

"Wave" The Deposit Goodbye: Franchisor Escapes Vicarious Liability After Franchisee Deposit Disappears

Noah Leszcz

February 8, 2018

In a recent decision, (*1738937 Alberta Ltd v Fair Waves Coffee Inc*), the Alberta Court of Queen's Bench has denied a claim that a franchisor was liable for the fraudulent actions of a master franchisee against a subfranchisee. This decision is a helpful reminder that a master franchisor can protect itself from vicarious liability for the acts of its master franchisee.

In this case¹, in 2013, an Alberta couple, the Kerrs, were in search for a new business opportunity and began making inquiries about a Fair Waves coffee (Waves) franchise. They applied by fax to the Waves' British Columbia head office, and Mr. Abraham Alhusin, the master franchisee for Waves in Alberta, reached out to them.

Alhusin provided the Kerrs with a disclosure document, which they gave to their corporate lawyer for review. The lawyer conducted a corporate registry and personal property search on M&M Alberta Coffee Ltd dba Waves Coffee Alberta (M&M), the corporate entity that Mr. Alhusin was using to operate as master franchisee. The lawyer advised the Kerrs that M&M and Fair Waves Coffee Inc., the franchisor, were separate companies, and that "everything looked fine."

The Kerrs then signed the franchise agreement with Mr. Alhusin, and paid M&M numerous fees, including \$225,000 for a construction deposit. The store was set to open in October of 2013. However, that never happened, as Mr. Alhusin and the deposit vanished, leaving the Kerrs without a franchise and with almost \$250,000 in losses.

Mr. Alhusin had been a trusted Vancouver Waves franchisee for many years, before signing the master franchise agreement with Waves for Alberta in 2009. Since that time, he had signed up nine Alberta franchisees, which were assigned to Waves after Alhusin's disappearance.

The Kerr's franchisee company, 1738937 Alberta Ltd., sued Waves and M&M in respect of its losses. The Kerrs argued that despite their franchise agreement being with M&M, the franchisor Waves should be vicariously liable because of: i) the language on the Waves website concerning franchise opportunities; ii) the franchisor's receipt of the franchisee application; and iii) the supervisory powers and financial benefits detailed in the master franchise agreement.

The Kerrs' argument was based on the concept of vicarious liability. Vicarious liability refers to one person

Cassels

being responsible for the wrongdoing of another because of the relationship between the parties. Commonly, this is seen when an employer is held liable for the misconduct of an employee.

In this case, the Court ruled that neither Mr. Alhusin nor M&M were employees of the franchisor, and they were in fact independent contractors. Justice Topolniski writes:

Fair Waves had no control over how Mr. Alhusin marketed, sold, or monitored his franchisees, who he hired, and in certain circumstances, how he priced product. Subject to the payment of new store and transfer fees, and royalties, Fair Waves did not bear any financial responsibility for or assume risks concerning M&M's operations. In other words, Fair Waves and M&M are separate businesses. They lack the kind of inter-relationship and control that is found in an employment structure.

Failing the employer-employee threshold, the Court turned to an analysis of whether Mr. Alhusin and M&M were ostensible or apparent agents of the franchisor, which is another means by which a person or entity can be found liable vicariously. In order to be found liable vicariously as an agent, the Kerrs needed to assert that Mr. Alhusin and M&M were agents of the franchisor, acting with apparent authority, and that the Kerrs relied on an express or implied unequivocal representation by the franchisor that it had authorized Mr. Alhusin or M&M to act on its behalf. This representation must be determined to have been reasonable, and further, that the loss suffered was attributable to that representation.

The Kerrs asserted at trial that the following facts amounted to a reasonable representation: i) the franchisee application on the franchisor's website, along with the franchisor's receipt of the application, and subsequent communication; ii) the Waves promotional materials available on the franchisor's website; iii) the disclosure document which disclosed the relationship between the master franchisee and the franchisor; and iv) Mr. Alhusin's comments that the franchisor and master franchisee were "one big family," and that "we all work together as one."

The Court ruled that while some of these facts "may have lulled an unsophisticated, vulnerable customer" into thinking that the franchisor had authorized the master franchisee to speak on its behalf, the Kerrs were not unsophisticated in the "language of franchises," having operated a different franchise for many years. While the Court was sympathetic to the plight of the Kerrs', Justice Topolniski ruled that they had opportunities to discover that Mr. Alhusin and M&M "were not, in any fashion, agents" of the franchisor. In coming to this decision, the courts relied on the fact that the Kerrs had assistance from corporate counsel, and were presented with multiple opportunities to discover the nature of the relationship between master franchisee and franchisor, and they instead chose to rest on their assumptions.

The takeaway from this decision is that franchisors should govern themselves carefully when dealing with master franchisees and subfranchisees to avoid the implications of vicarious liability. This can be done both contractually in the master franchise agreement, which can include appropriate disclaimers in the master franchisee's disclosure document and subfranchise agreement, and in practice by limiting interactions

Cassels

between the franchisor and subfranchisees. Franchisors can exercise their rights to review the subfranchise agreement and corresponding disclosure document while being mindful not to unnecessarily meddle in the affairs of their master franchisees as they pertain to their relationships with subfranchisees.

¹ 1738937 Alberta Ltd v Fair Waves Coffee Inc (Waves Coffee House), 2017 ABQB 714, <<http://canlii.ca/t/hnvf3>>

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.