

Franchising - Canada

Courts rule on the duty to inform

Contributed by [Lapointe Rosenstein Marchand Melançon LLP](#)

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Introduction

Civil law jurisdictions, such as the province of Quebec, are familiar with the obligation of good faith, as well as its derivative duty to inform a contracting party of material facts that may influence its decision to enter into a contract. The statutory duty of fair dealing contained in franchise legislation in Canada, such as the Ontario Arthur Wishart Act,⁽¹⁾ is defined so as to include the duty to act in good faith in accordance with reasonable commercial standards. Interestingly, the Ontario courts have recently had to interpret this statutory duty of fair dealing in the context of claims of breach of such duty by reason of a franchisor withholding critical information that influenced the franchisee's decision not to exercise a right of first refusal.

This update reviews the Ontario Court of Appeal's reasoning in *3574423 Canada Inc v Baton Rouge Restaurants Inc*⁽²⁾ in response to such claims, and then contrasts it with a recent decision of potentially significant import by the Quebec Court of Appeal with respect to the duty to inform under the civil law of Quebec.⁽³⁾

Baton Rouge

The franchise agreement signed by 3574423 Canada Inc as franchisee for its Baton Rouge restaurant contained a right of first refusal for subsequent locations in the Greater Toronto Area (the largest metropolitan area in Canada, with a population estimated at 5.6 million). Over a certain number of years, the franchisee was offered, but refused, the opportunity to exercise such right of first refusal in respect of some new locations, including in the municipality of Thornhill, Ontario.

The franchisee brought an action for damages claiming a breach of the duty of fair dealing contained in the Arthur Wishart Act resulting from:

- the failure by the franchisor to provide adequate information concerning the Thornhill location; and
- the withholding of information that would have influenced the franchisee's decision not to exercise the right of first refusal.

The franchisee claims that it waived its right of first refusal for a location that it would otherwise have chosen to acquire had it been reasonably informed. The Ontario Superior Court of Justice dismissed the franchisee's action and the franchisee appealed to the Ontario Court of Appeal.

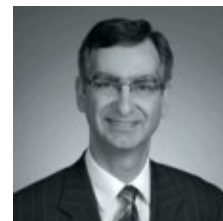
Issues

On appeal, the franchisee argued that the trial judge had erred in his application of the statutory duty of fair dealing. In particular, the franchisee argued that the information provided by the franchisor in respect of the Thornhill franchise was incomplete insofar as no information regarding the final lease or the size of the exclusive territory was provided. The franchisee contended that the terms of the final lease, which in its opinion were more favourable for a franchisee than those contained in the offer to lease that was disclosed to the franchisee, would have been material to its decision as to whether to exercise its right of first refusal.

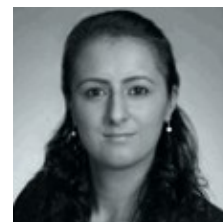
Finally, the franchisee argued that the franchisor had an obligation to disclose fully the scope of the exclusive territory, which would be the largest territory of all franchised Baton Rouge restaurants and would include the proposed future North York restaurant

Authors

[Bruno Floriani](#)



[Kiran Singh](#)



in which the franchisee had been interested. The franchisee asserted that without this critical information, it did not realise that by not exercising its right of first refusal for the Thornhill location, it was passing up the opportunity for a restaurant in North York.

Decision

The Ontario Court of Appeal contended that the Arthur Wishart Act's fair dealing provision calls "for a balancing of the rights of both franchisees and franchisors", and that if the franchisee required additional information, it could have requested and sought the same, particularly in respect of the final lease. The court also concluded that the franchisee could have exercised its right of first refusal subject to its review and negotiation of the final lease.

The appeal court found that the franchisee's principals were knowledgeable businesspeople with considerable experience and had sufficient information to make a reasoned decision. In addition, the court found that the final lease was not significantly different from the offer reviewed by the franchisee, as the basic provisions such as the tenant's allowance, rent and renewal were identical and the changes were minor in nature.

With regard to the scope of the Thornhill territory, the trial judge had found that the franchisee was aware that Thornhill would benefit from a larger location, given that as an experienced franchisee, it knew that franchises "located in dense, urban areas would likely enjoy smaller territories than those in less-densely populated suburban areas". Furthermore, the franchisee had previously rejected two other suburban territories without enquiring as to their size. The appeal court judge agreed with the trial judge that the size of the territory was not a significant factor in the franchisee's decision. If it was, the franchisee would have sought additional information relating thereto.

Franchises Cora

In *9150-0595 Quebec Inc v Franchises Cora Inc* the principal of 9150-0595 Quebec Inc applied to be franchisee of Franchises Cora Inc. In the course of the franchisor's evaluation of the principal's suitability, the principal completed a short internship during which she was evaluated by a representative of the franchisor and underwent a psychometric test. The principal requested a copy of the internship evaluator's notes and her test score, but did not receive either. The parties entered into a franchise agreement for a location which the principal had scouted and which had been approved by the franchisor as being a 'B-level' site; however, an employee of the franchisor sent an internal email in which he expressed doubts as to the location.

The restaurant's customer base dwindled significantly within four weeks of opening. A year after its opening, the franchisee's restaurant closed, despite the franchisor's representatives having visited the restaurant and offered their assistance and support on no fewer than 88 separate occasions.

The franchisee brought a motion to the Quebec Superior Court for termination of its franchise agreement due to fraud and error on the basis that it would never have entered into the agreement if its principal had been provided with:

- her psychometric test results;
- the internship evaluator's notes; and
- the internal email in which an employee of the franchisor expressed doubts as to the selected location.

The trial judge dismissed this case on the basis that even if the additional information had been provided to the franchisee, the franchisee would have entered into the franchise agreement. Interestingly, the trial judge held that in the absence of proof of a franchisor's intention to mislead, a franchisor has no obligation to divulge its internal documents such as evaluations. The trial judge found that the internal nature of these documents lent credence to the fact that they could not have been determinative to the consent of the franchisee to contract. The franchisee appealed to the Quebec Court of Appeal.

Decision

The Quebec Court of Appeal found that the trial judge had erred in affirming that the franchisor had fulfilled its duty to inform under the Quebec Civil Code. It held that a franchisor must provide a franchisee or prospective franchisee with all the information which could significantly influence its consent to contract. Nevertheless, the appeal court dismissed the appeal on the basis that the trial judge's finding rested on the fact that the franchisee would have entered into the franchise agreement even if provided with the requested documents. This was a decision based on fact and the franchisee did not establish that the trial court decision contained a manifest and determinative error which would allow the appeal court to intervene.

Comment

Despite the different fact patterns and basis of legal reasoning, these cases highlight some of the significant differences between the two Canadian legal systems regarding the duty to inform. In the Ontario case, the onus seems to be placed squarely on the franchisee to establish that it acted diligently in seeking information in respect of issues that it subsequently claims to be a determining factor in the franchisee's decision. In the Quebec case, the Quebec Court of Appeal treated internal exchanges and data as information to be disclosed to the potential franchisee, simply because it could significantly influence the franchisee's consent to enter into the contract. Perhaps the Quebec Court of Appeal's analysis would have been different had the principal of the franchisee not expressly requested this information. However, the willingness of the Quebec Court of Appeal's refusal to disqualify the disclosure of this information because of its internal nature should be heeded as a significant warning to franchisors in Quebec.

Another significant difference is that the franchisee's claim could be invoked in Ontario only because the franchise agreement had already been entered into, triggering the application of the statutory duty of fair dealing. In Quebec, the duty to inform clearly applies before execution of the franchise agreement by reason of the application of Article 1375 of the Civil Code, which stipulates that "[t]he parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished".

These decisions assist in clarifying the scope of the duty of good faith and highlight some of the important distinctions that should be made when franchising in different Canadian provinces.

For further information on this topic please contact [Bruno Floriani](#) or [Kiran Singh](#) at Lapointe Rosenstein Marchand Melançon LLP by telephone (+1 514 925 6300), fax (+1 514 925 9001) or email (bruno.floriani@lrmm.com or kiran.singh@lrmm.com).

Endnotes

- (1) Arthur Wishart Act (Franchise Disclosure) 2000, SO 2000, c 3 Section 3.
- (2) 2011 ONSC 6697.
- (3) 9150-0595 Quebec Incv Franchises Cora Inc, 2013 QCCA 531.

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