disclosure. In more than one section of her reasons, MacFarland J.A. suggested that the controlling principle was

47. *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.* (C.A.), *supra*, footnote 2, at para. 22.
48. *Supra*, footnote 2.
49. *Ibid.*, at para. 15.
50. *Ibid.*, at para. 32.
51. (2009), 437 A.R. 225 (C.A.).
52. *Dollar It Ltd.*, *supra*, footnote 2, at paras. 50-58.

whether or not, upon close examination of the disclosure document, the franchisee was able to make "an informed decision to enter into the franchise agreement."[53] One commentator has thus suggested that the legal test flowing from *Dollar It* is to determine whether a reasonable person would have been able to make an informed decision.[54] But MacFarland J.A. did not specifically state that this was the governing test and did not provide any guidance on how to apply it if it was. Moreover, in another section of her reasons, MacFarland J.A. suggested that, instead, the test was whether the disclosure document was in "substantial compliance" with the requirements of the Act.[55] Again, no guidance is given on how to apply this standard. Finally, in still other sections of her judgment, MacFarland J.A. endorsed the reasoning of the Ontario Superior Court in *6862829 Canada Ltd. v. Dollar It Ltd.*,[56] which held that any "material" omission in a disclosure statement was fatal and constituted absent disclosure. She also cited with approval the Superior Court decision in *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC*[57] where the materiality test also appears to be adopted.[58]

As discussed above, the Regulation contains approximately 25 content-based prescriptions for inclusion in a disclosure document. As is clear from s. 5(4)(a) of the Act, each of these prescribed areas is likely a "material fact" for inclusion in the disclosure statement. Therefore, if the correct interpretation of *Dollar It* is that *any* material omission triggers the two-year period, each of the 25 prescribed topics in the Regulation is a potential trap for the franchisor. Moreover, in *Dollar It*, MacFarland J.A. also held that where one of the Regulation's prescribed topics does not apply to the franchisor, "the disclosure document should say so,"[59] which suggests that the failure to do so would be material. To the extent that a material omission is the governing test for triggering the two-year limitations period for rescission, there is a very wide scope for its application.

53. *Ibid.*, at paras. 20, 44 and 68.
54. David Sterns, "Basic Franchise Disclosure: Advising the Purchaser of a Franchise Business,"*Focus on Franchising*, vol. 1(3) (Toronto, Ontario Bar Association, 2010).
55. *Dollar It Ltd.*, *supra*, footnote 2, at para. 35.
56. [2008] O.J. No. 4687 (S.C.J.) at paras. 64-65, revd on other grounds [2010] O.J. No. 214 (C.A.).
57. *Supra*, footnote 21, para. 71. ("In my view, this non-disclosure of material facts in itself meant there was not compliance with the *Act*").
58. *Dollar It Ltd.*, *supra*, footnote 2, at para. 78.
59. *Ibid.*, at para. 62 (see also para. 67).

It is still arguably an open question whether MacFarland J.A. intended for the test of materiality to govern the dividing line between deficient and absent disclosure. On the one hand, she went out of her way to state that certain deficiencies — such as the failure to execute the certificate and the failure to provide financial statements — were independently fatal to the disclosure statement.[60] The remaining deficiencies, such as the failure to include the master lease along with the sub-lease and the failure to disclose certain network-wide policies, were simply described as "material" omissions or contraventions of the Act. On the other hand, MacFarland J.A.'s endorsement of the materiality test as applied in two lower court decisions, with the simple caveat that "each case will fall to be considered on its own particular facts," strongly suggests that she intended to adopt that test for Ontario.[61]

In a future case, the court should clarify the legal test and, for the reasons set out below, should reject the materiality test.

3. Strict Liability on Franchisors and Effective Indemnity for Franchisees

The effect of the *Dig This Garden* and *Dollar It* decisions is to affirm a regime of strict liability in Ontario, where virtually all content-based omissions, and most formal deficiencies, will be fatal to a disclosure document and be held to constitute absent disclosure by the franchisor. Despite the lack of clarity regarding the operating legal test in *Dollar It*, to the extent that materiality is the governing test, most deviations from the requirements of the Act will constitute absent disclosure. Under this standard, the failure to address one of the topics prescribed in the Regulation, or the failure to expressly state that such a topic does not apply to the franchise system, will render the disclosure document a nullity. The same conclusion would follow if the disclosure statement was split into more than one formal document.

The test for materiality must be considered alongside the strict financial penalties that accompany statutory rescission. With these penalties, statutory rescission effectively transfers the first two years of inherent business risk in acquiring and operating a franchise from the franchisee to the franchisor.[62] As discussed

60. *Ibid.*, at paras. 32 and 35.
61. *Ibid.*, at paras. 33 and 37; *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC*, *supra*, footnote 21; *6862829 Canada Ltd. v. Dollar It Ltd.*, *supra*, footnote 56.
62. See *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*, *supra*, footnote 51, at paras. 134 and 136.

above, it does not matter whether or not the deficiency in the document, or the missing information, played any role in the franchisee's decision to acquire the franchise or can otherwise be linked to the financial losses for which compensation is sought. Indeed, the financial obligations follow even if the franchisee is aware, at the time of contracting, of the deficiency or material omission.[63] This will give franchisees incentives to look carefully for deficiencies in a disclosure document early on and to keep silent if one if located, in the anticipation of exercising the right of rescission and obtaining an effective indemnity for business losses in the first two years of business.[64] It may even provide a counterincentive for sound and prudent management of the franchise.

From the perspective of statutory interpretation, the materiality test cannot be justified. Section 6(1) of the Act makes clear that franchisees must exercise their rescission rights within 60 days where the basis for the rescission is the failure of the franchisee to deliver the disclosure document "within the time [periods] require[d] [by the Act]," or that "the *contents* of the disclosure document did not meet the [statutory] requirements."[65] The materiality test ignores this provision of the Act by providing that the absence in a disclosure statement of any of the content-based prescriptions in the Act or Regulation — each of which is surely "material" in the legal sense — will invalidate the disclosure and trigger the two-year limitations period. The court in *Dollar It* effectively ignored the language of s. 6(1) in terms of content-based deficiencies. By contrast, in *4287975 Canada Inc. v. Imvescor Restaurants Inc.*, the same court invoked the strict language of that same provision to hold that late, pre-contractual delivery of a disclosure statement triggered the 60-day period.[66]

From a policy perspective, the materiality test cannot be justified by sole reference to the goal of allowing franchisees to make informed decisions. In other areas of the law which advance

63. See *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*, *ibid.*, at paras. 134 and 136.

64. It has been suggested that a franchisee who sits on its rescission rights in this way would be acting contrary to the statutory duty of good faith and fair dealing found in s. 3 of the Act: David M. Shaw and Megan L. Roberts, "Advanced Franchise Disclosure: The Latest Word on Rescission," *Focus on Franchising*, vol. 1(1) (Toronto, Ontario Bar Association, 2009).

65. Act, s. 6(1) [emphasis added].

66. *4287975 Canada Inc. v. Imvescor Restaurants Inc.*, *supra*, footnote 4.

similar policy goals — for example, the law of informed consent[67] — the courts will actually examine the decision-making process and ask whether the claimant, or a reasonable claimant in similar circumstances, would have proceeded with the decision had they obtained proper disclosure. In the franchise context, the inquiry would be whether the franchisee, or a reasonable franchisee, would have proceeded with the transaction had there been no deficiency in the disclosure document. In other words, unlike in the law of informed consent, under the materiality test, a franchisee who receives a disclosure document containing a material omission, but who nonetheless proceeds to make an informed, rational, business decision to enter into the franchise agreement, will always be entitled to an effective two-year indemnity for all business risks flowing from the franchise acquisition.

In the law of securities regulation, the wide remedy of damages for prospectus misrepresentation is counterbalanced by the defences of rebuttable knowledge (allowing the defendant to establish that the plaintiff knew about the deficiency),[68] and loss causation (limiting liability to the depreciation in value caused by the disclosure deficiency).[69] Despite the shared goal of both securities and franchise disclosure laws of ensuring that certain investment decisions be informed decisions, the Act, as interpreted by the Ontario Court of Appeal, does not contemplate *any* defence to rescission, let alone rebuttable knowledge or loss causation, other than where the franchisor can establish full compliance with the detailed prescriptions in the Act and Regulation.

Nor can the principle of reasonable expectations be seen to be operating in this context. The effective two-year indemnity does not accord with the reasonable expectations of commercial parties to franchise agreements. Commercial parties reasonably expect an indemnity in circumstances where they specifically bargain for one or in circumstances of wrongful conduct causing specific harm for which compensation is sought. The policy goal of the Act is not *per se* to allocate the risk of poor performance in two first years of operation from franchisees to franchisors. Nor does anyone reasonably expect such an indemnity at the time of contracting. Indeed, the legal inquiry under the Act in individual cases does not

67. *Reibl v. Hughes*, [1980] 2 S.C.R. 880; *Hopp v. Lepp*, [1980] 2 S.C.R. 192; *Videto v. Kennedy* (1981), 33 O.R. (2d) 497 (C.A.).
68. Securities Act, s. 130(2).
69. *Ibid.*, s. 130(7).

concern itself with the litigants' reasonable expectations so far as any deficiencies in the disclosure document is concerned.

4. Conclusion

This comment has considered the franchise disclosure regime in Ontario with particular emphasis on the statutory rescission remedy under the Act. With a number of foreign franchisors looking to expand into Canada, the impact of the strict Ontario disclosure regime should be considered alongside the policy objectives for the Act. While pre-contractual disclosure is now a fundamental norm in the franchise transaction process, the regime can operate in a manner that is both punitive to the franchisor and wildly disproportionate to the reasonable expectations of the parties.

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