COURT OF APPEAL FOR ONTARIO

CITATION: Caffé Demetre Franchising Corp. v. 2249027 Ontario Inc., 2015 ONCA 258

DATE: 20150415

DOCKET: C58737

Doherty, Epstein and Tulloch JJ.A.

BETWEEN

Caffé Demetre Franchising Corp.

Plaintiff (Defendant by Counterclaim)

and

2249027 Ontario Inc. and Waqar Khan

Defendants (Plaintiffs by Counterclaim)

AND BETWEEN

2249027 Ontario Inc. and Waqar Khan

Plaintiffs by Counterclaim

(Appellants)

and

Caffé Demetre Franchising Corp. and Gary Steven Theodore

Defendants to the Counterclaim

(Respondents)

David S. Altshuller, for the appellants

John H. McNair, for the respondents

Heard: October 31, 2014

On appeal from the order of Justice T. A. Heeney of the Superior Court of Justice, dated April 3, 2014.

**Epstein J.A.:**

**OVERVIEW**

[1] The respondent, Caffé Demetre Franchising Corp., is the franchisor of a franchise system with a number of outlets in the Toronto area. The franchise specializes in freshly made desserts and ice cream. In 2011, the appellant, Waqar Khan, through his company, the appellant, 2249027 Ontario Inc., (collectively, the "franchisees"), purchased a Caffé Demetre franchise at 3280 Dufferin Street.

[2] This is another case from the franchise world involving whether the franchisor met its disclosure obligations under the *Arthur Wishart Act (Franchise Disclosure)*, *2000*, S.O. 2000, c. 3. The issue in this appeal is narrow – whether the failure to disclose ongoing litigation commenced by the franchisor against a competing business constituted a material deficiency such that the franchisees were entitled to rescind the franchise agreement pursuant to s. 6(2) of the Act.

[3] Approximately a year after the franchise was purchased in 2011, difficulties arose between the

parties that led the franchisor to sue the franchisees claiming, among other things, a declaration that the franchise agreement was at an end and damages for breach of contract. The franchisees counterclaimed, adding the principal of the franchisor to the action, the respondent, Gary Theodore, and claiming rescission of the franchise agreement and repayment of amounts they had invested in the business.

[4] The franchisees' claim for rescission was based on alleged deficiencies in the disclosure document the franchisor had provided at the time of purchase. The franchisor moved for partial summary judgment seeking dismissal of the rescission claim.

[5] The motion judge granted partial summary judgment and dismissed the claim for rescission. He held that it was in the interests of justice to deal with the issue of rescission summarily. He found that three of the four alleged disclosure omissions relied upon by the franchisees were not disclosure deficiencies at all. With respect to the fourth alleged omission, the motion judge concluded that while the franchisor should have disclosed the ongoing litigation in which it was involved, this omission failed to "come anywhere close" to the type of deficiency that entitled the franchisees to rescind the franchise agreement under s. 6(2) of the Act.

[6] On appeal, the franchisees challenge the motion judge's decision that the summary judgment procedure was appropriate in the circumstances as well as his conclusion that the undisclosed litigation did not entitle them to rescission under s. 6(2) of the Act.

[7] I would dismiss the appeal. I see no reason to interfere with the motion judge's exercise of discretion in dealing with the discrete issue of the franchisees' rescission right by way of summary judgment. And I agree that there was nothing about the franchisor's disclosure that afforded the franchisees the right to rescind the franchise agreement.

**FACTUAL BACKGROUND**

[8] On May 16, 2011, the franchisees acquired from the previous franchisee a Caffé Demetre franchise that had been operating on Dufferin Street. On June 24, 2011, the franchisees received a disclosure document from the franchisor.

[9] On July 22, 2011, the franchisees executed the franchise agreement and started operating their new business.

[10] Also on July 22, 2011, at the urging of other Caffé Demetre franchisees, the franchisor commenced an action against a former Caffé Demetre franchisee who was operating a competing business called Spin Dessert. The Spin Dessert operation was 7.5 km from the Dufferin Street Caffé Demetre location. While this lawsuit was started the same day as the franchisees entered into the franchise agreement, the litigation had been contemplated for some time, certainly prior to June 24, 2011, when the franchisor provided the disclosure document to the franchisees.

[11] By September 2011, the franchisees were aware of the Spin Dessert litigation. They did not express any concerns about it. Spin Dessert went out of business in December 2012 and the action was settled.

[12] In or around 2012, the franchisor decided to introduce a new up-scale menu. In the summer of 2012, in furtherance of this anticipated change the franchisor inspected various franchise outlets, including the franchisees' Dufferin Street location. As a result of this inspection, the franchisor informed the franchisees that they were required to perform repairs that would cost between $40,000 and $50,000. The franchisor was entitled to make this request pursuant to a provision in the franchise agreement under which the franchisees agreed to refurbish and renovate the premises as required by the franchisor from time to time. The franchisees did not perform any of the work the franchisor requested.

[13] In November 2012, the franchisor discovered that customer orders at the franchisees' Dufferin Street location were cancelled at point of sale roughly three times more often than at other outlets. The franchisor asked the franchisees for information to help it understand this anomaly. The franchisees did not provide it. As a result, the franchisor inferred that the franchisees were concealing cash sales to reduce their franchise fees.

[14] On December 12, 2012, the franchisor issued a notice of default to the franchisees for failure to improve the appearance of the location, and to provide financial statements and tax returns, both as required under the franchise agreement, and understating gross sales through excessive error/correct key entries. The franchisees did not respond. The franchisor therefore issued further default notices on March 8, 2013, and July 5, 2013.

[15] Still the franchisees did nothing. The franchisor conducted another inspection of the Dufferin Street operation. This inspection disclosed further problems related to the franchisees' procedures and the physical condition of the premises.

[16] On July 19, 2013, the franchisees served a notice of rescission of the franchise agreement.

[17] On August 2, 2013, the franchisor served notice of termination of the franchise agreement and directed the franchisees to vacate the premises in accordance with the post-termination obligations contained in the franchise agreement.

[18] The franchisees claimed that the franchisor's actions were illegal. The franchisees changed the locks of the Dufferin Street location, rebranded their operation, and continued under the trade name "Sugar'n Spice Café" as a business in competition with the Caffé Demetre franchise system.

[19] In August 2013, the franchisor commenced proceedings against the franchisees claiming termination of the franchise agreement and damages. In their statement of defence and counterclaim, the franchisees claimed that the franchise agreement was validly rescinded under s. 6(2) of the Act because the franchisor did not provide the disclosure mandated by the legislation.

[20] In their pleadings the franchisees identified the following information that they say the franchisor was aware of at the time it signed the disclosure document and that it was obliged to but did not disclose:

1. The franchisor was involved in the Spin Dessert litigation.

2. The franchisor was contemplating implementing a policy prohibiting franchisees from taking a share of their employees' tips (the "Tip Out Policy").

3. The franchisor was contemplating altering the ice cream policy to make franchisee owner principals directly responsible for preparing the ice cream (the "Ice Cream Manufacturing Policy").

4. The Dufferin Street location would require extensive remodelling and renovations that would cost in excess of $50,000 (the "Remodeling and Renovations").

[21] The franchisor brought a motion for partial summary judgment seeking a declaration that the franchisees were not entitled to rescission.

**THE STATUTORY FRAMEWORK**

[22] Section 5 of the Act sets out a franchisor's disclosure obligations. It requires that a franchisor provide a franchise disclosure document to a prospective franchisee no fewer than 14 days before the earlier of the signing by the prospective franchisee of the franchise agreement and the payment of any consideration by the franchisee relating to the franchise. Section 5 also governs, among other things, the means for delivery of the disclosure document, the requirements for disclosure of material changes, and the contents of the disclosure document.

[23] Subsection 5(4)(a) requires the franchisor to include in the disclosure document "all material facts". The Act defines "material fact" broadly in s. 1(1) to include any information about the business, operations, capital or control of the franchisor or the franchise system that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise.

[24] Regulations under the Act provide further details of the disclosure the Act mandates. Relevant to the issues here, s. 2 of O. Reg. 581/00 provides that every disclosure document shall contain:

> 5. A statement, including a description of details, indicating whether the franchisor, the

> franchisor's associate or a director, general partner or officer of the franchisor has been found liable in a civil action of misrepresentation, unfair or deceptive business practices or violating a law that regulates franchises or businesses, including a failure to provide proper disclosure to a franchisee, or if a civil action involving such allegations is pending against the person. [Emphasis added.]

[25] Section 6 of the Act provides the consequences for failing to strictly comply with the requirements set out in s. 5 and the regulations. These consequences include rights of rescission and compensation. Section 6 provides two separate time periods within which the franchisee can rescind:

> 6. (1) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than 60 days after receiving the disclosure document, if the franchisor failed to provide the disclosure document or a statement of material change within the time required by section 5 or if the contents of the disclosure document did not meet the requirements of section 5.
>
> (2) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the franchise agreement if the franchisor never provided the disclosure document.

[26] As mentioned above, the franchisees seek to rescind the franchise agreement by relying on s. 6(2) of the Act.

**REASONS OF THE SUMMARY JUDGMENT MOTION JUDGE**

## The Test for Summary Judgment

[27] The motion judge applied the test from *Hryniak v. Mauldin*, 2014 SCC 7, [2014] 1 S.C.R. 87, and held that he had the evidence required to fairly and justly adjudicate on the rescission issue in a timely, affordable, and proportionate manner. He found that the material relied on by the franchisor on the summary judgment motion consisted of documents, the franchisees' pleadings, uncontested facts, and admissions made by the franchisee Khan on cross-examination. The motion judge determined that his only task was to apply those facts to the applicable law to determine whether the franchisees had a right to rescission. In these circumstances he did not have to make use of any of the new fact-finding powers under ss. 20.04(2.1) or (2.2) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194.

[28] The motion judge acknowledged that in *Hryniak* the Supreme Court cautioned against deciding an issue on summary judgment when a trial will be required in any event. However, at para. 49 of his reasons, he found that if "the rescission claim is dismissed, the landscape for resolution will be fundamentally altered and the prospects for avoiding a lengthy trial greatly enhanced". Finally, the motion judge observed that because the facts were essentially undisputed, there was no risk of inconsistent findings.

## Standard for Rescission for Non-disclosure Under s. 6(2) of the Act

[29] Relying on *4287975 Canada Inc. v. Imvescor Restaurants Inc.*, 2009 ONCA 308, 98 O.R. (3d) 187, the motion judge observed that the test for rescission under s. 6(2) of the Act for failure to provide a disclosure document must be distinguished from the test under s. 6(1) of the Act for rescission where the "contents of the disclosure document did not meet the requirements of section 5". The motion judge then cited this court's decision in *6792341 Canada Inc. v. Dollar It Ltd.*, 2009 ONCA 385, 95 O.R. (3d) 291, for the proposition that where there are "stark and material deficiencies" in the disclosure document, the document cannot be considered a disclosure document at all and a franchisee may have a right of rescission under s. 6(2).

## The Spin Dessert Litigation

[30] In dealing with the franchisor's failure to disclose the Spin Dessert litigation, the motion judge expressed his view, at para. 26, that because the litigation was not a potential liability but rather a proactive measure for the benefit of the franchisees, "it is difficult to see how the existence of this

litigation could have a significant effect on the price to be paid by the franchisor, as required by the definition of "material fact"."

[31] Nevertheless, the motion judge held that the litigation did meet the definition of "material fact" and should have been disclosed. But the motion judge reasoned that while the failure to disclose the litigation was a "content deficiency" that would give rise to rescission rights under s. 6(1) if identified within 60 days of signing the franchise agreement, it was not a "stark and material deficiency".

[32] The motion judge concluded that the lack of disclosure of the Spin Dessert litigation failed to come close to the type of deficiency that amounts, in law, to no disclosure at all and the franchisees were not, therefore, entitled to rescission under s. 6(2) of the Act.

## The Tip Out Policy

[33] In August of 2012, the franchisor announced a new policy that prohibited franchisees from keeping a portion of their employees' gratuities. This policy was in response to proposed legislation that would prohibit employers from taking a share of tips.

[34] The motion judge held that the franchisor's policy of prohibiting franchisees from collecting a portion of their employees' tips did not constitute a "material fact". He found that the policy was not contemplated by the franchisor until June of 2012 and was not implemented until 14 months after the disclosure document was delivered. Its omission could not, therefore, constitute a material fact that should have been disclosed. The motion judge also noted that, "[a]s a practical matter", the change in policy had no impact on the profitability of the Dufferin Street location, as the franchisees refused to enforce the policy.

## The Ice Cream Manufacturing Policy

[35] The franchisor, as a result of a concern about the consistency of the ice cream made at the various franchise locations, announced a policy change on February 1, 2013, requiring that franchisee owner principals assume sole responsibility for ice cream production at their own restaurants.

[36] The franchisees considered the policy to be unreasonable and refused to implement it.

[37] Similar to his reaction to the Tip Out Policy, the motion judge held that the Ice Cream Manufacturing Policy could not be a deficiency in disclosure in the light of the 20-month period between the delivery of the disclosure document and the implementation of the policy. He again noted that the policy had no financial impact on the franchisees because they refused to implement it.

## The Remodelling and Renovations

[38] The motion judge noted that the Remodelling and Renovations sought by the franchisor did not arise until 14 months after delivery of the disclosure document. Again, this issue, as with the Tip Out Policy and the Ice Cream Manufacturing Policy, could not be said to be a material fact that should have been in the disclosure document. Further, the fact that repairs or renovations may have been needed in June 2011 did not constitute a "material fact" because it could not have had a significant effect on the price to be paid for the franchise. The motion judge reasoned that because the vendor of the premises had an obligation under the agreement of purchase and sale to do renovations as required by the franchisor, any required repairs or renovations were cost-neutral to the franchisees.

## Motion Judge's Conclusion

[39] Based on his analysis of the franchisees' four complaints about disclosure, the motion judge concluded that the franchisees had no right to rescind the franchise agreement under s. 6(2) of the Act and dismissed the claim for rescission.

### ISSUES

[40] On appeal, the franchisees submit that:

(1)the motion judge erred in concluding that the claim for rescission advanced in the counterclaim could be determined by way of summary judgment; and

(2)the motion judge misapprehended the evidence and otherwise erred in finding that the failure to disclose the existence of the Spin Dessert litigation did not give rise to rescission rights under s. 6(2) of the Act.

**ANALYSIS**

## 1. Did the motion judge err in concluding that the claim for rescission advanced in the counterclaim could be determined by way of summary judgment?

[41] The franchisees submit that it was not in the interests of justice to determine the rescission claim on summary judgment as other matters between the parties arising out of the franchise investment, including a claim for damages for misrepresentation under s. 7 of the Act, are proceeding to trial in any event. While the motion judge determined that the s. 6 rescission issue turned on undisputed facts, his findings that three of the four alleged disclosure deficiencies are not "material facts" essentially forecloses the s. 7 claim with respect to those deficiencies or creates a risk of inconsistent findings.

[42] I do not agree.

[43] I start with the franchisees' argument that their s. 7 claim will be affected by the results of the partial summary judgment.

[44] Section 7 of the Act gives a franchisee a statutory claim for damages where a franchisee suffers a loss because of a misrepresentation contained in a disclosure document. The franchisees' counterclaim does not appear to advance such a claim. The pleadings make no reference to s. 7 of the Act. And the pleadings contains but one reference to damages for misrepresentation – a bald reference in the prayer for relief.

[45] This pleadings deficiency notwithstanding, I agree with the motion judge's conclusion, at para. 48, that "there is no risk of inconsistent findings of fact" as the facts are essentially undisputed. Further, on appeal, the franchisees do not challenge the motion judge's findings with respect to the three alleged deficiencies. And the motion judge found the Spin Dessert litigation to be a material fact, leaving the franchisees free to pursue a claim for misrepresentation on the basis of this omission.

[46] I also agree with the motion judge that using the summary judgment mechanism to deal with the discrete matter of the franchisees' right to rescission was an expeditious and effective approach to resolving an important issue. The motion judge was mindful of the "shift in culture" (see para. 43 of his reasons) mandated by the Supreme Court's decision in *Hryniak* and was motivated to benefit the parties by narrowing their dispute and increasing the odds of settlement. As the Supreme Court noted in *Hryniak*, at para. 60, "the resolution of an important claim against a key party could significantly advance access to justice, and be the most proportionate, timely and cost effective approach."

[47] I see no reason to interfere with the motion judge's discretionary decision to determine the discrete issue of rescission by way of summary judgment. I would therefore not give effect to this ground of appeal. See *2240802 Ontario Inc. v. Springdale Pizza Depot Ltd.*, 2015 ONCA 236, at para. 35.

## 2. Did the motion judge misapprehend the evidence and otherwise err in finding that the failure to disclose the existence of the Spin Dessert

## litigation did not give rise to rescission rights under s. 6(2) of the Act?

[48] The focus of this appeal is on the motion judge's view that while the franchisor's failure to identify the Spin Dessert litigation in the disclosure document was a deficiency, it was not an egregious one, leading him to conclude that the franchisees were not entitled to rescission under s. 6(2) of the Act.

[49] The franchisees submit that it was unreasonable for the motion judge to infer that the Spin Dessert litigation had no impact on their decision to purchase the franchise or on the price they agreed to pay for the Dufferin Street franchise outlet. They argue that it was clear that Spin Dessert was a significant potential threat to the Caffé Demetre franchise system.

[50] The franchisees also submit that the motion judge further erred by finding that the franchisees' failure to complain about the litigation is relevant to whether the existence of the litigation could reasonably be expected to have affected their purchase decision.

[51] Again, I do not agree.

[52] The battle lines over the failure to disclose the Spin Dessert litigation were drawn around two questions. First, is the Spin Dessert litigation a material fact that had to be disclosed? Second, if the Spin Dessert litigation is a material fact, was the failure to disclose it a disclosure defect so egregious as to amount to no disclosure at all under s. 6(2) of the Act?

[53] I start with whether the franchisors were required to disclose the Spin Dessert litigation. Since there is nothing in the Act or in the regulations that expressly specify that this type of information must be contained in the disclosure document, the question is whether the Spin Dessert litigation falls within the definition of a "material fact" in the sense of being "information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise", as contemplated by s. 1(1) of the Act.

[54] While I say that neither the Act nor the regulations require reference to this type of litigation to be included in the disclosure document, I do note that s. 2(5) of O. Reg. 581/00 identifies a category of litigation that must be disclosed. Understandably, what must be disclosed is litigation *against* the franchisor or those associated with the franchisor based on claims of unfair or deceptive business practices, or violating a law that regulates franchises or businesses. I am not suggesting that s. 2 of the regulations should be interpreted as indicating that only the type of legal proceeding that falls within this description qualifies as a material fact that must be disclosed pursuant to s. 5 of the Act. However, in my view, the type of litigation that must be disclosed pursuant to s. 2(5) does inform the fact-specific analysis of whether the litigation in issue is material.

[55] The motion judge's reasoning and ultimate conclusion that, while the Spin Dessert litigation was a material fact, the failure to disclose it did not grant the franchisees a right to rescission under s. 6(2) of the Act, appear in paras. 41 and 42 of his decision, where he wrote:

> [41] To recap the above analysis, I conclude that of the four "material facts" that the defendants allege should have been disclosed, three of them can be dismissed for the reasons given. The only one that meets the definition of a material fact is the existence of the Spin Desserts litigation. I accept that if a franchisor is involved in ongoing litigation, this should be disclosed to prospective franchisees: see *2240802 Ontario Inc. v. Springdale Pizza*, 2013 ONSC 7288 (S.C.J.) at para. 48. To that extent, the disclosure document was deficient. However, as was made clear in *Imvescor*, above, a content deficiency only gives rise to rescission under s. 6(1). It is only where there are stark and material deficiencies in the disclosure document that a court may conclude that it amounts to no disclosure at all. The sweeping remedy of rescission is restricted to "instances of a complete failure to provide a disclosure document".
>
> [42] As already noted, the Spin Desserts lawsuit was a protective measure taken by the franchisor, at the request of and for the benefit of the franchisees. It did not constitute a potential liability that might attach to the franchise system as a whole. Given the distance between the competing outlet and the subject premises, there is no basis for inferring that it could have had any economic impact on the [franchisees'] operation, nor is there any

> evidence that it did so. The [franchisees] were aware of this litigation by September of 2011, but did not raise it as a concern until their Statement of Defence and Counterclaim was filed on September 24, 2013. If it had been a material fact that could reasonably be expected to have a significant impact on the price the defendants paid for the franchise, one would have expected them to have complained when, or shortly after, they found out about it.

[56] As the above passages demonstrate, notwithstanding his observations about the nature of the litigation at para. 42, the motion judge relied on the Superior Court's decision in *2240802 Ontario Inc. v. Springdale Pizza,* 2013 ONSC 7288 (CanLII), for the proposition that if a franchisor is involved in ongoing litigation, this should be disclosed to prospective franchisees. In other words, the motion judge held that any litigation involving a franchisor amounts to a material fact – no matter what the nature and circumstances of the litigation might be. Since the Spin Desserts litigation was not disclosed, the disclosure document was deficient.

[57] With respect, in my view the Superior Court's *Springdale* decision does not stand for the proposition identified by the motion judge. The litigation at issue in *Springdale* fell precisely within the type of litigation described in s. 2(5) of O. Reg. 581/00.

[58] The Spin Dessert litigation does not come within this category.

[59] Ongoing or prospective litigation involving the franchisor is not, by definition, a material fact. Of course, the litigation must be disclosed if it falls within the description contained in s. 2(5) of the regulations. But if the litigation in issue does not fall within that description, then whether it is a material fact, as contemplated by the Act, will be a question of fact determined on a case-by-case basis. Because the analysis is highly fact-specific, no bright-line rule can be articulated.

[60] In the light of the motion judge's unassailable observations about the Spin Dessert litigation, excerpted above – that it was a protective measure taken by the franchisor at the request of and for the benefit of the franchisees, did not constitute a potential liability that might attach to the franchise system and would not financially impact the Dufferin Street Caffé Demetre outlet - I am of the view that the lawsuit was not a material fact.

[61] It follows that the disclosure document was not deficient by reason of the franchisor's failure to reference the litigation.

[62] It goes without saying that even if the failure to mention the Spin Dessert litigation amounted to a disclosure deficiency, I am also of the view that it was not sufficiently significant that the franchisees were entitled to rescission beyond the 60-day period provided for in s. 6(1).

[63] On this record, I do not see how failing to mention the Spin Dessert litigation – litigation commenced against a competing business for the purpose of protecting the interests of the franchisees – effectively deprived the franchisees of the opportunity to make a properly informed decision to invest in the Caffé Demetre franchise: see *Dollar It*, at para. 35. I agree with the motion judge that the omission of the Spin Dessert litigation from the franchisor's disclosure document falls well short of putting the document into the category of no disclosure at all as contemplated by s. 6(2) of the Act.

**DISPOSITION**

[64] For these reasons, I would dismiss the appeal. In accordance with the parties' agreement, I would award the respondents their costs fixed in the amount of $8,500, including disbursements and applicable taxes.

Released: April 15, 2015 (DD)

"Gloria Epstein J.A."

"I agree David Doherty J.A."

"I agree M. Tulloch J.A."