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Franchisee's Claim for Rescission Frozen by Court

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Introduction

In *2364562 Ontario Ltd. et al. vs. Yogurtworld Enterprises Inc.* ("***Yogurtworld***"),[1] the court provided further guidance on the level of detail that franchisors are required to include in a disclosure document provided to prospective franchisees pursuant to Section 5(1) of the *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c.3 ("*Act*"), in respect of locations that have yet to be identified.

As set forth in the recent decision of the court in *2611707 Ontario Inc. et al v Freshly Squeezed Franchise Juice Corporation, et al.*,[2] pursuant to Section 6(2) of the *Act*, a franchisee can rescind their franchise agreement within two years, if the franchisor failed to provide the prospective franchisee a disclosure document. As the case law has articulated, the failure to provide includes circumstances in which the disclosure document was so deficient that it was tantamount to there being no disclosure document thereby impairing the franchisee's ability to make an informed investment decision.

Background Facts

2364562 Ontario Ltd. (the "**Franchisee**") sought a refund of the development fee it paid to Yogurtworld Enterprises Inc. (the "**Franchisor**") in respect of two franchise agreements (the "**FA's**") it entered into for two Menchie's yogurt franchises together with a multi-unit development agreement dated April 15, 2013 (the "**MUDA**" and with the FA's collectively the "**Franchise Agreements**"), paying $75,000.00 to the Franchisor for such right, which was fully earned by the Franchisor upon the execution of the Franchise Agreements.

The Franchise Agreements:

A) granted the Franchisee two exclusive territories (Pickering/King City);
B) most importantly, imposed on the Franchisee the obligation to secure suitable locations for their Menchie's stores in each exclusive territory;
C) required that the first location be secured within 90 days; and
D) required that both locations be opened within one year.

[1] 2021 ONSC 5112 (not published on CanLii).
[2] 2021 ONSC 2323.

If the Franchisee failed to meet the schedule set forth in (C) or (D), the Franchisor was entitled to terminate the Franchise Agreements and retain the $75,000.00 development fee.

Although the Franchisee was required to find the locations, it did not present any locations to the Franchisor for approval. The Franchisor however did submit locations to the Franchisee for its consideration, all of which were rejected by the Franchisee. The result is that the Franchisee did not secure its first location within the 90-day period set forth in the Franchise Agreements.

The Franchisee requested a change to their exclusive territory as well as an extension. These requests were agreed to by the Franchisor in November 2013. The extension afforded the franchisee until September 30, 2014, being an additional 10 months, to open both locations failing which the Franchisor would terminate the Franchise Agreements and keep the $75,000.00 development fee.

The Franchisee had not secured a location prior to September 30, 2014, being the new extended expiry date. The parties tried to further negotiate changes including a mutual termination or further extension, but no agreement was reached. Ultimately the Franchisor terminated the Franchise Agreements and retained the $75,000.00 fee. The Franchisee commenced legal proceedings.

In its claim, the Franchisee asserted the following disclosure deficiencies (there were also other procedural issues addressed in the litigation which have not been included in this article) which the Franchisee argued afforded it a right to rescind or claim misrepresentation:

A) lack of suitable locations within each territory;
B) that the landlord might require a personal guarantee;
C) the estimates provided were too broad;
D) no earnings projections were provided;
E) since the location was unknown, the Franchisee could not make an informed decision.

The Franchisee also argued that the Franchise Agreements were frustrated because they were not able to find a location within the time frame afforded to them. Finally, the Franchisee asserted that the Franchisor had breached its duty of good faith.

The Decision

All of the foregoing were rejected by the court. In respect of the first and second allegation, the court found that there was no evidence as to either a lack of availability

of locations, or that a landlord had required a personal guarantee in respect of any location (though that would not be at all unusual). In respect of the third allegation, the court held that range of estimates provided were supported by the underlying assumptions for such estimates. In respect of the fourth allegation, the court noted that a franchisor is not required to provide earnings projections.

Finally, in respect of the fifth allegation the court relied on the decision in *Raibex Canada Ltd. v. ASWR Franchising Corp.* (**"Raibex"**).[3] The import of the Raibex decision is that the "uncertainty of costs associated with a yet-to-be-negotiated lease is not a fatal disclosure flaw when there are safeguards in place to protect the franchisee." Following Raibex, the court stated that since the Franchisee had the responsibility for, and control over, the lease negotiations, adequate safeguards were in place to protect the Franchisee, stating as follows:

> "When considered in context, the information disclosed to the plaintiffs was sufficient to enable them to assess the potential costs and risks of establishing and operating a Menchie's franchise location. Business decisions such as this are not made based on perfect information. Informed business decisions can be made based on ranges and assumptions about future costs, which can then be estimated."

The court dismissed the frustration aspect of the claim as well stating that the Franchise Agreements in fact already addressed the issue of what would happen if the Franchisee did not secure a location by the extended date of September 30, 2014.

Finally, the rejected the Franchisee's claim that the Franchisor had breached its duty of good faith stating that: A) the Franchisor had submitted locations to the Franchisee for its consideration; B) the Franchisor had granted a 10-month extension of the agreement; and C) the consequences of the Franchisee not finding a location prior to the expiration date were clearly articulated.

Practice Takeaways

Following the decisions in both Raibex, and now Yogurtworld, it is clear that franchisors are able to issue disclosure documents, and sign franchise agreements, in circumstances in which both the franchisor is finding the location and entering into the lease, and in which the franchisee is itself finding the location and entering into the lease. Of course, franchisors must take care that the requisite disclosure is otherwise provided and that the parameters set forth in both Raibex and Yorgurtworld are met.

[3] 2018 ONCA 62.