

Opinion split on act's protection of franchisees

BY NATALIE FRASER
For Law Times

A "great divide" exists in the legal profession in respect of the rights of franchisees and franchisors in Ontario. While some lawyers believe the Ontario legislation goes too far regarding the liability of franchisors, others say franchisees need that protection.

The interpretation of a recent case, *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*, decided by the Ontario Court of Appeal in July 2005, exemplifies the division. In *Dig This Garden*, the franchisee's business did poorly and she rescinded the franchise agreement. The franchisor failed to make the rescission payments required under s. 6 of the Arthur Wishart Act (Franchise Disclosure). The court ruled that the franchisee could seek damages under these circumstances.

Granting the franchisee both rescission and damages represents a form of "double jeopardy" for the franchisor, says Peter Dillon, a franchise lawyer with Siskind Cromarty Ivey and Dowler LLP, which argued the case on behalf of the franchisor.

The legislation should be interpreted as providing the franchisee the choice of either rescission or damages as a remedy, but not both, Dillon says. This concept follows the common law principle of rescission, which forces franchisors to put franchisees back into the position they were in prior to the franchise agreement. While franchisees can also choose damages as a remedy, they cannot pursue both remedies.

"You shouldn't be able to do both. That argument is but-

tressed by centuries of common law," says Dillon.

Allowing both remedies forces too harsh a regime on franchisors, he says.

Javad Heydary, of Heydary Garfin Hamilton LLP, sees it differently, finding the court's interpretation of the legislation in *Dig This Garden* as reasonable. The court stated that the franchisee was entitled to rescission under s. 6 of the act. This includes an award for damages for any losses suffered in setting up the business, under s. 6(6)(d).

"The court makes the point that this is not rescission under common law, it's statutory," Heydary says. "If it is statutory right of rescission, you follow the provisions of the legislation that sets it out."

Since the section of the statute allowing rescission includes a provision for damages for any losses suffered by the franchisee in setting up the business, no double liability exists, says Heydary. The damages remedy forms part of the statutory rescission.

However, an action for consequential damages, representing the profits the franchisee could have made had he been running a successful business, would require an action under s. 7 of the act. Since the court did not rule that consequential damages could be claimed by the franchisor as well as rescission under s. 6, and that only the losses suffered in setting up the business could be claimed as damages, the court's decision was a fair one, Heydary says.

Another division of opinion exists regarding s. 6(6) of the act, which includes a list of the parties who can be held jointly and severally liable to the fran-



Granting the franchisee both rescission and damages represents a form of 'double jeopardy' for the franchisor, says Peter Dillon.

chisee on rescission. This list includes both "the franchisor, or the franchisor's associate, as the case may be." The act defines franchisor's associate as a person involved in the grant of the franchise and who has ongoing control of the franchisor's business.

Only the person who received the franchise fee should become liable for the franchise fee on rescission, and not both the franchisor and the franchisor's associate, Dillon says. To make them both jointly and severally liable puts the franchisor in the position of taking on too much risk on behalf of the franchisee.

"The plain wording of 'as the case may be' means that whoever got the money is the person responsible for refunding it. . . . If the franchisor received the franchise fee, then the franchisor is responsible for repaying it, and if the franchisor's associate got it, likewise. But they aren't all

lumped together here, the act is pretty clear," Dillon says.

The Court of Appeal made matters worse by giving a broad interpretation to this part of s. 6(6) in *Dig This Garden*, says Dillon. It found that two shareholders had control of the corporation and were therefore jointly and severally liable, although neither of them individually satisfied the requirement for control.

"The court simply tossed them all in the pot to boil together," Dillon wrote in a paper reviewing franchise law in Canada.

The inclusion of both franchisor and franchisor's associate as parties potentially liable to the franchisee provides a necessary protection to franchisees, Heydary says. Most of the problems experienced with franchise agreements occur when unsophisticated franchisees contract with unethical franchisors. Without broad definitions of who may be liable, franchisees who have suffered losses may find themselves with judgment-proof franchisors.

"Franchisors like that will go to great lengths to set up their business operations in a way to ensure that liability ends up with shell companies," Heydary says. "If you didn't have this legislation, you'd have unethical franchisors setting up their businesses in a way so that [franchisees] would only have a claim against a company with no assets."

Disagreement also exists regarding s. 7 of the act, which states that franchisors become liable to franchisees if they fail to comply "in any way" with the disclosure provisions of the law. This open-ended definition could make franchisors liable for minor errors in disclosure, says

Dillon.

"Section 5 says you've got to disclose the franchisor's address," he says. "I put it to you that if that disclosure document has the wrong address, you have failed to comply with the act and the regulations. With the way the courts have been interpreting this, I would not want to wager on a judge not saying, 'You didn't comply.'"

Franchise legislation in Alberta only requires substantial compliance from franchisors regarding disclosure provisions, which creates a much more reasonable situation, Dillon says. He would like to see the Ontario legislation follow suit.

The open-ended liability of s. 7 could pose a problem, Heydary says, but he believes the courts will interpret the clause fairly. The broad nature of the provision provides the courts with the ability to make their rulings fit the circumstances.

"It does leave room for abuse, but that's where we need to have some faith in our court system and judges. . . . You need this loose language to be able to give people remedies in a whole host of situations," he says.

Overall, the act protects franchisees while not going too far in penalizing franchisors, Heydary says.

"It's a great piece of legislation. It strikes a fine balance in my mind," he says.

Dillon believes the act protects franchisees far too much, calling it "something of a franchisee's absolute bill of rights."

"Franchisors are not all bad people. Most franchisors are small business people trying to do the best they can in a complicated and vague legislative environment," he says. **LT**