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Ontario court affirms franchisee's obligation to pay percentage rent

MARCH 30, 2017 4 MIN READ

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In *Mr. Lube Canada Limited Partnership v. 2070778 Ontario Limited*, 2016 ONSC 7707, the Ontario Superior Court of Justice affirmed that percentage rent does not constitute a franchise fee.

Background

In 2005, 2070778 Ontario Limited (the Franchisee) entered into a franchise agreement with Mr. Lube Canada Limited Partnership (Mr. Lube) for the operation of an automotive maintenance franchise business in Oakville, Ontario. Mr. Lube subleased the Oakville premises to the Franchisee. The parties signed a number of agreements, including a franchise agreement, a sublease agreement and a purchase agreement. Pursuant to the purchase agreement, Mr. Lube was not permitted to charge "any additional franchise licence fee on account of a renewal" for a period of 20 years.

In 2014, the franchise and sublease agreements were up for renewal. Mr. Lube provided the Franchisee with an updated disclosure package, which included new franchise and sublease agreements.

The parties executed the new franchise and sublease agreements in September 2014. The Franchisee was required to pay 2% of its gross sales at the franchise location (the 2% Rent), in addition to its existing rent. The 2% Rent was referred to in the sublease, the franchise disclosure document and in exhibits to the disclosure document. After executing the sublease and franchise agreements, the Franchisee refused to pay the 2% Rent, alleging that it was a franchise fee and was therefore prohibited by the purchase agreement.

The Franchisee applied for a declaration that it was not required to pay the 2% Rent, arguing that it constituted a franchisee fee in disguise and, therefore, was prohibited under the capital asset purchase agreement**.** Additionally, the Franchisee argued that Mr. Lube was in breach of its disclosure obligations pursuant to the *Arthur Wishart Act (Franchise Disclosure), 2000* (the *Wishart Act*), as it did not disclose or draw the Franchisee's attention to the 2% Rent before the execution of the franchise agreement or the sublease.

Mr. Lube brought a counter-application to require the Franchisee and its guarantors to pay the 2% Rent, arguing that its right to charge the 2% Rent was clearly set out in the executed sublease, and that it was not a franchise fee within the meaning of the purchase agreement.

Decision of the Ontario Superior Court of Justice

Dismissing the Franchisee's application, the Ontario Superior Court of Justice held that Mr. Lube was entitled to charge the 2% Rent.

The Court held that the 2% Rent was not a franchise fee and was therefore not prohibited by the purchase agreement. The disclosure document clearly distinguished between a franchise fee and the 2% Rent. Furthermore, the Franchisee clearly understood what a franchise fee was based on past dealings between the parties. The Court relied on the reasoning in *TA & K Enterprises Inc. v. Suncor Energy Products Inc*., 2011 ONCA 613, in which the Ontario Court of Appeal noted that "a franchise fee is in the nature of a fee paid for the right to become a franchisee. It does not include royalties or payments for goods and services." The Court therefore concluded that an ongoing payment in the nature of percentage rent was not a franchise fee.

The Court also held that Mr. Lube had not breached section 5 of the *Wishart Act*, as it had clearly disclosed the existence of the 2% Rent. The Court found that the Franchisee signed the documents without reading them or at least the relevant passages which clearly disclosed the 2% Rent ruling that if one fails to read an agreement, one is bound nevertheless.

Finally, the Court also took issue with the relief sought by the Franchisee, reaffirming that where a franchisor breaches section 5 of the *Wishart Act*, a franchisee's available remedies are limited to either rescission or damages. Non-payment of the 2% Rent was not an acceptable remedy. The Court refused to grant the declaration sought by the Franchisee.

Takeaway

Franchisors can take comfort in this decision as it affirms existing jurisprudence that what constitutes a franchisee fee should be limited to fees paid for the right to become a franchisee. Furthermore, it reaffirms that the remedies flowing from a breach of section 5 of the *Wishart Act* are limited to rescission and damages.