

Watch the Extra Step...When Crossing the Resale Exemption Path

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Section 5(7)(a)(iv) of the **Arthur Wishart Act** (Franchise Disclosure), 2000 (“AWA”), states that disclosure obligations do not apply to a franchisor in circumstances where there is a grant of a franchise by an existing franchisee to another person if the grant of the franchise is not effected by or through the franchisor (the “**Resale Exemption**”). For greater certainty, Section 5(8) of the AWA provides that a grant is not effected by or through a franchisor merely because, (a) the franchisor has a right, exercisable on reasonable grounds, to approve or disapprove the grant; or (b) a transfer fee must be paid to the franchisor in an amount set out in the franchise agreement or in an amount that does not exceed the reasonable actual costs incurred by the franchisor to process the grant. In other words, the resale exemption is intended to operate in circumstances where an existing franchisee sells its franchise business to a prospective franchisee with minimal involvement from the franchisor.

Three recent decisions dealing with the Resale Exemption have reaffirmed the court’s narrow interpretation and application of the Resale Exemption. In each case, the court held that the franchisor’s role in the resale extended beyond that of a “passive participant” (as stipulated by the jurisprudence), disqualifying the franchisor from being able to rely on the Resale Exemption.

In **Brister v 2145128 Ontario Inc.**, the Applicant franchisee (the newly admitted franchisee) called into question the Respondent franchisor’s reliance on the resale exemption. The Court reiterated jurisprudence that in order for a franchisor to rely on Section 5(7)(a)(iv) of the AWA, a franchisor must not be an active participant in the grant of the franchise and should essentially confine its role to merely exercising its right to consent to the transfer.

The Ontario Superior Court of Justice determined that the Respondent franchisor had in fact been an active participant in the grant of the franchise because it had required the Applicant franchisee (prospective franchisee at the time) to:

- Successfully pass an interview conducted by the Respondent franchisor prior to obtaining approval;
- Agree to undergo training from both the then-existing franchisee and the Respondent franchisor;

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- Assume the rights and obligations of the then-existing franchisee under the premises lease as sole tenant in place of the Respondent franchisor; and
 - Enter into a general security agreement in favour of the Respondent franchisor.

Importantly, the then-existing franchisee had not been required to execute a general security agreement. This requirement included something that went beyond the then-current arrangement with the then-existing franchisee.

A similar outcome arose in *2147191 Ontario Inc. v Springdale Pizza Depot Ltd.* The Ontario Court of Appeal upheld the summary judgment preventing the franchisor from relying on the Resale Exemption. The Court of Appeal found that the franchisor's course of conduct could not be construed as merely passive participation, but rather went beyond the bounds of the existing relationship:

- The franchisor met with the prospective franchisee on a number of occasions;
- The franchisor and prospective franchisee discussed the possibility of a fresh grant of a franchise right (although it was determined that the transfer was the preferable avenue in the end); and
- The franchisor required the prospective franchisee to sign and provide an acknowledgement providing additional comfort and protection to the franchisor that was not found in the original franchise agreement.

In *2256306 Ontario Inc. v Dakin News Systems Inc.*, the Ontario Superior Court of Justice rejected the Defendant franchisor's arguments that the resale exemption applied. In this case, the existing franchisee was operating on a month to month basis after the original franchise agreement had expired. Nonetheless, the existing franchise transferred the franchise business to a prospective franchisee. Subsequent to such transfer, the Defendant franchisor discovered that the original franchise agreement had expired and sought to have the Plaintiff prospective franchisee sign a franchise agreement for the continued operation of the franchise. This requirement went beyond a passive role on part of the Defendant franchisor and was enough to render the Resale Exemption inapplicable.

The approach of the courts have been consistent. The Resale Exemption will only apply in circumstances where franchisors remain "passive participants" in any grant or transfer transaction whereby an existing franchisee conveys the franchise business to a new franchisee. The plain example is where a franchisor does nothing more than provide its approval for the transaction. Particularly where a franchisor imposes additional requirements of the prospective franchisee, the franchisor is clearly no longer passive. Franchisors should tread very carefully when considering a reliance on the Resale Exemption.

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