

Just Desserts for a Weak Rescission Claim: The Ontario Superior Court of Justice Rejects a Franchisee Attempt at Statutory Rescission in a Site-Specific Disclosure Case

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A recent decision by the Ontario Superior Court of Justice provides further insight into how courts will grapple with rescission cases where the alleged disclosure deficiency is based on the failure to provide site-specific information in respect of a site that has not yet been secured. This case continues the line of jurisprudence set out in *Raibex*¹ and *Freshly Squeezed*,² which addressed the parameters of disclosure in cases where not all of the potentially disclosable information about the franchise has been ascertained at the time the parties enter into their franchise agreement.

Background

In *2364562 Ontario Ltd. vs. Yogurtworld Enterprises Inc. (Yogurtworld)*,³ the plaintiff franchisee sought damages for rescission of the parties' franchise agreement in respect of the development of two frozen yogurt franchises. Specifically, the franchisee claimed that the franchisor had failed to meet its disclosure obligations under the *Arthur Wishart Act (Franchise Disclosure), 2000* (the Wishart Act) and sought the return of an initial "development fee" of \$75,000. The plaintiff also sought various other damages for breach of the duty of good faith and misrepresentation but limited the cumulative damages to \$100,000 so the matter could proceed under Ontario's simplified procedure rules.

The unique aspect of this case was that neither of the franchise locations ever opened. Under the terms of the franchise parties' agreements, the franchisee was assigned two exclusive territories: the cities of Pickering and King City. It was the responsibility of the plaintiffs to secure locations for the stores (which were to be opened under the "Menchie's" brand). The franchisee paid the development fee for the right to develop the franchises. It was provided 90 days to secure its first location and one year to open both locations. The failure to meet these timelines resulted in the right for the franchisor (Yogurtworld) to terminate the agreements.

The franchisee was unable to find a location within the first 90 days. The franchisee was offered different exclusive territories and an extension of time was granted. Despite this, the franchisee failed to meet this deadline. The parties could not agree on the terms of a mutual termination or another extension, and Yogurtworld terminated the agreements and retained the development fee. Despite the limited damages

sought, the franchisee pressed ahead with the lawsuit and gave a variety of arguments as to why it was entitled to damages.

The Rescission Claims Are Rejected

In respect of the rescission claim, the franchisee provided a multitude of reasons as to why it believe that the disclosure it received was insufficient and that it was entitled to rescind the franchise agreements under section 6(2) of the Wishart Act. All of these reasons were explicitly rejected by the trial judge, the Honourable Justice Kimmel.

First, the franchisee claimed that Yogurtworld failed to disclose that there was a lack of availability of suitable store locations. The Court found that there was no substantive evidence to support this allegation.

Second, the franchisee claimed that Yogurtworld had failed to disclose the possibility that a landlord might insist on a personal guarantee. The Court held that this is a business term that might be negotiated, and that there was no evidence that any landlord ever asked for such a guarantee.

Third, the franchisee alleged that the estimates for start-up costs were too broad. The Court disagreed, holding that the variable underlying assumptions governing the estimate range were properly disclosed.

Fourth, the franchisee complained that the franchisor failed to disclose expected earnings or profitability. The Court held that the absence of earning projections are not a disclosure deficiency. Rather, if such projections are provided, the Wishart Act provides specific disclosure requirements. Given that none were provided, there was no disclosure deficiency.

Fifth, the franchisee alleged that there was a general inability of the franchisee to make an informed decision due to the fact that the location was unknown. The Court relied on the Ontario Court of Appeal's decision in *Raibex*, which held 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." The Court held that the uncertainty was mitigated by "[ceding] the authority and control over the lease costs in the Franchisee." Because the franchisee had control and responsibility over the lease negotiations, there were adequate safeguards in place to protect the franchisee. The Court pointed to the fact that the franchisee had independent legal advice prior to executing the agreements and had in fact investigated a number of locations before choosing their exclusive territories. Lastly, the Court noted that the franchisee had failed to provide evidence that lease costs were the reason why they were unable to secure franchise locations. Justice Kimmel commented:

"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

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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.”

Justice Kimmel pointedly rejected the plaintiff’s contention that a franchisee has a right to rescind its franchise agreement until the location has been determined and site-specific costs are known. The Court disagreed with the view that no franchisee should ever have to make a decision about whether to invest in a franchise until all site-specific costs are known, and again noted that *Raibex* held that there can be compliant disclosure in circumstances where the franchise location has not been determined if there are safeguards against the risk of unknown future costs and the risk of abuse by the franchisor. The Court indicated that if there was any imprecision or imperfection concerning the estimated lease and start-up costs, it would only entitle the franchisee to a 60-day rescission period under section 6(1) of the Wishart Act, not a two-year rescission period under section 6(2). No such claim was brought. The Court dismissed the rescission claim in its entirety.

The Other Causes of Action Are Rejected

After declining to address a limitation period issue concerning the rescission claim, the Court also dismissed the misrepresentation claims by the plaintiff and further held that the franchise agreements were not frustrated because the franchise agreements expressly contemplated the possibility of the franchisees failing to find and secure locations.

Yogurtworld also convinced the Court that it had not breached the duty of good faith. Yogurtworld pointed to the facts that (a) it had identified potential stores in the territories to the plaintiff, despite this being the plaintiff’s responsibility, (b) it had agreed to an extension of the agreement and (c) provided ample and clear notice of the potential termination, and Justice Kimmel concluded that no bad faith conduct had been established.

Conclusion

In summary, the decision of Justice Kimmel in *Yogurtworld* contains some helpful bedrock statements concerning franchisor disclosure obligations in respect of site-specific information. The Court plainly noted that “The Wishart Act does not require that the franchise location be known or that disclosure be site specific, nor does it foreclose the use of estimates or ranges of anticipated costs.” The debate over site-specific disclosure will no doubt continue but *Yogurtworld* can provide some assurances to franchisors that, in the correct context, franchisors may continue to enter into franchise agreements despite the fact that the franchise location has not yet been ascertained. It is encouraging to franchisors that commercial reasonableness can prevail in the face of scattershot rescission claims. Further, *Yogurtworld* also provides further guidance as to what may constitute good faith conduct in franchise relationships.

¹ <https://cassels.com/insights/an-allstar-decision-for-franchisors-court-of-appeal-restores-clarity-and-commercial-sense-to-disclosure-obligations-in-long-awaited-raibex-appeal-decision/>

² <https://cassels.com/insights/missing-notes-to-financial-statements-and-other-disclosure-deficiencies/>

³ 2364562 *Ontario Ltd. v. Yogurtworld Enterprises Inc.*, 2021 ONSC 5112 (not available on CanLII, although the subsequent costs awards has been published at <https://canlii.ca/t/jj2jf>).

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