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2. THE IMPORTANCE OF FULL DISCLOSURE BEFORE RENEWAL

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Introduction

In *Sirianni et. al. v. Country Style Food Services Inc. et. al.*, 2012 ONSC 881 ("*Sirianni*"), the Ontario Superior Court discussed the applicability of the disclosure requirements of *Arthur Wishart Act (Franchise Disclosure), 2000* (the "Wishart Act") to a franchise relationship that continued despite expiry of the franchise agreement. In a decision which favours the franchisee, the Court re-emphasizes to the franchising community the protective purpose of the Wishart Act in the franchise renewal context.

Significance

Sirianni is significant for the following reasons:

- it describes under what conditions a franchise agreement may be renewed or extended, emphasizing the fact that *any* document executed by the franchisee may be construed as a franchise agreement;
- it reiterates the importance of providing full disclosure when the renewal exemption (subsection 5(7)(f) of the Wishart Act) does not apply because there has been a material change since the franchise agreement was entered into or last renewed;
- it emphasizes that failure to disclose a single material fact can and will amount to "no disclosure document" thereby allowing the franchisee to rescind pursuant to subsection 6(2) of the Wishart Act within two years after entering into (or in this case renewing) the franchise agreement; and
- it confirms that significant damages will be awarded where the duty of fair dealing in 3 of the Wishart Act is breached.

Background

The corporate franchisee, owned by the two Sirianni brothers, entered into a franchise agreement for a Country Style franchise for a ten year term from February 8, 1996 to February 28, 2006. The franchise agreement had a five year renewal option, which the franchisee company properly exercised. February 28, 2006 came and went without any disclosure document provided or any renewal paperwork signed; the parties simply continued in business together as before.

Country Style's head lease for the premises was also for ten years, with a five year renewal option as well. Country Style had sublet the premises to the corporate franchisee. Country Style had until March 31, 2005 to exercise its head lease renewal option for the premises, which it did. The head lease stated that upon exercise of the renewal option the parties would agree to the renewal term rents, and if they

could not agree they would submit the issue to arbitration. In fact Country Style and the landlord could not come to agreement and the rents issue was scheduled for a February, 2007 arbitration. The Court found that in all of its internal documentation, and also in its correspondence with its landlord, Country Style referred to the head lease renewal term as commencing on April 1, 2006. The Court did not explain why this April 1, 2006 date was chosen by Country Style instead of February 29, 2006.

In June 2006, Country Style provided the Siriannis and their company with a generic disclosure document, and in September, 2006 presented for signature a renewal form of franchise agreement and related documents (but not a sublease). The renewal form of franchise agreement had a term from February 28, 2006 to March 1, 2011. The Siriannis told Country Style that they would not sign the renewal documents until the rents under the head lease for the renewal term were decided and a sub-lease was provided; they also expressed concern that Country Style had not provided a scope of the renovations required as a condition of renewal.

In October, 2006 Country Style told the Siriannis that negotiations with the landlord were continuing and that the rent issue likely would have to go to arbitration. But when February, 2007 came around, instead of going forward with the rents arbitration Country Style and its landlord continued to negotiate. On April 1, 2007 Country Style and the landlord came to an agreement to lease the premises from April 1, 2006 to December 31, 2007, at which time Country Style would either vacate or continue as a month-to-month tenant.

On May 1, 2007, Country Style sent the Siriannis a letter informing them that Country Style had finally agreed on the renewal term rent with its landlord and setting out the new rents and the amount of arrears due. The letter also said that that renovations to the premises would be required, that in due course Country Style would provide a cost estimate for the renovations, and that if additional documents were needed to amend the current agreement to reflect the letter terms they would be forwarded in due course. The letter asked the Siriannis to acknowledge their agreement by signing and returning a copy of the letter, which the Siriannis did. The letter did not state that the renewed head lease would end on December 31, 2007, nor did it mention what the term of the renewal franchise agreement would be.

On March 20, 2008 the franchisee delivered a notice of rescission to Country Style.

Parties' Positions

Country Style argued that the franchise agreement was never renewed, because the September, 2006 renewal form of franchise agreement was never signed. In the alternative, Country Style argued that the franchise was renewed on a month-to-month basis commencing December 31, 2007. In the further alternative, it argued that if the franchise was in fact renewed, then it was renewed from February 27, 2006, which was the date of the renewal form of franchise agreement sent to the Siriannis in September, 2006 for signature by them.

The Siriannis argued that the franchise agreement was renewed as of April 1, 2006, because the May 1, 2007 letter stated that the adjusted rent arrears were due from April 1, 2006 and because the discussions between Country Style and the landlord referred to an April 1, 2006 commencement date for the head lease renewal term. The Siriannis relied on the fact that the new terms of the head lease were never disclosed.

Justice Mesbur's Decision:

Was the Franchise Agreement Renewed?

Justice Mesbur held that the term of the original franchise agreement ended on February 28, 2006, and that from February 29, 2006 to April 30, 2007 the term had been extended on a month-to-month basis. The fact that Country Style was aware that the Siriannis intended to renew, but were waiting to receive the sub-lease agreement and renovations estimate, was not discussed by Justice Mesbur, who evidently did not consider whether an implied agreement existed.

Based on the Wishart Act's definition of franchise agreement ("any agreement that relates to a franchise between, a franchisor or a franchisor's associate, and a franchisee"), Justice Mesbur construed the May 1, 2007 signed-back letter between Country Style and the franchisee as a franchise agreement. Justice Mesbur then held that although by implication the May 1, 2007 letter renewed the franchise on the same terms and conditions as in the original franchise arrangement, the letter was ambiguous regarding the length of the renewal term. Justice Mesbur therefore applied the doctrine of *contra proferentem* (i.e. an ambiguity in a contract of adhesion will be construed against the drafter of the document) to find that the May 1, 2007 letter created a five year renewal term commencing May 1, 2007.

It is noteworthy that the Siriannis and their franchisee company never did sign the September, 2006 form of franchise agreement and related documents, just the May 1, 2007 letter, a letter that apparently only stated the new rent requirement, alluded briefly to required renovations, and stated the possibility that some additional franchise documentation might be needed to reflect the new arrangement. It seems, therefore, that almost any document signed by franchisor and franchisee that has at least something to do with the franchise may be construed as a "franchise agreement" that requires adequate disclosure be given at least 14 days before the document is signed.

Was Disclosure Required?

Justice Mesbur reiterated subsection 5(7)(f) of the Wishart Act, which states that the disclosure obligations under the Act are not absolute and a franchisor will be exempt from the Wishart Act's disclosure requirement where there has been no material change since the parties entered into the franchise agreement or its most-recent renewal. Justice Mesbur held that the radical change in length of the head lease term was a material change, and therefore Country Style was obliged to make the full disclosure required by the Wishart Act but had not done so.

Justice Mesbur also held that during the period from February 29, 2006 to April 30, 2007 the franchisee was operating on a month to month basis, and so the franchisor was exempt from disclosure during that period since subsection 5(7)(g)(ii) of the Wishart Act applied (franchise agreements valid for not more than one year which do not involve payment of a non-refundable franchisee fee are exempt from disclosure).

Was the Disclosure Adequate?

In June, 2006 Country Style provided a disclosure document, and in September, 2006 a package which included a new form of franchise agreement, a sign rental agreement, a guarantee and other documents. The package did not include either a new sublease or a summary of the terms of it, and Justice Mesbur found that these sublease terms were deliberately withheld from the Siriannis until after the May 1, 2007 letter was signed. Justice Mesbur relied on *Mapleleaf Franchise Concepts Inc. v. Nassus Frameworks Ltd.*, 2011 CarswellAlta 1709 (QB), where the Court held that the location and length of continued operation of the franchise in the renewal term were material facts. Justice Mesbur also relied on *1518628 Ontario Inc. v. Tutor Time Learning Centers LLC*, [2006] O.J. No. 3011 (S.C.J. Comm. List), where non-

disclosure of material facts in itself meant there was not compliance with the Wishart Act as to the required disclosure. Based on these cases Justice Mesbur concluded that the failure to inform the Siriannis of the new terms of the sub-lease was the equivalent of no disclosure at all. As a result, the franchisee was well within subsection 6(2)'s two-year window for rescinding the franchise agreement (i.e. the May 1, 2007 letter). Justice Mesbur found that Country Style should have paid the franchisee some $187,700 pursuant to subsection 6(6) of the Wishart Act but did not, and awarded that amount as damages pursuant to subsection 7(1) of the Wishart Act.

Breach of the Duty of Fair Dealing?

Justice Mesbur also awarded $25,000 in damages for Country Style's breach of the Wishart Act section 3 duty of fair dealing, because Country Style deliberately hid the status of head lease renewal from the franchisee. Justice Mesbur relied on *Salah v. Timothy's Coffees of the World Inc.*, [2009] O.J. No. 4444 (S.C.J.), aff'd [2010] O.J. No. 4336 (O.C.A.), in which the Court awarded $50,000 in damages for breach of the duty of fair dealing and for mental distress. In that case, the franchisor deliberately and actively kept the franchisee in the dark about the franchisor's intentions, asking the landlord to refrain from passing on any information about the new terms of the lease and avoiding communication with the franchisee. Although Country Style also deliberately failed to inform the Siriannis of the terms of the new lease, it did not do so in as active a manner as the franchisor in *Salah*; also, in *Sirianni* there was no claim for damages for mental distress.

Conclusion

This case re-confirms to the franchising community the franchisor's obligation to disclose at the time of the renewal of a franchise agreement, whenever there has been a material change since the parties entered into original franchise agreement or its most recent renewal. It also re-emphasizes that the terms of a sub-lease are material facts that must be disclosed to the prospective franchisee, and that failure to do so will be the equivalent to "no disclosure". Finally, the case calls attention to the fact that a "franchise agreement" may take many forms, and franchisors must always bear this in mind when inviting prospective franchisees to sign documents.

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