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Location-specific disclosure requirements following Freshly Squeezed and Yogurtworld

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Introduction

The "Freshly Squeezed" decision (*2611707 Ontario Inc., et al v. Freshly Squeezed Franchise Juice Corporation, et al.*, 2021 ONSC 2323) and the "Yogurtworld" decision (*2364562 Ontario Ltd. v. Yogurtworld Enterprises Inc.*, 2021 ONSC 5112) are the most recent decisions released by the Ontario Superior Court that consider the scope of "all material facts" and location-specific disclosure requirements in the context of franchise disclosure under the *Arthur Wishart Act (Franchise Disclosure), 2000* (AWA). Freshly Squeezed quickly generated some debate about whether franchisors must contend with a new standard of disclosure. The scope of the obligation to disclose all material facts has been a regularly debated issue before our courts since it was originally considered in *1490664 Ontario Ltd v. Dig This Garden Retailers Ltd*, in 2005.[1] It is an understandably popular topic, given that the failure to disclose all material facts could give rise to the two-year rescission remedy under the AWA, whereby, if successful, a franchise agreement can be unraveled and the franchisor is obliged to, among other things, refund all monies received from the franchisee and compensate the franchisee for any losses incurred in acquiring, setting up and operating the franchise.

In this article, we explore the principal cases from Ontario courts that have considered the issue of location-specific disclosure, meaning disclosure of information that is unique to the specific franchised location to be acquired by a specific franchisee. The article culminates with an examination of how these two recent decisions in particular may affect the requirement to disclose location-specific information going forward.

Where we have been: A review of location-specific disclosure cases in Ontario

1490664 Ontario Ltd v. Dig This Garden Retailers Ltd., [2005] O.J. No. 3040 (C.A.):

- The franchisee claimed rescission on the basis that the disclosure document provided by the franchisor was so deficient that it amounted to no disclosure at all, as it contained only about 70% of the required disclosure.

- The franchisor argued that even if the contents of the disclosure document were deficient, Section 6(1) of the AWA, which provides a 60-day rescission period for the franchisee if the contents of the disclosure document do not meet the disclosure requirements, should apply, not Section 6(2) which provides for a two-year rescission period if there is no disclosure document delivered at all.
- The Ontario Court of Appeal held that the disclosure document was materially deficient and amounted to no disclosure at all, which entitled the franchisee to rescind the agreement under Section 6(2) of the AWA.
- This was not a location-specific disclosure case, however, the court's holding that a two-year rescission remedy under Section 6(2) of the AWA can result from failure to comply with the content requirements for the disclosure document, and that the franchisee was not limited to a 60-day rescission remedy, opened the door for rescission for failure to provide all material facts. This, in turn, opened the door for rescission cases relating to location-specific disclosure**.**

6792341 Canada Inc v. Dollar It Ltd, 2008 Carswell Ont 8970 (S.C.J.), rev'd 2009 ONCA 385.

- The franchisee claimed rescission on the basis that the disclosure document provided by the franchisor was materially deficient and amounted to no disclosure at all.
- The Ontario Court of Appeal held that there were many material deficiencies in the disclosure, including the franchisor's failure to include a copy of the head lease. While the AWA does not expressly list the head lease in the disclosure requirements, the court found that the omission of the head lease was material as it contained pass-through obligations and acknowledgements of the franchisee sub-tenant which the franchisee could not possibly accept without reviewing it.
- This case provided the basis for including location-specific disclosure as a material fact.

1159607 Ontario Inc v. Country Style Food Services Inc, 2012 ONSC 881, aff'd 2013 ONCA 589.

- The franchisee claimed rescission of the renewed lease on the basis that the franchisor failed to disclose the terms of the lease extension agreement between the franchisor and landlord.
- The lease extension agreement signed by the franchisor expired three years and three months earlier than the renewed franchise agreement. The Superior Court held that the new expiry date of the lease was a material fact that should have been disclosed in the franchise renewal agreement. The Court granted rescission.

2337310 Ontario Inc v. 2264145 Ontario Inc, 2014 ONSC 4370 (DeliMark).

- The franchisee claimed rescission on the basis that the disclosure document provided by the franchisor was materially deficient as it failed to include a head lease and sublease for the franchised location. The case differed from *Dollar It* because neither the head lease nor the sublease existed at the time of initial disclosure.
- The Ontario Superior Court held that the failure to provide a head lease or sublease was a material non-disclosure, even though the lease or sublease did not exist at the time of initial disclosure. However, the Court did not award rescission in this case but rather

confirmed the acceptability of using a statement of material change to disclose material facts that did not exist at the time of initial disclosure but came into existence prior to the franchise agreement being entered into by the parties.

Caffé Demetre Franchising Corp v. 2249027 Ontario Inc, 2014 ONSC 2133, aff'd 2015 ONCA 258.

- The franchisee claimed rescission, citing multiple material deficiencies, including a failure to disclose that the franchise store would require extensive remodeling and renovations in excess of $50,000.
- The Ontario Superior Court did not award rescission in this case and held that the repairs and renovations did not constitute a material fact because they would not have had a significant effect on the price to be paid for the franchise and were cost neutral to the franchisee.
- On appeal, the Ontario Court of Appeal stated that there must be stark and material deficiencies in a disclosure document before the Court will find that effectively no disclosure was provided. A material fact is information about the franchise that would reasonably be expected to significantly impact the price of the franchise.

2122994 Ontario Inc v. Lettieri, 2016 ONSC 6209, aff'd 2017 ONCA 830.

- The franchisee claimed rescission on the basis that, among other things, the franchisor failed to provide the head lease, which was available at the time of initial disclosure.
- The Ontario Superior Court held that the franchisor's failure to include the head lease as part of the disclosure document constituted material non-disclosure.
- The franchisor claimed that the offer to lease was disclosed and contained all material elements, however, the Court rejected this argument stating that there was insufficient evidence to prove when and to whom the offer to lease was disclosed.

Raibex Canada Ltd v. ASWR Franchising Corp, 2016 ONSC 5575, rev'd 2018 ONCA 62.

- The franchisee claimed rescission on the basis that the franchisor failed to include a copy of the head lease and failed to disclose adequate estimates for the costs of establishing the franchise, among other things. The location of the franchised business was not known at the time of initial disclosure.
- The Ontario Superior Court awarded the franchisee rescission, holding that it was not possible for a franchisor to provide adequate disclosure to a prospective franchisee prior to identifying a site and signing a lease. This caused some consternation in the franchise community given the common practice of identifying a site after the franchise agreement was signed.
- The Ontario Court of Appeal overturned the Superior Court's decision noting that that rescission is an "extraordinary remedy" and stating that the AWA draws a clear distinction between imperfect disclosure and disclosure so deficient as to amount to no disclosure. The deficiencies in disclosure must be determined on the facts of each case.
- The Court of Appeal clarified that in order for a disclosure document to amount to no disclosure at all, the franchisee must be effectively deprived of the opportunity to make an informed investment decision to acquire the franchise; and this determination must be

made with reference to the terms of the franchise agreement and all relevant surrounding circumstances of the grant of the franchise.

- The Court of Appeal held that the disclosure deficiencies in this case were not so serious as to amount to a complete lack of disclosure. In particular, the Court found that the parties knew that the location of the proposed franchise had not yet been selected and agreed that the franchisor and franchisee would work collaboratively to select a site. The franchisor also had contractual obligation to use "reasonable best efforts" in selecting a location which acted as a constraint on the franchisor's ability to enter into a lease without considering the franchisee's legitimate interests. Finally, the agreement contained an opt-out clause which allowed the franchisee to receive its money back if the franchisee found the location unsuitable.

2611707 Ontario Inc v. Freshly Squeezed Franchise Juice Corporation et al, 2021 ONSC 2323.

- The franchisee claimed rescission on the basis of, among other things, that the franchisor's location-specific disclosure was materially deficient because the disclosure document did not disclose the absence of the head lease and the franchisee was not provided with the opportunity to opt out of the franchise agreement and sublease if the terms of the head lease were unacceptable.
- The Ontario Superior Court held that the franchisor's location-specific disclosure was materially deficient. In particular, the Court identified two fatal flaws: First, the franchisor did not disclose the lack of a head lease. Second, the franchisor did not disclose the existence of an agreement to lease executed by the franchisor prior to the delivery of the disclosure document. Other deficiencies in the disclosure document and disclosure process were identified, but were not related to location-specific disclosure.
- The Court stated that without an "opt-out" clause or other contractual safeguards in the franchise agreement, as was done in *Raibex,* the non-disclosure was a material deficiency.
- The Court confirmed that the standard for determining whether there are alleged deficiencies that deprive the franchisee of making an informed investment decision is an objective standard. However, the Court went on to say that the objective standard must take into account the particular facts of each case.
- The Court also held that the franchisor should have disclosed that this was the first "non-mall" location in the franchise as it could pose a risk to the financial viability of the venture. However, the Court held that failure to disclose this particular material fact on its own was not sufficient to give the franchisee the right to rescind under Section 6(2), but left open the possibility that such deficiency could give the franchisee the right to rescind under Section 6(1).

2364562 Ontario Ltd. v. Yogurtworld Enterprises Inc., 2021 ONSC 5112.[2]

- The franchisee claimed rescission on the basis of the franchisor's failure to disclose that, in the opinion of the franchisee, there were no suitable Menchie's store locations in the franchisee's designated territories, among other reasons.
- Under the Franchise Agreements, the franchisees were designated two exclusive territories in Ontario and were responsible for securing suitable locations for their

Menchie's stores. The franchisees were required to pay a Development Fee of $75,000 which was fully earned and non-refundable upon execution of the franchise agreements. The franchisees were required to secure their first Menchie's location within 90 days and to open both of their Menchie's stores within one year.

- The franchisees did not secure a location in either of their designated exclusive territories within the initial 90-day deadline. Despite being granted an extension, the franchisees were unable to find a suitable location and the agreement was terminated by *Yogurtworld,* who was entitled to retain the Development Fee.
- The Ontario Superior Court denied rescission, stating that the AWA does not require that the franchise location be known at the time of the agreement. The Court stated that the financial uncertainty related to a yet-to-be-negotiated lease is not a fatal disclosure flaw when there are safeguards in place to protect the franchisee. The uncertainty here was mitigated by the franchisee having the control and responsibility over lease negotiations.

Where are we going? The impact of Freshly Squeezed and Yogurtworld on disclosure obligations going forward

Neither the AWA nor its regulation make any mention of location-specific disclosure. In the early days of disclosure, it was common practice for franchisors to deliver the same, non-customized disclosure document to all prospective franchisees. As a result of jurisprudence about the scope of information that could be considered a "material fact", that practice evolved and customized franchise disclosure documents became the norm. As the body of case law grew, so did the facts that must be included in a disclosure document, despite not being expressly included in the AWA or its regulation.

Freshly Squeezed follows established jurisprudence in respect of certain findings, particularly relating to the materiality of lease-related information. In this case, the finding that a two-year rescission remedy arose from the failure to disclose the agreement to lease, which existed at the time of disclosure, continues from the 2008 *Dollar It* decision. We see again that the lack of certain lease-related location-specific disclosure can be treated as a fatal deficiency which, depending on the facts of the case, can give rise to the two-year rescission remedy under section 6(2) of the AWA.

However, where *Freshly Squeezed* could be seen as breaking new ground is the Court's findings of deficiencies with respect to negative disclosure as it relates to location-specific disclosure. Specifically, the Court faulted the franchisor for not disclosing negative information (i.e., "there is no head lease" or "we have never granted a franchise outside of a mall location"). The scope of the definition of a "material fact", which is already open ended, could be troublingly expanded if a franchisor is now required to express, location-specific negative disclosure. However, in our view, this is not a foregone conclusion arising out of *Freshly Squeezed*.

The Court also implies, citing *Raibex,* that even where location-specific lease related disclosure is materially deficient, it can be saved by providing a franchisee with an "opt-out" clause or some other form of contractual protection to enable the franchisee to back out of the franchise agreement in the event the franchisee disagrees with the terms of the final head lease. Query whether it is consistent with the spirit and intent of the disclosure obligations in the AWA – with its no-waiver provision – that certain of these obligations can be avoided simply by including an opt-out provision in the underlying franchise agreement. It will be interesting to see how this analysis is applied in practice or considered by future courts as it suggests that a court may be required to examine the commercial deal between

the franchisor and the franchisee when determining the adequacy of disclosure, which we do not believe was the legislature's intention. Many U.S. states have provisions that affect the ability of the franchisor and franchisee to freely enter into whatever commercial arrangements they choose, such as importing "good cause" termination requirements. The AWA does not do so. As the name of the Ontario statute strongly implies, the focus is on unilateral disclosure from the franchisor to the franchisee, not on contractual protections for the franchisee.

The *Freshly Squeezed* decision, unfortunately, created some uncertainty for franchisors about the required standard of disclosure related to leasing and other site specific information if the commercial deal does not grant a franchisee with an opt-out. Surely we cannot be back in world of disclosure defined by the first instance decision of the Ontario Superior Court in *Raibex* (which was unwieldly in its broad scope before being refined on appeal), meaning that a disclosure document cannot be provided unless the location is known and the head lease is finalized prior to initial disclosure. In good news for franchisors, recently following *Freshly Squeezed*, the Ontario Superior Court in *Yogurtworld* resolves some of this uncertainty. *Yogurtworld* has already proven that having a location identified and a head lease finalized at the time of disclosure is not a definitive requirement. *Raibex*, *Freshly Squeezed* and *Yogurtworld* all show that the disclosure options will depend on the facts and circumstances of each case, including who is responsible for locating and securing a site, so there will be paths forward for franchisors who use this common disclosure and post-agreement site-selection process.

While the jurisprudence may continue to find new "material facts" that must be included in a disclosure document based on the circumstances of a particular case, it seems inconsistent with the spirit and intent of the legislation that a new line of disclosure cases stand for the proposition that the commercial terms of the franchise agreement are subject to scrutiny. The franchisor for *Freshly Squeezed* has appealed the decision to the Ontario Court of Appeal so there may soon be further clarity on these important disclosure issues.

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[1] [2005] O.J. No. 3040.

[2] Yogurtworld Enterprises Inc. was represented by Osler, Hoskin & Harcourt LLP in this case.