

Estimating franchise start-up costs: A shared responsibility

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Prospective franchisees have an interest in knowing the extent of the investment required to start a franchise – but who is responsible for such an estimate? A recent judgment of the Superior Court of Québec confirms that this responsibility rests with both the franchisor and the franchisee. In *9266-0257 Québec inc. v. Wrapcity Gourmet Restaurants inc.*, 2017 QCCS 746, the Court reiterated that the franchisor, on the one hand, has an obligation to inform a prospective franchisee of start-up costs and the franchisee, on the other hand, has a duty to inquire as to such costs.

The facts

Wrapcity Gourmet Restaurants inc. is the franchisor of the Wrapcity chain of restaurants (the Franchisor). The franchisee, 9266-0257 Québec inc., is a company formed by Mr. Paul Brisebois and his two children for the purpose of operating a Wrapcity franchise (collectively the Franchisee).

In 2012, the Franchisee was offered the acquisition of a Wrapcity franchise in a well situated location. Another restaurant had been operating there until recently. Discussions took place between the parties regarding, in particular, the cost of starting the franchise. In addition, the Franchisee was given a brochure containing information in that regard. A franchise agreement was eventually signed.

In 2013, the Franchisee ceased operations due to a lack of financial resources. It sued the Franchisor and its shareholders, and then the third party that had introduced them. The Franchisee claimed that it had received false representations that it would cost no more than \$100,000 to acquire and start operating the franchise. Instead, it cost a total of \$273,000. The Franchisee pled that these false representations vitiated its consent. It claimed nullity of the franchise agreement and damages, including repayment of the investments made to start the franchise.

Reasons and conclusions

The Court analyzed the situation through two lenses: simple error, under article 1400 of the *Civil Code of Québec*, and error caused by fraud, under article 1401.

With regard to simple error, two questions arose. First, did the Franchisee commit an error that could vitiate its consent? Second, if so, would such error be inexcusable?

The Court rejected the defendants' argument that the brochure given to the Franchisee would defeat the Franchisee's claim. It is true that the leaflet mentions an estimated investment of \$240,000 for leasehold improvements and equipment, which exceeds the

\$194,000 invested by the Franchisee for these two elements. However, the leaflet was only relevant for the construction of a new restaurant, whereas in this case the aim was to adapt the facilities of an existing restaurant. On the other hand, the evidence shows that discussions between the parties alluded to an investment of between \$65,000 and \$150,000 for the start-up of the franchise, which is well below what the Franchisee ultimately paid. Because this error induced the Franchisee's consent, the Court found there to be simple error.

To vitiate consent, this error must not be inexcusable. In this regard, the Court takes into account the good faith obligations of both parties, that is, the Franchisor's duty to provide information and the Franchisee's obligation to obtain adequate information. It concluded that in the case at bar, there was no inexcusable error. Indeed, the Court recognized at the outset that the behaviour of the Franchisee is "at the limit of the acceptable." Before signing the contract, the Franchisee asked few questions, did not ask to see the Franchisor's figures, did not require a list of equipment or a list of leasehold improvements, and did not ask for plans or specifications for the construction of the franchise. However, this negligence of the Franchisee does not rise to the level of inexcusable error. Further, the Court held that answers to some of the questions that should have been asked were not available. Thus, the Franchisee could not have obtained certain information even if it had tried.

As to error caused by fraud, the Court concluded in the absence of false representations. Confronted with contradictory accounts, the Court was unable to conclude that the Franchisor represented or guaranteed that starting up would cost no more than \$100,000. Moreover, though the Franchisor's estimate lacked a certain expertise, this did not go so far as to constitute false representations. The Franchisor did not know, when signing the franchise agreement, that the Franchisee would be unable to limit its investments to those that the Franchisee had predicted. A competent Franchisor might have foreseen this, but such considerations do not determine whether there was fraud on the part of the Franchisor. In other words, the Franchisor may have been negligent with regard to its duty to inform the Franchisee, but this is not sufficient to prove fraud.

Moreover, the Court held that the Franchisee had been negligent. It follows that the source of the error is the negligence of both parties and not only that of the Franchisor: both parties failed to appropriately analyze the costs associated with starting the franchise. Under these circumstances, there was no error caused by fraud.

Given its finding of simple error, the Court declared the franchise agreement to be null and void. To restore the parties, it ordered the Franchisor to reimburse half of the franchise fees. Indeed, the Court was of the opinion that the full reimbursement of expenses would constitute an unjust enrichment on the part of the Franchisee because the Franchisor had fulfilled several of its obligations (e.g., assistance in starting the franchise, training, and providing manuals relating to the operation of the franchise). In the absence of fraud, however, the Franchisee cannot obtain the damages sought.

Commentary

This case confirms, both in the analysis of inexcusable error and in the analysis of error caused by fraud, the importance of not just taking into account the franchisor's duty to provide information. The extent to which the franchisee fulfills its obligation to obtain adequate information is also relevant to these two analyses.

That being said, it would be imprudent for a franchisor to rely solely on the franchisee's obligation. The franchisor must always act in good faith and reasonably by providing the franchisee with relevant information about the proposed franchise to avoid having to pay

damages for misrepresentation, and to avoid the risk of an action for the nullity of the franchise agreement.