CITATION: Burnett v.Cuts, 2012 ONSC3358
COURT FILE NO.: CV-05-301869-0000
DATE: 20120606

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: Burnett Management Inc. et al – Plaintiffs

AND:

Cuts Fitness for Men et al – Defendants

BEFORE: Justice Kevin Whitaker

COUNSEL: *Jeffrey P. Hoffman* for the Plaintiffs

No one appearing for the Defendants

HEARD: June 4, 2012

AMENDED JUDGMENT

What This Case is About

[1] This is an action for rescission of a master franchise agreement, under the provisions of the *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 (the "Act").

[2] A counterclaim served by the defendants on March 6, 2006 was vigorously prosecuted from the outset. The counterclaim was abandoned two weeks before trial.

[3] With the consent of the corporate defendants, their counsel was removed as counsel of record at the commencement of trial.

[4] By correspondence to the plaintiff's counsel, the personal defendant John Gennaro indicated that he would not participate in the trial.

The trial proceeded in the absence of the defendants. Mr. John Burnett, one of two personal plaintiffs, testified on behalf of the plaintiffs.

Remedies Sought

[5] In addition to compensation that was to be paid following the delivery of a notice of rescission under the Act, the plaintiffs seek damages under s. 7 of the Act for the failure, on the part of the defendant franchisor, to comply with its disclosure obligations as well as damages for breach of the duty of fair dealing. The plaintiffs seek related declaratory relief.

[6] For reasons which follow, the plaintiffs' claims are allowed.

The Facts

[7] Burnett Management Inc. (the "Franchisee") was the master franchisee of Cuts Fitness for Men (Canada) Inc. (the "Franchisor") in the provinces of Ontario, New Brunswick, Newfoundland, Nova Scotia and Prince Edward Island under (a) a Letter of Intent for Master

Franchise, dated November 17, 2004 (the "LOI") and (b) an Ontario Master Development Agent Agreement made on June 1, 2005 (the "Agreement"). The Franchisor was incorporated under the laws of the Province of British Columbia in August, 2004, shortly before the dealings between the parties began.

[8] John Burnett was the president of the Franchisee. He was responsible for negotiating the LOI and Agreement on behalf of the Franchisee and for the day-to-day operations of the franchised business. Mr. Burnett's wife, Lenora Burnett, was not involved in the negotiations that led to the agreements or in the day-to-day operation of the franchised business. Both Mr. and Mrs. Burnett executed the Agreement personally and agreed "to be individually bound by all of its terms and conditions". The Franchisee, Mr. Burnett and Mrs. Burnett were all franchisees for purposes of the Act.

[9] The defendant, Cuts Fitness for Men, LLC, is a company incorporated under the laws of the State of New Jersey. It was the franchisor of the Cuts Fitness for Men franchise system in the United States ("the "US Franchisor").

[10] During negotiations that led to the execution of the LOI and Agreement, Cuts LLC, delivered to Mr. Burnett a Uniform Franchise Offering Circular ("UFOC") for his review. The UFOC was provided to Mr. Burnett for informational purposes only. It was not intended to be disclosure of the master franchise opportunity in Canada and could not have been as it was not provided by the Franchisor.

[11] Cuts Fitness (Canada) Inc. is a company incorporated under the laws of the State of New Jersey. It is the parent of the Franchisor.

[12] John Gennaro is the sole, officer, director and shareholder of the Franchisor and of its parent, Cuts Fitness (Canada) Inc. He also held an 80% interest in the US Franchisor.

[13] John Burnett travelled to a franchise show in Los Angeles in October, 2004. He wished to purchase a franchise.

[14] At the show, Mr. Burnett met Steven Haase and John Genarro of Cuts. Most of his dealings were with Mr. Haase both at the show and after. Mr. Haase told him that there was an opportunity to purchase the master franchise rights for all or part of Canada. He told Mr. Burnett that Cuts had just completed the preparation of its franchise agreements for use in Canada.

[15] Mr. Burnett returned home and decided to pursue the opportunity. He was initially looking at a master licence for Ontario, but this was later expanded to include other provinces. Mr. Haase sent Mr. Burnett the UFOC and told him that a version for use in Canada would be provided to him.

[16] On October 28, 2012, Mr. Haase sent Mr. Burnett a draft disclosure document for prospective franchisees dated August, 2004 and copies of various draft agreements, including a draft franchise agreement and a license agreement between "the US franchisor, (i.e., Cuts Fitness for Men, LLC) and the Canadian affiliated franchisor (i.e., Cuts Fitness for Men (Canada) Inc."

[17] On November 8, 2004, Mr. Haase sent Mr. Burnett a draft Letter of Intent ("LOI"). The draft LOI had not been included in the draft disclosure document sent to Mr. Burnett on October 28, 2012.

[18] The LOI was entered into by the Franchisor and Franchisee on November 17, 2004. The LOI set out the principal terms under which the Franchisor granted master franchise rights to the

Franchisee for the Province of Ontario. It required the immediate payment of $20,000 USD and the payment of a further $80,000 USD "upon signing [the] master agreement".

[19] John and Lenora Burnett paid the $20,000 USD fee on November 17, 2004. They paid a further $80,000 USD fee on December 3, 2004. Both payments were made to the US Franchisor as directed by Mr. Haase. Mr. Burnett, purchased the $20,000 USD at an exchange rate of approximately 1.19 (or $23,848 CAD) and the $80,000 USD at an exchange rate of 1.177 ($94,150 CAD).

[20] Mr. Gennaro considered the LOI to be binding upon signing. The Franchisee began to sell unit franchises in Canada while the parties continued to negotiate a master franchise agreement.

[21] When unit franchises were sold, Mr. Burnett was directed by Mr. Haase to make cheques for franchise fees payable to the US Franchisor. The defendant corporations carried on business as one franchisor enterprise, under the control and direction of Mr. Gennaro. They did not distinguish between their American and Canadian operations. For example, the Burnetts paid the master franchise fees to the US Franchisor and paid franchise fees for the Canadian-based unit franchises to the US Franchisor instead of to the Canadian Franchisor, Cuts Fitness for Men (Canada) Inc. Similarly, when the plaintiffs received fees for the sale of unit franchises, they were paid by the US Franchisor.

[22] In April, 2005, Mr. Burnett submitted a list of unit franchise sales in Canada to Mr. Haase and sought payment of his fees. Both parties had been operating as if there was an agreement in place. Yet Mr. Haase, in response, informed Mr. Burnett that Cuts "can't distribute any funds until we received the signed Master Agreement."

[23] As of April, 2005, Mr. Burnett had yet to receive a franchise disclosure document or a final draft of the master franchise agreement. He wrote to Mr. Haase on April 7, 2007 asking to complete the paperwork in order to get paid.

[24] Mr. Haase responded the same day promising to provide the disclosure document to Mr. Burnett the following morning.

[25] It was not until May, 2005 that Mr. Burnett received a document that purported to be a disclosure document.

[26] The purported disclosure document was delivered after the payment of master franchise fees and not at least 14 days before payment. The document;

(a) was delivered after the execution of the LOI and not at least 14 days before it was entered into;

(b) was not delivered "as one document at one time It was delivered in piecemeal fashion, with draft agreements delivered separately;

(c) did not have any financial statements (or an opening balance sheet) including "as prescribed".

(d) did not include copies of "all proposed franchise agreements and other agreements relating to the franchise to be signed by the plaintiffs";

(e) did not include a copy of the Agreement subsequently entered into by the parties, which included a guarantee to be signed by both John Burnett and Lenora Burnett, a confidentiality and non-competition agreement and an assignment of telephone numbers agreement.;

(f) was not certified (signed or dated by Mr. Gennaro, the sole officer and director of the Franchisor);

(g) was sent by e-mail (not by a method permitted by the Act);

(h) did not contain an accurate list of the franchisees that were terminated, cancelled or not renewed or who otherwise left the franchise system within the last fiscal year immediately preceding the date of the disclosure document; and

(i) did not contain a list of the franchises that had closed in the previous three years or set out the reasons for the closure.

[27] Lenora Burnett did not receive a disclosure document.

[28] On June 1, 2005 the plaintiffs signed the Agreement.

[29] As soon as the Agreement was signed, Cuts stopped communicating with Mr. Burnett. Mr. Burnett's requests for information and assistance were ignored. He later learned that the defendants were focussing on the development of another brand Cuts Fitness for Women and were busy dealing with the fallout of the rapid decline of the Cuts Fitness for Men franchise system in the US.

[30] By notice dated July 6, 2005, the plaintiffs rescinded the Agreement.

[31] On August 24, 2005, lawyers for the plaintiffs wrote to lawyers for the Franchisor seeking the return of the franchise fee and payment of a further $64,000 in operating losses. The Franchisor refused to pay.

[32] This action was commenced.

The Law

[33] It is well established that the Act is remedial legislation and as such has and will continue to be given "such fair, large and liberal interpretation as best ensures the attainment of its objects".[1]

[34] The Court of Appeal has made a number of statements regarding the objects of the Act, including the following:

> Section 6 ... provides certain rights of rescission in the event of inadequate disclosure... s. 7 provides the right to an action for damages in the event, inter

[1] *Legislation Act, 2006*, S.O. 2006, c. 21, Sch. F, s. 64 *Salah* v. *Timothy's Coffees of the World Inc.*, [2010] O.J. No. 4336 (C.A.) at para. 26 , *2130489 Ontario Inc. v. Philthy McNasty's (Enterprises) Inc.*[2012] O.J. No.381 (C.A)

> alia, of the failure to meet the requirements of the s. 5 disclosure provision. It is evident then that the thrust of the Act is to set standards for adequate disclosure and to create significant penalties for failing to meet those standards.[2]
>
> One of the prime purposes of the Act is to obligate a franchisor to make full and accurate disclosure to a potential franchisee so that the latter can make a properly informed decision about whether or not to invest in a franchise.[3]
>
> The [Act] was passed by the legislature of Ontario in 2000 to level the legal playing field between franchisees and franchisors by protecting franchisees when they enter into franchise agreements. The Act provides a drastic remedy against franchisors who do not provide prior disclosure, in the required disclosure document, of all the relevant information that franchisees may need before deciding whether to enter into a franchise arrangement and to sign the franchise agreement.
>
> The remedy is that the franchisee may rescind the franchise agreement and obtain the return of all monies paid, equipment purchased etc., as well as damages.[4]
>
> The purpose of the legislation is to protect franchisees and the mechanism for so doing is the imposition of rigorous disclosure requirements and strict penalties for non-compliance. The legislation must be considered and interpreted in light of this purpose.[5]

[35] In the Sears class action, Mr. Justice Strathy wrote:

> The [Act] is remedial legislation that was designed to address the inequality in bargaining power between franchisors and franchisees. It obliges a franchisor to make comprehensive pre-contract disclosure and it gives the franchisee powerful remedies if the franchisor breaches its obligations.[6]

[36] There can be rescission on the basis of a failure to disclose. In *1490664 Ontario Ltd.* v. *Dig This Garden Retailers Ltd.*[7], the franchisee did not receive a disclosure document delivered at one time as one document, but rather in piecemeal fashion. The court noted that "While some of the required information can be found in the documents that the applicant received before she signed the franchise agreement, there is no one document that you can look at where all of the required information is located."[8]

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[2] *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*, [2005] O.J. No. 3040 (C.A.) at para. 12
[3] *Ibid.*,, at para. 16
[4] *MDG Kingston Inc. v. MDG Computers Canada Inc.* [2008] 92 O.R. (3d) 4, (C.A.) at paras. 1 and 2, leave to appeal dismissed, [2010] S.C.C.A. No. 94
[5] *6792341 Canada Inc. v. Dollar It Ltd.*, [2009] O.J. No. 1881(C.A.) at para. 72
[6] *578115 Ontario Inc. o/a/ McKee's Carpet Zone* v. *Sears Canada Inc. et al.*, [2010] O.J. No. 3921 (S.C.J.) at para. 19
[7] *Supra*, fn 2

[8] [2004] O.J. No. 3008 (S.C.J.) per Horkins J. at para. 23

[37] The Court of Appeal agreed the rescission by the franchisee was valid. It confirmed that disclosure must be provided in a single disclosure document delivered to the prospective franchisee at least fourteen days prior to the execution of the franchise agreement or the payment of any consideration to the franchisor.[9]

[38] In *Sovereignty Investment Holdings, Inc.* v. *9127-6907 Quebec Inc.*[10], Mr. Justice Wilton-Siegel concluded that any one or more of the following technical or legal requirements, if absent in a disclosure document, could lead to a declaration of rescission:

(a) failure to provide disclosure in a single document at one time as required by section 5(3) of the Act;

(b) failure to provide financial statements as required by section 5 (4) (b) of the Act;

(c) failure to include a statement specifying the basis for earnings projections (where such projections are provided); or

(d) absence of a signed and dated certificate.

[39] Three of the 4 deficiencies listed above are present in the case now before me: (a), (b) and (d).

[40] Of these errors, the one that has drawn particular attention is the failure to include a signed and dated certificate in a disclosure document.[11]

[41] In *Hi Hotel Limited Partnership* v. *Holiday Hospitality Franchising Inc.* the Alberta Court of Appeal held that signatures on the certificate were not a mere formality as the signed certificate was "the lynchpin of the substance of the disclosure".[12]

[42] The Court held that the certificate forms part of the disclosure document and prevents mischief on the part of franchisors who make statements and then do not stand behind them. Directors must sign the certificate in order to ensure that there is oversight of the disclosure process. This is one of the reasons why there is personal liability on the part of those who sign the certificate where losses are suffered as a result of the failure on the part of the franchisor to comply with its disclosure obligation.

[43] The *Hi Hotel* case was followed by the Court of Appeal for Ontario in the *Dollar It* case.[13] Madam Justice MacFarland, speaking for the Court, wrote:

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[9] *Supra*, fn 2, at paras. 12, 15 and 18

[10] [2008] O.J. No. 4450 (SCJ),

[11] Section 7 of O. Reg 581/00 provides that "every disclosure document shall include a certificate certifying that the document,

(a) contains no untrue information, representations or statements; and

(b) includes every material fact, financial statement, statement and other information required by the Act and this Regulation."

[12] *Hi Hotel Limited Partnership* v. *Holiday Hospitality Franchising Inc.*, [2008] A.J. No. 892 (C.A.) at para. 61

> In that case [referring to Hi Hotel], the mere absence of a signed and dated certificate was enough to permit the franchisee to rescind the franchise agreement. I agree with that decision and would find in the circumstances here, that the failure to include the mandated Certificate alone would be enough to conclude that there was not disclosure as required by the Act. That being the case the franchisee in my view, was entitled to rescind the franchise and related agreements as it did in February, 2008.[14]

[44] The failure to include an opening balance sheet in a disclosure document where a franchisor is just starting its operations or a financial statement, as prescribed, for franchisors that have been in operation for at least a year is also fatal to the defence of a franchisor facing a rescission claim:

> When one considers that the purpose of disclosure is to enable a prospective franchisee to make an informed decision about whether or not to invest in a franchise, financial disclosure is of the utmost importance.[15]

[45] The delivery of a UFOC for informational purposes is inadequate for the purposes of complying with a franchisor's disclosure obligations in Ontario.[16]

[46] Where a disclosure document is so deficient as to not be a "disclosure document" as defined by the Act, it is as if no disclosure document was provided. In this case, a franchisee is entitled to rescind the agreement under subsection 6 (2) of the Act and to be compensated in accordance with the provisions of subsection 6(6) of the Act.

[47] Here, the plaintiffs are entitled to recover the amounts paid to the franchisor in the way of franchise fees under subsection 6(6)(a) of the Act, $23,848 and $94,160 as well as to recover the losses that they incurred in the acquiring, setting up and operating the business under subsection 6(6)(d) of the Act, $49,327.32.

[48] In addition, the plaintiffs have claimed damages under section 7 of the Act for fees that the Franchisor refused or failed to pay.

[49] In the *Dig This Garden* case, the Court of Appeal held that the right to seek damages under section 7 of the Act is in addition to the right to recover the payments to be made under subsection 6(6) of the Act.[17]

[50] The plaintiffs are entitled to recover unpaid fees in the amount of $9,400.00

[51] Section 3 of the Act imposes on parties to a franchise agreement a duty to perform and enforce it in good faith and a right of action in damages for a failure to comply with this duty.

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[13] *Supra.*, fn.5
[14] *Supra.*, fn. 5, at para. 32
[15] *Supra*, fn. 5, at para. 35.

[16] *1518628 Ontario Inc.* v. *Tutor Time Learning Centres LLC*, [2006] O.J. No. 3011 (SCJ), paragraphs 51-73 and, in particular, paras. 70-73; appeal dismissed April 12, 2007, unreported, Div Ct.

[17] *Supra.*, fn 2, at paras. 37 and 38.

[52] In *Salah* v. *Timothy's Coffees of the World Inc.*[18], the trial judge concluded that the failure to offer the plaintiff the option to amend the agreement for a new lease in a new location in a mall was a breach of the franchise agreement and that the price suggested by Timothy's for the new location was "dishonest and apparently intended only to dissuade him".[19]

[53] Timothys was held to have acted unfairly and in bad faith in breach of s. 3 of the *Act*.[20] Timothys did not communicate with the plaintiff on a timely basis and "actively sought to keep its franchisee from finding out what was going on with the lease that he expected to be renewed and that was in fact renewed". [21]

[54] Timothys did not give the franchisee timely notice of the end of the term of the lease or the fact that his agreements were not going to be renewed. It "actively misled him until June 2005, some four months before the end of the term". [22]

[55] The plaintiffs were awarded damages for breach of contract, including past lost income and future lost income over the ten year term of the agreement that ought to have been extended to him, totalling about $330,000 (subject to adjustment).They were also awarded damages of $50,000 for the breach of the duty of good faith (with a portion allocated to mental distress damages).[23]

[56] The Court of Appeal upheld the trial judge. It held that damages for breach of the duty of fair dealing need not be compensatory:

> In summary, I am in agreement with the trial judge that s. 3(2) of the *Wishart Act* permits an award of damages for the breach of the duty of good faith, separate and in addition to any award in compensation of pecuniary losses. I would go further to say that any such award must be commensurate with the degree of the breach or offending conduct in the particular circumstances. Taking the conduct of the appellant as found by the trial judge into account, I see no error in her decision to award damages on a merged basis for the breach of duty of good faith and mental distress, either in principle or in respect of quantum. In my view, her finding as to the breach of duty of good faith alone would support the amount of the award.[24]

[57] The Timothy's case was followed by Madam Justice Mesbur in *1159607 Ontario Inc.* v. *Country Style Food Services Inc.*[25] where damages were awarded to the franchisee for a breach

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[18] [2010] O.J. No. 4336,

[19] [2009] O.J. No. 4444 (SCJ), Per Metivier J. at 113 and 114

[20] Ibid., para. 118

[21] Ibid., para. 121

[22] Ibid., para. 122

[23] Ibid., para. 156

[24] *Salah v. Timothy's Coffees of the World, Supra.*, fn 1

[25] [2012], O.J. No. 1241 (SCJ),

of the duty of good faith. In the *Country Style* case, the franchisor concealed (i.e. failed to disclose) a fundamental piece of information regarding the term of the lease from the franchisee, which would have had an impact on the franchisee's decision to renew. The withholding of this information was held to be a breach of the duty of good faith resulting in damages of $25,000 under this head of damages. [26]

[58] The plaintiffs here have claimed damages for breach of the duty of good faith in the amount of $50,000. Like the *Country Style* case, the Franchisor failed to disclose the true state of affairs of the Cuts franchise system and, in particular, the fact that it was in a state of rapid decline. The Franchisor failed to respond to reasonable requests for information and assistance after the LOI was signed and the franchise fee was paid. There was, in the minds of all parties, a franchise agreement in place that ought to have been performed and enforced in good faith. The franchisor failed to comply with this obligation.

[59] With respect to the defendants' counterclaim, they did not appear at trial despite having notice. An adverse inference may be drawn from that failure. In any event, there is no evidence before me in support of this claim.

[60] Considerable time and resources were spent defending the counterclaim. The defendants abandoned their counterclaim on the eve of trial, after more than 6 years of litigation, including a two-year delay while the defendants pursued their former lawyers by way of a third party action. This was dismissed, without costs, a few weeks before trial.

Declaration

[61] The plaintiffs seek a declaration that Cuts Fitness (Canada) Inc., Cuts Fitness for Men, LLC and Mr. Gennaro are "franchisor's associates" as that term is defined in the Act.

[62] Cuts Fitness (Canada) Inc. controls the Franchisor which in turn is controlled by Mr. Gennaro. Mr. Gennaro was examined for discovery on behalf of all three corporate defendants. He was directly involved in the grant of the franchise.

[63] The defendants carried on the business of a franchisor as a common enterprise. They did not distinguish between the US Franchisor and the Canadian Franchisor when it came to the payment and collection of fees.

[64] In *MAA Diners Inc.* v. *3 for 1 Pizza & Wings (Canada) Inc.*[27], the court held that the three corporate defendants were essentially the same entity. The Court or Appeal agreed finding that the lower court decision was supported by direct and circumstantial evidence and by the lack of evidence from the appellants.

[65] Under Section 7 of the Act, where a franchisee suffers a loss as a result of a failure to comply with the disclosure obligations under section 5, the franchisee has a right of action in damages against the franchisor, the franchisor's associate and others.

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[26] Ibid., para. 106 – 110 and 127-131.

[27] [2003] O.J. No. 430 (SCJ) at para. 21 "I find that the respondents treated the three corporations as if they were one entity". Para. 22 "I have concluded that all of the respondent corporations were franchisors"; appeal dismissed, [2004] O.J. No. 297 (CA)

[66] Under Section 8(1) and (3), all or any one or more of the defendants may be held jointly and severally liable both for the damages sought under section 7 of the Act and for the damages sought under section 3 of the Act.

[67] Adopting these principles, I declare that Cuts Fitness (Canada) Inc., Cuts Fitness for Men, LLC and Mr. Gennaro are "franchisor's associates" as that term is defined in the Act. Further, they are jointly and severally liable for damages awarded here. Finally, that the Ontario Master Development Agent Agreement between the parties and any related agreements were rescinded by Notice of Rescission dated July 6, 2005.

Damages

[68] The following liquidated damages are awarded:

A.	November 17, 2004:	**$20,000** USD Purchased by the Plaintiffs at a cost of **$23,848** CAD (at a rate of 1.1924)
B.	December 3, 2004:	**$80,000** USD Purchased by the Plaintiffs at a cost of **$94,160** CAD (at a rate of 1.177)
C.	July 7, 2007:	**$49,327.32** CAD
D.	April 20, 2005:	**$950** CAD
E.	April 29, 2005:	**$950** CAD
F.	June 8, 2005:	**$7,500** CAD
Principal:		**$176,735.32**

[69] **$25,000** are awarded for breach of fair dealing.

[70] Total damages of **$201,735.32** are awarded ($176,735.32 + $25,000.00) with interest.

Costs

[71] I have reviewed the detailed bill of costs provided by the plaintiffs in the context of the factors referred to in Rule 57 that should guide my discretion to award costs. I am particularly mindful of the direction that I should consider the reasonable expectations of the parties in the absence of success. I also note that this matter has drawn on for over six years, with the defendants vigorously pursuing a crossclaim of about two million dollars- only to abandon the claim weeks before trial.

[72] The plaintiffs are entitled to their costs of $70,000.00 inclusive of taxes and disbursements, with interest, payable forthwith.

Outcome

[73] The plaintiffs' claim is allowed, the defendants counter claim is dismissed.

Judgment accordingly.

Whitaker, J.

Date: June 6, 2012