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The importance of signing a proper franchise agreement

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Enthusiasm sometimes leads a franchisor and franchisee to postpone the most basic contractual formalities. The case of *Duchesneau c. Gestion Milsa inc.*, 2017 QCCS 1593 serves as a reminder of the importance of signing a franchise agreement before starting the process of opening a new franchise.

The facts

Mr. Louis Duchesneau and his company 9000-6560 Québec inc. (the Franchisee), was interested in acquiring a franchise of Le Milsa, a Brazilian-style rotisserie restaurant. The franchise system is operated by Mr. Samir Tadros, in collaboration with his wife Mrs. Milsa Farias, through various companies, including Gestion Milsa inc. (the Franchisor).

The parties first signed a mutual confidentiality agreement. Through this agreement, the parties undertook to negotiate, in good faith, a franchise agreement containing the "[translation] usual clauses" for this type of contract. Draft franchise contracts were then exchanged, but the parties could not agree. Instead, they signed an agreement in principle, according to which the Franchisee agreed to acquire a franchise for a given price.

As negotiations continued, the parties prepared for the opening of the franchise. The Franchisee payed a portion of the sale price and rented a location. He completed the necessary renovations and bought the necessary equipment. However, the parties still could not agree, in particular on the payment of royalties and the contribution to the ad fund. Meanwhile, the Franchisee was faced with the Franchisor's failure to provide him with the necessary support and documentation to operate the restaurant. And yet, the Franchisee invested hundreds of thousands of dollars so that the restaurant could open.

As the restaurant opened, the disagreements grew and there was still no signed franchise agreement. On the one hand, the Franchisee implemented certain initiatives relating to the menu and the restaurant's opening hours, among other things. The Franchisor did not approve of these initiatives because he wanted to ensure a certain uniformity across his network. On the other hand, the Franchisor left the Franchisee out of his advertisements. The relationship between the two continued to deteriorate until the restaurant closed.

This misadventure led the Franchisee to sue the Franchisor. He accused the Franchisor of numerous breaches and misrepresentations and sought the annulment of the agreement in principle as well as damages.

Analysis

Beyond the agreement in principle, the Court concluded that there was a true franchise agreement, which contained, at least implicitly, all the elements generally contained in such a contract. Such a conclusion was justified, according to the Court, by the evidence of the negotiations between the parties and their conduct leading to the opening and operation of the restaurant.

Relying on the judgment of the Court of Appeal in *Dunkin' Brands Canada Ltd. c. Bertico inc.*, 2015 QCCA 624, the Superior Court held that a franchise agreement, which presupposes a long-term business relationship, imposes a duty of collaboration. Here, the Franchisor had failed to co-operate with the Franchisee. This lack of collaboration resulted in the difficult and unsuccessful negotiation of the franchise agreement, the unfair treatment of the Franchisee in the Franchisor's advertisements, and the inadequate support and supervision given to the Franchisee.

According to the Court, these circumstances gave the Franchisee the right to damages in the amount of $34,959 for the losses and various inconveniences he suffered. The Franchisee was also entitled to an amount that had been paid as royalties on the gross income of the franchise, which were held in trust awaiting the judgment on the merits.

Commentary

Although the Court of Appeal will soon pronounce on the judgment at first instance, one thing is clear: failure to sign a franchise agreement entails significant risks for the franchisor and the franchisee.

Franchise agreements are often long and detailed. This detail provides the parties with an adequate determination of their respective obligations, which will govern their business relationship for years to come. The contract thus eliminates uncertainty and prevents conflicts. Indeed, it is more difficult to require a franchisee to adhere to the operating standards of the franchise system if such standards are not described in a franchise agreement. Such standards can include, for example, hours of operation and payment methods that a franchisor may want to ensure are uniform across the network.

That being said, the franchise agreement is not a guarantee against conflicts. At the very least, the precision of the franchise agreement will facilitate the resolution of any eventual dispute, while limiting the interpretative freedom of the courts.

In short, signing a proper franchise agreement can help to avoid many unpleasant surprises.