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Rescission 101: An Introduction to the Statutory Rescission Remedy Under *The Arthur Wishart Act* (Franchise Disclosure), 2000

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RESCISSION 101: AN INTRODUCTION TO THE STATUTORY RESCISSION REMEDY UNDER THE *ARTHUR WISHART ACT (FRANCHISE DISCLOSURE), 2000*[1]

By Sam Hall and Derek Ronde[2]

1. The statutory right to rescind a franchise agreement

The right to rescind a franchise agreement contained in the *Arthur Wishart Act (Franchise Disclosure) 2000*, c. 3 (the "Act") is one of the most drastic remedies available to a franchisee. The remedy may be available when a franchisee does not receive a disclosure document that complies with the strict provisions of the Act and its regulation (the "Regulation")[3]. Franchisors, franchisees and their respective counsel should familiarize themselves with statutory rescission under the Act, as it has dramatically changed the landscape of franchise litigation in this province and creates complexities that go beyond the typical common law contractual dispute between franchise parties.

As with equitable rescission, the aim of statutory rescission under the Act is to compensate a franchisee who receives either defective or no disclosure by restoring the franchisee to its pre-contractual position. However, the Act relieves some of the problems that arise in a claim of equitable rescission. For example, a franchisor would instinctively assert by way of defence to a rescission claim that the rescinding franchisee was satisfied with what it received by way of disclosure, that the franchisee was aware of the deficiencies of disclosure at the time it was given and nonetheless proceeded to enter into its agreements with the franchisor,

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[1] The authors have drafted this paper as an overview of the basics of rescission claims under the *Wishart Act*, and have attempted to provide a balanced view of the legislation in respect of both franchisors and franchisees.

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[3] O. Reg. 581/00.

thereby affirming its contracts and disentitling it to rescission. However, these defences do not have traction in a rescission claim brought under the Act. The onus of proper disclosure under the Act rests solely on the shoulders of the franchisor and a franchisee's conduct is irrelevant with respect to the discharge of that obligation and its consequential impact on a rescission claim.[4] In essence, it is arguable that rescission under the Act is akin to a strict liability regime.

2. Initiating a claim of statutory rescission

A claim of statutory rescission is initiated with the service of a notice of rescission on the franchisor by the franchisee. There is no prescribed form of notice under the Act. Section 6(3) of the Act does require that the notice of rescission be in writing and be delivered to the franchisor personally, by registered mail, or by fax at the franchisor's address for service or to any other person designated for that purpose under a franchise agreement.

The notice of rescission should describe in detail why the purported disclosure document is not compliant with the Act and Regulation or, where appropriate, advise that the rescinding franchisee did not receive any disclosure document.

A record of the manner and date of service of the notice should be kept given the existence of statutory limitation periods discussed below. Franchisee counsel preparing the notice should pay particular attention to whether the notice is addressed to and from the correct parties. The terms "franchisor" and "franchisee" are defined terms under section 1 of the Act and should be reviewed to ensure that the proper parties are listed in the notice of rescission.

[4] The distinction between equitable and statutory rescission is discussed at length by Madam Justice MacFarland in the early rescission case of *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*, (2005) 256 D.L.R. (4th) 451 (Ont. C.A.) ("*Dig This Garden*").

Franchisor counsel should also pay close attention to ensure that the notice of rescission has been properly delivered to the correct parties.

Because the Act provides for the potential liability of individuals in addition to the franchisor who may be responsible for the payment of a rescinding franchisee's losses, the notice of rescission should also be served on those individuals where appropriate. More specifically, in addition to the franchisor, a "franchisor's associate" may be responsible for making the rescission payment under section 6(6) the Act. A "franchisor's associate" is defined under the Act as follows:

> "franchisor's associate" means a person,
>
> (a) who, directly or indirectly
>
> (i) controls or is controlled by the franchisor, or
>
> (ii) is controlled by another person who also controls, directly or indirectly, the franchisor, and
>
> (b) who,
>
> (i) is directly involved in the grant of the franchise,
>
> (A) by being involved in reviewing or approving the grant of the franchise, or
>
> (B) by making representations to the prospective franchisee on behalf of the franchisor for the purpose of granting the franchise, marketing the franchise or otherwise offering to grant the franchise, or
>
> (ii) exercises significant operational control over the franchisee and to whom the franchisee has a continuing financial obligation in respect of the franchise;

By interviewing clients about the principals and companies who may have been involved in the grant of the franchise, considering the operational control of individuals and entities within the franchise system, and establishing whether the rescinding franchisee had a "continuing financial obligation" to such entities, the franchisee's counsel can determine what additional parties may be appropriate to add to the notice of rescission (and subsequent claim) as

"franchisor's associates". The disclosure document (even if it is deficient) may provide guidance as to who might be considered a franchisor's associate, given the requirement set out in section 2 of the Regulation to provide comprehensive information on the business background of the franchisor, its directors and officers.

A notice of rescission can contain the estimated losses of the franchisee under section 6(6) of the Act, which sets out four broad categories of losses, discussed below.

Once a notice of rescission is served, and unless the claim is disputed, the franchisor or franchisor's associate is required to pay to the rescinding franchisee its section 6(6) losses within 60 days of the effective date of rescission. The effective date of the notice of rescission is set out at section 6(4) of the Act and is (i) on the day the notice is delivered personally; (ii) the fifth day after it was mailed; or, (iii) on the day it was sent by fax, if sent before 5p.m., or on the day after it was sent by fax, if it was sent at or after 5p.m.[5]

In cases where the franchisor disputes its liability, disputes the quantum of liability, or otherwise fails to make the rescissionary payment required under section 6(6) of the Act, the rescinding franchisee may initiate a claim or application to compel payment of its section 6(6) entitlements and obtain a declaration that its franchise agreements[6] have been validly rescinded. Alternatively, a franchisor may themselves seek declaratory relief from the court to the effect that the franchisee is not entitled to rescind the franchise agreement.

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[5] The limitation period for bringing an action based on the failure to respond to the notice of rescission begins to run when either the sixty days expires or the franchisee is put on notice that the franchisor does not intend to fulfil its obligations under the Act, whichever is earlier. See *2130489 Ontario Inc. v. Philthy McNasty's (Enterprises) Inc.*, 2011 ONSC 6852.

[6] The term "franchise agreement" is defined under section 1 of the Act and includes "any agreement that relates to a franchise between (a) a franchisor or franchisor's associate, and a franchisee."

3. Common defences to a rescission claim

There are three common forms of defences to a rescission claim - (i) the franchisor provided a disclosure document that meets the requirements of the Act and Regulation; (ii) the rescinding party has not rescinded its agreements within the statutory limitation periods found at sections 6(1) and 6(2) of the Act, and (iii) a statutory exemption to disclosure applies relieving the franchisor of the obligation to otherwise have supplied a disclosure document to a prospective franchisee.

(i) Defence #1 - the disclosure document meets the requirements of Act and Regulation

Section 5(4) of the Act requires that the disclosure document contain:

(a) all material facts, including material facts as prescribed;

(b) financial statements as prescribed;

(c) copies of all proposed franchise agreements and other agreements relating to the franchise to be signed by the prospective franchisee;

(d) statements as prescribed for the purposes of assisting the prospective franchisee in making informed investment decisions; and

(e) other information and copies of documents as prescribed.

Corporate franchise counsel often lament the challenges of preparing disclosure documents for their clients that comply with the prescribed requirements of the Act and Regulation. The process involves a thorough, detailed examination and understanding of the franchisor's business. The challenge is compounded when one considers that the requirement to disclose "all material facts" as set out in section 5(4)(a) of the Act is open-ended and includes both prescribed and non-prescribed "material facts".

The term "material fact" is defined in the Act to include: "any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise." In evaluating the merits of a compliance defence, the broad language of the Act forces counsel to consider matters beyond the identified or specific disclosure requirements set out in the Act and Regulation. In short, this legislation should not be treated as merely a closed checklist of items to be disclosed.

That said, a substantive knowledge of what is expressly required by the statute to be disclosed is usually the starting point for evaluating the compliance defence. The following questions should be considered reviewing a purported disclosure document to evaluate compliance and they are by no means an exhaustive list:

- Were financial statements attached to the disclosure document at the time of disclosure? If so, do they meet the prescribed standard? Are there any exemptions respecting the standard of financial statements which may apply? (See Section 5(4)(b) of the Act and Section 3 of the Regulation)

- Were all of the franchise agreements attached to the disclosure document, including any collateral agreements related to the franchise? (Section 5(4)(c) of the Act)

- Did the disclosure document contain a certificate certifying that the document contains no untrue information, representations or statements; and includes every material fact, financial statement and other information required by the Act and Regulation? Was the certificate signed by the correct individuals? Was the certificate dated? (Section 7 of the Regulation)

- Was the disclosure document presented as one document at one time and not in a piecemeal manner to the prospective franchisee? Is the information in the subject disclosure document accurately, clearly and concisely set out? (Section 5(3) and Section 5(6) of the Act)

- Is there an earnings projection provided in the disclosure document, and if so, does the disclosure document contain a statement specifying the reasonable basis of the projection, the assumptions underlying the projection and a location where information is available for inspection that substantiates the projection? (Section 6(3) of the Regulation)

While there are many more problem areas to consider in evaluating the merits of a compliance defence, the foregoing areas are some of the more common ones. The presence of a problem in one or more of these areas may be enough for a court to determine that a disclosure document has not been delivered in compliance with the Act and Regulation such that a franchisee may be entitled to rescind.[7]

(ii) Defence #2 - Limitation periods under the Act

The battle between franchise counsel on a rescission claim is often fought on the issue of limitation periods under the Act. This is not surprising given the many ways in which a franchisor can fail to meet the substantive elements of disclosure.

Section 6(1) and section 6(2) of the Act describes two circumstances under which a franchisee may rescind its agreements:

> **Rescission for late disclosure**
> **6.**(1)A franchisee may rescind the franchise agreement, without penalty or obligation, no later than 60 days after receiving the disclosure document, if the franchisor failed to provide the disclosure document or a statement of material change within the time required by section 5 or if the contents of the disclosure document did not meet the requirements of section 5.
>
> **Rescission for no disclosure**
> (2)A franchisee may rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the franchise agreement if the franchisor never provided the disclosure document.

In the first scenario (i.e. section 6(1) of the Act), a franchisee may rescind its franchise agreement no later than 60 days after receiving a disclosure document if:

[7] *Sovereignty Investment Holding, Inc. v. 9127-6907 Quebec Inc.*, (2008) 303 D.L.R. (4th) 515 (S.C.J.) ("*Sovereignty*").

(i) the franchisor failed to provide a disclosure document or statement of material change within the time required by section 5 of the Act. Section 5 requires a 14 day "cool off" between the provision of disclosure and the acceptance of money from a franchisee by the franchisor or the execution of any agreement by the franchisee related to the prospective franchise; or

(ii) if the contents of the disclosure document do not meet the requirements of section 5.

It is this second aspect of section 6(1) (failure to comply with section 5) that has caused interpretive difficulty.

In the second scenario (i.e. section 6(2) of the Act), a franchisee may rescind its franchise agreements within two years of entering into the franchise agreement if the franchisor never provided a disclosure document.[8]

The courts have interpreted section 6(2) to find that even where a document purporting to be a disclosure document has been delivered by a franchisor to a franchisee, the substantive defects may be such that the court will determine that what was provided was not a ''disclosure document'' within the meaning of the Act such that a franchisee may avail itself of the two year limitation period provided by section 6(2).[9]

[8] For judicial discussions of the differences between sections 6(1) and 6(2), see *4287975 Canada Inc. v. Imvescor Restaurants Inc.*, [2009] O.J. No. 1508 (C.A.), *Personal Coffee Services v. Beer*, [2005] O.J. No. 3043 (C.A.), and *779975 Ontario Ltd. v. Mmmuffins Canada Corp*., [2009] O.J. No. 2357 (S.C.J.).

[9] See, for example, *Sovereignty, supra.*

Defence #3 – Statutory exemptions

There are a handful of circumstances where a franchisor need not provide a disclosure document to a prospective franchisee. The onus of showing that an exemption exists is on the franchisor claiming the benefit of the exemption.[10]

Section 5(7)(a)-(h) of the Act[11] sets out these disclosure exemptions:

> This section does not apply to,
>
> (a) the grant of a franchise by a franchisee if,
>
> (i) the franchisee is not the franchisor, an associate of the franchisor or a director, officer or employee of the franchisor or of the franchisor's associate,
>
> (ii) the grant of the franchise is for the franchisee's own account,
>
> (iii) in the case of a master franchise, the entire franchise is granted, and
>
> (iv) the grant of the franchise is not effected by or through the franchisor;
>
> (b) the grant of a franchise to a person who has been an officer or director of the franchisor or of the franchisor's associate for at least six months, for that person's own account;
>
> (c) the grant of an additional franchise to an existing franchisee if that additional franchise is substantially the same as the existing franchise that the franchisee is operating and if there has been no material change since the existing franchise agreement or latest renewal or extension of the existing franchise agreement was entered into;[12]
>
> (d) the grant of a franchise by an executor, administrator, sheriff, receiver, trustee, trustee in bankruptcy or guardian on behalf of a person other than the franchisor or the estate of the franchisor;
>
> (e) the grant of a franchise to a person to sell goods or services within a business in which that person has an interest if the sales arising from those goods or services, as anticipated by the parties or that should be anticipated by the parties at the time the franchise

[10] *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*, (2011) 336 D.L.R. (4th) 234 (C.A.)
[11] As supplemented by Section 5(8) of the Act and Sections 8, 9 and 10 of the Regulation.
[12] See *3574423 Canada Inc. v. Baton Rouge Restaurants Inc.*, 2011 ONSC 6697 (S.C.J.).

> agreement is entered into do not exceed, in relation to the total sales of the business, a prescribed percentage;
>
> (f) the renewal or extension of a franchise agreement where there has been no interruption in the operation of the business operated by the franchisee under the franchise agreement and there has been no material change since the franchise agreement or latest renewal or extension of the franchise agreement was entered into;[13]
>
> (g) the grant of a franchise if,
>
> (i) the prospective franchisee is required to make a total annual investment to acquire and operate the franchise in an amount that does not exceed a prescribed amount,
>
> (ii) the franchise agreement is not valid for longer than one year and does not involve the payment of a non-refundable franchise fee, or
>
> (iii) the franchisor is governed by section 55 of the *Competition Act* (Canada);
>
> (h) the grant of a franchise where the prospective franchisee is investing in the acquisition and operation of the franchise, over a prescribed period, an amount greater than a prescribed amount.[14]

In practice, the most common disclosure exemption relied on by franchisor in the face of a rescission claim is the exemption contained in section 5(7)(a), sometimes colloquially referred to as the "franchise resale exemption". This exemption may apply if a franchise agreement is assigned from a vendor franchisee to a purchaser franchisee by way of resale. Whether the franchise resale exemption applies requires examination of the factual circumstances surrounding the resale.[15] The involvement of the franchisor in the sale or assignment process and/or the franchisor's imposition of conditions on the sale or assignment that were not specified in the Franchise Agreement as a condition of its consent may result in the exemption not applying.[16] To

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[13] See *TA & K Enterprises Inc. v. Suncor Energy Products Inc.*, 2011 ONCA 613 (Ont. C.A.) ("*Suncor*").
[14] See *Suncor*.
[15] See *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd*., 2010 ONSC 3695 (S.C.J.), affirmed (2011), 336 D.L.R. (4th) 234 (C.A.) ("*Springdale Pizza*") for a jurisprudential analysis of this provision. See also *MAA Diners Inc. v. 3 for 1 Pizza & Wings (Canada) Inc.*, 2003 CarswellOnt 455 (Ont. S.C.J.), affirmed 2004 CarswellOnt 492 (Ont. C.A.), and *1518628 Ontario Inc. v. Tutor Time Learning Centres LLC*, 2006 CarswellOnt 4593 (Ont. S.C.J.).
[16] *Springdale Pizza, supra*.

date, many of the exemptions contained in section 5(7) of the Act have not been considered fully by Ontario courts.

4. Rescissionary losses under section 6(6) of the Act

There are four categories of damages that the franchisee can claim under section 6(6). Specifically, if the franchisee has established that they are entitled to statutory rescission under sections 6(1) or 6(2), the franchisor must:

(a) refund any money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment (section 6(6)(a));

(b) purchase from the franchisee any inventory that the franchisee had purchased pursuant to the franchise agreement that is remaining at the date of rescission, at a price equal to the purchase price paid by the franchisee (section 6(6)(b));

(c) purchase from the franchisee any supplies or equipment that the franchisee had purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee (section 6(6)(c)); and

(d) compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, minus the amounts claimed under the other categories (section 6(6)(d)).

Statutory rescission under the Act is a "drastic remedy" given the many heads of recovery it offers a rescinding franchisee.[17] A franchisor faced with a successful rescission claim may face a significant award of damages against them, particularly in circumstances where the franchisee

[17] *MDG Kingston Inc. v. MDG Computers Canada Inc.*, [2008] O.J. No. 3770 (C.A.).

has already commenced operations and is losing money. The Ontario Court of Appeal addressed the legislative purpose of the Act and the rescission damages provision in section 6(6) in its decision in *Dig This Garden*:

> The Act is designed to put the franchisee back in its pre-franchisee position where there has been non-disclosure, provided notice is served within the prescribed time.[18]

Although the Act has been in force for over a decade, there has not been much guidance from the courts on how section 6(6) damages should be calculated and what kinds of losses fit into which section 6(6) categories. The most thorough judicial examination of section 6(6) was in *Payne Environmental Inc. v. Lord & Partners Ltd.*[19], a Superior Court decision which involved the rescission of a cleaning products sales franchise. The court addressed the different heads of damages available to the plaintiff franchisee as a result of the franchisee's successful rescission claim. In that case, the damages under section 6(6)(a) consisted of the return of the franchisee fee. The damages under section 6(6)(c) included the cost of various supplies and equipment purchased by the franchisee in connection with entering into the agreement. Lastly, the claim for "losses" included individual expenses incurred as a result of setting up the business. This included meals and related expenses, publications, truck fuel and service, office equipment, postal expenses, parking and taxi expenses, truck/trailer accessories, photocopy and stationary expenses, legal fees, truck leases, licenses, insurance, accounting fees, and trailer parking. From this expense total, the court deducted gross revenue to come up with the amount owed under section 6(6)(d).

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[18] *Dig This Garden*, *supra*.

[19] *Payne Environmental Inc. v. Lord & Partners Ltd.* (2006), 14 D.L.R. (4th) 117 (Ont. S.C.J) ("*Payne Environmental*").

The decision in *Payne Environmental* is helpful to parties litigating rescission claims as it explains that parties should avoid duplicating amounts claimed in sections 6(6)(a), (b), and (c) and the losses calculated in section 6(6)(d). Specifically, the court noted:

> Subsection 6(6)(d) of the Act is designed to compensate the franchisee for all losses the franchisee incurred in acquiring, setting up and operating the franchise. This calculation of "all losses incurred" under ss. 6(6)(d), at least initially, may include the amounts which have been identified in ss.6(a), (b), and (c). It is precisely because "all losses incurred" may include the amounts identified by ss. 6(6)(a), (b), and (c) that those amounts are deducted from "all losses" in order to ensure there is no duplication in the calculation of compensation to be paid pursuant to that subsection....In this case, the plaintiff did not include in its ss. 6(6)(d) calculation any of the amounts owing pursuant to ss. 6(6)(a), (b) and (c). As long as these amounts have not been included in the calculation of all losses incurred, no deduction need be made.[20]

The method of analysis undertaken in *Payne Environmental* is likely preferable to that used in the decision in *Melnychuk v. Blitz Ltd*.[21] In that case, the plaintiff franchisee (and the court) did not take into account the actual losses of the business in determining the losses under section 6(6)(d), but rather dealt with piecemeal claims for different types of damages, such as the cost of preparing a business plan and legal and accounting expenses. It is certainly arguable that the term "losses" under section 6(6)(d) should be viewed in an accounting sense and should treat items such as business plans and legal expenses as being offset by revenues made by the franchise company. Support for this view can be found in Alberta's legislation, which pre-dates the Act and provides that "net losses" are recoverable.

Similarly, parties should use caution when relying on the recent Ontario decision in *1706225 Ontario Ltd. v. Grill It Up Holdings Inc.* for the purpose of determining what

[20] *Payne Environmental, supra*.
[21] *Melnychuk v. Blitz Ltd.*, 2010 CarswellOnt 373 (S.C.J.).

constitutes "losses that the franchisee incurred in acquiring, setting up and operating the franchise" under section 6(6)(d).[22] In this case, the court allowed for the recovery of a lost income opportunity of the individual franchisee owner, despite the fact that the franchisee appears to have been a corporation. Specifically, the franchisee owner resigned his employment to enter into a franchise agreement that was eventually rescinded under section 6 of the Act. The court permitted the loss of his income from his resigned job to be recovered. It is unclear how such an alleged loss falls under section 6(6)(d), which on its face addresses losses suffered by the franchised business.

Beyond these cases, however, there is little analysis of damages claims under section 6(6).[23] In fact, in many cases, franchisors have not disputed the amounts sought in the notice of rescission and the actual quantum of damages is an afterthought to other legal arguments made in the cases.[24] Franchisors can argue that there may be an obligation on franchisees to mitigate losses claimed under section 6(6). Reliance for this argument could be found in the Court of Appeal's decision in *Dig This Garden* held that:

> It is...no answer to suggest that the franchisor would be obligated to pay such costs or expenses to the franchisee under s. 6(6) or in an action for damages under s. 7 of the Act. In my view, it is preferable for a franchisee to make reasonable efforts for an orderly winding down of the business and to minimize its losses where possible.

However, franchisees may counter that there is no mitigation obligation due to their right under section 6 to rescind "without penalty or obligation."

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[22] *1706225 Ontario Ltd. v. Grill It Up Holdings Inc.*, 2011 CarswellOnt 3378 (S.C.J.).

[23] For a helpful accounting-based analysis of section 6(6) claims, see "Clarifying Financial Remedies Under the Arthur Wishart Act" by Ephraim Stulberg, *The Lawyers Weekly*, May 13, 2011.

[24] See, for example, *MAA Diners Inc. v. 3 for 1 Pizza & Wings (Canada) Inc.* (2003), 30 B.L.R. (3d) 279 (S.C.J.); *Beer v. Personal Service Coffee Corp.*, 2005 CarswellOnt 3142 (S.C.J.); *Ahmed v. 3 for 1 Pizza & Wings (Canada) Inc.*, 2004 CarswellOnt 255 (S.C.J.); *Khachikian v. Williams*, [2003] O. J. No. 5876 (S.C.J.).

Franchisors resisting rescission claims should pay close attention to whether franchisees have indeed made the "reasonable efforts" of mitigation alluded to in the Court of Appeal's decision. There are many ways in which a franchisee can mitigate its losses while winding down the operation of its business. If the franchisee has a lease, the franchisee could negotiate a break fee with the landlord or work with the franchisor to have the franchisor assume the lease. Similarly, franchisors should also examine any claim for the purchase of inventory to ensure that the purchases by the franchisee have been reasonable and are not excessive in the circumstances of a business that is winding-down.

Franchisors faced with claims for rescission should pay close attention to the specific amounts being claimed by franchisees. Specifically, franchisors should examine two important issues in these claims:

(a) Are there any losses being claimed that are not "market rate" losses?

If a franchisee is claiming losses from their operation of their franchise, franchisors should examine whether the losses allegedly suffered are inflated. There are various circumstances in which such inflation could arise. For example, if the franchisee owns the property on which they operate their franchise business, they could be charging above-market rents to the franchise, which would increase the loss suffered by the franchise. Franchisees can structure their assets and businesses for tax- and business-efficiency, but these structures can also result in inflated losses. Another area to carefully examine is the salaries paid to the franchisee (and the franchisee's family members, where applicable). If these salaries are above-market salaries, this could cause increased losses to the franchise that the franchisee might claim as rescission damages. Franchisors can argue that damages should be "normalized" and reflective

of a standard franchise rather than structured around the idiosyncrasies and self-interested business practices of the aggrieved franchisee.

(b) Are there non-business-related expenses being run through the franchise business?

Franchisors should closely examine the rescission damages claimed by franchisees to determine whether the franchisee's personal expenses are being claimed through the franchise business. Because financial statements are so important to any analysis of this sort, franchisors must be diligent in ensuring that franchisees consistently deliver copies of their financial statements to the franchisors if it is a requirement under the franchise agreement between the parties.

5. Responsibilities of lawyers when advising on rescission

While the Act and Regulation are relatively short pieces of legislation, they are detailed and nuanced. Lawyers who advise in the area of franchise disclosure should know the relevant legislation and be familiar with the pantheon of franchise cases which have evolved since the introduction of the legislation. In order to protect the interests of both franchisee and franchisor clients, as well as their own interest in avoiding negligence claims, the franchise bar should exercise care and caution in dealing with franchise rescission claims.

It is important to advise the client about the requirements of disclosure and the rescission remedy regardless of whether the retainer arises at the outset of a franchise acquisition or sale or during the operation of the franchise. The issue of proper disclosure may be relevant in a variety of different circumstances.

In the case of franchisee claims, it is crucial for the advising lawyer to be aware of the limitation periods contained in the Act and to ensure that a notice of rescission is served within the appropriate time frame. Enforcement proceedings must be commenced in accordance within the limitation period that would apply after proper service of a notice of rescission within the applicable limits set out in section 6(1) or 6(2) of the Act. With respect to franchisors, limitation periods provide the strongest defence to section 6 claims and can give rise to Rule 21 motions to strike the claim. As such, this should be the starting point for any defence analysis.

Both franchisee and franchisor counsel should discuss with their client the steps that may be required to litigate a rescission claim under section 6 of the Act. Moreover, both parties should consider any forum clauses in the franchise agreement which may require the parties to proceed through arbitration.

In the case of franchisee counsel, before serving a notice of rescission, counsel should conduct a thorough analysis of the nature of the defects of disclosure in a purported disclosure document and discuss with the client the rescinding client's section 6(6) losses. Counsel should ensure that their retainer is sufficient to carry out this work. With respect to franchisor counsel, the alleged defects in the disclosure document should be examined to see if there is any factual merit to the franchisee's claim, and an analysis should be done to determine whether the defects constitute either a valid 6(1) or 6(2) claim, taking into account the different limitation periods for these claims. Franchisor counsel should take steps to ensure that any obvious defects are immediately remedied for the purposes of future disclosure documents.

One of the limitations of the Act is that it does not provide immediate protection to the rescinding franchisee from the claims of third party creditors. Thus, service of a rescission claim

can be a catalyst for demands made from lenders (often Small Business Loan lenders) or landlords for payments from the franchisee who has ceased operation of its business. One may request a stay of these claims from the court in the rescission enforcement proceeding while claiming over against the franchisor and related parties, or choose to negotiate with third parties outside of the enforcement claim. Accordingly, it may be helpful to have a discussion with the rescinding client of the effects of rescission on third parties prior to proceeding with a statutory rescission claim in order to devise a proper strategy for dealing with potential third party liabilities and claims. For franchisor counsel dealing with rescission claims where the franchisee abandons the franchised business, it may be necessary to contact and negotiate with suppliers, landlords and customers where appropriate in order to ensure the continued operation of the business (if desired) and to maintain ongoing commercial relationships.

The subject disclosure document will be a central piece of evidence on a rescission claim and thus is important to both franchisors and franchisees. It is incumbent on franchisee and franchisor counsel to emphasize to their respective clients the importance and integrity of that document, to carefully examine and assess the original document, and to question the client thoroughly about the circumstances in which it delivered or received the document. When acting for franchisor counsel, it is vital to stress the importance of disclosure procedures and updating the disclosure document. As discussed above, there may be serious consequences for a franchisor if it neglects basic document management protocols established with the assistance of counsel.

6. Conclusion

Rescission claims will continue to be a mainstay of franchise litigation as long as the Act is in force, so franchise counsel must understand section 6 and its interaction with the rest of the

Act and the Regulation to ensure that their franchisee and franchisor clients are able to properly exercise their statutory rights. Further litigation arising out of the Act may clarify the remaining ambiguities in the statute. In the meantime, franchise counsel should strive to develop a full knowledge of the cause of action, process, and defences available to section 6 claims.