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The Dough(Nut) Does Not Rise (Nowhere Nearly Enough) for The Franchisor

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Introduction

Coffee Time Corp. v 1685247 Ontario Ltd.,[1] involved a motion for summary judgement by Coffee Time (2015) Corp. (the "**Franchisor**") for amounts owing by 1685247 Ontario Limited, and its principal (collectively, the "**Franchisee**") pursuant to a franchise agreement (the "**Franchise Agreement**") and sublease (the "**Sublease**"). Although the Court granted summary judgement in favour of the Franchisor, it was for an amount substantially less than what was being claimed.

Background Facts

The Franchisee had executed the Franchise Agreement and Sublease with Coffee Time Donuts Incorporated ("**CTDI**"). CTDI assigned the Franchise Agreement and Sublease to the Franchisor. No formal notice of the assignment was provided to the Franchisee. The Franchise Agreement required the Franchisee to pay royalties and advertising contributions (collectively the "**Franchise Fees**") in consideration for the right to operate a "Coffee Time Donuts" business (the "**Franchised Business**"). The Sublease required the Franchisee to pay rent.

The Franchisor exercised the "Fourth Extension Term" referred to in a certain Lease Amending Agreement dated April 20, 2017 (the "**Lease**") between the Franchisor and the landlord, with the result being that the term for the head lease was extended to August 31, 2022 (the "**Extension Term**"). Minimum rent per month for the Extension Term commencing September 1, 2017, was reduced from $3,262.60 to $1,750.00.

The Franchise Agreement and Sublease expired on August 30, 2017. Despite the expiry of both agreements, the Franchisee continued to operate the Franchised Business. The Franchisee held itself out as a "Coffee Time" restaurant, occupying the subleased premises and paying rent, but did not, however, pay the Franchise Fees. In August 2018, the Franchisor terminated the Franchise Agreement and Sublease due in part to the Franchisee being in default of payment of the Franchise Fees. The Franchisor took possession of the subleased premises at the same time. The Franchise Agreement stated that amounts in arrears accrued interest at 24% per annum. After the termination of the Franchisee, the Franchisor, exercising its early termination right, terminated the head effective November 30, 2018.

[1] *Coffee Time Corp v 1685247 Ontario Ltd.*, 2023 ONSC 3353 [*Coffee Time Corp*].

The Franchisor's Position

The Franchisor claimed $241,382.18, which was comprised of the following amounts:

(a) Franchise Fees of $70,000.00. This was based on an estimate by the Franchisor since the Franchisee had failed to remit royalty reports on the Franchisee's sales at the Franchised Business.[2]

(b) Rent of $51,417.78 (based on $7,287.82/month for March to August 2018 and partial arrears for January and February 2018) ("**Rent**"). The Franchisor acknowledged that this amount must be reduced to account for the rent deposit of $6,405.68. According to the Franchisor's evidence, the Franchisee had a zero-rent balance as of June 30, 2017, and that the amount owing was based on 14 months rent at $7,287.82/month (including HST). Further, the Franchisor asserted that the *Real Property Limitations Act* ("**RPLA**"), provides for a six-year limitation period for claims for payment of rent from when the rent has become due or any acknowledgment that rent is due.

(c) Accelerated rent for the period from September 1, 2018, to November 1, 2018, in the amount of $21,863.46, plus HST for a total of $24,705.71.

(d) Interest at 24% per annum from the due date of each payment to May 1, 2023. In respect of interest on the rent arrears, the Franchisor argued that the Sublease provides that the Franchisee would pay the Franchise Fees as rent reserved at the times and in the manner provided for in the Franchise Agreement, and that the foregoing has the effect of making the interest rate set out in the Franchise Agreement applicable to rent arrears.

The Franchisee's Position

In reply, the Franchisee asserted that:

(a) The Franchisor's claim for Franchise Fees was excessive and was not based on the actual sales upon which the Franchise Fees were to be calculated.

(b) The Franchisor's claims for Rent under the Sublease exceeded the amount properly due.

(c) The Franchisor's claims for accelerated rent were not owing.

[2] This amount, nor the rationale for the calculation, does not appear in the decision. It was obtained by the author based on a conversation with the Franchisor's counsel since the decision itself does not set forth how the initial claim by the Franchisor was calculated.

(d) The Franchisor should deduct the value of inventory, furniture and equipment left behind by the Franchisee.

(e) Under the *Limitations Act, 2002*, the Franchisor's claims for Franchise Fees, Rent and accelerated rent were statute barred for the period after November 21, 2017.

(f) Pursuant to s. 53 of the *Conveyancing and Law of Property Act*, absent notice, the assignments are ineffective as against the Defendants.

The Decision

Citing *Coffee Time Donuts Incorporated v. 2197938 Ontario Inc.*,[3] the court first established that the Franchise Agreement continued after the expiry of its written terms due to the conduct of the parties.

1. Although the court found that CTDI was not joined as a party to this action as required by rule 5.03(3) of the *Rules of Civil Procedure*,[4] it was satisfied that the failure to join CTDI as a party does not prejudice the Franchisee and relieved the Franchisor against the requirement of joinder as permitted by rule 5.03(6).

2. During the hearing, the Franchisor accepted that the amount owing for Franchise Fees was $4,432.29.

3. The Franchisor's claim for Rent, by virtue of suspension of the limitation period under the *Emergency Management and Civil Protection Act*, and accelerated rent by virtue of the RPLA, is not statute barred.

4. The Franchisee was not informed of the rent reduction. The Franchisor continued to claim arrears based on monthly rental of $7,287.82 even though total monthly rent was only $5,578.90 (including HST) after August 2017.

5. At the time of the termination of the Sublease, the Franchisee was a month-to-month tenant and therefore did not have an obligation to pay rent for any fixed remaining term. There were no further rentals due under the Sublease and no remaining term. Therefore, the Franchisor was not entitled to recover accelerated rent from the Franchisee.

6. In respect of interest on Rent, the court stated that although the Sublease had the effect of making the Franchise Fees payable as rent under the Sublease, it did not provide that rent arrears are payable under the Franchise Agreement as Franchise Fees, and therefore could not attract interest at 24%.

[3] *Coffee Time Donuts Incorporated v. 2197938 Ontario Inc.*, 2022 ONCA 436.
[4] The court quoted from Landmark Vehicle Leasing Corp. v. Mister Twister Inc., 2015 ONCA 545, at para. 14, stating that the joinder requirement is intended to guard against a possible second action by the assignor and to permit the debtor to pursue any remedies it may have against the assignor without initiating another action.

7. Interest is payable on the outstanding Franchise Fees ($4,432.29) at the rate of 24% per annum in accordance with the Franchise Agreement.

8. The court, finding no evidence on the value to be attributed to Franchisee's inventory, furniture and equipment, did not find that the Franchisee should be given credit for same.

Conclusion and Key Practice Tips

Although this appears to be a very straightforward decision, there are a multitude of practice tips and takeaways that emanate from this decision.

The Franchisee was self-represented, which means that he was either very knowledgeable about the law or received some assistance and leeway from the judge. If the latter, perhaps one explanation may be due to the Franchisor's attempt to claim the higher amount for Rent than was actually paid to the landlord. This attempt was not, in the authors' view, consistent with their statutory duty of fair dealing[5] and common law duty of honesty in the performance of contractual relations,[6] though we do not know what influence, if any, this had on the judge's overall decision (we however note that the Franchisor may have been lucky not to have damages awarded against it for said breaches).

Further, because of compounding of interest at 24%, the claim for Rent, together with the claim for Franchise Fees and for accelerated rent, created a higher damage claim than was realistic. A more honest assessment by the Franchisor of its legal position may have resulted in a settlement at an earlier stage and without the expenditure of the legal fees needed for a summary judgement motion. Finally, we note that the judge did permit the claim to proceed despite that CTDI was not joined as a party, a decision which if it had been averse to the Franchisor, could have had a significantly disastrous effect on the entire case.

[5] *Arthur Wishart Act (Franchise Disclosure), 2000*, 2000, c. 3, s.3(1).
[6] *Bhasin v. Hrynew*, 2014 SCC 71.