

Breach of the franchise agreement: No automatic compensation for the franchisor

APR 19, 2018 4 MIN READ

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In *Caux & Fils inc. c. 9215-4012 Québec inc. (Scellants Elastek)*, 2017 QCCS 4948, the Québec Superior Court confirmed that a franchisor is not liable for a franchisee's failure to be profitable. On the other hand, when a franchisee is in breach of the franchise agreement and ceases to operate, a franchisor cannot claim lost profits without adequate evidence.

Background

Caux & Fils Inc. (the Franchisee) was a family business in search of a new business opportunity. Les Scellants Elastek (the Franchisor) operated a network of franchises, notably, for selling and installing asphalt sealant in the residential sector.

In November 2013, the parties entered into a franchise agreement. The Franchisor granted the Franchisee an exclusive right to operate in a given territory, for a price of \$57,500. The price included a franchise and training fees, equipment and pro forma financials prepared by a company related to the Franchisor (Gestion). The agreement contained an "entire agreement" clause and language that made it clear that there was no guarantee of success. The Franchisee expressly recognized the risks involved in the venture.

Unfortunately, the Franchisee remained in business for only a few weeks, and eventually ceased to operate due to the franchise's unprofitability. The Franchisee brought an action against the Franchisor and Gestion alleging misrepresentations in respect of the economic potential of the franchise. It sought the annulment of the agreement for fraud and its rescission for breach. The Franchisee claimed the restitution of the amounts paid as well as damages for hardship. The Franchisor counterclaimed for lost profits and unpaid franchise fees and royalties.

Reasons and conclusions

The Court dismissed both the Franchisee's action and the Franchisor's counterclaim. First, after analyzing the circumstances leading to the signature of the agreement, the Court concluded that there was insufficient evidence of fraud. The Franchisee failed to meet the high burden required to prove fraudulent misrepresentations.

The Court noted that the Franchisee had ample time to analyze the information provided by the Franchisor, and that it was aware that the business' profitability was directly connected to the Franchisee's ability to make sales. Furthermore, the pro forma financials prepared by Gestion were only given to the Franchisee after the signature of the agreement, such that they were irrelevant to the Franchisee's claim. The Court also found that the Franchisor acted

in good faith. Meanwhile, the Franchisee made little effort to verify the information made available to it, failing to ask any questions or consult with professionals.

Second, the Franchisee could not establish any actual breach of the franchise agreement. The Franchisee's failed venture was mainly due to the weather conditions, which greatly affected the Franchisee's ability to sell and install sealant, and the children's decision to leave the family business.

As to the Franchisor's counterclaim, the Court concluded that the Franchisee breached its obligations by ceasing its operations after only a few weeks and failing to pay the required fees. The Franchisor was therefore entitled to rescind the franchise agreement.

However, there was no evidence to support the Franchisor's claim for lost profits. This, combined with its failure to mitigate its damages, meant that the Franchisor could not be compensated. The Franchisor attempted to claim what it qualified as minimal franchise fees and royalties. However, the franchise agreement expressly provided for a way to sanction the Franchisee's breach in such cases, that is, suspension of the Franchisee's rights. Therefore, the Franchisor was not entitled to compensation for the minimal franchise fees and royalties.

Commentary

This case is an illustration of a common type of litigation in the franchise world. A franchisee who fails to make a franchise profitable is often tempted to blame the franchisor and use litigation to recoup its lost investment. Here, the Court once more reminds franchisees that they have an obligation to seek the information they need to make an informed decision to enter into a franchise agreement. Absent clear evidence of fraud, it will be very hard for a franchisee who asked no questions and sought no professional advice prior to signing the franchise agreement to obtain any form of remedy.

Finally, franchisors must be careful when drafting or negotiating a franchise agreement. There is no reason to provide for a specific remedy in case of unpaid fees or royalties (i.e., the suspension of the franchisee's rights) without reserving all its other rights and recourses. A franchisor may want to include clear language making the franchisee liable for all amounts payable under the agreement, while reserving all its other rights and recourses. The franchisor may also want to include a clause that sets out an objectively measurable and reasonable liquidated damages clause. Such a clause can be an effective way for a franchisor to obtain compensation and to avoid having to prove damages before the court.