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Institute 2012 of Continuing Professional Development

Franchise Law
Dealing With and Litigating Disputes Involving Franchises

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February 9-11, 2012

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Franchise Law

Dealing With and Litigating Disputes Involving Franchises

Thursday, February 9, 2012 | 1:30 pm to 4:50 pm

The Westin Harbour Castle Conference Centre, 2 Harbour Square, Toronto

Program Chairs: **Tanya Walker,** Walker Law
Larry Weinberg, Cassels Brock & Blackwell LLP

Agenda

1:30 pm	**Opening Remarks**
1:35 pm	**Overview of the Act** **Richard Leblanc,** Miller Thomson LLP **Debi Sutin,** Gowling Lafleur Henderson LLP – Hamilton
2:20 pm	**Hotspots in Franchising** **Ian Roher,** Teplitsky, Colson LLP **Frank Zaid,** Osler, Hoskin & Harcourt LLP
3:00 pm	**Break**
3:20 pm	**The Rescission Remedy- What the Act Says and What Really Happens** **Sam Hall,** Sotos LLP **Derek Ronde,** Cassels Brock & Blackwell LLP
4:05 pm	**Other Remedies and Dispute Resolution Mechanisms** **Jonathon Baker,** Wardle Daley Bernstein LLP **Mary Paterson,** Osler, Hoskin & Harcourt LLP
4:45 pm	**Question Period/Closing Remarks**
4:50 pm	**Program Concludes**

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Program Participants

Tanya Walker (Program Chair)

Obtained Honours Bachelor of Commerce degree from McMaster University in 2002 and law degree from Osgoode Hall in 2005. Was called to the bar in 2006. Received the Simms Shuber award from Osgoode Hall for the highest academic standing in corporate governance. In 2010 and 2012 was featured on the black history month poster and was the recipient of Women's Enterprise Woman of the Year award in 2010. Was appointed by the Lieutenant Governor for a judicial role with the Assessment Review Board, where she adjudicates property tax dispute. Practised at mid-sized downtown Toronto firms before creating Walker Law, her commercial litigation firm. Is a member of the Canadian Association of Black Lawyers, the Ontario Bar Association Franchise Committee, the Women's Executive Network, the Canadian Association of Women Executives and Entrepreneurs and the Black Business and Professional Association.

Larry Weinberg (Program Chair)

Partner at the Toronto law firm of Cassels Brock & Blackwell LLP, and head of the firm's franchise law practice group. Has a practice that specializes in franchise law and providing all necessary legal services to franchisors. Vice-Chair of the Ontario Bar Association's Franchise Law Section, and was the founder of, and to date has organised and chaired four Ontario Bar Association annual franchise law conferences. Member of the American Bar Association's Forum on Franchising, and in 2006, was the first Canadian lawyer to be appointed Director of the ABA Forum's International Division and to a leadership role on its Governing Committee. In 2009 had the honour of being Co-chair of the 32nd Annual Forum on Franchising annual conference. Member of the International Bar Association, the International Franchise Association, and the Canadian Franchise Association. In 2004 acted as co-editor of the ABA Forum on Franchising's book entitled *Fundamentals of Franchising-Canada*. Was co-editor and co-author of the Canadian Franchise Association's first and only official book publication entitled, *How To Franchise Your Business*. Co-author and the regional editor of the chapter on Canada for the ABA Forum's book entitled *International Franchise Sales Laws*. In 2004, 2005, 2009, 2010 and 2011 was named by Franchise Times to their "Legal Eagles" list of the top 100 franchise lawyers in the United States and Canada. He and Cassels Brock are each listed in the *Lexpert*® Canadian legal directory as being among the leaders in Canada in franchise law. Was called to the Bar of the Province of Ontario in 1989.

Jonathon Baker

Called to the Bar in 1995 and is a partner in Wardle Daley Bernstein LLP. Practises commercial litigation, with a strong emphasis on franchising, but also with extensive experience in fraud-related remedies, bankruptcy and insolvency, debtor-creditor remedies, partnership and shareholder disputes. Recently begun acting as mediator and arbitrator. Graduate of the JD/MBA Programme of Osgoode Hall and the Schulich School of Business. Subsequently obtained two LLM degrees, one from the University of Edinburgh in the economic and commercial law of the European Union and a second from Osgoode Hall in banking and financial services. Frequently speaks at OBA, LSUC, CFA and ICSC events and has been an advocacy instructor and special needs tutor for the Bar Admission Course. Is in the process of completing a paper on the judicial interpretation of fair dealing, good faith and reasonable commercial standards in franchising.

Sam Hall

Commercial litigator with the Toronto based franchise law firm, Sotos LLP. Provides strategic counsel in the areas of commercial litigation and corporate disputes, with an emphasis on franchising, commercial leasing, privacy and alternative dispute resolution. Has extensive experience representing franchisors and franchisees and has successfully prosecuted and defended numerous franchise rescission proceedings. Contributor to various legal publications including, the Franchise and Distribution Press (Federated Press) and Franchising World (International Franchise Association). Past speaker at the 2010 Canadian Franchise Association's National Convention, Quebec. Member of the Ontario Bar Association, the Advocates' Society, the Ontario Trial Lawyers Association, German Chamber of Commerce, and International Association of Privacy Professionals. Sits on the Board of Directors for Mid-Toronto Community Services.

Richard Leblanc

Practises corporate and commercial law with emphasis on franchising, distribution, secured lending and mergers and acquisitions. Is on the executive of the Franchise Law Section of the Ontario Bar Association and is a member of the Legal and Legislative Affairs Committee of the Canadian Franchise Association. Advises on all aspects of franchising, including in relation to: compliance with Canadian franchise legislation; disclosure requirements; purchase and sale of franchises; business structuring; multi-unit franchising; reorganizations and refranchisings; corporate governance; shareholder relations; privacy and consumer protection issues; commercial leasing; trade matters; dispute resolution; enforcement of restrictive covenants; and intellectual property issues. Frequent speaker and contributor in the areas of commercial and franchising law issues. Contributed the chapter on Franchising in *Business Laws of Canada* published by West. Wrote "The Purchase and Sale of a Privately Held Business" in *Advanced Corporate Procedures* published by Emond Montgomery. Member of the Ontario Bar Association Corporate Law Subcommittee, the Canadian Bar Association Business Law Section and the American Bar Association Business Law Section and Forum on Franchising. Registered trade-marks agent, and is fluent in French and Italian. LL.B, University of British Columbia. B.Soc. Sc. *magna cum laude* (Political Science), University of Ottawa. Clerk to the Honourable Mr. Justice Robert Décary, Federal Court of Appeal, 1995-96.

Mary Paterson

Associate in Osler, Hoskin & Harcourt LLP's litigation department. Commercial litigation practice focuses on franchise disputes (including injunctions), contract disputes in court or in arbitrations, and insolvency litigation. Acts for franchisors and has written several articles on franchise law that you can view through her LinkedIn page or on Osler.com. Has appeared in the Court of Appeal for Ontario as amicus curiae, in the Superior Court of Justice and on the Commercial List.

Ian Roher

Obtained LLB from Osgoode Hall Law School in 1974 and was admitted to the Bar of Ontario in 1976. Since then, has practised as a commercial litigator with a significant portion of his practice dedicated to franchising and related issues, including commercial leasing disputes and class proceedings. Taught Civil Procedure in the Ontario Bar Admission Course for 5 years and has represented clients before arbitrators, mediators, the Superior Court of Justice, the Ontario Court of Appeal and the Supreme Court of Canada. Has written and lectured extensively on various franchise and associated topics. Provided the Judicial Update at the 2008 Ontario Bar Association's ("OBA") Annual Franchise Law Conference and was co-chair of such Conference in 2010. Member of the OBA, the Canadian Bar Association, American Bar Association (Forum Committee on Franchising), Executive Committee of OBA's Franchise Section, the Canadian Franchise Association and the Advocates Society. Since 1982, has enjoyed highest peer rating of "AV" from Lexis-Nexis Martindale Hubbell for legal ability and ethical standards. Has been listed for a number of years in *Lexpert*® Canadian legal directory as an expert in franchise law and as one of Law Day's 46 leading Canadian franchise lawyers.

Derek Ronde

Lawyer at Cassels Brock & Blackwell LLP in Toronto, Ontario. Commercial litigator who specializes in franchise-related litigation and class proceedings. Has significant experience in a wide range of franchise-related matters, including class actions, injunctions, franchise agreement disputes, terminations, and day-to-day franchise relations issues. Member of the Ontario Bar Association's franchise section and is on the executive of the OBA class action section. Member of the CFA, IFA and ABA, and has written and presented on a variety of franchise-related topics.

Debi Sutin

Partner at Gowling Lafleur Henderson LLP where she is a member of the Business Law Group, the Franchise and Distribution Law National Practice Group and co-editor of Gowlings' Franchise and Distribution Law quarterly newsletter. Practises general corporate/commercial law with a focus on all matters relating to franchising, licensing and distribution law and regularly counsels domestic and international franchisors in all matters relating to the establishment and operation of their franchise systems and to the preparation of their franchise and disclosure documents. Frequent writer on franchise-related matters and speaks regularly at franchise-related conferences and seminars and served as Co-Chair of the 2010 Ontario Bar Association Franchise Law Conference. Member of the Canadian Franchise Association, the American Bar Association Forum Committee on Franchising, the International Franchise Association and a member of the Executive of the Ontario Bar Association's Franchise Law Section. Named in *The Best Lawyers in Canada* as a leading lawyer in Franchise Law, in *Who's Who Legal: Canada 2011* for Franchise Law and as Repeatedly recommended in the *Canadian Legal Lexpert® Directory*.

Frank Zaid

Partner in the Toronto office of Osler, Hoskin & Harcourt LLP where he specializes in franchise law and is Co-chair of the firm's National Franchise & Distribution Law Group. Practice focuses on providing strategic business, structural, acquisition and relationship advice to established Canadian and international franchisors. Over the past 35 years Osler has advised more than 400 franchise systems in virtually every product and service category. Has served as Chair of the Supplier Forum of the International Franchise Association, Chair of the Ontario Bar Association Franchise Law Section and General Counsel to the Canadian Franchise Association. In May 2009, the Canadian Franchise Association honoured him with the CFA's prestigious Lifetime Achievement Award which is presented "to an individual who has achieved excellence throughout their career in franchising". Has been listed as a leading or the most frequently recommended franchise lawyer in Canada in every published edition of the *Canadian Legal Lexpert Directory,* the *Lexpert/American Lawyer Guide to the Leading 500 Lawyers in Canada*, the *International Who's Who of Franchise Lawyers, Who's Who Legal – Canada, Best Lawyers in Canada* and the *Franchise Times Legal Eagles*. In 2001, was appointed a Co-Chair of the Uniform Law Conference of Canada Commercial Law Strategy project on a uniform franchise law. This project was completed in August 2005 with the adoption of a *Uniform Franchises Act* and *Regulations* to serve as a model franchise law for all of the provinces and territories of Canada. As of January 1, 2012 joined ADR Chambers in Toronto where he is a mediator and arbitrator specializing in resolving domestic and international franchise disputes.

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The Arthur Wishart Act (Franchise Disclosure), 2000 – An Overview

Richard Leblanc
Miller Thomson LLP
and
Debi Sutin
Gowling Lafleur Henderson LLP - Hamilton

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THE ARTHUR WISHART ACT – AN OVERVIEW

1. A Brief History

It took more than 30 years to bring franchise legislation into Ontario. In 1970, the government of Ontario launched a comprehensive inquiry to review and report upon referral, pyramid or multi-level sales practice, and franchises. The Grange inquiry was commissioned to report upon the alleged financial abuse of franchisees by franchisors. The Grange Commission report was the initial basis for what ultimately led to passage by the Ontario Legislature, on May 17, 1995 of the Arthur Wishart Act (Franchise Disclosure), 2000[1] (the "Act"), formerly Bill 33. Many wonder, of course, how the Act came to be named.

Arthur Wishart was the Conservative MPP for Sault Ste Marie and the Minister of Financial and Commercials Relations under whose Ministry the committee was tasked with the mandate, the precise terms of reference being "*to report upon and to consider all aspects of the relationship of franchisors and franchisees and the implications of these arrangements to the consumer and the investor, and generally to recommend what, if any, changes in the law are desirable*." The review led to the Grange Report in 1971[2] which recommended:

(1) that Legislation be introduced to apply to all franchises within all industries;

(2) that a Franchisor be required to file prospectus setting forth detailed information on the franchise "scheme"

(3) that a Franchisee have a compulsory 48-hour cooling-off period before signing a franchise;

(4) that a Franchisee to have right to apply to Tribunal or Court to determine:

  (a) whether the contract is fair; and

  (b) whether conduct of franchisor is fair in circumstances;

(5) the Tribunal or Court have the authority to discourage following:

  (a) arbitrary termination

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[1] S.O. 2000, C.3. Also referred to herein as the "Ontario Act".
[2] The Grange Report can be found at: http://www.wikidfranchise.org/grange-report

(b) arbitrary refusal of assignment or renewals

(c) arbitrary forfeiture of deposits

(d) forced purchases and secret profits

(e) competitive and discriminating practices by franchisors

Little was done to implement the recommendations of the Grange Report notwithstanding the introduction in the United States, both at the federal level and in some US states, and in the Province of Alberta, of franchise-specific legislation. It was not until 1994, as a result of the publicity surrounding the dispute between Pizza Pizza and its franchisees, that the Ontario government formed the Franchise Sector Working Team to establish a framework for franchise legislation in Ontario.

Bill 33 "*An Act to require fair dealing between parties to franchise agreements, to ensure that franchisees have the right to associate and to impose disclosure obligations on franchisors*" was introduced in 1995 and, following significant public consultation, the Act received royal assent in June, 2000. Proclamation of the Act followed in 2 stages: first, all provisions of the Act other than the disclosure requirements came into force on July 1, 2000 with the disclosure requirements following on January 31, 2001.

In many ways, the Act followed Alberta's *Franchises Act*[3], which in its current form has been in force since 1995 (herein, the "Alberta Act"). The Act imposes on franchisors the requirement to provide disclosure to prospective franchisees of all "material facts", as defined in the Act, including matters prescribed by the Regulations[4] and imposes some restraints on the franchisor-franchisee relationship. All of these are discussed below in this paper.

Given the definition of "franchise", the application of the Act is far-reaching, and can include arrangements not intended by the parties to be a franchise. The definition, in Subsection 1(1) of the Act reads as follows (*emphasis added*):

> "franchise" means a right to engage in a business where the franchisee is required by contract or otherwise to make a payment or continuing payments, whether direct or indirect, or a commitment to make such payment or payments, to the franchisor, or the franchisor's associate, in the course of operating the business or as a condition of acquiring the franchise or commencing operations and,

[3] RSA 2000, Chapter F-23

[4] Ontario Regulation 581/00

(a) in which,

(i) the franchisor grants the franchisee the right to sell, offer for sale or distribute goods or services that are substantially associated with the franchisor's, or the franchisor's associate's, trade-mark, service mark, trade name, logo or advertising or other commercial symbol, and

(ii) the franchisor or the franchisor's associate exercises significant control over, or offers significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training, or

(b) in which,

(i) the franchisor, or the franchisor's associate, grants the franchisee the representational or distribution rights, whether or not a trade-mark, service mark, trade name, logo or advertising or other commercial symbol is involved, to sell, offer for sale or distribute goods or services supplied by the franchisor or a supplier designated by the franchisor, and

(ii) the franchisor, or the franchisor's associate, or a third person designated by the franchisor, provides location assistance, including securing retail outlets or accounts for the goods or services to be sold, offered for sale or distributed or securing locations or sites for vending machines, display racks or other product sales displays used by the franchisee

As a result, any business arrangement that involves the sale or distribution of goods or services associated with another's trade-mark or brand may be a "franchise" under this definition so long as there is some payment element and an element of control or assistance. There is no exception from the payment element, as there is under Alberta's *Franchises Act* which provides for an exemption for payment by the franchisee of a reasonable amount of goods or services at a reasonable bona fide wholesale price. Further, there is no guidance provided in the definition as to what would be considered to be "significant" control or assistance.

2. The Key Elements of the Act

The aim of the Act is the regulation of the franchise marketplace and to protect both prospective franchisees and those already party to a franchise relationship. It is remedial legislation, intended to "level the playing field" and the perceived imbalance of power in the franchisor-franchisee relationship. Achievement of this goal is attempted through the following three key principles of the Act and the remedies made available to franchisees:

- the obligation imposed on franchisors to provide disclosure;

- the duty of fair dealing imposed upon the franchisor and franchisee; and
- the right of franchisees to associate

A franchisee has a right to rescind the franchise agreement, and a right of action for damages, arising from a franchisor's failure to comply with the disclosure requirements as well as a right of action for damages if the franchisor breaches the duty of fair dealing or restricts the franchisee's right to associate.

3. The Disclosure Obligation

Section 5 of the Act sets forth the disclosure obligation and requires that a franchisor provide a franchise disclosure document (or "FDD") to a prospective franchisee not less than 14 days before the earlier of the signing by the prospective franchisee of the franchise agreement *or any other agreement relating to the franchise* (*emphasis added*) and the payment of any consideration relating to the franchise. As "franchise agreement" is defined in the Act to include any agreement relating to the franchise, this could include a confidentiality agreement or an agreement to purchase assets of an existing unit from the franchisor, even if conditional. Accordingly, it is best practice to provide a disclosure document to a prospective franchisee prior to having the prospect sign any agreement that may be associated with or connected in some way with the franchise opportunity.

Section 5 also contains particulars pertaining to, among other things, the means for delivery of the disclosure document, the requirements for disclosure of material changes, what transactions are exempt from disclosure and, most importantly, the contents of the disclosure document. Section 5(4) of the Act may be the most all-encompassing of the Act's provisions. It provides as follows for the required contents of the disclosure document:

The disclosure document shall contain,

(a) all material facts, including material facts as prescribed;

(b) financial statements as prescribed;

(c) copies of all proposed franchise agreements and other agreements relating to the franchise to be signed by the prospective franchisee;

(d) statements as prescribed for the purposes of assisting the prospective franchisee in making informed investment decisions; and

(e) other information and copies of documents as prescribed.

Although the various items for disclosure are prescribed in the Regulations, these prescribed items are not exhaustive. Particular attention must be made to Subparagraph 5(4)(a) of the Act which provides for the disclosure of all "material facts" which is broadly defined to include any information about the business, operations, capital or control of the franchisor or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise. It is this requirement for disclosure of all material facts that has led to some of the most significant franchise law decisions, which are discussed below, and as a result require that disclosure documents be particularized with information applicable to the proposed location of the franchised unit.

The disclosure document must also contain the franchisor's financial statements, which must be either audited or with a review engagement report. Financial statements prepared in another jurisdiction may be used provided that they have been prepared in accordance with generally accepted accounting principles which are *at least equivalent to* the audit or review engagement standards of the Canadian Institute of Chartered Accountants Handbook. Franchisors who have operated for less than one fiscal year are permitted to include an opening balance sheet in lieu of audited or review engagement financial statements.

An exemption from the requirement to disclose financial statements is available for large, experienced franchisors which meet the criteria prescribed in Paragraph 11 of the Regulations.

Section 5(4) of the Act also requires that a disclosure document contain copies of all proposed franchise agreements and other agreements relating to the franchise which a prospective franchisee may be required to sign. "Franchise agreement" is broadly defined to include any agreement between the franchisor or the franchisor's associate and the franchisee which relates to a franchise. As a result, the following, if they form part of the franchisor's requirements, need to be included in the disclosure document: sublease, general security agreement, personal guarantee and turn-key development agreement. As "other agreements relating to the franchise" are also part of the prescribed disclosure, a franchisor may also wish to include in its disclosure documents, agreements to be signed by a franchisee and a third party which could include equipment lease agreements, maintenance contracts and construction contracts.

Finally, the disclosure document must be certified as complete disclosure in accordance with the Act. In the case of a franchisor that is not incorporated, the certificate must be dated and

signed by the franchisor; if a franchisor is incorporated and has only one director or officer, the certificate must be signed by that director or officer; and in the case of a franchisor that is incorporated and has more than one officer or director, the certificate must be signed by at least two persons who are officers or directors. A dated and signed certificate is a mandatory requirement of the franchise legislation, not a mere formality. Failure to have a disclosure document properly certified has been held to entitle the franchisee to rescind the franchise agreement on the basis that no disclosure document was provided.[5] Franchisors that are incorporated must ensure that this Certificate is signed by one or more officers or directors, as the case may be, who are named as officers or directors in the disclosure document, and that it is signed in their personal capacity and not on behalf of the franchisor.

The Act also mandates formal delivery requirements for the disclosure document, which the Courts have not been hesitant to strictly enforce. A disclosure document must be one document, *delivered … as one document at one time* (Ss 5(3)) and the information in a disclosure document must be *accurately, clearly and concisely set out* (Ss 5(6)). Furthermore, as the Regulations require that certain of the information required to be disclosed must be set out together and in a certain place in the disclosure document, it is unlikely that an Ontario disclosure document, prepared based upon a pre-existing disclosure document from another jurisdiction would comply with the Act's requirements. In addition, unlike the franchise disclosure legislation in force in each of Alberta, New Brunswick[6] and Prince Edward Island[7] and the yet to be proclaimed Manitoba *Franchises Act*[8], the Act does not expressly permit the use of a "wrap-around" for the creation of an Ontario disclosure document.

4. The Rescission Remedy

If a franchisor fails to comply with the Act's disclosure requirements, a franchisee has the right to rescind the franchise agreement. Section 6 of the Act provides 2 separate, and seemingly distinct, time periods within which the franchisee can rescind. However, as discussed below, the interpretation by the Courts of the rescission remedy has blurred these 2 time periods.

The rescission remedy reads as follows:

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[5] *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising* [2008] A. J. No. 892 (C.A.)

[6] *Franchises Act*, Chapter F-23.5 (herein, the "NB Act")

[7] *Franchises Act*, Chapter F-14.1 (herein, the "PEI Act")

[8] S.M. 2010, c. 13

> 6.(1) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than 60 days after receiving the disclosure document, if the franchisor failed to provide the disclosure document or a statement of material change within the time required by section 5 or if the contents of the disclosure document did not meet the requirements of section 5.
>
> (2) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the franchise agreement if the franchisor never provided the disclosure document.

Notice of rescission must be given in writing and delivered to the franchisor, personally, by registered mail, by fax or by any other prescribed method (to date no other delivery methods have been prescribed). Once faced with a notice of rescission, the franchisor is required to comply with the following obligations, set out in Section 6(6) of the Act, within 60 days of the effective date of rescission:

(a) refund to the franchisee any money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment;

(b) purchase from the franchisee any inventory that the franchisee had purchased pursuant to the franchise agreement and remaining at the effective date of rescission, at a price equal to the purchase price paid by the franchisee;

(c) purchase from the franchisee any supplies and equipment that the franchisee had purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee; and

(d) compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts set out in clauses (a) to (c).

This is certainly an onerous obligation imposed upon a franchisor. Although much has been written about what a franchisee could seek to claim on account of losses incurred, that discussion is beyond the scope of this paper. The amounts payable by the franchisor pursuant to (a) – (c) are more easily discernable.

Judicial decisions on rescission claims have made it clear that strict compliance with the disclosure requirements of the Act and the Regulations is required. If the deficiencies in the

disclosure document are so significant as to have prevented the franchisee from making an informed decision, there is a significant risk that the document provided by the franchisor will be deemed to not be a disclosure document required to be provided by the Act. As a result, the franchisee will be entitled to rescind its franchise agreement within 2 years of entering into the franchise agreement. In other words, provision by a franchisor of a document purporting to be a disclosure document will not restrict the franchisee to the 60-day rescission remedy under Section 6(1) of the Act.

Furthermore, disclosure provided to a prospective franchisee piecemeal over a period of time or one containing information not required by the Act or the Regulations to be provided for disclosure purposes, will be deemed not to meet the Act's requirements.

In *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd*.[9], the Court stated that the main purpose of the Act is the obligation imposed upon a franchisor to make full and accurate disclosure so that a prospective franchisee can make an informed decision about investing in the franchise opportunity.

In *Sovereignty Investment Holdings, Inc. v. 9127-6907 Quebec Inc*.[10], the Court identified four deficiencies in the disclosure document provided to the franchisee, out of the 19 deficiencies claimed by the franchisee, any one of which was fatal to a compliant disclosure document:

(a) failure to include financial statements in accordance with Subsection 5(4)(b) of the Regulations;

(b) failure to include a statement specifying the basis for earnings projections provided in the disclosure document;

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

(d) the absence of a signed certificate as required by Section 7 of the Regulations.

Failure to comply with any of these requirements, according to the Court, precluded a prospective franchisee from making an informed investment decision.

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[9] [2005] O.J. 3040 (herein, "Dig this Garden")
[10] [2008] O.J. No. 4450 (Ont SC) (herein, "Sovereignty Investment")

The Court further held, in *Sovereignty*, that the assignee of the franchisor's obligations under the franchise agreement was also liable for the original franchisor's failure to deliver a compliant disclosure document. As a result, the original franchisor and the purchaser of the franchise system were jointly and severally liable for the franchisor's post-rescission obligations under Subsection 6(6) of the Act. For that reason, third party purchasers of a franchisor's assets should ensure that their purchase agreement contains appropriate indemnities for any failure by the vendor franchisor to have provided proper disclosure to its franchisees.

The leading Ontario case on the interpretation of the "material facts" disclosure requirement is the Court of Appeal decision in *6792341 Canada Inc.* v. *Dollar It Limited*[11]*.* In that case, the franchisee attempted to rescind its franchise agreement pursuant to Section 6(2) of the Act and made application to the Superior Court for declaratory relief. The Court dismissed the application on the grounds that, as the franchisee had received a disclosure document, it was entitled only to the right of rescission under Section 6(1) of the Act.

On the franchisee's appeal to the Court of Appeal, the Court relied in part on the decision in *Hi Hotel* (see note 4 above) and held that the lack of a signed and dated Certificate of Disclosure was sufficient to establish that the franchisor failed to provide a disclosure document to the franchisee. However, the Court also discussed other "material" information missing from the disclosure document which was necessary for the franchisee to make an informed decision.

The Court, in its reasons, looked to the purpose and intent of the Act, being to protect the interests of franchisees and to permit a prospective franchisee to make an informed decision about whether to make the investment. The Court held that the provisions of Sections 6(1) and 6(2) must be read and interpreted broadly in light of the intended purposes of the Act and that to interpret those provisions strictly would "lead to absurdity". Taken together, the disclosure document deficiencies were so material that "the only reasonable conclusion is that the franchisor never provided the disclosure document within the meaning of Section 6(2)".

Among the deficiencies noted by the Court in *Dollar It,* the disclosure document provided by the respondent franchisor did not include:

(1) a signed and dated Certificate of disclosure;

(2) financial statements or an opening balance sheet;

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[11] (2009), 95 O.R. 3d 291 (CA) (herein, "Dollar It")

(3) a copy of the lease for the premises under which the franchisee was the subtenant;

(4) information on the franchisor's affiliate which was the tenant and sublandlord of the premises;

(5) prescribed information pertaining to the franchisor's advertising program; and

(6) a description of the exclusive territory to be granted and the franchisor's policy on proximity between franchisees.

In its decision, the Court acknowledged that whether disclosure is deficient is fact specific and each case would have to be reviewed based upon what information the disclosure document contained. Accordingly, it is not clear from the decision whether any of the noted deficiencies alone would have been sufficient to constitute a failure to provide disclosure within the meaning of the Act or whether the Court relied on the fact of a number of deficiencies. However, of note is the Court's determination that the failure to provide a copy of the lease for the premises at which the franchised business was to be operated as well as information regarding the franchisor's affiliate which was the tenant under the lease was a failure to disclose material facts.

The decision in *Dollar It* has been followed in a number of cases involving allegedly deficient disclosure. The uncertainty felt by franchise law practitioners as to the precise disclosure requirements under Section 5 of the Act and the interplay between Subsections 6(1) and (2) has now been all but eliminated. It is now evident that franchisors in Ontario must comply strictly with the disclosure requirements of the Act and ensure that all available material information is included in their disclosure documents. This includes information particular to the specific location at which the franchised business will be operated. A generic, "standard form" disclosure document will not suffice to protect a franchisor from the penalties imposed under the Act for non-compliance if, at the time that disclosure is made, location specific information was known by the franchisor.

5. Claim for Misrepresentation

In addition to the rescission remedy, Section 7 of the Act provides a franchisee with the right to sue if it suffers loss because of a misrepresentation contained in the disclosure document or if the franchisor fails to comply with section 5. It is arguable therefore, that if a franchisee misses the time period for rescission in Section 6, it can still seek damages for breach of the Section 5

disclosure obligation. The claim can be made against not only the franchisor but also against the franchisor's agent, the franchisor's broker, the franchisor's associate and any director or officer of the franchisor who signed the Certificate of disclosure. "[F]ranchisor's agent, "franchisor's broker" and "franchisor's associate" are all defined in the Act.

"Misrepresentation" is defined in the Act to include "an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made." A franchisee is deemed to rely on a misrepresentation in a disclosure document, (unless proven that the franchisee was aware of the misrepresentation and still proceeded to acquire the franchise) and, if there is a failure to comply with the Section 5 disclosure requirements, a franchisee is deemed to have relied on the information contained in the disclosure document that has been provided.

6. The Duty of Fair Dealing, Right of Association and Non-Waiver

The Act imposes significant other obligations upon the parties to a franchise agreement in addition to a franchisor's disclosure obligation, and provides remedies for breach of such obligations. Each of these provisions has been considered by the Courts in Ontario. The duty of fair dealing, the right of association and the non-waiver provisions of the Act are discussed below.

7. Duty of Fair Dealing

Section 3 of the Act imposes on each party a duty of fair dealing in its performance and enforcement and provides that "the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards." This requirement has been interpreted generally to require that the franchisor enforce the franchise agreement absent any malice or ulterior purpose, and in a manner which takes into account the interests of the franchisee in the franchise relationship in addition to its own. More specifically, the obligation imposes limitations on the scope of discretion which the franchisor may employ in enforcing its strict contractual rights where such exercise negatively impacts the interests of the franchisee. The obligation has also been interpreted to require the franchisor to be transparent in its dealings with the franchisee where failure to do so may unfairly harm or prejudice the franchisee. The duty to act fairly applies equally to the franchisor and its franchisees[12] and a breach of this obligation

[12] See *Gerami v. Double Double Pizza Chicken Ltd.* [2005] O.J. No. 5252 and *Personal Services Coffee Corp. v. Beer*, (2005) 256 D.L.R. (4th) 466 (Ont. C.A.)

subjects the breaching party to a claim for damages pursuant to subsection 3(2) of the Act. The operation of section 3 of the Act will be illustrated in the caselaw referred to below.

Shelanu v. Print Three Franchising Corporation is one of the leading cases to consider the scope of the duty of fair dealing[13]. In that case, which addressed, *inter alia*, whether the franchisor had breached its statutory and common law duty of good faith by establishing a separate printing franchise named "Le Print Express" and by permitting the upstart franchises to operate in close proximity to the franchisee. The franchisor contended that Le Print Express was formed to service retail customers whereas the franchisee's stores purportedly targeted commercial clients.

The trial judge found a common law duty of good faith notwithstanding the application of the Act. In finding that the duty had been breached, he wrote:

> "Even though the Le Print Express franchises were directed at a specific segment of the industry, I am satisfied that they not only would, but did, take work and customers from existing Print Three franchises. As a consequence, in my view, the establishment of such an enterprise by the very person who owned and controlled the defendant was fundamentally at odds with the defendant's obligations, including the obligation to deal in good faith, to its franchisees."[14]

The *Shelanu* case was cited in *Katotikidis v. Mr. Submarine Ltd.* [15] in support of the proposition that a common law duty of good faith exists notwithstanding the statutory duty set out in the Act. In *Katotikidis*, a Mr. Submarine franchisee in Toronto's Eaton Centre failed, partially as a result of the closing of the Eaton's department store. Despite assurances that it would offer an alternative nearby location to the franchisee, the franchisor recanted and another franchisee opened the new location in competition with the existing franchisee's failing store.

Taliano J. of the Ontario Superior Court of Justice held that "by opening a new restaurant in unreasonably close competitive proximity to the plaintiffs and then awarding the restaurant to someone else, the defendant violated the implied duties of good faith and fair dealing contained in their franchise agreement and promotional materials and thereby betrayed the trust that epitomizes the relationship between a franchisor and franchisee."

As noted above, the duty of fair dealing requires franchisors to take the interests of the franchisee into account and to address these interests with transparency and integrity. In

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[13] *Shelanu Inc. v. Print Three Franchising Corporation* (2003), 64 O.R. 533 (C.A.) (herein, "Shelanu")
[14] See Shelanu, Note 13, *supra*, at paragraph 38.
[15] *Katokidis v. Mr. Submarine*, 2002 CanLII 49646 (Ont. S.C.J.)

Country Style Food Services v. 1304271 Ontario Ltd.[16] a franchisee alleged breach of the duty of good faith and fair dealing against a franchisor who failed to actively oppose a landlord whose redesign of a commercial development materially adversely affected the drive-through traffic flows and access to a proposed Country Style outlet. The Ontario Court of Appeal upheld the trial judge's findings that while the franchisor, who was on the head lease, had formally objected to the development, it had breached its duty of good faith by failing "to support the franchisee and it attempted to walk the fence between the franchisee and the landlord." The Court of Appeal concurred and commented that the franchisor took no legal steps to halt the development or shield the franchisee from the unilateral and arbitrary acts of the landlord, but instead asserted in its defence to the franchisee's counterclaim that the landlord's activities did not result in any damages to the franchisee.

The Courts will not apply this duty to require a franchisor to renew a franchise agreement where a renewal right is not provided for by the express terms of the written agreement between the parties[17]. However, the Courts have imposed the duty of fair dealing where a franchisor has interpreted the franchise agreement renewal provisions in order to avoid renewal of the franchise agreement by an existing franchisee.[18] In *Salah v. Timothy's Coffees,* the franchise agreement between the parties required the franchisor to renew the agreement if it successfully negotiated a new head lease for the location. The franchisor was unable to secure new lease terms for the existing location on the third floor of a mall but entered into head lease negotiations for a new location on the second floor. It actively withheld from the franchisee its plans to open the new location on the second floor and refused to communicate with the franchisee during the renewal process. The appeal court concurred with the findings of the trial judge that the franchisor had breached its duty of fair dealing by actively keeping the franchisee "from finding out what was going on with the lease" and by deliberately withholding critical information and not returning telephone calls.

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[16] *Country Style Food Services Inc. v 1304271 Ontario Ltd.* (2003), 32 B.L.R. (3d) 207, aff'd (2005), 7 BLR (4th) 171; 200 OAC 172.

[17] See *TDL Group Ltd. v. 1060284 Ontario Limited*, 2000 CanLII 22758 (Ont. S.C.J.), aff'd [2001] O.J. 3614 (Div. Ct); *530888 Ontario Ltd. v. Sobeys Inc.*, 2001 CanLII 28359, 12 B.L.R. (3d) 267 (Ont. S.C.J.); and Automobiles Jalbert Inc. v. BMW Canada Inc., [2006] J.Q. No.8803 (Q.C.A.).

[18] See *Salah v. Timothy's Coffees of the World Inc.* (2010), 65 B.L.R. (4th) 235 (Ont. S.C.J.), aff'd 2010 ONCA 673 (C.A.) (herein, "Salah")

In actions for breach of the duty of fair dealing, the Courts have seen fit to award general damages above and beyond a franchisee's monetary loss[19] and will award punitive damages in appropriate circumstances.[20]

8. Right of Association

Section 4 of the Act provides as follows:

> 4.(1) A franchisee may associate with other franchisees and may form or join an organization of franchisees.
>
> (2) A franchisor and a franchisor's associate shall not interfere with, prohibit or restrict, by contract or otherwise, a franchisee from forming or joining an organization of franchisees or from associating with other franchisees.
>
> (3) A franchisor and franchisor's associate shall not, directly or indirectly, penalize, attempt to penalize or threaten to penalize a franchisee for exercising any right under this section.
>
> (4) Any provision in a franchise agreement or other agreement relating to a franchise which purports to interfere with, prohibit or restrict a franchisee from exercising any right under this section is void.

In summary, a franchisor may not interfere with a franchisee's right to communicate with one another, or to establish and be part of an association of franchisees. Breach of this section by a franchisor entitles an affected franchisee to a statutory right of action for damages.

In *405341 Ontario Limited v. Midas Canada Inc*.[21], Section 4 was interpreted to protect the franchisee's right to participate in a class action claim against its franchisor. In that case, the Courts considered the enforceability of certain provisions in the Midas franchise agreement requiring a general release from the franchisee as a condition to any assignment or renewal. The issue arose in the context of a class action proceeding alleging that Midas had breached its common law and statutory duties of good faith and fair dealing by outsourcing its product supply to a third party supplier. The delivery of the release would have had the effect of disqualifying the plaintiff from the class proceeding. The Court granted the relief sought partially on the basis

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[19] See Salah, Note 18, *supra*.
[20] See *Katokidis*, Note 15, *supra.*
[21] 2010 ONCA 478 (herein, "Midas").

that section 4(4) voids any provision in a franchise agreement which "purports" to interfere with or restrict the exercise of the right of association, including provisions which "have the effect of interfering or restricting the statutory right and not merely those which assert or profess an intention to do this." In other words, the fact that the requirement for a release arose in the context of an assignment by the franchisee of its franchise agreement and did not directly and expressly interfere with the right to participate in a class action did not prevent the Court from holding that the requirement in the franchise agreement for a release was void.

9. Rights Cannot be Waived

Section 11 of the Act provides as follows:

> *11. Any purported waiver or release by a franchisee of a right given under this Act or of an obligation or requirement imposed on a franchisor or franchisor's associate by or under this Act is void.*

This "anti-waiver" provision ensures that franchisees cannot intentionally or unknowingly compromise the rights and remedies available to them under the Act.[22] The anti-waiver provision renders void any attempt to contract out of the rights, obligations and requirements of the Act. A franchisor cannot, for example, enforce an agreement to dispense with its disclosure obligations and the franchisee's accompanying rescission rights. Nor can a franchisor bind a franchisee to ignore the franchisor's duty of fair dealing, or to agree not to associate with other franchisees. Finally, a franchisee cannot contract out of its statutory rights to damages arising from a franchisor's breach of its obligations to act in good faith, to permit association, and to comply with its disclosure obligations.

Despite the foregoing, the Courts will uphold a release of existing known claims given by a franchisee with the benefit of independent legal advice, as part of a negotiated settlement between the franchisor and the franchisee.[23] In the *Tutor Time* decision, the Courts upheld the public policy rationale which supported permitting parties to finally settle their disputes in an informed negotiation for fair consideration with the benefit of legal counsel.

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[22] See *Dig This Garden*, Note 9, *supra.*
[23] See *1518628 Ontario Inc. v. Tutor Time Learning Centre, LLC* 2006 CANLII 25276 (Ont. S.C.J.) (herein, "Tutor Time")

As discussed above in *Midas*[24], a release given as a condition to assignment or renewal of a franchise agreement is *prima facie* void pursuant to Section 11 and that provisions in a franchise agreement requiring such releases as conditions to the franchisor's consent to assignment or renewal are unenforceable. As a result of *Midas*, the longstanding practice of requiring a general release as a condition of renewal or assignment has been modified. Franchisors may request releases of matters which are not protected by section 11 (ie common law claims), but must be cautious in requiring any waivers or releases of statutory rights of the franchisee or statutory obligations of the franchisor, upon any assignment or renewal.

10. Preparation and Review of Franchise Disclosure Document

The preparation of a franchise disclosure document that complies with the Act (and with the franchise laws in force in Alberta, PEI and NB) is an increasingly complex undertaking which requires not only an exhaustive and current knowledge of the legislation but also very disciplined practices and procedures. The latter will ensure that all material facts and other required information are made available to the drafter and technical knowledge will ensure that the information is presented in the correct manner.

(a) Information Gathering

Typically, data is collected directly from the franchisor and its directors, officers and managers through the use of questionnaires which are tailored to solicit information specifically required from such individuals pursuant to the Act's regulations. In addition to the statutorily prescribed disclosures, the questionnaires must include general and specific inquiries about the existence of other facts which may be known by the franchisor's executives and which may, if known to the franchisee, impact negatively upon the franchisee's decision to purchase the franchise or the price it would be willing to pay for the franchise. Examples of such material facts may include decisions of the franchisor (whether or not implemented) to materially alter the brand image, product mix or trade dress of the franchise system at some time in the future; plans to expand, merge, acquire or divest some or all of the franchised business; plans to repatriate franchises to corporate or vice versa; decisions to expand into new channels of trade which may impact upon the traditional franchise delivery model; and settled, pending or threatened proceedings or lawsuits. Other types of information which require specific inquiry may include:

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[24] See Midas, *Supra*, Note .

- Impact of specific or proposed regulatory, market or local changes on the operation of the franchised business
- Background and risk factors relating to the nature of the franchised business
- Warranty, return, customer complaint and employee policies
- Requirement for the grant of security and personal guarantees
- Historical revenue data of individual franchisees

While the disclosure document is ultimately the franchisor's product, the quality of the questionnaire will influence the quality of the responses and therefore cannot be overlooked. Questionnaires should be supplemented with interviews in order to discern information specific to the particular franchise, and franchisor's counsel are advised to review all documentation pertaining to the franchisee recruitment process, such as sales and promotional materials, websites and application forms, in order to ensure that these documents are consistent with the information contained in the disclosure document.

(b) Sufficiency of Disclosure

As noted above, the Act requires that the franchise disclosure document be delivered as one document at one time[25] and include all information required by the Act and Regulations, including all prescribed information, material facts (as that term is defined in the Act), facts required by the regulations, financial statements, copies of all agreements relating to the franchise and the certificate of the directors or officers, in an accurate, clear and concise presentation. Piecemeal delivery of the constituent elements of the disclosure document is not permitted in Ontario[26] and failure to include all of the elements of the disclosure at one time may result in a finding that "no disclosure document" was provided within the meaning of the Act, exposing the franchisor to the two year rescission window. It is noteworthy that franchise legislation in PEI and Alberta[27] do provide that a disclosure document will be properly given if it is "substantially complete", although there is no clear judicial definition of the term. Manitoba's pending legislation states that a franchisor complies with its disclosure obligations if its

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[25] See *MAA Diners Inc. v. 3 for 1 Pizza & Wings (Canada) Inc.*, [2003] O.J. No. 430 and *Dig this Garden*, Note 9, *supra*.
[26] *Dig this Garden,* Note 9, *supra.*
[27] See section 2(4) of Alberta Regulation 240/95 and section 3(3) of the PEI Regulation Chapter F-14.1.

document "substantially complies" with the Act and "even if the disclosure document contains a technical irregularity or mistake not affecting the substance of the document"[28].

As described above, the Alberta Court of Appeal held in *Hi Hotel* that failure to sign and date the required certificate attesting to the accuracy and completeness of the disclosure document invalidated the disclosure document and was tantamount to no disclosure, affording the franchisee the right to rescind the franchise agreement within the two year rescission period.[29]

This judicial trend is reflected in Ontario, where circumstances in which a disclosure document though given at one time and on time but which lacked certain critical material information, including the signed certificate, details of the franchisor's associates, required financial disclosures, disclosures relating to the advertising fund, and policies respecting exclusive territory and rebates, was found not to be a "disclosure document" within the meaning of the Act.[30] The practical effect of the judicial activism in Ontario, as discussed above, is to raise the standard of care of franchise lawyers in their drafting of disclosure documents and to ensure that franchisors are scrutinizing their disclosure procedures to ensure that no critical issues are overlooked.

In practice, a disclosure document prepared for use in the U.S. is not suitable for use in Ontario.[31] While much of the information from the U.S. FDD can be imported with little and in some cases no modification, practice standards dictate that an Ontario (or provincially) specific disclosure document should be drafted.[32] As earlier noted, the Alberta, NB, PEI and Manitoba statutes expressly permit the use of a "wrap around" or supplementary addendum to a disclosure document of another jurisdiction. The addendum must contain all information and statements which are specifically required by the province's legislation.

Franchisors are usually advised to make voluntary disclosure in provinces without disclosure laws in order to ensure fairness amongst franchisees and to comply with the Code of Ethics of the Canadian Franchise Association. The franchisor would normally not provide a signed certificate as it would in the disclosure provinces, and is advised to obtain an acknowledgement and release from the prospective franchisee agreeing that the disclosure is voluntary and

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[28] See section 5(10) of the *Franchises Act* (Manitoba).
[29] See *Hi Hotel*, Note 5, *supra*.
[30] See *Dollar It*, Note 11, *supra*. See also Sovereignty Investment, Note 10, *supra.*
[31] Section 5(6) of the Act requires all information in a FDD or statement of material change to be accurately, clearly and concisely set out.
[32] See, for example, Tutor Time, Note 23, supra, at 72 and 73.

releasing the franchisor from any claims resulting from discrepancies between information or assumptions in the FDD and the market realities of the prospect's home province.

11. Method of delivery and receipt

(a) Delivery

The Act requires that the disclosure document be delivered in person, by registered mail, or by other prescribed means. No other means have been prescribed. The Alberta Act simply requires that the franchisor "give" the document to the prospective franchisee.

The PEI Act's regulations permit, in addition to personal and mail delivery, electronic delivery and delivery by courier provided a receipt is given. Electronic disclosure may be used provided the document is in a single integrated document or file, has no extraneous content beyond what is required by law, has no links to or from external documents or content, is capable of being stored, retrieved and printed, conforms to legal form and content requirements, is recorded by the franchisor and is acknowledged by the franchisee in writing. The NB Act also permits delivery by prepaid courier and delivery by electronic means on terms similar to the PEI legislation.

(b) Receipt

The various provincial franchise statutes require that the disclosure document be provided and the prospective franchisee receive the document not less than 14 days prior to the execution of any agreement or the receipt of any payment. Although not expressly required by the legislation, it is strongly recommended that the franchisor obtain a signed and dated receipt from the franchisee acknowledging that it has received a complete copy of the relevant disclosure document together with all attachments. In addition, the franchisor should retain an exact duplicate copy of the disclosure provided for evidence purposes if needed in the future.

12. Statement of material change

A franchisor must deliver to a prospective franchisee a written statement detailing any material change as soon as possible after such change and before the earlier of the signing of any agreement relating to the franchise and the payment of any consideration in relation to the franchise. Material change is defined in section 5(5) of the Act as:

> "a change in the business, operations, capital or control of the franchisor or franchisor's associate, a change in the franchise system or a prescribed change, that would reasonably be expected to have a significant ***adverse*** effect on the value or price of the franchise to be granted or on the decision to acquire the franchise and includes a decision to implement such a change made by the board of directors of the franchisor or franchisor's associate or by senior management of the franchisor or franchisor's associate who believe that confirmation of the decision by the board of directors is probable;"
>
> [emphasis mine]

It is important to note that only adverse material changes are worthy of supplementary disclosure and that changes which benefit the franchisee (such as amendments to the franchise agreement which do not affect the balance of the document) do not need to be disclosed.

The legislation does not prescribe that the franchisee is entitled to an additional 14 days from the date of the statement to contemplate the material changes. However, the prospective franchisee should be given reasonably sufficient time to consider the changes and consult with their professional advisors as to the effects of the new information.

The format of the material change statement is not prescribed. The statement should at a minimum refer to the original disclosure document and its headings and subheadings in order to meet the Act's requirements of accuracy, clarity and conciseness. The statement should be certified in the same manner as the original disclosure document and should be delivered by means permitted by the applicable regulations.

13. Correcting a disclosure document after the fact

Where a franchisor or its counsel discover, prior to the execution of a franchise agreement, that a deficient disclosure document has been provided to a prospective franchisee, it may correct the disclosure by immediately retracting the original disclosure and reissuing a fresh (and corrected) disclosure document with a new 14-day waiting period.

The real issue arises when a franchisor discovers a material deficiency after the franchise agreement is entered into. The franchisor is faced with a true conundrum in that failure to correct the disclosure leaves it with a potentially disastrous liability, albeit limited by the appropriate rescission and statutory limitations periods, respectively. Admission of the defect (howsoever minor) and the request for correction may precipitate a demand for consideration by the franchisee (or even worse, the threat of a claim) which may prove disproportionate to the gravity of the deficiency.

It has been proposed[33] that a franchisor could deliver corrected disclosure accompanied by an offer to the franchisee to rescind the franchise agreement. If the franchisee acquiesces, a replacement franchise agreement could be entered into, at the expiry of the 14-day disclosure period, on the same terms as the original contracts. This would "novate" the agreement, there would arguably be no original "grant" left to rescind and limiting section 7 damages under the Act. Consideration for the novation and the new "grant" would be the discharge of the obligations under the existing contract.

14. Key Differences between the provincial statutes

While the provincial franchise disclosure statutes of Ontario, Alberta, PEI and NB share most of their basic elements, there are certain significant differences that highlight the innovations in the newer statutes and some of the shortcomings of the Act. It is important when drafting disclosure documents for different provinces or when creating a national disclosure document to be acutely aware of these differences and to ensure that the standard of disclosure is met for each province in which the franchisor recruits franchisees. Without intending to be exhaustive, some of the principal differences are set out below:

(a) Exclusion of wholesale arrangements

The Alberta, PEI and NB Acts specifically exclude arrangements where the distributor is required to purchase goods but which are at *bona fide* wholesale prices. The Act does not provide for this. Accordingly, arrangements which involve the purchase of goods, even for *bona fide* wholesale prices, for sale in connection with a trademark where the vendor exercises some control over the purchaser or provides some measure of assistance, must be carefully tailored to avoid arguments that they constitute franchise relationships.

(b) Agreements relating to the franchise

The Act prohibits the entering into of any agreement relating to the franchise prior to the expiry of the 14-day waiting period. The PEI, Alberta and NB Acts permit the execution of confidentiality and site selection agreements at any time. The Alberta Act also permits the execution of fully refundable deposit agreements at the outset of the franchise relationship and prior to the expiry of the 14 day waiting period. This omission from the Act prevents a franchisor from obtaining a deposit at the outset of the relationship and perhaps more onerously, from

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[33] Trebilcock, Arthur, "Draft Disclosure Documents: Some Issues and Tips", 5th Annual Franchise Law Conference, Ontario Bar Association, September 21, 2005, pp.15-16.

protecting confidential disclosures in its FDD by means of a binding non-disclosure agreement. This is somewhat (although unsatisfactorily) remedied by the practice of drafting a notice on the covering page of the FDD indicating that it is a confidential document.

(c) Substantial completeness

As indicated above, the Alberta and PEI legislation provide that a substantially complete disclosure document is deemed to satisfy the requirements of the respective statutes. As we have earlier noted, the Act requires strict compliance with the disclosure requirements to avoid the possibility of a rescission argument under section 6(2) of the Act.

(d) Delivery

The NB Act and PEI Act permit delivery by courier and electronic delivery of the disclosure document, subject to certain conditions to ensure that the electronic documents are functionally equivalent to the paper versions. The PEI Act also expressly provides that the FDD may be delivered in machine-readable media and the NB Act expressly permits delivery by fax.

(e) Wrap-around

The PEI, NB and Alberta Acts permit the use of a disclosure document prepared to comply with the requirements of another jurisdiction (eg. a U.S. FDD) provided that supplementary information (commonly known as a wrap-around) is included to comply with the requirements of the applicable Act.

(f) Application to the Crown

The PEI Act exempts the government and its agents (the "Crown") in its entirety, whereas the Ontario Act exempts service contracts or franchise-like arrangements with the Crown. Alberta and Manitoba have no exemption for the Crown. Section 2(1) of the NB Act expressly binds the Crown.

(g) Background of directors and officers

The Alberta Act and PEI Act limit disclosure to the business background of directors, general partners and officers of the franchisor who will have day to day management responsibilities relating to the franchise while the Act requires disclosure of <u>all</u> directors and officers, irrespective of a director or officer's role in the management and operation of the franchisor or the franchise system.

(h) Time limits on disclosure of past administrative and civil actions

The PEI Act and NB Act limit disclosure of liabilities relating to misrepresentation, unfair or deceptive practices or violation of law regulating franchising (including a failure to provide proper disclosure) to the past 10 and 5 years preceding the date of the FDD, respectively. The analogous disclosures required under the Ontario and Alberta Act look back indefinitely.

(i) Guarantees and security interests

The PEI Act requires disclosure of the franchisor's requirements relating to guarantees and security interests to be provided by franchisees.

(j) Operations Manual

The NB Act requires disclosure of the table of contents of each operations manual used in the system or a statement of the location in New Brunswick where the manuals may be inspected.

(k) Internet and distance sales

The NB Act further requires the disclosure of the franchisor's policies respecting internet and distance sales. With the growth of ecommerce and the possibility of encroachment on traditional sales channels such as retail franchises, the addition of this disclosure is an important development.

(l) Dispute resolution

The NB Act contains a dispute resolution procedure whereby any party to the franchise agreement may deliver a notice to the other party setting out the dispute. The parties have 15 days within which to seek to resolve the dispute. After the expiry of such period, either party may deliver a notice to mediate the dispute. Mediation procedures are prescribed in a separate regulation.

There exist other differences and discrepancies between the various statutes and the reader is encouraged to review the various Acts and their regulations in detail to gain a comprehensive appreciation of these distinctions.

15. Conclusion

It is clear from the Courts' decisions that the Act will be broadly interpreted to ensure that the principles and purpose of franchise legislation will be met. The opportunity to level the playing

field and to remedy the apparent imbalance of power in the franchisor-franchisee relationship is being met by the Courts through a strict enforcement of the key provisions of the Act: the obligation placed upon franchisors to provide disclosure to prospective franchisees, the duty of fair dealing imposed on parties to a franchise agreement, the right of franchisees to associate and the bar against franchisees waiving rights granted to them under the Act. Whether or not one agrees with the extent to which the Courts have gone in their interpretation of these key provisions, the reality is that franchise legislation is a part of the franchise landscape and a key element for those wishing to expand their businesses through franchising.

OBA Institute 2012
Dealing with and Litigating Disputes Involving Franchises

The Arthur Wishart Act (Franchise Disclosure), 2000

An Overview

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Purpose:

- Regulation of the franchise marketplace
- Protection of prospective and current franchisees
- Compensate for perceived imbalance of power

3 Key Elements:

- The obligation imposed on franchisors to provide disclosure
- The duty of fair dealing imposed on each party to a franchise agreement
- The right of franchisees to associate

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"franchise"

means a right to engage in a business where the franchisee is required by contract or otherwise to make a payment or continuing payments, whether direct or indirect, or a commitment to make such payment or payments, to the franchisor, or the franchisor's associate, in the course of operating the business or as a condition of acquiring the franchise or commencing operations and, ,

(a) in which,

(i) the franchisor grants the franchisee the right to sell, offer for sale or distribute goods or services that are substantially associated with the franchisor's, or the franchisor's associate's, trade-mark, service mark, trade name, logo or advertising or other commercial symbol, and

(ii) the franchisor or the franchisor's associate exercises significant control over, or offers significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training, or

(b) in which,

(i) the franchisor, or the franchisor's associate, grants the franchisee the representational or distribution rights, whether or not a trade-mark, service mark, trade name, logo or advertising or other commercial symbol is involved, to sell, offer for sale or distribute goods or services supplied by the franchisor or a supplier designated by the franchisor, and

(ii) the franchisor, or the franchisor's associate, or a third person designated by the franchisor, provides location assistance, including securing retail outlets or accounts for the goods or services to be sold, offered for sale or distributed or securing locations or sites for vending machines, display racks or other product sales displays used by the franchisee;

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Franchisor's obligation to disclose

5(1) A franchisor shall provide a prospective franchisee with a disclosure document and the prospective franchisee shall receive the disclosure document **not less than 14 days before the earlier of**,

(a) the signing by the prospective franchisee of the franchise agreement **or any other agreement** relating to the franchise; and

(b) the payment of any consideration by or on behalf of the prospective franchisee to the franchisor or franchisor's associate relating to the franchise

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Contents of disclosure document

The disclosure document shall contain,

(a) all material facts, including material facts as prescribed;

(b) financial statements as prescribed;

(c) copies of all proposed franchise agreements and other agreements relating to the franchise to be signed by the prospective franchisee;

(d) statements as prescribed for the purposes of assisting the prospective franchisee in making informed investment decisions; and

(e) other information and copies of documents as prescribed

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"material fact"

includes any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise

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Certification

O. Reg. 581/00, s. 7

(1) 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

(2) A certificate referred to in subsection (1) shall be signed and dated by,

(a) in the case of a franchisor that is not incorporated, the franchisor;
(b) in the case of a franchisor that is incorporated and has only one director or officer, by that person;
(c) in the case of a franchisor that is incorporated and has more than one officer or director, by at least two persons who are officers or directors

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Delivery Requirements

- A disclosure document may be delivered personally, by registered mail or by any other prescribed method
- A disclosure document must be one document, delivered …as one document at one time
- All information in a disclosure document and a statement of a material change shall be accurately, clearly and concisely set out

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Rescission Remedy

Rescission for late disclosure

6.(1) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than 60 days after receiving the disclosure document, if the franchisor failed to provide the disclosure document or a statement of material change within the time required by section 5 or if the contents of the disclosure document did not meet the requirements of section 5.

Rescission for no disclosure

(2) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the franchise agreement if the franchisor never provided the disclosure document

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Franchisor's obligations on rescission

The franchisor, or franchisor's associate, as the case may be, shall, within 60 days of the effective date of the rescission,

a) refund to the franchisee any money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment;

b) purchase from the franchisee any inventory that the franchisee had purchased pursuant to the franchise agreement and remaining at the effective date of rescission, at a price equal to the purchase price paid by the franchisee;

c) purchase from the franchisee any supplies and equipment that the franchisee had purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee; and

d) compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts set out in clauses (a) to (c).

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Leading Disclosure Cases

1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd. [2005] O.J. No. 3040

- Main purpose of the Act is the obligation imposed on the franchisor to make full and accurate disclosure so that a prospective franchisee can make an informed decision about investing in the franchise opportunity
- Strict compliance with the disclosure requirements of the Act and the Regulations is required
- If the disclosure document does not comply it will be deemed not to be a disclosure document
- Disclosure provided to a prospective franchisee piecemeal over a period of time does not to meet the Act's requirements.

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Leading Disclosure Cases

686289 Canada Limited v. Dollar It Limited

Ontario Court of Appeal -"Ss. 6(1) and 6(2) must be read and interpreted broadly"

Deficiencies noted by the Court included:

- ✓ Signed and dated Certificate of Disclosure;
- ✓ Financial statements or an opening balance sheet;
- ✓ Copy of the lease for the premises under which the franchisee was the subtenant;
- ✓ Information on the franchisor's affiliate which was the tenant and sublandlord of the premises;
- ✓ Prescribed information pertaining to the franchisor's advertising program; and
- ✓ Description of the exclusive territory to be granted and the franchisor's policy on proximity between the franchisees.

Each of the foregoing was material information required for the franchisee to make an informed investment decision

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Leading Disclosure Cases

Sovereignty Investment Holdings, Inc. v. 9127-6907 Quebec Inc.

The Court identified four deficiencies in a disclosure document, any of which was fatal to compliant disclosure:

- •Failure to include financial statements
- •Failure to include a statement specifying the basis for earnings projections provided in the disclosure document
- •Failure to provide disclosure in a single document at one time; and
- •The absence of a signed certificate of disclosure

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Damages for misrepresentation, failure to disclose

7(1)If a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or in a statement of a material change or as a result of the franchisor's failure to comply in any way with section 5, the franchisee has a right of action for damages

Misrepresentation includes "an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made."

Deemed reliance by the franchisee where there is a misrepresentation in a disclosure document.

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DUTY OF FAIR DEALING

3(1) Every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement

…the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

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THE DUTY OF FAIR DEALING

Shelanu v. Print Three

- Establishment of a downmarket print franchise near an existing Print Three location was contrary to the duty of good faith

Katokidis v. Mr. Submarine

- Punitive damages awarded for the franchisor's breach of the duty of fair dealing where franchisor opened a competing franchise

Salah v. Timothy's Coffees of the World Inc.

- the franchisor breached the duty of fair dealing where it deliberately interpreted the franchise agreement renewal provisions in order to avoid renewal of the franchise agreement by an existing franchisee

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RIGHT OF ASSOCIATION

4(1) *A franchisee may associate with other franchisees and may form or join an organization of franchisees.*

(2) *A franchisor and a franchisor's associate shall not interfere with, prohibit or restrict, by contract or otherwise, a franchisee from forming or joining an organization of franchisees or from associating with other franchisees.*

(3) *A franchisor and franchisor's associate shall not, directly or indirectly, penalize, attempt to penalize or threaten to penalize a franchisee for exercising any right under this section.*

(4) *Any provision in a franchise agreement or other agreement relating to a franchise which purports to interfere with, prohibit or restrict a franchisee from exercising any right under this section is void.*

S. 4 has been interpreted to validate a franchisee's participation in a class action claim against its franchisor (*405341 Ontario Limited v. Midas Canada Inc.*).

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RIGHTS CANNOT BE WAIVED

11. *Any purported waiver or release by a franchisee of a right given under this Act or of an obligation or requirement imposed on a franchisor or franchisor's associated by or under this Act is void.*

405341 Ontario Limited v. Midas Canada Inc.

- A release given as a condition to assignment or renewal is *prima facie* void pursuant to s. 11 and the requirement to provide the release is unenforceable.

But see: 1518628 Ontario Inc. v. Tutor Time Learning Centre

- Release is valid where given for valuable consideration as part of a settlement of an action between the franchisor and franchisee, in respect of an existing, known claim by an informed franchisee who has had the benefit of independent legal advice.

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Preparation and Review of Disclosure Documents

Information gathering

- Data typically collected by questionnaire and supplemented with interviews
- Quality of questionnaire is key.
- Must provide not only prescribed disclosure but also other material facts which may impact on price of franchise or on decision to acquire franchise
- Consider whether internal matters need to be disclosed:
  - Ownership changes
  - Shareholder disputes
  - System changes
  - Decisions to acquire systems
  - Changes to business mix/new products etc.
  - Pending or threatened lawsuits

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Preparation and Review of Disclosure Documents

Sufficiency of Disclosure

- Document delivered as one document at one time and must be complete
- In *1490664 Ontario Ltd. V. Dig this Garden* – piecemeal delivery resulted in a finding that no disclosure document was provided
- Failure to disclose certain critical information, including the signed certificate, details of franchisor's associates and required financial disclosures, can invalidate disclosure (see *6792341 Canada Inc. v. Dollar It Limited, Hi Hotel, Sovereignty*)
- AB and PEI allow "substantial disclosure". Manitoba Act permits piecemeal delivery subject to conditions.

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Preparation and Review of Disclosure Documents

Methods of Delivery and Receipt

- Ontario Act requires delivery in person or by registered mail. Packages often exceed the weight limit and courier with delivery receipt often employed.
- PEI and NB Acts permit delivery by courier and electronic means, and PEI permits disclosure in machine-readable media
- Electronic Commerce Act suggests that electronic disclosure would be acceptable in Ontario if functional equivalency rules observed but this is not common practice and has risks
- 14 day count begins on date of signed receipt

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Material Change

Material change is defined in section 5(5) of the Act as:

- "a change in the business, operations, capital or control of the franchisor or franchisor's associate, a change in the franchise system or a prescribed change, that would reasonably be expected to have a **significant adverse effect** on the value or price of the franchise to be granted or on the decision to acquire the franchise and **includes a decision** to implement such a change made by the board of directors of the franchisor or franchisor's associate or by senior management of the franchisor or franchisor's associate who believe that confirmation of the decision by the board of directors is probable"
- Franchisor must deliver written statement detailing any material change as soon as practicable after the change and prior to execution of any franchise agreement or payment of consideration
- Timing and format are not prescribed but the statement should be delivered and certified in the manner prescribed

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Correcting a Disclosure Document

Scenario One:

- If the Franchise Agreement has not been signed, retract the earlier FDD, reissue the corrected document and reset the clock

Scenario Two:

- If the FA has been signed, then franchisor must weigh pros and cons
- Possible solution – deliver corrected FDD accompanied by offer to rescind franchise agreement; sign the new FA after 14 days if franchisee acquiesces

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Correcting a Disclosure Document after the fact

- Failure to disclose deficiency subjects franchisor to potentially significant liability
- Disclosure may result in demand for consideration by franchisee
- Potential solution – deliver corrected disclosure accompanied by offer to rescind franchise agreement

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Differences between Provincial Statutes

- Wholesale agreements not excluded from ON Act
- PEI, NB and AB Acts permit execution of confidentiality and site selection within the 14-day waiting period
- AB and PEI provide that substantially complete disclosure document satisfies requirements
- NB and PEI Acts permit delivery by courier and electronic means
- PEI, NB and AB Acts permit use of disclosure document prepared to comply with requirements of another jurisdiction
- Contracts with the Crown treated differently by various Acts
- ON Act requires disclosure for all directors and officers, regardless of role in management of franchisor
- NB Act contains a novel dispute resolution procedure

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Conclusion

- Act is broadly interpreted to ensure remedial purpose of legislation is met
- In attempt to remedy imbalance of power, courts are strictly enforcing key provisions relating to disclosure obligations, fair dealing, rights to associate and anti-waiver provisions
- Current knowledge of laws and jurisprudence are essential

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QUESTIONS?

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Institute 2012 of Continuing Professional Development

Franchise Law
Dealing With and Litigating Disputes Involving Franchises

Hot Spots in Franchising

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With thanks to KRISTINA DAVIES of Teplitsky, Colson LLP for her assistance

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A Branch of the Canadian Bar Association

DEALING WITH AND LITIGATING DISPUTES INVOLVING FRANCHISES - HOTSPOTS IN FRANCHISING

By IAN ROHER, Teplitsky, Colson LLP and
FRANK ZAID, Osler, Hoskin & Harcourt LLP

A. INTRODUCTION

The relationship between a franchisor and franchisee is one of independent contractors and is established contractually through a number of documents, principally a franchise agreement. There may be ancillary agreements, depending upon the nature of the franchise, between the franchisor and the franchisee, including a lease and/or a sublease, a guarantee by the principals of the franchisee if the franchisee is a corporation, a security agreement in favour of the franchisor securing payments and other obligations under the franchise agreement, a software licence agreement, separate non-competition agreements executed by officers, directors and/or shareholders of the franchisee corporation, and specialized documents depending upon the nature of the franchise including a reservations systems agreements, loan documents, promissory notes, internet usage and participation agreements, pre-authorized deposit agreements and assignment agreements. While disputes between franchisors and franchisees typically arise under the franchise agreement, ancillary or additional disputes may also arise under any of the other documents executed by the parties in connection with the franchise.

In addition to contractual disputes, with the enactment of the *Arthur Wishart Act (Franchise Disclosure)*[1] (the "*Act*"), certain statutory obligations between the parties also exist. These obligations include the obligation of the franchisor to deliver a disclosure document (subject to applicable exemptions), the obligation on each party to deal fairly in respect of the performance and enforcement under the franchise agreement, a prohibition of the franchisor against interfering with a franchisee from forming or joining an organization of franchisees or from associating with other franchisees, the right of a franchisee to rescind the franchise agreement for late disclosure or no disclosure, and a prohibition against a waiver or release by a franchisee of a right given under the legislation or an obligation or a requirement imposed on a franchisor by or under the legislation.

Since enactment of the *Act*, there has been a continually increasing number of franchise disputes heard by the courts with respect to the statutory obligations imposed under the *Act*. These claims may also include contractual claims. The claims may be brought by an individual franchisee, a group of franchisees, or a class proceeding.

This paper will canvas the following "hotspots" in franchising involving disputes between franchisors and franchisees:

1. Problems with the content of franchise disclosure documents.

2. Problems with the franchise disclosure process.

3. Misrepresentation in franchising.

4. Disputes relating to the duty of good faith and the right to associate.

5. Common contractual troubles spots, including claims relating to advertising funds, the supply chain, renewals and re-sales.

[1] *Arthur Wishart Act (Franchise Disclosure) 2000*, S.O 2000, c. 3 (the "*Act*").

The paper will also canvas a lawyer's duties related to the content of and process relating to franchise disclosure documents.

B. PROBLEMS WITH THE CONTENT OF FRANCHISE DISCLOSURE DOCUMENTS

1. Definitions

The *Act* requires a franchisor to deliver a disclosure document to a prospective franchisee The Regulations to the *Act* (the "Ontario Regulations")[2] contain details of the disclosure requirements. The starting point for determining whether a disclosure document is required is to determine whether the arrangement between the parties constitutes a "franchise" as defined in section 1(1) of the *Act*. The definition is complicated and difficult to interpret. In effect, it is a two part definition covering traditional business format franchises, and business opportunities. However, due to the all encompassing definition, many relationships commonly known as distributorships or dealerships can be caught by the definition. The essential elements of a franchise include the following:

- Franchisee required to make a payment or continuing payments.
- Payments to be made to the franchisor.
- Payments made in the course of operating the franchise or as a condition of acquiring the franchise.
- Franchisor grants the franchisee the right to sell or distribute goods or services substantially associated with the franchisor's trade-marks.
- Franchisor exercises significant control over, or offers significant assistance in, franchisee's method of operation.

Along with analysing whether the arrangement constitutes a "franchise", it is equally necessary to determine who is the "franchisor" and who may be the "franchisor's associate". Both terms are defined in the *Act* and are relevant in establishing who is required to deliver the disclosure document.

In *1706228 Ontario Ltd. v. Grill It Up Holdings Inc.*[3], the plaintiff brought an action seeking a return of its deposit and damages for an aborted transaction to purchase a restaurant from the Defendants. The plaintiff sought damages on the basis that it had agreed to purchase a franchise but never received a disclosure document. The Defendants argued that the parties intended to enter into a franchise agreement but never did so and that instead, they executed an asset purchase agreement, a sub-lease and a licence agreement. A draft franchise agreement had been prepared by the Defendants and rejected by the plaintiffs and both parties proceeded towards closing without a document formally described as a "franchise agreement". The Court determined that the definition of "Franchise" under the *Act* addressed the substance of the relationship and not whether the parties executed a document titled a "franchise agreement." The Court further found that the parties' dealings constituted a franchise transaction because the characteristics of the relationship met the definition of "franchise" under s. 1(a) and (b) of the *Act*. Such characteristics included, among others, the following:

a. The parties understood they were entering into a franchise relationship;

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[2] O. Reg. 581/00
[3] *1706228 Ontario Ltd. v Grill It Up Holdings Inc.* 2011 ONSC 2735

b. The transaction was structured in a manner typical of franchise transactions;

c. The Defendant granted the plaintiff the right to sell and offer for sale food that was associated with their name and trademarks; and

e. The Defendants, although they had not exercised control over the plaintiff, did offer significant assistance respecting the store, construction, design, equipment, location, menu, training and branding.

In *MBCO Summerhill Inc. v. MBCO Associates Ontario Inc.*[4], on a motion for summary judgment brought by the franchisee seeking rescission and return of monies payable under the *Act*, the motions judge held that a principal of the Defendant, Elian, was a franchisor's associate on the basis that a. he was directly involved in the grant, b. he met with the principal of the plaintiff on several occasions and c. he ran the day to day business of the Defendant franchisor.

The motions judge also found that the Defendant, MBCO Rosedale, which entered into a sublease with the plaintiff for the premises in which the franchise would be operated, was also a franchisor's associate. This finding was made on the basis that Elian was the president and sole shareholder of MBCO Rosedale and that he signed various agreements with the plaintiffs on behalf of MBCO Rosedale. Moreover, the plaintiff franchisee had an ongoing obligation pursuant to the sublease to pay rent to MBCO Rosedale for the duration of the agreement and thus, MBCO Rosedale exercised "significant operational control" over the plaintiff franchisee.

On appeal, the finding of the motions judge that Elian was a franchisor's associate was upheld. However, the Court set aside the order finding that MBCO Rosedale was a franchisor's associate on the basis that the motions judge had not cited evidence to support the finding that MBCO Rosedale "exercised significant operational control" over the franchisee. Accordingly, that issue was ordered to proceed to trial.

2. Form and Content

With respect to the actual content of franchise disclosure documents, as set out in the Ontario Regulations, there are a number of specific items that must be contained in the disclosure document. Pursuant to section 5(4) of the *Act*, a disclosure document must contain[5]:

- all material facts (a defined term);
- material facts prescribed in the Ontario Regulations;
- financial statements as prescribed in the Ontario Regulations;
- copies of all proposed franchise agreements and other agreements relating to the franchise to be executed by the prospective franchisee;
- statements prescribed in the Ontario Regulations for the purposes of assisting the prospective franchisee in making informed investment decisions; and
- other information and copies of documents as prescribed (none prescribed to date).

[4] *MBCO Summerhill Inc. v MBCO Associates Ontario Inc.* 2011 ONSC 5432; 2011 ONCA 236

[5] *Act*, *supra* note 1 at s. 5(4)

Section 5(6) of the *Act* requires that all information in a disclosure document should be accurately, clearly and concisely set out.[6] On occasion this requirement may conflict with the obligation to provide details with respect to material facts, including the prescribed material facts. However, it is generally the view of most franchise practitioners that over-disclosure is preferred to under-disclosure in terms of the risk analysis pertaining to the right of rescission for incomplete disclosure.

3. Franchisor Information

The Ontario Regulations require disclosure of business background information concerning the franchisor, including the name and address of the franchisor as well as the name and business form under which the franchisor does or will do business. If incorporated, the jurisdiction of incorporation of the franchisor must be included and if the franchisor is a subsidiary, the name and principal business address of its parent corporation must be included. The names of affiliates and predecessors are not expressly required under the Ontario Regulations, but are recommended to be included if they would be considered to be material facts as defined in the *Act*.[7]

The principal business address of the franchisor is required and, if the principal business address is outside Ontario, the name and address of a person authorized to accept service in Ontario on the franchisor's behalf must be disclosed. The principal business addresses of affiliates who have dealings with the prospective franchisee may well be considered to be material, but the principal business address of a predecessor in many cases will not be considered to be material.

The disclosure document must include a description of the franchisor's business and the franchises to be offered. In addition, the franchisor must disclose how long it has been selling the franchises, the length of time it has operated a similar business, whether the franchisor sells franchises in other lines of business (including a description of each), the number of franchises sold in the previous five years in each other line of business, the length of the time the franchisor has offered franchises in the other lines of business. Similar disclosures are recommended for affiliates or a predecessor if the information would constitute a material fact.[8]

The names of the directors, general partners and officers of the franchisor and their current positions are required to be disclosed. Unlike in other provinces, disclosure in Ontario is not limited to those persons who will have day-to-day management responsibilities relating to the franchise. The disclosure document must also contain a description of each person's principal occupation and employers during the five years preceding the date of the disclosure document, and a brief description of the relevant prior business experience of such persons and the length of time each has engaged in the line of business of the franchise.[9]

4. Litigation History

A franchisor is required to provide details relating to the franchisor and its affiliates of any of the directors, general partners, and officers of the franchisor on currently pending criminal charges involving a violation of a law that regulates franchises or other businesses or offences involving fraud, embezzlement, unfair or deceptive acts or practices, and other comparable offences. Details relating to such parties are also required in respect of any currently pending civil actions including violation of a law that regulates franchises or other businesses and actions involving misrepresentation, unfair or deceptive

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[6] *Act, supra* note 1 at s. 5(6).
[7] *O. Reg. 581/00, supra* note 2 at s. 2(1).
[8] *Ibid* at s. 2(1).
[9] *O. Reg. 581/00, supra* note 2 at s. 2(2).

acts of practices, and other comparable actions regardless of the merits or status of such actions. For past or concluded criminal matters, the requirement is to provide details on convictions relating to the franchisor and its affiliates and any of the directors, general partners and officers of the franchisor for the commission of such criminal offences. For past or concluded civil matters, the requirement is to provide details relating to all such persons on any finding of liability in a civil action involving any such civil matters. It is uncertain as to whether the disclosure requirements for civil matters includes matters subject to arbitration, and arbitration decisions.[10]

The franchisor is also required to provide details relating to such persons of any prior administrative order or penalty, including any currently effective injunctive or restrictive orders imposed by, or any pending administrative actions to be heard before, any public agency, involving a law that regulates franchises or other businesses.[11]

Details on criminal convictions are required for the previous ten years, but there is no time limit regarding the disclosure of the details of civil or administrative matters.

If a franchisor is involved in a civil action against one or more franchisees involving matters other than the prescribed civil matters, such an action may be required to be disclosed if it is considered to be a material fact.

The Ontario Regulations do not expressly require that arbitration awards or proceedings be disclosed, but they must be disclosed if they are considered to constitute material facts.

Finally, there are no express requirements to disclose a settlement of a civil proceeding unless such a settlement would be considered to be a material fact.

5. Bankruptcy

The Ontario Regulations require disclosure of the details of any bankruptcy or insolvency proceedings, voluntary or otherwise, any part of which took place during the previous six years against the franchisor and its associates, a corporation any of whose directors or officers either currently are or were, at a time when the proceeding was taking place, directors, general partners, or officers or the franchisor, a partnership any of whose general partners either currently are or were, when the time the bankruptcy or insolvency proceeding was taking place, directors, general partners or officers of the franchisor, and a director, general partner or officer of the franchisor in his or her personal capacity.[12]

6. Costs and Fees

With respect to fees, the Ontario Regulations require disclosure of all of the franchisees costs associated with the establishment of the franchise. They further require disclosure of certain items including the amount of deposits or initial franchise fees, estimates of the costs for leases, rentals, pre-paid expenses and all other tangible and intangible property necessary to establish the franchise, and an explanation of any assumptions underlying the estimates; and any other costs associated with the establishment of the franchise not otherwise listed, including any payments to the franchisor, whether direct or indirect, required by the franchise agreement, an estimate of the nature and amount of the payment, and when the payment is due.[13] Franchisors must be careful to ensure that all required costs are disclosed. However,

[10] *O. Reg. 581/00, supra* note 2 at s. 2(3)
[11] *O. Reg. 581/00, supra* note 2 at s. 2(4)
[12] *O. Reg. 581/00, supra* note 2 at s. 2(6)
[13] *O. Reg. 581/00, supra* note 2 at s. 6(1)

unless they are amounts to be paid by the franchisee directly, there is no specific obligation to disclose fee sharing arrangements or commissions payable by the franchisor to consultants, agents, brokers or area representatives.

While the Ontario Regulations do not specifically require that ongoing or recurring fees to the franchisor or its associate be detailed, under the assumption that these might nevertheless constitute material facts, most disclosure documents will contain a list of these items, including royalty fees, advertising fund payments, training fees, renewal fees, transfer fees and any other typical payments.

7. Operating Costs

In addition to the requirement described above relating to a list of the franchisee's costs associated with the establishment of the franchise, if an estimate of annual or other regular periodic operating costs is to be provided by the franchisor, directly or indirectly, the Ontario Regulations require a statement specifying the assumption and basis underlying the estimate, and that the same are reasonable, and in location where information substantiates the estimate is available for inspection.[14] Franchisors need to be very complete when describing the assumptions. The obligation to disclose the costs of establishing a franchise pertains to the particular province or provinces in which the franchise is to be operated. Franchisors without experience in establishing franchises in Ontario need to use care in the preparation of the description of such costs as it should not be assumed that conditions in Ontario are like or similar to those in the franchisor's domestic market. Further, there are no special provisions or guidance in the Ontario Regulations for franchisors having no previous operational or franchise experience in the province and, accordingly, franchisors need to undertake a fair amount of research in order no estimate the required initial investment amounts for Ontario.

8. Advertising Contributions

The Ontario Regulations require disclosure in respect of advertising fund contributions including the percentage of the fund that has been spent on national campaigns and local advertising in the past two fiscal years, the percentage of the fund other than such disclosed percentages that has been retained by the franchisor or the franchisor's parent or associate during the two fiscal year period. The franchisor is also required to disclose the same percentages projected for the current fiscal year and the amount of the franchisee's contribution to the fund that is projected for the current fiscal year.[15]

Finally, the disclosure document must indicate whether reports on advertising activities financed by the fund will be made available to the franchisees, but does not require disclosure of such advertising activities.

9. Products and Services

A regular source of dispute between franchisors and franchisees pertains to the supply chain or sources of products and services. The Ontario Regulations require disclosure of any obligations on the part of the franchisee to purchase or lease from the franchisor or its associates or from suppliers approved by the franchisor or its associates or under the franchisor or its associates' specifications. The franchisor is also required to disclose restrictions or conditions imposed on the goods or services that the franchisee may

[14] *O. Reg. 581/00, supra* note 2 at s. 6(2).

[15] *O. Reg. 581/00, supra* note 2 at s. 6(6).

sell, or that limit the customers to whom or the means by which the franchisee may sell goods or services.[16]

10. Rebates

The franchisor is required to disclose its policies and practices, if any, regarding volume rebates, commissions, payments or other benefits. There is considerable uncertainty associated with the meaning of the terms "policies" and "practices", but franchisors should be diligent and thorough in making such disclosure. The franchisor must state whether or not there are any rebates or other benefits that the franchisor or its associates may receive or are receiving as a result of the purchase of goods or services by franchisees and to indicate if any of these rebates or other benefits are shared with franchisees, either directly or indirectly.[17]

The Ontario Regulations do not mandate that the amounts of such rebates or other such benefits, or the names of the sources, need to be disclosed. There is considerable uncertainty as to the types of items which might be required to be disclosed under this item. However, the general "other benefits" language would indicate that disclosure should be broad, as opposed to narrow, in respect of the types of rebates or other benefits. For example, landlord inducements or allowances payable to the franchisor or its associates in respect of the leasing of or construction of franchisee premises to be occupied by the franchisee arguably are either subject to disclosure under this item or constitute a material fact which should be otherwise disclosed.

11. Obligations of Franchisor

There is no specific requirement to the Ontario Regulations for a chart or list of any obligations of the franchisor, but arguably a summary of the franchisee's obligations may be required under the general requirement to disclose all material facts. While there are specific requirements in the Ontario Regulations for disclosure of particular obligations, the list is not exhaustive due to the general requirement to disclose all material facts.

12. Licenses

A regular item of controversy under the Ontario Regulations pertains to the requirement to disclose every licence, registration, authorization or permission the franchisee is required to obtain under any applicable law, to operate the franchise in Ontario or to sell or distribute the particular goods or services sold or distributed by the franchisee.[18] While this item was included in the Ontario Regulations likely for the purpose of ensuring that any licence or permit unique to the business will be disclosed, its general practice has developed to disclose all usual licences and registrations including, for example, registrations with municipal and taxing authorities, liquor licence requirements, facility licences and the like. While a specific statement is not required under the Ontario Regulations, the practice has also developed, due to the difficulty of determining specific municipal licence requirements for every possible location where a franchise may be offered, that the franchisee should make its own inquiries to determine whether it will be required to obtain further licences, registrations, authorizations or other permissions to operate the franchise under other laws or local by-laws not specifically disclosed by the franchisor.

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[16] *O. Reg. 581/00, supra* note 2 at s. 6(7).

[17] *O. Reg. 581/00, supra* note 2 at s. 6(8)

[18] *O. Reg. 581/00, supra* note 2 at s. 6(10)

13. Financing

The Ontario Regulations required disclosure of the terms and conditions of any financing arrangement that the franchisor or its associate directly or indirectly offers to the franchisee.[19] This may relate to such common items as financing for the establishment of franchise, ongoing trade terms for inventory or supplies, equipment lease terms, and arrangements negotiated with third parties (including suppliers and financial institutions) to provide financing or trade terms.

14. Franchisor Obligations

The Ontario Regulations do not expressly require any description of the franchisor's obligations, either before or after the franchisee opens the franchise business. However, there are specific references in the Ontario Regulations to disclose descriptions of a number of particular items. Interestingly, the Ontario Regulations do not specifically reference disclosure of operations manuals or the table of contents of such manuals. It is arguable that the contents of operations manual constitute material facts, particularly if the franchisee is required to operate the franchise business in accordance with the manuals. It is further arguable that if the contents of the manual constitute terms and conditions of the franchise agreement, and the franchisor has the right to unilaterally amend the manual, that such facts should be disclosed as a material fact.

15. Territory

The Ontario Regulations require disclosure of a description of any exclusive territory granted to the franchisee.[20] The franchisor must also disclose its policies and practices, if any, as to how proximate to an existing franchise outlet the franchisor may establish another franchise, a franchisor outlet may be established, the franchisor may establish another distributor or licensee or other methods of distribution using the franchisor's trade-marks, the franchisor may establish other franchises that distribute similar products or services under a different trade-mark, and the franchisor may establish an outlet that distributes similar products or services under a different trade-mark.[21] These disclosure obligations are particularly relevant to multi-system franchisors. The Ontario Regulations do not specifically require description of any restrictions on the franchisee's territorial promotion via the internet or otherwise, subject to the requirement for disclosure under the general requirement to disclose material facts.

In *1230995 Ontario Inc. v. Badger Daylighting Inc.*[22], the plaintiff franchisee brought an action against the franchisor for breach of contract. The court found that the franchisee was entitled to damages for prior and future income loss resulting from the loss of territory taken from his assigned work zones. The franchisor had failed to comply with the disclosure requirements because the disclosure document referred to a work zone agreement that was not attached to the disclosure document and the only description of the franchisee's territory was in the Marketing Agreement, which was also not attached to the disclosure document. Moreover, the disclosure document did not include the performance levels required to continue the franchisee's exclusive territory. This decision was affirmed by the Court of Appeal.

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[19] *O. Reg. 581/00, supra* note 2 at s. 6(4)
[20] *O. Reg. 581/00, supra* note 2 at s. 6 (12)
[21] *O. Reg. 581/00, supra* note 2 at s. 6(14)
[22] *1230995 Ontario Inc. v Badger Daylighting Inc.* 2010 ONSC 1587; aff'd 2011 ONCA 442

16. Intellectual Property

Disclosure with respect to intellectual property is quite limited under the Ontario Regulations. The regulations require a description of the rights the franchisor or its associate has to trade-marks associated with the franchise.[23] There is no requirement that the trade-marks be applied for or registered when offering franchises, but if they are not so protected, this should likely be disclosed as a material fact. There is no specific reference in the Ontario Regulations to domain names, but these will likely fall under the general reference to "other commercial symbols". Accordingly, if domain names are important to the business, their registration and duration should be disclosed. Disclosure of information regarding pending or threatened legal or administrative action relating to their marks or their use, and any restrictions on the franchisee's right to use the marks, would likely constitute material facts although not specifically required to be disclosed.

The Ontario Regulations do not deal with disclosure of patents or copyrights specifically, subject to the general requirement to disclose material facts.

17. Personal Participation

The regulations require the franchisor to disclose whether it requires the franchisee to participate personally and directly in the operation of the franchised business, and if the franchisee is a corporation, the requirement is extended to the principals of the corporation.[24]

18. Restrictions on Sales

The Ontario Regulations require disclosure of restrictions or conditions imposed on the sale of goods or services by the franchisee, or that limit the customers to whom the franchisee may sell goods or services.[25] Disclosure is also required of any exclusive territory grant to the franchisee which may have the effect of being a restriction or condition imposed on the franchisee's sales activities. The Ontario Regulations do not specifically require disclosure of restrictions on the franchisee as to channels in which the franchisee may sell, or where the franchisee may sell, unless this information otherwise constitutes a material fact.

19. Termination, Renewal and Transfer

The Ontario Regulations require disclosure of any provisions of the franchise agreement relating to termination, renewal and transfer.[26] The general practice is to list in the disclosure document the paragraphs in the franchise agreement and other documents that contain provisions dealing with termination, renewal and transfer of the franchise, with at least a brief description or summary of such provisions. It is also common practice for the franchisor to disclose and describe the governing law, jurisdiction and venue provisions in the franchise agreement, and that these provisions cannot be waiver or released by the franchisee. Post-termination obligations of the franchisee arguably relate to termination, and as such should be disclosed.

[23] *O. Reg. 581/00, supra* note 2 at s. 6(9)
[24] *O. Reg. 581/00, supra* note 2 at s. 6(11)
[25] *O. Reg. 581/00, supra* note 2 at s. 6(7)
[26] *O. Reg. 581/00, supra* note 2 at s. 6(18)

20. Dispute Resolution

With respect to dispute resolution, the Ontario Regulations require the inclusion of a mandatory warning statement that mediation is a voluntary process to resolve disputes with the assistance of an independent third party, and that any party may propose mediation or another dispute resolution process, and that the process may be used to resolve disputes if agreed to by all parties. In addition, if an internal or external mediator or other alternative dispute resolution process is used by the franchisor in disputes with the franchisee, the Ontario Regulations require disclosure of a description of a mediation or other alternative dispute resolution process and the circumstances under which the process may be invoked.[27]

21. Earnings Projections

One of the most controversial and frequently contested disclosure items under the Ontario Regulations pertains to disclosure of certain information if the franchisor provides earnings projections or financial performance information. If an earnings projection is made by the franchisor, the disclosure document must include a statement specifying the reasonable basis for the projection, the assumptions underlying the projection, and the place where substantiating information is available for inspection by the franchisee.[28] Earnings projections made on the internet or in the media, or in some other means of communication, are not regulated differently in Ontario from other financial representation. There is no definition of what is meant by or what is included in the term "earnings projection". It is generally assumed that earnings projections include both historical earnings information and future oriented projections, and may be made directly or indirectly, in all cases requiring disclosure.

In *Sovereignty Investment Holdings Inc. v. 9127-6907 Quebec Inc.*[29], the applicant franchisee was granted rescission of a franchise agreement on the basis that the disclosure document did not comply with s. 5 of the *Act*. In addition to the fact that the purported disclosure document did not include a certificate of the franchisor and that all the documentation was not collected in a single document, the franchisor failed to provide any financial statements. Moreover, although the disclosure document did contain earnings projections with the required principal assumptions underlying the projections, no location was identified where substantiating information could be reviewed by the then prospective franchisee, as required by the Regulations. Accordingly, Justice Wilton-Siegel found that the franchisee was unable to make an informed assessment of the credibility of this financial information even though such information was highly relevant to a prospective franchisee's investment decision. He further concluded that the franchisor had failed to deliver a disclosure document because of the four fundamental deficiencies set out above, but noted that each of them, on its own, was sufficient to the franchisor's assertion that it had delivered a "disclosure document.

22. Franchisee Information

The Ontario Regulations require the disclosure of the names, mailing addresses, and phone numbers of all franchisees operating in Ontario, but do not require specific disclosure of outlets owned or operated by the franchisor or its associates.[30] However, such information may constitute a material fact, thereby requiring disclosure. If there are fewer than 20 franchises in Ontario, disclosure is required on additional outlets geographically closest to Ontario until information on 20 franchises is provided.[31]

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[27] *O. Reg. 581/00, supra* note 2 at s. 5
[28] *O. Reg. 581/00, supra* note 2 at s. 6(3)
[29] *Sovereignty Investment Holdings Inc. v. 9127-6907 Quebec Inc*. [2008] 303 D.L.R. (4th) 515 (Ont SCJ).

[30] *O. Reg. 581/00, supra* note 2 at s. 6(17)
[31] *Ibid* at s. 6(17)

Disclosure is required with respect to any franchisee or outlet of the name, address and telephone number of every former franchisee, whose franchise has been terminated, cancelled, not renewed, re-acquired by the franchisor, or otherwise left the system within the franchisor's previous fiscal year. This information has to include all former franchisees in Ontario.

For each closure of a franchise or the type being offered within the previous three fiscal years, the franchisor must disclose the reasons for closure, including whether the franchise was terminated or cancelled by the franchisor, not renewed by the franchisor, not renewed by the franchisee, or otherwise left the system. The information is not limited to franchises located only in Ontario.[32]

23. Financial Statements

As stated earlier, a disclosure document must contain financial statements, reports, and other documents in accordance with the requirements of the *Act* and the Ontario Regulations. The financial statements of the franchisor must be included in the disclosure document and be prepared in accordance with generally accepted accounting principles. The statements must be for the most recently completed fiscal year or, if 180 days have not yet passed since the end of the most recently completed fiscal year and financial statements have not been prepared and reported on for that fiscal year, the financial statements for the previous fiscal year must be included. If the franchisor has not completed one fiscal year of operation or 180 days have not passed since the end of the first fiscal year of operation, and financial statements have not been prepared and reported on for that fiscal year, the disclosure document must include the franchisor's opening balance sheet.[33]

The financial statements must be either audited in accordance with generally accepted auditing standards set out in the Canadian Institute of Chartered Accountants Handbook, or reviewed in accordance with the review standards and reporting standards applicable to review engagements set out in the Canadian Institute of Chartered Accountants Handbook. The auditing, review, and reporting standards of other jurisdictions that are least equivalent to those described are acceptable. However, it is uncertain what supporting material may be required to confirm that the reporting standards of another jurisdiction are equivalent to those in Ontario. There have been a number of cases in which franchisors have not prepared or included financial statements which meet the required standards, or where financial statements have been delivered but not as part of the disclosure document.

There are specific exemptions from the requirement to include financial statements based on net worth, number of franchises, engagement in the line of business, and absence of any judgement, order or award relating to fraud, unfair or deceptive practices, or a law regulating franchises.[34] One of the difficulties pertaining to exemption from financial disclosure is the fact that the net worth of the franchisor must be determined on the basis of the most recent financial statements, even though the determination may result in the conclusion that these statements need not be disclosed. As a result, franchisors who have determined on an internal net worth valuation that they will be exempt from disclosure but without independent financial statements will not meet the exemption requirements because such statements were not been prepared to support the make the net worth conclusion.

In *6792341 Canada Inc. v. Dollar It Ltd*.[35], the court determined that the franchisor's complete failure to provide any financial statements or a balance sheet precluded any finding of substantial compliance and accordingly, the deficiencies in the disclosure document were so materials that it could not be considered

[32] *O. Reg. 581/00, supra* note 2 at s. 6(16)
[33] *O. Reg. 581/00, supra* note 2 at s. 3
[34] *O. Reg. 581/00, supra* note 2 at s. 11
[35] *6792341 Canada Inc. v Dollar It Ltd* 2009 ONCA 385.

to be a disclosure document under s. 6(2) of the *Act.* The Franchisee was accordingly entitled to a two year period for rescission.

In *Melnychuk v. Blitz Ltd.*[36] the plaintiff/franchisee sought to rescind its franchise agreement on the ground that the disclosure of material fact required under the *Act* did not take place and what was provided to him, amounted, in law, to no disclosure. The court found that the financial statements were stale and did not meet the required accounting standard and that this was a material deficiency. The disclosure provided was so deficient as to constitute no disclosure pursuant to Section 6 (2) of the *Act*.

24. Receipts; Certificate of Disclosure

No receipt page is required to be signed and dated by the prospective franchisee, although a receipt page is permissible and is most frequently used in practice in order to provide evidence of receipt of the disclosure document.

The Ontario Regulations require that every disclosure document shall include a certificate certifying that the disclosure document contains no untrue information, representations or statements, and include every material fact, financial statement, statement or other information required by the *Act* in the regulations. This certificate must be signed and dated by the franchisor (if not incorporated), by the director or officer of a franchisor that is incorporated and has only one officer or director, or by at least two persons who are officers or directors for corporate franchisors that have more than one officer or director.[37]

In *6792341 Canada Inc. v. Dollar It Ltd.*[38], the franchisor's failure to include a certificate of disclosure that was executed and dated was in itself a basis for finding that no disclosure was provided as required by the *Act* and the franchisee was entitled to rescind within 2 years pursuant to s. 6(2) of the *Act*.

25. Miscellaneous

The *Act* does not expressly permit the use of a disclosure document from another jurisdiction. Therefore, the standard practice in Ontario is to prepare the disclosure document that follows the Ontario Regulations in respect of mandated order, format and content, and not to use a disclosure document from another jurisdiction that has been amended or supplemented.

In *1518628 Ontario Inc. v. Tutor Time Learning Centres LLC*[39], a U.S. franchisor provided its U.S. equivalent to a "disclosure document" called a Uniform Franchise Offering Circular ("UFOC") to an Ontario franchisee. The franchisee subsequently sought to rescind the Franchise agreement. One of the issues to be determined was whether the American UFOC constituted proper disclosure under the *Act* and accordingly whether disclosure was simply incomplete or whether the UFOC did not constitute disclosure at all. The court determined that the UFOC was not provided by the franchisor for disclosure purposes and was provided only for information purposes a few days before the transaction was completed. Further, the UFOC did not provide all of the information required under the *Act*. Moreover, it failed to provide the material facts pertinent to the franchise. Accordingly, the non-disclosure of material facts in itself meant that there was no compliance with the disclosure required by the *Act*. Rescission was granted.

If a material change (as defined) has occurred since delivery of the disclosure document prior to execution of a franchise agreement or the payment of consideration by the franchisee, a franchisor must provide a

[36] *Melnychuk v Blitz Ltd* 2010 ONSC 566.

[37] *O. Reg. 581/00, supra* note 2 at s. 7

[38] *Dollar It, supra* note 9 at para 32.

[39] *1518628 Ontario Inc. v Tutor Time Learning Centres LLC* (2006), 150 ACWS (3d) 93 (Ont SCJ).

franchisee with a form of material change statement confirming the nature of the material change. Failure to provide the material change statement as soon as practicable after the change has occurred will constitute non-disclosure under the *Act*.

The *Act* requires that the contents of the disclosure document be clear and concise, that all required enclosures be contained within one document, and that the disclosure document be delivered as a whole at one time.

In *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*[40], the Court of Appeal affirmed the decision of the applications judge, permitting the franchisee to rescind the Franchise agreement pursuant to s. 6(2) of the *Act* where the required disclosure was provided in several documents. The franchisor had argued that they provided proper disclosure, albeit in a piecemeal fashion, over the course of several meetings and in several different documents. They argued that this method of disclosure substantively met the requirements of the *Act* and that rescission was inappropriate. In upholding the order for rescission, Justice MacFarland stated the following:

> There is no issue of "substantive" versus "procedural" compliance. The requirement that disclosure occur in the form of a single document is not an empty formal requirement. The legislature clearly envisioned that the purpose of the legislation – i.e., ensuring that decision to enter into a franchise agreement is an informed one – would be best fulfilled by giving prospective franchisees the opportunity to review a single document or documents, so that all information is before them at the same time...
>
> Section 6(1) presupposes the existence of a single disclosure document. None was provided on the facts of this case. Accordingly, s. 6(1) is inapplicable...Section 6(2) is the provision applicable to this case.[41]

The disclosure document must be current at the time of delivery, and updating is dependent on the accuracy of the information as at the time of disclosure. This requirement in practice mandates an updating of a disclosure document at least annually, and more frequently in the event of material changes. Annual updating is triggered by the requirement in the Ontario Regulations that the disclosure document contain financial statements for the most recently completed fiscal year, and other specific items must be disclosed based on completed fiscal years.

In addition, disclosure must be particular to the specific franchise being offered. Accordingly, it has become the practice to prepare separate disclosure documents, or that contain separate sections pertaining to specific disclosure items, in the case of a new franchise, the transfer or resale of an existing franchise, the renewal or extension of an existing franchise, or the sale of a corporate unit, subject to any exemptions contained in the *Act*.

C. PROBLEMS WITH THE FRANCHISE DISCLOSURE PROCESS

In addition to the onerous requirements with respect to the content of disclosure documents and the ambiguities and uncertainties in the Ontario Regulations pertaining to the scope and detail of disclosure, a franchisor must cope with a number of additional challenges and uncertainties in connection with the actual franchise disclosure process.

1. Who is the Franchisor

[40] *1490664 Ontario Ltd. v Dig This Garden Retailers Ltd.* (2005), 256 DLR (4th) 1 (Ont CA) [*Dig This Garden*] aff'g (2004), O.J. No. 3008 (Ont SCJ)

[41] *Dig This Garden*, *supra* note 13 at paras 18 and 22.

The question as to who must give disclosure is dealt with in a circular manner in the *Act*. Section 5 of the *Act* requires a franchisor to provide a prospective franchisee with a disclosure document. However, the term "franchisor" means one or more persons who grant or offer to grant a franchise. The term "franchise", as discussed earlier, is quite extensive, and in certain cases a franchisor may include a franchisor's associate as being a party involved in the grant of a franchise or exercising control or offering assistance in the method of operation. Therefore, in certain situations there may be more than one entity constituting the "franchisor", and the disclosure document must be provided on behalf of all such entities.

2. Who is the Franchisee

Another issue pertaining to the franchise disclosure process pertains to the actual persons to whom the disclosure document should be delivered. Section 5 of the *Act* requires the delivery of a disclosure document to a "prospective franchisee". The term "prospective franchisee" means a person who has indicated, directly or indirectly, to a franchisor or a franchisor's associate, agent or broker an interest in entering into a franchise agreement, and a person whom a franchisor or a franchisor's associate, agent or broker, directly or indirectly, invites to enter into a franchise agreement. In many cases, a prospective franchisee will be an individual inquiring about a franchise, prior to any consideration being given to the ultimate form or constitution of ownership of the franchise. Most franchisees will eventually incorporate a corporation to act as franchisee for business, tax and liability reasons. Further, there may be one or more individuals who intend to operate the franchise, or who will be shareholders in the corporate franchisee. This information is frequently not known to either the franchisor or the franchisee at the time of delivery of the disclosure document. Therefore, it has become common practice for a franchisor to deliver the disclosure document to the individual franchisee candidate known to the franchisor at the time of delivery, on his or her own behalf and on behalf of a corporation which may be incorporated by that person. If it becomes known to the franchisor at a subsequent date that other individuals would be involved in the operation of the franchise or as shareholders or even guarantors of the corporate franchisee, it is recommended that the franchisor provide disclosure to such additional persons prior to the time at which they execute the franchise agreement or any other agreement pertaining to the franchise.

As discussed earlier, there are a number of types of arrangements which may constitute a "franchise". It should be noted that the *Act* states in Section 1(2) that the franchise includes a master franchise and a subfranchise, each of which term is separately described. However, the courts have often been forced to address these issues within the context of unusual facts which did not easily fall within the literal wording of the *Act*.

In *Bekah v. Three for One Pizza & Wings (Canada) Inc.*[42], the issue before the court was whether a purchaser of a franchise in a transaction that had not yet closed was a franchisee within the meaning of the *Act* and accordingly entitled to the right of rescission for breach of the disclosure obligations set out in section 5 of the *Act.*

In determining that the plaintiffs were franchisees within the meaning of the *Act,* the presiding judge noted that even though a franchisee is defined as a "person to whom a franchise is granted", this did not require the closing of the franchise transaction.

On the facts of this case, the presiding judge found that the purchasers were franchisees because they had entered into a binding agreement for the purchase and sale of a franchise business, under which they were obligated to enter into a full franchise relationship, and monies were paid under said agreement.

[42] *Bekah v. Three for One Pizza & Wings (Canada) Inc*. (2003) 67 OR (3d) 305 (Ont SCJ).

3. Timing of Disclosure

With respect to the timing of disclosure, the *Act* requires that a disclosure document be received by a prospective franchisee at least 14 days before the earlier of the signing by the prospective franchisee of any agreement relating to the franchise, or the payment of any consideration by or on behalf of prospective franchisee to the franchisor or its associate relating to the franchise.[43]

It is uncertain whether the payment requirement is triggered if the franchisee makes the payment of any consideration to a third party in respect of the franchise such as a landlord, supplier or service provider.

There are no exceptions in the *Act* with respect to the timing of disclosure prior to the execution of an agreement. Therefore, a disclosure document must be provided to a prospective franchisee prior to the execution of a binding letter of intent or option, or the payment of money under a letter of intent or option. Further, preliminary agreements are not excepted, and therefore may not be signed in advance of disclosure. This would include the execution of a deposit agreement, a territorial reservation agreement, a confidentiality agreement, a location agreement or any other form of preliminary agreement. The Ontario Regulations specify a certain ordering of disclosure items in the disclosure document, particularly the disclosure of risk statements. Therefore, while it has not been determined whether inappropriate ordering of disclosure items would constitute non-disclosure or incomplete disclosure, franchisors should follow the ordering of disclosure items as required under the Ontario Regulations.

In *4287975 Canada Inc. v. Imvescor Restaurants Inc.*[44], the issue on appeal was whether the appellant had a right of rescission under the *Act*. The motion judge had held that the rescission rights provided for in s. 6 of the *Act* were not available to the appellant. The franchisee had paid a fee to the franchisor two months before receiving a disclosure document. Six months after delivery of the disclosure document, the franchisee executed a franchise agreement. Almost two years later, the franchisee sought to rescind the franchise agreement. The motions judge held that the appellant did not have a right to rescind the franchise agreement under s. 6(2) because that section only applied where the franchisor never provides disclosure. He conversely also found that the appellant also did not have a right to rescind under s. 6(1) of the *Act* because the appellant had six months to consider the disclosure document before signing the franchise agreement. The decision was upheld on appeal. The Court of Appeal stated that s. 6(2) cannot be triggered in cases where a disclosure document is provided, because it expressly applies only when a disclosure document was "never provided". S. 6(1) of the *Act* deals directly with the consequences of a franchisor's failure to provide a disclosure document that meets the timing and/or content requirements of the *Act*.

4. Delivery Requirements

With respect to the methods of delivery of disclosure document, the *Act* requires that a disclosure document be one document, delivered as one document and at one time. The disclosure document must be delivered either by personal delivery, registered mail or any other method permitted by the Ontario Regulations (at present, no other methods are prescribed). The practice has arisen to deliver a disclosure document in paper form, and possibly on CD-Rom, as that facilitates receiving a signed receipt for delivery of the disclosure document. There is no authority or practice for delivery of a disclosure document by e-mail or through a website. Section 5(7) of the *Act* specifies certain exemptions from the obligation to provide a disclosure document. Each of these exemptions is described in a very specific language, and must be carefully reviewed if the franchisor determines to rely on an exemption. Co-

[43] *Act*, *supra* note 1 at s. 6.
[44] *4287975 Canada Inc. v Imvescor Restaurants Inc* 2009 ONCA 308; aff'g (2008), 91 OR (3d) 705 (Ont SCJ).

incident with the exemptions is the fact that Section 12 of the *Act* states that in any proceeding under the *Act* the burden of proving an exemption or exclusion from a requirement or provision is on the person claiming it.

5. Exemptions

In view of the uncertainties and ambiguities of various definitions and provisions in the *Act*, and the consequences of failure to disclose or improper disclosure, franchisors do not generally rely on exemptions from disclosure unless there is absolute certainty that an exemption will apply. The following are the specific types of exemption provided for in the *Act*, each of which must be carefully reviewed for language, content and applicability:[45]

- resale exemption
- sale to an insider
- sale of an additional franchise
- sale by a trustee or similar custodian
- sale of a factual franchise
- renewal or extension of a franchise agreement
- small franchise exemption
- sophisticated purchaser exemption

It should also be noted that there are no exemptions provided for specific industries. Therefore, and by way of example, petroleum dealers, motor vehicle dealers, farm implement dealers, credit card service agreements, and wholesale arrangements are covered by the *Act* if the relationship otherwise falls within the definition of a franchise.

In *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*[46], the appellant franchisor had executed a franchise agreement with the previous franchisees of the respondent franchisee's business. The franchise agreement included transfer provisions which stated that if the franchisee wished to sell its franchise, it had to obtain the franchisor's consent and provide the franchisor with certain specific documents executed by the new franchisee. When the previous franchisee sold its business to the respondent, the franchisor did not provide the purchasers with a disclosure document but required that the purchasers execute documents not listed in the transfer provisions of the franchise agreement.

The respondent later sought to rescind the franchise agreement. The franchisor took the position that it was exempt from the disclosure requirements as the transaction constituted a resale, which was exempted where the "grant of a franchise" is "not effected by or through the franchisor." The motions court granted rescission. The appeal was dismissed and the court found that where a franchisor imposes conditions on a

[45] *Act*, *supra* note 1 at s. 5(7)

[46] *2189205 Ontario Inc. v Springdale Pizza Depot Ltd* 2011 ONCA 467; aff'g 2010 ONSC 3695 (Ont SCJ).

new buyer that extend beyond those in the franchise agreement, and where it is more than a passive participant in the resale, disclosure obligations are triggered.

In *TA&K Enterprises Inc. v. Suncor Energy Products*[47], the issue was whether the franchisor was exempt from disclosure where the franchisor entered into agreements which had a term of not more than 1 year and repeatedly renewed these agreements. There was also no requirement for the franchisee to pay any up-front fees to the franchisor. The franchisor relied upon s. 5(7)(g)(ii) of the *Act* which provides an exemption where "the franchise agreement is not valid for longer than one year" and "does not involve the payment of a non-refundable franchise fee." The court held that the term "franchise fee" meant a fee for the purposes of acquiring membership in the franchise chain, stating that the term did not encompass every fee paid to a franchisor from a franchisee. The court also held that month to month extensions of an agreement that was otherwise valid for one year did not change the validity of the exemption. The franchisee's appeal was dismissed on the basis that the obligations were not stated to be for a period of more than one year, and therefore the agreement fell within the exemption as not being "valid" for longer than this period.

6. Disclosure Specific to Each Franchise

A frequently overlooked requirement pertaining to the franchise disclosure process under the *Act* is the fact that disclosure must be relevant to the particular franchise being offered. Therefore, there may be different disclosure documents, or different items contained in a disclosure document, pertaining to the following types of franchise sales:

- new franchise
- renewal or extension of an existing franchise
- resale or transfer of a franchise
- a conversion franchise
- a franchisor operated unit

As each disclosure will be specific to the particular franchise or location, although there may be general disclosure items common to new franchise sales, any particular information pertaining to the specific location of a franchise must be included in the relevant disclosure item or as a material fact.

As discussed above, the concept of determining whether a material fact exists is dependent upon the definition of the term "material fact" and the judgment of the franchisor in assessing the implication of the facts of a particular franchise to the perspective franchisee. Proof of delivery of a disclosure document is problematic for some franchisors who do not take the time to obtain receipts, properly document the specific contents of the disclosure document delivered, and maintain reliable and satisfactory proof of delivery and the contents of the franchise disclosure document.

D. MISREPRESENTATIONS IN FRANCHISING

1. Pre-Contractual Common Law Misrepresentations and Exclusionary Clauses

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[47] *TA&K Enterprises Inc. v. Suncor Energy Products Inc.*, 2010 ONSC 7022; aff'd 2011 ONCA 613

With the enactment of the *Act*, the dynamic between franchisors and franchisees was significantly and permanently altered. Extensive disclosure obligations[48], franchisees' rights of rescission[49], restitution and damages where franchisors have failed to comply with their disclosure obligations[50], the prohibition against contracting out of the *Act*[51] and the statutory embodiment of the common law duty of good faith through the imposition of a similar, but extended duty of "fair dealing"[52], have changed the landscape for franchisors in a manner and to a degree that was wholly unprecedented. Even though one might have thought that the requirement to provide a written disclosure document should, in theory, limit issues surrounding pre-contractual representations made to prospective franchisees, in practice that has not turned out to be the case.

Such results ought not to be surprising due to the very structure and nature of the business of selling franchises, which inherently creates tension between franchisors' marketing or sales departments and those entrusted with ensuring that proper compliance with appropriate standards are met. The sales teams have targets to meet and are under pressure to sell franchises. Their job is to persuade prospective franchisees to purchase their employers' franchises, rather than a competitors and this often gives rise to continued pre-contractual communications between franchisors' representatives and franchisees relating to the franchise, the likelihood of its future success and its perceived attractiveness. Invariably, certain franchisees will later claim that some of those communications were untrue, and were made negligently or fraudulently in order to induce the franchisee to enter the franchise agreement in question. Not surprisingly, these claims usually arise when the business purchase has not performed as expected or has actually failed.

The claims of misrepresentations may arise from the distribution of marketing materials, information sessions with prospective franchisees, brochures and, most often, financial or earnings projections (or, as referred to in the United States, Financial Performance Representations or "FPR"s) made to convince the prospective franchisee that he or she will earn a substantial income from buying into that particular franchise system.

Such misrepresentations may be negligent, innocent or fraudulent and each type requires that certain constituent elements be proven in order to be actionable. The two most frequently alleged misrepresentations are those which are fraudulent or negligent. One of the reasons for this relates to the remedies available to the plaintiff depending upon what kind of misrepresentation is found to exist.

In the case of a pure innocent misrepresentation [being an untrue statement made by one party with the honest belief, based on reasonable grounds, that the statement is true], the aggrieved party may be limited to a claim for common law rescission and be deprived of claims for damages. Conversely, claims for rescission, with or without damages, are available where negligent or fraudulent misrepresentations have been made, depending on the facts of the matter in issue.

So, for instance, in the decision of the Ontario Superior Court of Justice in *Murray v. TDL Group Ltd.*[53], the court found that for a claim based upon negligent misrepresentations within a franchise context to succeed, the plaintiff must establish the following 5 basic elements:

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[48] *Act*, *supra* note 1 at s. 5
[49] *Act*, *supra* note 1 at s. 6
[50] *Act*, *supra* note 1 at s. 7
[51] *Act*, *supra* note 1 at s. 11
[52] *Act*, *supra* note 1 at s. 3
[53] *Murray v TDL Group Ltd* [2002] OTC 1024 (Ont SCJ).

- There must a duty of care based on a "*special relationship*" between the defendant and the plaintiff;
- The representation in issue must be untrue, inaccurate or misleading;
- The defendant must have acted negligently in making the representation;
- The plaintiff must have relied, in a reasonable manner, on the representation; and
- The reliance must have been detrimental to the plaintiff in the sense that damages resulted.

In the *Murray* decision, while the court found that there was a special relationship giving rise to a duty of care, it also found that no misrepresentation had been made and the plaintiff was unsuccessful.

In its reasons, the court in *Murray* relied upon the decision of the Supreme Court of Canada in *Queen v. Cognos*[54]. In that case, the court stated the following propositions:

1. There are five general requirements for a successful claim for the tort of negligent misrepresentation: (1) there must be a duty of care based on a "special relationship" between the representor and the representee; (2) the representation in question must be untrue, inaccurate, or misleading; (3) the representor must have acted negligently in making the misrepresentation; (4) the representee must have relied, in a reasonable manner, on the negligent misrepresentation; and (5) the reliance must have been detrimental to the representee in the sense that damages resulted;

2. An action in tort for negligent misrepresentation may lie even though the relevant parties to the action are in a contractual relationship. The fact that the alleged negligent misrepresentations are made in a pre-contractual setting, such as during negotiations or in the course of an employment hiring interview, and the fact that a contract is subsequently entered into by the parties do not, in themselves, bar an action in tort for damages caused by the misrepresentations.

3. Depending on the circumstances, however, the subsequent contract may play a very important role in determining whether or not, and to what extent, a claim for negligent misrepresentation will succeed. Such a contract can have the effect of negating the action in tort and of confining the plaintiff to whatever remedies are available under the law of contract. Moreover, even if the tort claim is not barred altogether by the contract, the duty or liability of the defendant with respect to negligent misrepresentations may be limited or excluded by a term of the subsequent contract so as to diminish or extinguish the plaintiff's remedy in tort. Equally, however, there are cases where the subsequent contract will have no effect whatsoever on the plaintiff's claim for damages in tort.

Moreover, although addressed elsewhere in this paper, even absent the fair dealing obligations set out in section 3 of the *Act*, the good faith requirements of common law may require a franchisor to advise the prospective franchisee of potential difficulties by providing accurate financial disclosure, particularly given that such information is available to the franchisor alone.[55]

Knowing that allegations of misrepresentations will continue to be asserted by franchisees, how have franchisors attempted to protect themselves? As, or more importantly, how effective have such methods

[54] *Queen v Cognos Inc* [1993] 1 SCR 87.

[55] See for example, *Machias v Mr. Submarine Ltd.* (2002), 24 B.L.R. (3d) 228 (Ont SCJ) [*Machias*]; *Perfect Portions Holding Co. v New Futures Ltd.* [1995] OJ No. 2113 (Gen Div) [*Perfect Portions*].

been? These strategies employed generally fall into one of two categories. The first is the inclusion of certain provisions in the franchise agreement and related documents. The second is what I would refer to as a "best practices" approach to dealing with franchisees.

I have not chosen to segregate these topics in "defensive drafting" and "best practices" sections below, simply because there is often overlap between them and some of the topics tend to extend or lead into others. It will be quite obvious from the context however, into which general approach the strategies fall.

It should also be noted that while it may seem that the decision to employ some or all of these strategies ought to be a simple one, there will inevitably be a number of factors that may lead to a franchisor deciding not to do so. Some will be perceived as too costly to implement. Others may tend to make the franchise appear less attractive to prospective franchisees, and therefore will no doubt trigger strong resistance from the franchisor's sales staff, particularly where such staff's income is dependent on sales performance. For the purposes of this paper, these business decisions are not addressed and the strategies discussed below are considered only insofar as they insulate the franchisor from later attack.

In the end result, each franchisor will determine what works best for it and whether the additional protections some of these strategies may provide are outweighed by the perceived or actual disadvantages attendant thereto.

Accordingly, keeping in mind these cautionary observations, consideration should be given to the following:

2. Exclusionary Clauses: Non Waiver and Entire Agreement Clauses

Historically, the franchisors' most frequently used tool to limit claims based on allegations of conduct inconsistent with the provisions of its franchise agreement has been the use of various exclusion clauses, such as those which require that changes to the agreement to be in writing, what are referred to as the "non-waiver" provisions, and the ever present "entire agreement clauses".

While these provisions have been of some assistance in limiting franchisees' successes, their efficacy is, by their very nature, limited and cannot be relied upon.

A decision which clearly illustrates this point is the seminal decision of the Ontario Court of Appeal in *Shelanu Inc. v. Print Three Franchising Corp*[56]. In this case, the court had occasion to review the applicability of various exclusion clauses in a franchise agreement, as they related to oral representations made *after* the execution of the said agreement. In addressing this issue, the Honourable Justice Weiler stated the following:

> 28 The paragraphs in the written franchise agreement which the appellant submits are contrary to the oral agreement are paragraph 20 (delay in exercising a right or breach of default is not waiver of right), paragraph 26 (no waiver, amendment or change of any terms unless signed by all parties) and paragraph 27 (this [written] agreement constitutes the entire agreement between the parties with respect to all matters herein)…
>
> 31 Paragraphs 20, 26, and 27 are not limitation or exclusion clauses in the traditional sense that they limit or exclude liability for damages for breach of contract or for a tort connected to the contract. Their purpose is, rather, to limit the parties' duties to each other to what has been reduced to writing and, as a corollary, to exclude any other duties. More specifically, an entire

[56] *Shelanu Inc. v Print Three Franchising Corp* [2003] 172 O.A.C. 78 (Ont CA); rev'g in part (2000), BLR (3d) 69 (Ont SCJ) [*Shelanu*]

> agreement clause seeks to exclude liability for statements other than those set out in the written contract and is sometimes referred to as an exclusion clause…
>
> 32 … In construing an exclusion clause, the issue to be addressed is whether, as a matter of construction, the exclusion clause covers the alleged occurrence or breach in question. **Exclusion clauses are to be approached with the aid of the cardinal rules of contractual construction: t****hey must be read *contra proferentem* and clear words are necessary for the exclusion clause to apply.** See *Photo Production Ltd. v. Securicor Transport Ltd.*, [1980] A.C. 827 (U.K. H.L.) per Lord Wilberforce at 846, cited by Dickson C.J. at 458-459 of his judgment.
>
> 33. **When the exclusion clause covers the alleged occurrence or breach, the question is whether to enforce the exclusion clause. Where the court is of the opinion extreme unfairness would result from the enforcement of an exclusion clause, such as, for example, where there was inequality of bargaining power, this concern should be addressed directly through the doctrine of unconscionability**…(emphasis added)[57]

In the end result, Justice Weiler found that paragraphs 20 and 26, strictly construed, did not apply to the facts of the matter before her. She also observed that entire agreement clauses are normally used to try to exclude representations made *prior* to the signing of written agreements. In this instance, she determined that nothing in this provision suggested that an oral agreement made *subsequently* would be excluded.

Although the court acknowledged that the foregoing findings were sufficient to have disposed of the matter, Justice Weiler also commented on the enforceability of such exclusion clauses. The court found that enforcing the exclusionary clauses in this instance, where they were contrary to the reasonable expectation and understanding of the parties, would not be fair or reasonable. In coming to that conclusion, she observed the following:

> 58 **I would also note that the agreement that we are dealing with is a franchise agreement. A franchise agreement is a type of contract of adhesion, that is, a type of contract whose main provisions are presented on a "take it or leave it basis". In such situations, the case for holding that an exclusion clause represents the intention of the signer and that the signer should be bound by it is weaker because there is usually an inherent inequality of bargaining power between the parties.**..[emphasis added][58]

In addition to these comments, courts have often refused to apply an entire agreement clause if the contract in which it was found was induced by misrepresentation. Typical of this judicial approach is this statement of the Honourable Justice Wilson in *Machias v Mr. Submarine Ltd.*[59] where she reviewed the jurisprudence and found that:

> 107. Many of the noted cases share a common theme. Specific misrepresentations were made to a potential franchisee with respect to projected earnings and/or expenses of the franchise. The result was a distorted, overly optimistic financial projection that did not accord with reality. **In all of these decisions, the courts refused to apply the entire agreement, independent investigation or disclaimer clauses and found that the independent tort of misrepresentation had been established. Alternatively, the courts concluded that to strictly enforce the governing agreement would be unconscionable. The franchisees in these cases were successful in their claims for rescission or damages.** [emphasis added]
>
> 108. […]

[57] *Shelanu, supra* note 23 at paras 28-33.
[58] *Ibid* at para 58.
[59] *Machias, supra* note 22.

> 109. A recurrent theme in these cases is the inherent inequality of bargaining power between an established franchisor and an individual franchisee, as well as the unique inter-dependant relationship between franchisor and franchisee. [60]

Given that franchisors can assume that in a dispute, their exclusionary clauses will generally be interpreted in a manner consistent with the approaches taken in the *Shelanu* and *Machias* decisions, it would be easy to conclude that clauses of this nature in franchise agreements will be of limited or possibly no utility. What therefore can be done to maximize their effect?

It is clear that it will be very difficult to convince a court that although the impugned representations are found to have been made, the exclusion clauses should act to insulate the franchisor from their effect. However, what a franchisor can do is add to the various exclusionary clauses, a provision which limits the liability that a franchisor may face should claims of misrepresentation be asserted. While the courts will likely view such a clause critically and continue to apply the principle of *contra proferentem,* at least the franchisor will not be faced with the conundrum created where a clause says that certain representations were not made but the evidence clearly reflects otherwise.

Moreover, some of these clauses, suitably modified and coupled with several other steps available to franchisors may convince a court that the representation were either not made, or if made, not relied upon. For instance, instead of having the exclusionary clauses buried somewhere in the "General Provisions" section near the end of the Franchise Agreement, a franchisor could have terms placed in one or more pages, in capitalized, bold print, attached to the front of the Franchise Agreement. The franchisor could also insist that the franchisee confirm that he or she has read each exclusionary clause by providing his or her initials in the appropriate space beside each such clause.

In addition, the franchisor can have the franchisee execute an acknowledgment on the page where such clauses appear, confirming that he or she has read and understood such provisions and has consulted counsel, or at least been given the opportunity to do so, before affixing his or her signature.

All of these strategies may be of limited utility. One strategy, however, which may be effectively used to rebut an allegation that the execution of the franchise agreement was induced by misrepresentations, is the use of a questionnaire.

In using such a mechanism, the franchisor would require, as a condition of executing the franchise agreement, that the franchisee be obliged to complete the questionnaire. The questionnaire may be structured so that the franchisee is obliged to check a "yes" or "no" box beside specific questions relating to alleged representations. Undoubtedly, that will lead to allegations that the franchisor checked off the various boxes and required the franchisee to place his or her initials beside them. In the alternative, it may be alleged that the franchisee's initials were signed to a blank questionnaire, which the franchisor completed later. Accordingly, a better and more persuasive way of implementing this strategy is to require an answer that will force the franchisee to read the question and to take affirmative steps to respond. An example of this approach might be to ask the franchisee whether he or she was told anything about future anticipated income, sales or expenses concerning the prospective franchise. If an affirmative answer is provided, then the next question should require the franchisee to provide details about what was allegedly said and to identify the person who made the representation.

The best approach however, in terms of demonstrating that conscious, considered and voluntary responses were given, is simply to ask the franchisee to briefly describe what he or she was told about the

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[60] *Machias, supra* note 22 at paras 107-09.

franchise's future sales, income and expenses at a later time. If the franchisee responds by stating that there were no such representations, it may be difficult for them to make claims later to the opposite effect.

3. Statutory Misrepresentations

There are various rights of rescission provided under section 6 of the *Act*. These must be enacted under very strictly enforced time periods. Without presently addressing the issue of when the courts have found that no disclosure document has been provided (even when documents containing many of both the prescribed and defined material facts are included), a franchisee's rights to rescission must be asserted within:

(a) 60 days after receipt of a disclosure document "if the franchisor failed to provide the disclosure document or a statement of material change within the time required by section 5 or if the contents of the disclosure document did not meet the requirements of section 5." [add footnote] or

(b) 2 years "after entering into the franchise agreement if the franchisor never provided the disclosure document" [61]

The law is clear that where a specific period of time is provided within which certain actions must be taken and starting from a clearly described event, then the issue of "discoverability" which would normally apply to determine whether a limitation period has expired, is irrelevant.[62]

However, all is not lost since the strict temporal provisions of subsections 6(1) and (2) do not apply to section 7 of the *Act*, which provides a franchisee with a remedy of damages against the franchisor, the franchisor's agent, broker or associate and anyone who signed the disclosure document or statement of material change, where a franchisee suffers a loss because of:

(a) A misrepresentation contained in the disclosure document;
(b) A misrepresentation contained in a statement of a material change; or
(c) The franchisor's failure to comply in any way with section 5 of the *Act*.[63]

Section 7 must be read carefully because of, among other things, the following:

- The misrepresentation must be contained in a disclosure document or in a statement of material change. Common law misrepresentations, unless they also fall within the obligations relating to a disclosure document, are not included;

- The misrepresentation does not need to be one of commission or omission in that if there is a failure to comply with the section 5 disclosure obligations "in any way", then the relief in section 7 is triggered;

- Because of the fact that there is no period of time set out within which to act, the usual provisions under section 4 of the Ontario *Limitations Act*[64] apply. This brings into play the principle of discoverability and accordingly would extend the period in which to commence a claim from the date when the cause of action was "discovered" as that term is used in the *Limitations Act*. This,

[61] *Act, supra* note 1 at s.6.
[62] See for example, *Waschkowski v. Hopkinson Estate* [2000] 47 OR (3d) 370 (Ont CA).
[63] *Act, supra* note 1 at s.7
[64] *Limitations Act*, 2002, S.O. 2002, c. 24, Sched. B.

of course, raises a number of issues since actual discovery is not required and the period of limitations would also start to run when the cause of action ought reasonably to have been discovered; [65]

- The claims that can be asserted are not limited just to the franchisor, but also to the franchisor's agent, the franchisor's broker and every person who signs the disclosure document or statement of material change. This would include, where a corporation has more than 1 officer and director, 2 officers or directors thereof ; and [66]

- Of significant important, subsection 7(2) of the *Act*, provides that there is deemed reliance by the franchisee on the misrepresentation. Moreover, there is no reference in the subsection to the deemed reliance being rebuttable. Other statutes, which have used similar concepts, have employed clear and unambiguous language in this regard. For instance, sections 95(1) and (2) of the *Bankruptcy and Insolvency Act* (the "*BIA*")[67] as amended, dealing with preferences, provide as follows:

> 95(1) A transfer of property made, a provision of services made, a charge on property made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person:
>
> (a) In favour of a creditor who is dealing at arm's length with the insolvent person…with a view to giving that creditor a preference over another creditor is void as against…the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the date that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy; and
>
> (b) In favour of a creditor who is not dealing at arm's length with the insolvent person…that has the effect of giving that creditor a preference over another creditor is void as against…the trustee if it is made, incurred, taken or suffered…during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy;
>
> (2) If the transfer, charge, payment, obligation or judicial proceeding referred to in paragraph 1(a) has the effect of giving any creditor a preference, it is, *in the absence of evidence to the contrary, presumed to have been made*, incurred, taken or suffered with a view to giving the creditor the preference – even if it was made, incurred, taken or suffered…under pressure – and evidence of pressure is not admissible to support the transaction[68] [emphasis added]

First, it may be argued that as a matter of law, there is a difference between "deemed" and "presumed". Regardless however, the absence of any provision in the *Act* comparable to section 95(2) of the *BIA*, might suggest that the "deeming" provision in section 7(2) is not rebuttable. Conversely however, given that the draftsman simply didn't address the issue at all, it is equally arguable that if such presumption was to be absolute, the *Act* would have said so.

- Subsection 7(3) provides a similar right of relief relating to the franchisor's failure to comply with the obligations under section 5 of the *Act*.

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[65] *Limitations Act, supra* note 30 at s.5
[66] O. Reg. *supra* note 2 at s. 7.2
[67] *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3 [*BIA*]
[68] *BIA, supra* note 33 at s. 95.

- Subsection 7(4) provides that a person is not liable under section 7 if it can be proven that the franchisee acquired the franchise with knowledge of the misrepresentation or a failure to comply with the disclosure obligations under section 5 of the *Act*.

- Next, subsection 7(5) provides other defences to a "person" in regard to claims made under section 7. Subsections 7(5) (a) and (b) address such person's lack of knowledge of the misrepresentation in the disclosure document or statement of material change and require the person to provide notice to the franchisee of the person's lack of knowledge or to withdraw any consent, if one had been provided.

- Subsection 7(5) (c) is a little different in that if a statement in the disclosure document or statement of material change was made on the authority of an expert, or purports to be a copy of or an extract of an expert's report or opinion, the "person" will not be liable if he or she had no reasonable grounds to believe that such statement was not a misrepresentation and did not believe that there had been a misrepresentation, the disclosure document did not fairly represent the report or opinion or that the portion included was not a fair copy or extract form the report or opinion of the expert.

4. Hot Spots-An Example

One of the most contentious areas of dispute is that relating to earnings projections or representations made about the future success of the franchise. Although the *Act* requires that when earnings projections are made, certain other disclosure obligations, addressed earlier in this paper, are triggered, this still remains an area fraught with danger.

The quality of the new franchisee as a business operator may not be what was expected. New competitors may move into areas in close proximity with the franchise. Economic conditions may change. Where the franchise depends on a specific population of customers, such as a food service operation situated in a stand-alone office tower, a major tenant may be in the process of leaving.

Other potential problems, not always recognized, include the differences between mall locations and store fronts and large metropolitan areas and smaller urban centres. Experienced franchisors provide a detailed breakdown recognizing these differences. Other less experienced or less upstanding franchisors do not.

In some of the instances cited above, the franchisor could not reasonably be expected to know of the existence of factors that leads to later problems. Nonetheless, earnings projections, even with the appropriate *caveats*, may give rise to subsequent litigation.

Specific problems also arise where a corporate store is being sold to a franchisee. With or without earning projections or representations, the past financial performance of that particular store is a material fact under the *Act* and ought to be disclosed.

While it is beyond the scope of this paper to outline all of the hotspots giving rise to misrepresentation claims, or even a significant number arising from earnings claims, in today's world franchisors have to carefully consider whether the possible business advantages gained in including information, even if wholly factual, relating to financial performance is worth the risks.

F. DISPUTES RELATING TO THE DUTY OF GOOD FAITH AND THE RIGHT TO ASSOCIATE

1. Common Law Duty of Good Faith

The courts in Canada have long accepted the proposition that quite aside from any requirements imposed by statute, an implied duty of good faith is imposed on the parties to a contract to ensure that their respective obligations are carried out in good faith. However, this duty of good faith is tied to the provisions of the agreement, does not exist in the air and cannot create or undo the terms and provisions of the contract in question. [69]

The duty of good faith has been defined in many different ways by the courts. For instance, it has stated that good faith must include, at a minimum, that a party be candid, reasonable, honest, forthright and fair[70]. Conversely, the courts have determined that one party must have regard to the legitimate interests of the other, and have inserted as component elements thereof, the concepts of loyalty and respect.[71] However, although this duty exists in regard to carrying out the terms of an existing contract, the law is clear that there is no duty to negotiate such contract in good faith. [72]

In addition, the courts have not always been consistent in their interpretation of how far the common law duty of good faith extends. For instance, in *Perfect Portions*[73], the Honourable Justice Fleury characterized the duty owed between franchisors and franchisees as one of the "utmost good faith", somewhat akin to the duty imposed on insurers in regard to how they deal with their insureds. Somewhat surprisingly, this description was subsequently adopted in *Machias*[74] and also in *1176560 Ontario Ltd. v. Great Atlantic & Pacific Company of Canada Ltd.*[75]

However, notwithstanding these repeated references to the "utmost good faith", it has now generally been accepted that such higher duty does not exist within the contractual framework of a franchise relationship.[76]

The common law duty of good faith imposed on the parties to a contract, ought not to be confused with the duties imposed on fiduciaries. That is not to say that under certain circumstances, a fiduciary duty could not arise within the context of a franchise relationship. So, for example, if:

a. The franchisor has power or discretion;
b. The franchisor can exercise such power or discretion unilaterally so as to affect the franchisee's legal or practical interests; and
c. The franchisee is particularly vulnerable or dependent on the franchisor,

then fiduciary obligations may arise.

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[69] See for example, *Agribrands Purina Canada Inc. v Kasamekas* 2011 ONCA 460 at para 51; *Transamerica Life Canada Inc. v ING Canada Inc.* (2003), 68 OR (3d) 457 (Ont CA) [*Transamerica*]; *1193430 Ontario Inc. v. Boa-Franc Inc*. [2005], 78 OR (3d) 81 (CA) leave to appeal to S.C.C. refused [2006] SCCA No 2.

[70] *Wallace v. United Grain Growers Ltd.* [1979] SCR 701.

[71] *Machias, supra* note 22; *Shelanu, supra* note 23.

[72] See for example, *978011 Ontario Ltd. v Cornell Engineering Co.* (2001), 53 O.R. (3d) 783 (Ont CA) and *Transamerica, supra* note 35 at paras 52- 53 and 56.

[73] *Perfect Portions, supra* note 22 at para 14.

[74] *Machias, supra* note 22 at para 121.

[75] *1176560 Ontario Ltd v Great Atlantic & Pacific Company of Canada Ltd* (2002), 62 OR (3d) 535 (Ont SCJ) at paras 86-88.

[76] See for example, *TDL Group Ltd. v. Zabco Holdings Inc,* 2008 MBQB 239.

In the absence of the foregoing however, the courts have consistently found that unlike relationships which by their very nature carry with them fiduciary obligations (i.e. lawyer-client), no fiduciary relationship arises merely out the execution of a franchise agreement.[77]

In this regard, the comments of the Court of Appeal in *Shelanu* are of particular interest. At paragraphs 68 to 71 of its decision, Justice Weiler, writing for the court, stated the following:

> 68 The imposition of a duty of good faith and a fiduciary duty are closely related. As stated in *Cornell Engineering Co.*, *supra* at para. 33 they, along with the standard of unconscionability:
>
> [a]re points on a continuum in which the law acknowledges a limitation on the principle of self-reliance and imposes an obligation to respect the interests of the other. They are defined by P. Finn, "The Fiduciary Principle" in T. Youdan, ed., *Equity, Fiduciaries and Trusts*, (1989), 1 at 4 as follows:
>
> "Unconscionability" accepts that one party is entitled as of course to act self-interestedly in his actions towards the other. Yet in deference to that other's interests, it then proscribes excessively self-interested or exploitative conduct. *"Good faith," while permitting a party to act self-interestedly, nonetheless qualifies this by positively requiring that party, in his decision and action, to have regard to the legitimate interests therein of the other*. The "fiduciary" standard for its part enjoins one party to act in the interests of the other — to act selflessly and with undivided loyalty. There is, in other words, a progression from the first to the third: from selfish behaviour to selfless behaviour. Much the most contentious of the trio is the second, "good faith." It often goes unacknowledged. It does embody characteristics to be found in the other two [footnotes omitted].
>
> 69 There is at least one important difference between the duty of good faith and a fiduciary duty. If, for example, A owes a fiduciary duty to B, A must act only in accordance with B's interests when A exercises its powers or exercises a discretion arising out of the relationship: see *York Condominium Corp. No. 167 v. Newrey Holdings Ltd.* (1981), 122 D.L.R. (3d) 280 (Ont. C.A.), at 289, leave to appeal to the Supreme Court of Canada refused [1981] 1 S.C.R. xi (S.C.C.); *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 (S.C.C.). If, on the other hand, A owes a duty of good faith to B, A must give consideration to B's interests as well as to its own interests before exercising its power. Thus, if A owes a duty of good faith to B, so long as A deals honestly and reasonably with B, B's interests are not necessarily paramount: see for example *Freedman v. Mason*, [1958] S.C.R. 483 (S.C.C.).
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> 70 The trial judge recognized that the relationship between a franchisor and a franchisee would not normally be characterized as a fiduciary one in accordance with *Jirna Ltd. v. Mister Donut of Canada Ltd.* (1971), [1972] 1 O.R. 251 (Ont. C.A.), aff'd, (1973), [1975] 1 S.C.R. 2 (S.C.C.). I do not agree that it logically follows from the trial judge's reference to partners that he applied the fiduciary standard in this case. At a later point in his reasons, the trial judge reiterated that a franchise relationship was akin to that of a partnership and, accordingly, like a partnership required mutual respect. He quoted from the decision of Kelly J. in *Gateway Realty Ltd. v. Arton Holdings Ltd. (No. 3)* (1991), 106 N.S.R. (2d) 180 (N.S. T.D.), at 191-192, aff'd (1992), 112 N.S.R. (2d) 180 (N.S. C.A.), to the effect that parties to a contract are required to exercise their rights under that agreement honestly, fairly, and in good faith, and that, when a party acts contrary to community standards of honesty and reasonableness or fairness, he acts in bad faith. The trial judge well knew the distinction between a duty of good faith and a fiduciary duty and did not hold Print Three to a fiduciary duty.
>
> 71 Moreover, the fact that contractual terms are ultimately complied with, does not mean that

[77] See for example, *887574 Ontario Inc. v Pizza Pizza Ltd*. (1994), 23 BLR (2d) 239 (Gen. Div.), leave to appeal ref'd [1994], 35 C.P.C. (3d) 323; *Jirna Ltd. v Mister Donut of Canada Ltd*. (1973), 40 DLR (3d) 303 (SCC); *Shelanu, supra* note 23.

there has been no breach of the duty of good faith.[78]

Not surprisingly, although different courts have at different times tried to define good faith, such definitions have not always been consistent.

Statutory Duty of Fair Dealing

Section 3 of the *Act* provides that a duty of fair dealing is imposed on each party in its performance and enforcement of a franchise agreement.[79] It also provides that the duty of fair dealing *includes* good faith and reasonable commercial standards. It is hard to imagine at this stage what other duty might be included as a component of fair dealing and to date, no case has addressed this issue.[80]

Of significant importance is the fact that Section 3 also provides a party to a franchise agreement with an independent right of action against another party to the franchise agreement who breaches the duty of fair dealing in the performance or enforcement of that franchise agreement. More is set out about this right of action below.

Moreover, unlike most of the provisions of the *Act*, which take effect from the date the statute came into effect, section 3 applies, in accordance with subsection 2(2) of the *Act*, retroactively with respect to a franchise agreement entered into before the coming into force of the section if the business operated by the franchisee under such agreement, is operated or to be operated, partly or wholly in Ontario.

As mentioned above, Canadian courts have not recognized a stand-alone duty of good faith independent from the terms of the contract or from the objectives that emerge from those terms.[81] In this regard, the provisions of section 3 of the *Act* clearly reflect this principle and limit the duty of fair dealing to the "performance and enforcement" of the terms of the franchise agreement.

Accordingly, the courts have held that while the duty of fair dealing applies to the conduct of the parties in the implementation of the contractual terms, it does not affect the interpretation of renewal provisions in a franchise agreement and is not intended to change the terms of the contract.[82]

The requirement to comply with the fair dealing provisions in section 3 permeates not only the *Act*, but has repercussions to the franchisor-franchisee relationship as well as how franchise agreements are and will be drafted.

By way of example, many franchise agreements formerly referred to franchisors having certain rights which they could exercise "in their sole and unfettered discretion". Given the fair dealing obligations, coupled with section 11 of the *Act*, which makes any purported waiver or release by a franchisee of a right given thereunder, or any obligation or requirement imposed on a franchisor under the said *Act*, void, the word "unfettered" may have become essentially meaningless. Lawyers who are drafting franchise agreements should accordingly be well advised to frame the franchisor's rights in absolute terms, with the word "discretion" nowhere to be found. If discretion is to be exercised, given the duty of fair dealing, it must be for proper and defendable purposes and not to punish a franchisee perceived as wayward or as an instigator of system wide complaints.

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[78] *Shelanu*, *supra* note 23 at paras 68-71.
[79] *Act*, *supra* note 1 at s. 3(1).
[80] *Act*, *supra* note 1 at s. 3(3).
[81] *Transamerica*, *supra* note 35.
[82] *Pointts Advisory Ltd v 754974 Ontario Inc*, 2006 CarswellOnt 5293 (Ont SCJ).

As briefly referenced herein, the duty of fair dealing in section 3 may become of central importance when a renewal of a franchise agreement is in issue. It is clear that where the term of the contract is for a set or stipulated time with no right of renewal contained therein, the obligations of fair dealing will not create such a right. In *Retail Inc. v Blanaru*[83], quoted in *33177447 Manitoba Ltd. v. Beaver Lumber Inc*.[84], the court made the following statement:

> It is one thing to say that good faith may be employed so that one party cannot harm the other in exercising the other's rights under the agreement or, to put it another way, that one party cannot prevent the other from securing bargained benefits. It is another to say that, absent elements of this character, good faith can be utilized to provide for something unbargained.[85]

However, the issue becomes significantly more complicated when a franchisee has been lead by the franchisor, by words or actions, to believe that a new term will be provided at the expiration of the old, even where no express right of renewal exists. One example would be the franchisor forcing the franchisee to engage in a major, extensive and costly renovation 2 years prior the expiration of the term under circumstances where the costs of such renovation could never be recouped absent a new term being provided.

Lastly, in the Court of Appeal's decision in *Salah v Timothy's Coffees of the World Inc*.[86], an Ontario Court awarded damages specifically for a breach of the duty of fair dealing. The decision was written by Winkler, CJO, who stated, among other things, the following:

> 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...[87]

Statutory Right to Associate

Section 4 of the *Act* creates a new right for franchisees-the right to associate.

More particularly, the section:

(a) Permits franchisees to associate with other franchisees and to form or join an organization of franchisees[88];
(b) Prevents franchisors from interfering with, prohibiting or restricting, by contract or otherwise, a franchisee from forming or joining an organization of franchisees or from associating with other franchisees[89];
(c) Prevents a franchisor from, whether directly or indirectly, penalizing, attempting to penalize or threatening to penalize a franchisee from exercising its rights under this section[90]; and
(d) Provides that any provision in a franchise agreement "or any other agreement relating to a franchise" which purports to interfere with, prohibits or restrict a franchisee from exercising any right under this section, is void.[91]

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[83] *Imasco Retail Inc. v Blanaru* (1995), 9 W.W.R. 44 (Man QB).
[84] *33177447 Manitoba Ltd. v Beaver Lumber Inc*. 2006 SKQB 414 [*Beaver Lumber*].
[85] *Beaver Lumber*, *supra* note 50 at para 26.
[86] *Salah v Timothy's Coffees of the World Inc*. 2010 ONCA 673; aff'g (2010), 65 BLR (4th) 235.

[87] *Ibid* at para 29.
[88] *Act*, *supra* note 1 at s. 4(1).
[89] *Act*, *supra* note 1 at s. 4(2).
[90] *Act*, *supra* note 1 at s. 4(3).

This section has also been the subject of significant judicial attention recently.

In *405341 Ontario Limited v. Midas Canada Inc.*[92] a number of issues relating to the rights afforded under section 4 were canvassed.

Although this was a class proceeding which dealt with various other issues, one of the disputes that arose during the pendency of the matter related to the expiration of the representative plaintiff's franchise agreement. As is the case in virtually every franchise agreement, the right to renew was conditional upon the franchisee providing a general release of the franchisor.

The motion judge, from whose decision Midas had appealed, found that the pre-existing provision in the franchise agreement which required delivery of such a release was subject to the overriding provisions of the *Act*. He also found that if such provision interfered with the franchisees' right of association and if it required the franchisees to release rights under the *Act*, then it was void. Conversely, the motions judge rejected the franchisor's argument that the franchisees were not obliged to exercise their rights of renewal and thereby bring the release requirement into play, referring to the same as being "of no relevance". Accordingly, for various reasons, including breach of section 4(4) of the *Act*, the motion judge found the impugned provision void.

More particularly, the motions judge found that when read within the context of the *Act*, the right of association in section 4 does encompass the right of franchisees to participate in a class action for the purpose of enforcing their rights. He concluded by finding that section 4's inclusion in the statute would be inexplicable if it was not intended to permit franchisees to associate for the purpose of protecting their interests and enforcing their rights through collective action.

All of the findings of the motions judge were upheld on appeal.

In *1318214 Ontario Ltd. v. Sobeys Capital Inc.*[93], certain franchisees were concerned about the defendant's *pro forma* projections for the upcoming year and hired counsel to represent them to address this issue. Sobeys however, under its low equity program in which these franchisees were involved, restricted each store to paying a maximum of $2,000 per year to outside counsel. The franchisees in question withdrew significantly more than the $2,000 each for the purpose of funding counsel. Sobeys indicated it intended to terminate the franchise agreements after sending notices of default concerning the withdrawal of such amounts. It also advised that if the excess funds were not returned, it would terminate and re-possess the franchises in question. The franchisees-plaintiff commenced an action and brought a motion for injunctive relief.

In addressing the first part of the test for injunctive relief, the court found that there was a serious issue to be tried concerning whether the franchisees had breached the provision relating to the removal of corporate funds for litigation purposes, as well as the interpretation, scope and enforceability of such provision.

Justice Conway also addressed the franchisees' submission that by restricting their access to funds for legal fees and terminating the agreements of those franchisees who withdrew such funds, Sobeys was

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[91] *Act*, *supra* note 1 at s. 4(4).
[92] *405341 Ontario Limited v Midas Canada Inc.* [2009], 64 BLR (4th) 251; aff'd 2010 ONCA 478.

[93] *1318214 Ontario Ltd. v Sobeys Capital Inc*. 2010 ONSC 4141.

interfering with their right of association contrary to section 4 of the *Act.* After quoting from the decision in *Midas*, she stated the following:

> 31 This is not a class proceeding, but it is a collective effort of the Franchisees to enforce their rights. I find that there is a serious issue to be tried as to whether the issuance of the Notices and proposed terminations under these circumstances amount to an interference with the Franchisees' ability to pursue collective action against the franchisor contrary to the Act.[94]

So where will section 4 take us next? It has been used to form a triable issue on such seemingly unrelated subjects as whether a franchisor can restrict the use of its franchisees' in regard to litigation brought against it. It has been applied to support the proposition that franchisees had a right to associate to protect their interests and enforce their rights through collective action.

G. COMMON CONTRACTUAL TROUBLE SPOTS, INCLUDING CLAIMS RELATING TO ADVERTISING FUNDS, THE SUPPLY CHAIN, RENEWALS AND RE-SALES

Franchise disputes may include one or more of the following types of claims:

- pre-contractual misrepresentations (innocent, negligent or fraudulent)
- contractual breach
- contractual failure to perform
- fundamental breach
- breach of the duty of fair dealing
- breach of the right to associate
- no disclosure
- incomplete disclosure

As most franchise disputes are factually dependent, and pertain to specific provisions of the franchise agreement, it is difficult to generalize the exact nature of all such disputes. However, there are a number of provisions in a typical franchise agreement which can be the source of disputes between the parties. The fundamental principal for both parties is to ensure that the provisions of the agreement with respect to these items are clear, unambiguous and drafted with certainty. While the parties will be subject to the duty of fair dealing in respect of their performance and enforcement of the franchise agreement, where the agreement is precise and unambiguous in its wording, the duty of fair dealing will only apply to the enforcement and performance of the specific provisions, and will not be used by a court to modify or interpret the provisions in what would be considered to be a "fair manner". However, the courts have clearly stated that, in the event of ambiguity or uncertainty, they will interpret the agreement against the interest of the party that prepared, which consequentially means in favour of the franchisee.

The following are typical provisions of a franchise agreement which may give rise to a dispute between the parties:

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[94] *Ibid* at Para 31.

- grant of rights, including reserved rights and territorial exclusivity
- encroachment by the franchisor, including operation of corporate locations
- conflict between the period of time for which the franchise is granted and the period of time for which the franchisee is permitted under a lease or sublease to occupy premises
- renewals and renewal conditions, including
    - right to renew
    - term
    - fees
    - conditions of renewal
    - execution of then current form of agreement
    - releases (subject to *Midas* decision)
- obligations of franchisee, including
    - upgrading and renovations
    - products and services
    - full time and attention
- pricing of products and/or services
    - competitive prices
    - full line purchasing
- supply arrangements
    - approved suppliers
    - pricing and terms of purchase and supply
- non-competition
    - in-term
    - post-term
    - parties
- confidentiality

  - parties
- transfers and assignments for franchise
  - by franchisees
  - by franchisee owners
  - by franchisor
- trade-marks
  - current status
  - indemnity
  - right of franchisor to change
- system changes
  - application of operations manual
  - right of franchisor to make changes
- defaults
- remedies on defaults
  - cure periods
  - self-help remedies
  - common law remedies
  - cross-default with other agreements
- termination
- entire agreement clause

D. LAWYERS' DUTIES RELATED TO THE CONTENT OF AND PROCESS RELATED TO FRANCHISE DISCLOSURE DOCUMENTS

Whether advising a franchisor or a franchisee, the scope of the lawyer's retainer and engagement, and the nature of the advice to be given by a lawyer, is dependent upon any specifics in the engagement and the duty of care which a reasonably prudent solicitor would exercise in carrying out the solicitor's responsibilities. Franchise law, as a specific practice area, is relatively new and constantly evolving. In view of the considerable risks to both parties should the relationship deteriorate or a dispute result, lawyers acting for either party must exercise diligence and due care to ensure that their clients are properly advised and aware of the rights and obligations for which they contract under the franchise agreement and which are available to either party under common law or statute. Further, for lawyers

acting for a franchisor, in view of the considerable exposure of franchisors to claims for rescission by franchisees alleging no or improper disclosure, and the magnitude of damages associated with such claims, combined with the propensity of franchisees in large systems to commence class actions, lawyers representing franchisors must ensure that they provide comprehensive and, ideally, written explanations of the processes involved in preparing franchise agreements, ancillary documents and disclosure documents, and the appropriate use of and requirements with respect to disclosure documents on an ongoing basis.

The following are a number of items pertaining to lawyers' duties relating to the content and use of franchise disclosure documents which lawyers should consider in respect of their client responsibility and due diligence:

- explaining the legal requirements for disclosure to the franchisor client
- explaining the consequences of failure to disclose or incomplete disclosure to the franchisor client
- the lawyer's duty to assist or give direction in gathering facts for preparation of disclosure documents
- the responsibility of the lawyer to verify or review facts contained in a disclosure document and to obtain confirmation from the franchisor regarding same
- the responsibility of the lawyer to ensure that the franchisor client is aware of the requirement to canvass the possibility of other material facts for inclusion in disclosure document
- the lawyer's duty to review and comment on draft disclosure documents for a franchisor client
- the lawyer's role in explaining the disclosure process to a franchisor and ensuring strict compliance with same
- advising a franchisor client on execution and delivery of a disclosure document, retention of duplicate documents, and obtaining confirmation of receipt
- the contents of a solicitor's report to a franchisor client on the preparation, maintenance, use and updating of a disclosure document
- the responsibility of a lawyer to advise a franchisor client on modifications to a standard disclosure document required for specific situations including renewals or extensions, re-sales or transfers, new franchises, and corporate sales
- the lawyer's duty if the lawyer suspects incomplete or inaccurate disclosure
- the lawyer's duty if the lawyer suspects improper, misleading or fraudulent disclosure
- should a franchisor lawyer advise the lawyer's client to require a certificate of independent legal advice from each franchisee and explain the consequences of not obtaining same
- the role of a franchisee lawyer in reviewing a disclosure document with the franchisee client
- the obligation of a franchisee lawyer to inform the franchisor or the franchisor's lawyer if the franchisee lawyer is aware of incomplete, misleading or non-disclosure.

- what should a franchisor lawyer do if the lawyer is aware that a franchisee has not received legal advice before signing a franchise agreement or paying consideration for a franchise
- what reporting should a lawyer do to a franchisee client
- what limitations should a lawyer include in an engagement letter when acting for a franchisor
- what limitations should a lawyer include in an engagement letter when acting for a franchisee
- if a lawyer acts for a franchisee in a particular system, is the lawyer precluded from acting for the franchisor on another matter not specifically related to the original franchisee client

Authors' Disclosure

Teplitsky, Colson LLP was counsel of record in the following cases noted above:

4287975 Canada Inc. v Imvescor Restaurants Inc. 2009 ONCA 308; aff'g (2008), 91 OR (3d) 705 (Ont SCJ).

2189205 Ontario Inc. v Springdale Pizza Depot Ltd. 2011 ONCA 467; aff'g 2010 ONSC 3695 (Ont SCJ).

Osler LLP was counsel of record in the following cases noted above:

TA&K Enterprises Inc. v. Suncor Energy Products Inc., 2010 ONSC 7022; aff'd 2011 ONCA 613

1176560 Ontario Ltd v Great Atlantic & Pacific Company of Canada Ltd. (2002), 62 OR (3d) 535 (Ont SCJ)

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1176560 Ontario Ltd v Great Atlantic & Pacific Company of Canada Ltd (2002), 62 OR (3d) 535 (Ont SCJ)

1193430 Ontario Inc. v. Boa-Franc Inc. [2005], 78 OR (3d) 81 (CA) leave to appeal to S.C.C. refused [2006] SCCA No 2

1230995 Ontario Inc. v Badger Daylighting Inc. 2010 ONSC 1587; aff'd 2011 ONCA 442

1318214 Ontario Ltd. v Sobeys Capital Inc. 2010 ONSC 4141

1490664 Ontario Ltd. v Dig This Garden Retailers Ltd. (2005), 256 DLR (4th) 1 (Ont CA) [*Dig This Garden*] aff'g [2004] O.J. No. 3008 (Ont SCJ)

1518628 Ontario Inc. v Tutor Time Learning Centres LLC (2006), 150 ACWS (3d) 93 (Ont SCJ)

1706228 Ontario Ltd. v Grill It Up Holdings Inc. 2011 ONSC 2735

2189205 Ontario Inc. v Springdale Pizza Depot Ltd 2011 ONCA 467; aff'g 2010 ONSC 3695 (Ont SCJ)

33177447 Manitoba Ltd. v Beaver Lumber Inc. 2006 SKQB 414

405341 Ontario Limited v Midas Canada Inc. [2009], 64 BLR (4th) 251; aff'd 2010 ONCA 478

4287975 Canada Inc. v Imvescor Restaurants Inc 2009 ONCA 308; aff'g (2008), 91 OR (3d) 705 (Ont SCJ)

6792341 Canada Inc. v Dollar It Ltd 2009 ONCA 385

887574 Ontario Inc. v Pizza Pizza Ltd. (1994), 23 BLR (2d) 239 (Gen. Div.), leave to appeal ref'd [1994], 35 C.P.C. (3d) 323

978011 Ontario Ltd. v Cornell Engineering Co. (2001), 53 O.R. (3d) 783 (Ont CA)

Agribrands Purina Canada Inc. v Kasamekas 2011 ONCA 460

Bekah v. Three for One Pizza & Wings (Canada) Inc. (2003) 67 OR (3d) 305 (Ont SCJ)

Imasco Retail Inc. v Blanaru (1995), 9 W.W.R. 44 (Man QB)

Jirna Ltd. v Mister Donut of Canada Ltd. (1973), 40 DLR (3d) 303 (SCC)

Machias v Mr. Submarine Ltd. (2002), 24 B.L.R. (3d) 228 (Ont SCJ)

MBCO Summerhill Inc. v MBCO Associates Ontario Inc. 2011 ONSC 5432; 2011 ONCA 236

Melnychuk v Blitz Ltd 2010 ONSC 566

Murray v TDL Group Ltd [2002] OTC 1024 (Ont SCJ)

Perfect Portions Holding Co. v New Futures Ltd. [1995] OJ No. 2113 (Gen Div)

Queen v Cognos Inc [1993] 1 SCR 87

Salah v Timothy's Coffees of the World Inc. 2010 ONCA 673; aff'g (2010), 65 BLR (4th) 235

Shelanu Inc. v Print Three Franchising Corp [2003] 172 O.A.C. 78 (Ont CA); rev'g in part (2000), BLR (3d) 69 (Ont SCJ)

Sovereignty Investment Holdings Inc. v. 9127-6907 Quebec Inc. [2008] 303 D.L.R. (4th) 515 (Ont SCJ)

*TA&K Enterprises Inc. v. Suncor Energy Products Inc.***,** 2010 ONSC 7022; aff'd 2011 ONCA 613

TDL Group Ltd. v. Zabco Holdings Inc, 2008 MBQB 239

Pointts Advisory Ltd v 754974 Ontario Inc, 2006 CarswellOnt 5293 (Ont SCJ)

Transamerica Life Canada Inc. v ING Canada Inc. (2003), 68 OR (3d) 457 (Ont CA)

Waschkowski v. Hopkinson Estate [2000] 47 OR (3d) 370 (Ont CA)

Wallace v. United Grain Growers Ltd. [1979] SCR 701

Legislation

Arthur Wishart Act (Franchise Disclosure) 2000, S.O 2000, c. 3

Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3

Limitations Act, 2002, S.O. 2002, c. 24, Sched. B.

O. Reg. 581/00

2012 ONTARIO BAR ASSOCIATION INSTITUTE – FRANCHISE LAW
DEALING WITH AND LITIGATING DISPUTES INVOLVING FRANCHISES

Thursday, February 9, 2012 – 1:30 p.m. – 4:50 p.m.
The Westin Harbour Castle Conference Centre
1 Harbour Square, Toronto

HOT SPOTS IN FRANCHISING

By IAN ROHER, Teplitsky, Colson LLP and
FRANK ZAID, Osler, Hoskin & Harcourt LLP

With thanks to KRISTINA DAVIES of Teplitsky, Colson LLP for her assistance

TEPLITSKY, COLSON LLP BARRISTERS

OSLER

HOT SPOTS IN FRANCHISING

INTRODUCTION

- Nature of franchise relationship
- Types of documents
- Statutory disputes
- Contractual disputes
- Statute appears clear on initial reading – but be clear, it is uncertain and ambiguous in parts, and always subject to specific fact situations and judicial decisions

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INTRODUCTION (continued)

- Hotspots
  - Content of disclosure documents
  - Problems with franchise disclosure process
  - Misrepresentations
  - Disputes relating to duty of good faith and rights to associate
  - Common contractual trouble spots
  - Lawyers' duties related to content of and process relating to disclosure documents

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A. PROBLEMS WITH CONTENT OF FRANCHISE DISCLOSURE DOCUMENTS

- Definitions
  - Franchise agreement
  - Franchisee
  - Franchisor
  - Franchisor's associate

Case: *1706228 Ontario Ltd. v. Grill It Up Holdings Inc.* – What is a franchise

Case: *MBCO Summerhill Inc. v. MBCO Associates Ontario Inc.* – Franchisor's associate

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A. PROBLEMS WITH CONTENT OF FRANCHISE DISCLOSURE DOCUMENTS (continued)

- Form and Content
  - Required contents
  - Material facts as prescribed
  - Other material facts
  - Financial statements
  - Agreements
  - Statements
  - Accurate, clear and concise
  - One document, one time

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A. PROBLEMS WITH CONTENT OF FRANCHISE DISCLOSURE DOCUMENTS (continued)

- Major Problem Areas
  - Required disclosure items
    - Franchisor information
    - Litigation history
    - Costs and fees
    - Annual operating costs
    - Rebates
    - Licenses
    - Territory

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A. PROBLEMS WITH CONTENT OF FRANCHISE DISCLOSURE DOCUMENTS (continued)

- Restrictions on sales
- Earnings projections
- Financial statements

Case: *6792341 Canada Inc. v. Dollar It Ltd*.
Case: *Melychuk v. Blitz Ltd.*

- Certificate of disclosure
  - Receipt

Case: *6792341 Canada Inc. v. Dollar It Ltd.*

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A. PROBLEMS WITH CONTENT OF FRANCHISE DISCLOSURE DOCUMENTS (continued)

- Miscellaneous
  - wrap-arounds or addendums

  Case: *1518628 Ontario Inc. v. Tutor Time Learning Centres LLC*.

  - Material change
  - One document at one time

  Case: *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd*.

  - Updating
  - Specific franchise being offered

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B. PROBLEMS WITH FRANCHISE DISCLOSURE PROCESS

- Who is the Franchisor
- Who is the Franchisee
- Timing of Disclosure
  - 14 days
  - No exceptions in Ontario
  - Franchise agreement definition
- Delivery requirements

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B. PROBLEMS WITH FRANCHISE DISCLOSURE PROCESS (continued)

- Exemptions from disclosure
  - Resale/transfer
  - Additional franchise
  - Fractional franchise
  - Renewal or extension
  - Small franchise
  - Sophisticated purchaser

Case: *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*

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B. PROBLEMS WITH FRANCHISE DISCLOSURE PROCESS (continued)

Case: *TA&K Enterprises Inc. v. Suncor Energy Products*

- Disclosure specific to each type of franchise
  - New
  - Renewal or extension
  - Resale or transfer
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  - Corporate/franchisor unit

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C. MISREPRESENTATIONS IN FRANCHISING

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  - Types of misrepresentations

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  - Special relationship

  - Duty of fair dealing
  - Defensive drafting

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C. MISREPRESENTATIONS IN FRANCHISING (continued)

- Exclusionary Clauses
  - Types of exclusionary clauses
  - Non-waiver clauses
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  Case: *Shelanu v. Print Three Franchising Corp*.
  Case: *Queen v. Cognos*
  - Enforcement of clauses
  - Contract of adhesion
  - Entire agreement clause

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C. MISREPRESENTATIONS IN FRANCHISING (continued)

Case: *Machias v. Mr. Submarine Ltd*.

- Best practices
- Questionnaires
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C. MISREPRESENTATIONS IN FRANCHISING (continued)

- Statutory Misrepresentations
  - Rights of rescission – s.6
  - Misrepresentation – s.7
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  - Limitations period
  - Deemed reliance
- Hot Spots
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  - Utmost good faith?
  - No fiduciary duty

  Case: *Shelanu*
  - Meaning of good faith
  - Duty of franchisor

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D. DISPUTES RELATING TO DUTY OF GOOD FAITH AND RIGHT TO ASSOCIATE (continued)

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  - Both parties
  - Performance and enforcement of agreement
  - Includes good faith
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  - Discretion
  - Application to renewals

  Case: *33177447 Manitoba Ltd. v. Beaver Lumber Ltd.* – damages award

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D. DISPUTES RELATING TO DUTY OF GOOD FAITH AND RIGHT TO ASSOCIATE (continued)

Case: *Salah v. Timothys' Coffees of the World Inc.* – tort damages

- Statutory Right to Associate
  - S. 4
  - Application to class actions

Case: *405341 Ontario Limited v. Midas Canada Inc.*

Case: *1318214 Ontario Ltd. v. Sobeys Capital Inc.*
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E. Common Contractual Trouble Spots

- Fundamental drafting principles
  - *Contra proferentum*
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  - Contract of adhesion
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  - Territory
  - Encroachment
  - Renewals
  - Pricing of products/services

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E. Common Contractual Trouble Spots (continued)

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- Resales, transfers and assignments
- System changes
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F. LAWYERS' DUTIES RELATED TO CONTENT OF AND PROCESS RELATED TO FRANCHISE DISCLOSURE DOCUMENTS

- Explaining disclosure document to franchisor/franchisee client
- Consequences of incomplete/no disclosure
- Gathering facts process
- Updating of specific disclosure items
- Material facts
- Execution and delivery

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F. LAWYERS' DUTIES RELATED TO CONTENT OF AND PROCESS RELATED TO FRANCHISE DISCLOSURE DOCUMENTS (continued)

- Solicitor's report to franchisor client
- Modifications to/updating of disclosure document
- Incomplete or inaccurate disclosure
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- Advising a franchisee
- Requiring franchisee to obtain independent legal advice
- Engagement letters – franchisor/franchisee client
- Future legal conflicts

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THANK YOU!!

- Questions and Answers?

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Institute 2012 of Continuing Professional Development

Franchise Law
Dealing With and Litigating Disputes Involving Franchises

Rescission 101: An Introduction to the Statutory Rescission Remedy Under *The Arthur Wishart Act* (Franchise Disclosure), 2000

Sam Hall
Sotos LLP
and
Derek Ronde
Cassels Brock & Blackwell LLP

February 9-11, 2012

Ontario Bar Association
A Branch of the Canadian Bar Association

RESCISSION 101: AN INTRODUCTION TO THE STATUTORY RESCISSION REMEDY UNDER THE *ARTHUR WISHART ACT (FRANCHISE DISCLOSURE), 2000*[1]

By Sam Hall and Derek Ronde[2]

1. The statutory right to rescind a franchise agreement

The right to rescind a franchise agreement contained in the *Arthur Wishart Act (Franchise Disclosure) 2000*, c. 3 (the "Act") is one of the most drastic remedies available to a franchisee. The remedy may be available when a franchisee does not receive a disclosure document that complies with the strict provisions of the Act and its regulation (the "Regulation")[3]. Franchisors, franchisees and their respective counsel should familiarize themselves with statutory rescission under the Act, as it has dramatically changed the landscape of franchise litigation in this province and creates complexities that go beyond the typical common law contractual dispute between franchise parties.

As with equitable rescission, the aim of statutory rescission under the Act is to compensate a franchisee who receives either defective or no disclosure by restoring the franchisee to its pre-contractual position. However, the Act relieves some of the problems that arise in a claim of equitable rescission. For example, a franchisor would instinctively assert by way of defence to a rescission claim that the rescinding franchisee was satisfied with what it received by way of disclosure, that the franchisee was aware of the deficiencies of disclosure at the time it was given and nonetheless proceeded to enter into its agreements with the franchisor,

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[1] The authors have drafted this paper as an overview of the basics of rescission claims under the *Wishart Act*, and have attempted to provide a balanced view of the legislation in respect of both franchisors and franchisees.

[2] Sam Hall is a lawyer at Sotos LLP in Toronto, Ontario. Derek Ronde is a lawyer at Cassels, Brock & Blackwell LLP in Toronto, Ontario.

[3] O. Reg. 581/00.

thereby affirming its contracts and disentitling it to rescission. However, these defences do not have traction in a rescission claim brought under the Act. The onus of proper disclosure under the Act rests solely on the shoulders of the franchisor and a franchisee's conduct is irrelevant with respect to the discharge of that obligation and its consequential impact on a rescission claim.[4] In essence, it is arguable that rescission under the Act is akin to a strict liability regime.

2. Initiating a claim of statutory rescission

A claim of statutory rescission is initiated with the service of a notice of rescission on the franchisor by the franchisee. There is no prescribed form of notice under the Act. Section 6(3) of the Act does require that the notice of rescission be in writing and be delivered to the franchisor personally, by registered mail, or by fax at the franchisor's address for service or to any other person designated for that purpose under a franchise agreement.

The notice of rescission should describe in detail why the purported disclosure document is not compliant with the Act and Regulation or, where appropriate, advise that the rescinding franchisee did not receive any disclosure document.

A record of the manner and date of service of the notice should be kept given the existence of statutory limitation periods discussed below. Franchisee counsel preparing the notice should pay particular attention to whether the notice is addressed to and from the correct parties. The terms "franchisor" and "franchisee" are defined terms under section 1 of the Act and should be reviewed to ensure that the proper parties are listed in the notice of rescission.

[4] The distinction between equitable and statutory rescission is discussed at length by Madam Justice MacFarland in the early rescission case of *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.*, (2005) 256 D.L.R. (4th) 451 (Ont. C.A.) ("*Dig This Garden*").

Franchisor counsel should also pay close attention to ensure that the notice of rescission has been properly delivered to the correct parties.

Because the Act provides for the potential liability of individuals in addition to the franchisor who may be responsible for the payment of a rescinding franchisee's losses, the notice of rescission should also be served on those individuals where appropriate. More specifically, in addition to the franchisor, a "franchisor's associate" may be responsible for making the rescission payment under section 6(6) the Act. A "franchisor's associate" is defined under the Act as follows:

> "franchisor's associate" means a person,
>
> (a) who, directly or indirectly
>
> (i) controls or is controlled by the franchisor, or
>
> (ii) is controlled by another person who also controls, directly or indirectly, the franchisor, and
>
> (b) who,
>
> (i) is directly involved in the grant of the franchise,
>
> (A) by being involved in reviewing or approving the grant of the franchise, or
>
> (B) by making representations to the prospective franchisee on behalf of the franchisor for the purpose of granting the franchise, marketing the franchise or otherwise offering to grant the franchise, or
>
> (ii) exercises significant operational control over the franchisee and to whom the franchisee has a continuing financial obligation in respect of the franchise;

By interviewing clients about the principals and companies who may have been involved in the grant of the franchise, considering the operational control of individuals and entities within the franchise system, and establishing whether the rescinding franchisee had a "continuing financial obligation" to such entities, the franchisee's counsel can determine what additional parties may be appropriate to add to the notice of rescission (and subsequent claim) as

"franchisor's associates". The disclosure document (even if it is deficient) may provide guidance as to who might be considered a franchisor's associate, given the requirement set out in section 2 of the Regulation to provide comprehensive information on the business background of the franchisor, its directors and officers.

A notice of rescission can contain the estimated losses of the franchisee under section 6(6) of the Act, which sets out four broad categories of losses, discussed below.

Once a notice of rescission is served, and unless the claim is disputed, the franchisor or franchisor's associate is required to pay to the rescinding franchisee its section 6(6) losses within 60 days of the effective date of rescission. The effective date of the notice of rescission is set out at section 6(4) of the Act and is (i) on the day the notice is delivered personally; (ii) the fifth day after it was mailed; or, (iii) on the day it was sent by fax, if sent before 5p.m., or on the day after it was sent by fax, if it was sent at or after 5p.m.[5]

In cases where the franchisor disputes its liability, disputes the quantum of liability, or otherwise fails to make the rescissionary payment required under section 6(6) of the Act, the rescinding franchisee may initiate a claim or application to compel payment of its section 6(6) entitlements and obtain a declaration that its franchise agreements[6] have been validly rescinded. Alternatively, a franchisor may themselves seek declaratory relief from the court to the effect that the franchisee is not entitled to rescind the franchise agreement.

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[5] The limitation period for bringing an action based on the failure to respond to the notice of rescission begins to run when either the sixty days expires or the franchisee is put on notice that the franchisor does not intend to fulfil its obligations under the Act, whichever is earlier. See *2130489 Ontario Inc. v. Philthy McNasty's (Enterprises) Inc.*, 2011 ONSC 6852.

[6] The term "franchise agreement" is defined under section 1 of the Act and includes "any agreement that relates to a franchise between (a) a franchisor or franchisor's associate, and a franchisee."

3. Common defences to a rescission claim

There are three common forms of defences to a rescission claim - (i) the franchisor provided a disclosure document that meets the requirements of the Act and Regulation; (ii) the rescinding party has not rescinded its agreements within the statutory limitation periods found at sections 6(1) and 6(2) of the Act, and (iii) a statutory exemption to disclosure applies relieving the franchisor of the obligation to otherwise have supplied a disclosure document to a prospective franchisee.

(i) Defence #1 - the disclosure document meets the requirements of Act and Regulation

Section 5(4) of the Act requires that the disclosure document contain:

(a) all material facts, including material facts as prescribed;

(b) financial statements as prescribed;

(c) copies of all proposed franchise agreements and other agreements relating to the franchise to be signed by the prospective franchisee;

(d) statements as prescribed for the purposes of assisting the prospective franchisee in making informed investment decisions; and

(e) other information and copies of documents as prescribed.

Corporate franchise counsel often lament the challenges of preparing disclosure documents for their clients that comply with the prescribed requirements of the Act and Regulation. The process involves a thorough, detailed examination and understanding of the franchisor's business. The challenge is compounded when one considers that the requirement to disclose "all material facts" as set out in section 5(4)(a) of the Act is open-ended and includes both prescribed and non-prescribed "material facts".

The term "material fact" is defined in the Act to include: "any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise." In evaluating the merits of a compliance defence, the broad language of the Act forces counsel to consider matters beyond the identified or specific disclosure requirements set out in the Act and Regulation. In short, this legislation should not be treated as merely a closed checklist of items to be disclosed.

That said, a substantive knowledge of what is expressly required by the statute to be disclosed is usually the starting point for evaluating the compliance defence. The following questions should be considered reviewing a purported disclosure document to evaluate compliance and they are by no means an exhaustive list:

- Were financial statements attached to the disclosure document at the time of disclosure? If so, do they meet the prescribed standard? Are there any exemptions respecting the standard of financial statements which may apply? (See Section 5(4)(b) of the Act and Section 3 of the Regulation)

- Were all of the franchise agreements attached to the disclosure document, including any collateral agreements related to the franchise? (Section 5(4)(c) of the Act)

- Did the disclosure document contain a certificate certifying that the document contains no untrue information, representations or statements; and includes every material fact, financial statement and other information required by the Act and Regulation? Was the certificate signed by the correct individuals? Was the certificate dated? (Section 7 of the Regulation)

- Was the disclosure document presented as one document at one time and not in a piecemeal manner to the prospective franchisee? Is the information in the subject disclosure document accurately, clearly and concisely set out? (Section 5(3) and Section 5(6) of the Act)

- Is there an earnings projection provided in the disclosure document, and if so, does the disclosure document contain a statement specifying the reasonable basis of the projection, the assumptions underlying the projection and a location where information is available for inspection that substantiates the projection? (Section 6(3) of the Regulation)

While there are many more problem areas to consider in evaluating the merits of a compliance defence, the foregoing areas are some of the more common ones. The presence of a problem in one or more of these areas may be enough for a court to determine that a disclosure document has not been delivered in compliance with the Act and Regulation such that a franchisee may be entitled to rescind.[7]

(ii) Defence #2 - Limitation periods under the Act

The battle between franchise counsel on a rescission claim is often fought on the issue of limitation periods under the Act. This is not surprising given the many ways in which a franchisor can fail to meet the substantive elements of disclosure.

Section 6(1) and section 6(2) of the Act describes two circumstances under which a franchisee may rescind its agreements:

> **Rescission for late disclosure**
> **6.**(1)A franchisee may rescind the franchise agreement, without penalty or obligation, no later than 60 days after receiving the disclosure document, if the franchisor failed to provide the disclosure document or a statement of material change within the time required by section 5 or if the contents of the disclosure document did not meet the requirements of section 5.
>
> **Rescission for no disclosure**
> (2)A franchisee may rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the franchise agreement if the franchisor never provided the disclosure document.

In the first scenario (i.e. section 6(1) of the Act), a franchisee may rescind its franchise agreement no later than 60 days after receiving a disclosure document if:

[7] *Sovereignty Investment Holding, Inc. v. 9127-6907 Quebec Inc.*, (2008) 303 D.L.R. (4th) 515 (S.C.J.) ("*Sovereignty*").

(i) the franchisor failed to provide a disclosure document or statement of material change within the time required by section 5 of the Act. Section 5 requires a 14 day "cool off" between the provision of disclosure and the acceptance of money from a franchisee by the franchisor or the execution of any agreement by the franchisee related to the prospective franchise; or

(ii) if the contents of the disclosure document do not meet the requirements of section 5.

It is this second aspect of section 6(1) (failure to comply with section 5) that has caused interpretive difficulty.

In the second scenario (i.e. section 6(2) of the Act), a franchisee may rescind its franchise agreements within two years of entering into the franchise agreement if the franchisor never provided a disclosure document.[8]

The courts have interpreted section 6(2) to find that even where a document purporting to be a disclosure document has been delivered by a franchisor to a franchisee, the substantive defects may be such that the court will determine that what was provided was not a ''disclosure document'' within the meaning of the Act such that a franchisee may avail itself of the two year limitation period provided by section 6(2).[9]

[8] For judicial discussions of the differences between sections 6(1) and 6(2), see *4287975 Canada Inc. v. Imvescor Restaurants Inc.*, [2009] O.J. No. 1508 (C.A.), *Personal Coffee Services v. Beer*, [2005] O.J. No. 3043 (C.A.), and *779975 Ontario Ltd. v. Mmmuffins Canada Corp*., [2009] O.J. No. 2357 (S.C.J.).

[9] See, for example, *Sovereignty, supra.*

Defence #3 – Statutory exemptions

There are a handful of circumstances where a franchisor need not provide a disclosure document to a prospective franchisee. The onus of showing that an exemption exists is on the franchisor claiming the benefit of the exemption.[10]

Section 5(7)(a)-(h) of the Act[11] sets out these disclosure exemptions:

> This section does not apply to,
>
> (a) the grant of a franchise by a franchisee if,
>
> (i) the franchisee is not the franchisor, an associate of the franchisor or a director, officer or employee of the franchisor or of the franchisor's associate,
>
> (ii) the grant of the franchise is for the franchisee's own account,
>
> (iii) in the case of a master franchise, the entire franchise is granted, and
>
> (iv) the grant of the franchise is not effected by or through the franchisor;
>
> (b) the grant of a franchise to a person who has been an officer or director of the franchisor or of the franchisor's associate for at least six months, for that person's own account;
>
> (c) the grant of an additional franchise to an existing franchisee if that additional franchise is substantially the same as the existing franchise that the franchisee is operating and if there has been no material change since the existing franchise agreement or latest renewal or extension of the existing franchise agreement was entered into;[12]
>
> (d) the grant of a franchise by an executor, administrator, sheriff, receiver, trustee, trustee in bankruptcy or guardian on behalf of a person other than the franchisor or the estate of the franchisor;
>
> (e) the grant of a franchise to a person to sell goods or services within a business in which that person has an interest if the sales arising from those goods or services, as anticipated by the parties or that should be anticipated by the parties at the time the franchise

[10] *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*, (2011) 336 D.L.R. (4th) 234 (C.A.)
[11] As supplemented by Section 5(8) of the Act and Sections 8, 9 and 10 of the Regulation.
[12] See *3574423 Canada Inc. v. Baton Rouge Restaurants Inc.*, 2011 ONSC 6697 (S.C.J.).

> agreement is entered into do not exceed, in relation to the total sales of the business, a prescribed percentage;
>
> (f) the renewal or extension of a franchise agreement where there has been no interruption in the operation of the business operated by the franchisee under the franchise agreement and there has been no material change since the franchise agreement or latest renewal or extension of the franchise agreement was entered into;[13]
>
> (g) the grant of a franchise if,
>
> (i) the prospective franchisee is required to make a total annual investment to acquire and operate the franchise in an amount that does not exceed a prescribed amount,
>
> (ii) the franchise agreement is not valid for longer than one year and does not involve the payment of a non-refundable franchise fee, or
>
> (iii) the franchisor is governed by section 55 of the *Competition Act* (Canada);
>
> (h) the grant of a franchise where the prospective franchisee is investing in the acquisition and operation of the franchise, over a prescribed period, an amount greater than a prescribed amount.[14]

In practice, the most common disclosure exemption relied on by franchisor in the face of a rescission claim is the exemption contained in section 5(7)(a), sometimes colloquially referred to as the "franchise resale exemption". This exemption may apply if a franchise agreement is assigned from a vendor franchisee to a purchaser franchisee by way of resale. Whether the franchise resale exemption applies requires examination of the factual circumstances surrounding the resale.[15] The involvement of the franchisor in the sale or assignment process and/or the franchisor's imposition of conditions on the sale or assignment that were not specified in the Franchise Agreement as a condition of its consent may result in the exemption not applying.[16] To

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[13] See *TA & K Enterprises Inc. v. Suncor Energy Products Inc.*, 2011 ONCA 613 (Ont. C.A.) ("*Suncor*").
[14] See *Suncor*.
[15] See *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd*., 2010 ONSC 3695 (S.C.J.), affirmed (2011), 336 D.L.R. (4th) 234 (C.A.) ("*Springdale Pizza*") for a jurisprudential analysis of this provision. See also *MAA Diners Inc. v. 3 for 1 Pizza & Wings (Canada) Inc.*, 2003 CarswellOnt 455 (Ont. S.C.J.), affirmed 2004 CarswellOnt 492 (Ont. C.A.), and *1518628 Ontario Inc. v. Tutor Time Learning Centres LLC*, 2006 CarswellOnt 4593 (Ont. S.C.J.).
[16] *Springdale Pizza, supra*.

date, many of the exemptions contained in section 5(7) of the Act have not been considered fully by Ontario courts.

4. Rescissionary losses under section 6(6) of the Act

There are four categories of damages that the franchisee can claim under section 6(6). Specifically, if the franchisee has established that they are entitled to statutory rescission under sections 6(1) or 6(2), the franchisor must:

(a) refund any money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment (section 6(6)(a));

(b) purchase from the franchisee any inventory that the franchisee had purchased pursuant to the franchise agreement that is remaining at the date of rescission, at a price equal to the purchase price paid by the franchisee (section 6(6)(b));

(c) purchase from the franchisee any supplies or equipment that the franchisee had purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee (section 6(6)(c)); and

(d) compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, minus the amounts claimed under the other categories (section 6(6)(d)).

Statutory rescission under the Act is a "drastic remedy" given the many heads of recovery it offers a rescinding franchisee.[17] A franchisor faced with a successful rescission claim may face a significant award of damages against them, particularly in circumstances where the franchisee

[17] *MDG Kingston Inc. v. MDG Computers Canada Inc.*, [2008] O.J. No. 3770 (C.A.).

has already commenced operations and is losing money. The Ontario Court of Appeal addressed the legislative purpose of the Act and the rescission damages provision in section 6(6) in its decision in *Dig This Garden*:

> The Act is designed to put the franchisee back in its pre-franchisee position where there has been non-disclosure, provided notice is served within the prescribed time.[18]

Although the Act has been in force for over a decade, there has not been much guidance from the courts on how section 6(6) damages should be calculated and what kinds of losses fit into which section 6(6) categories. The most thorough judicial examination of section 6(6) was in *Payne Environmental Inc. v. Lord & Partners Ltd.*[19], a Superior Court decision which involved the rescission of a cleaning products sales franchise. The court addressed the different heads of damages available to the plaintiff franchisee as a result of the franchisee's successful rescission claim. In that case, the damages under section 6(6)(a) consisted of the return of the franchisee fee. The damages under section 6(6)(c) included the cost of various supplies and equipment purchased by the franchisee in connection with entering into the agreement. Lastly, the claim for "losses" included individual expenses incurred as a result of setting up the business. This included meals and related expenses, publications, truck fuel and service, office equipment, postal expenses, parking and taxi expenses, truck/trailer accessories, photocopy and stationary expenses, legal fees, truck leases, licenses, insurance, accounting fees, and trailer parking. From this expense total, the court deducted gross revenue to come up with the amount owed under section 6(6)(d).

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[18] *Dig This Garden*, *supra*.

[19] *Payne Environmental Inc. v. Lord & Partners Ltd.* (2006), 14 D.L.R. (4th) 117 (Ont. S.C.J) ("*Payne Environmental*").

The decision in *Payne Environmental* is helpful to parties litigating rescission claims as it explains that parties should avoid duplicating amounts claimed in sections 6(6)(a), (b), and (c) and the losses calculated in section 6(6)(d). Specifically, the court noted:

> Subsection 6(6)(d) of the Act is designed to compensate the franchisee for all losses the franchisee incurred in acquiring, setting up and operating the franchise. This calculation of "all losses incurred" under ss. 6(6)(d), at least initially, may include the amounts which have been identified in ss.6(a), (b), and (c). It is precisely because "all losses incurred" may include the amounts identified by ss. 6(6)(a), (b), and (c) that those amounts are deducted from "all losses" in order to ensure there is no duplication in the calculation of compensation to be paid pursuant to that subsection....In this case, the plaintiff did not include in its ss. 6(6)(d) calculation any of the amounts owing pursuant to ss. 6(6)(a), (b) and (c). As long as these amounts have not been included in the calculation of all losses incurred, no deduction need be made.[20]

The method of analysis undertaken in *Payne Environmental* is likely preferable to that used in the decision in *Melnychuk v. Blitz Ltd*.[21] In that case, the plaintiff franchisee (and the court) did not take into account the actual losses of the business in determining the losses under section 6(6)(d), but rather dealt with piecemeal claims for different types of damages, such as the cost of preparing a business plan and legal and accounting expenses. It is certainly arguable that the term "losses" under section 6(6)(d) should be viewed in an accounting sense and should treat items such as business plans and legal expenses as being offset by revenues made by the franchise company. Support for this view can be found in Alberta's legislation, which pre-dates the Act and provides that "net losses" are recoverable.

Similarly, parties should use caution when relying on the recent Ontario decision in *1706225 Ontario Ltd. v. Grill It Up Holdings Inc.* for the purpose of determining what

[20] *Payne Environmental, supra*.
[21] *Melnychuk v. Blitz Ltd.*, 2010 CarswellOnt 373 (S.C.J.).

constitutes "losses that the franchisee incurred in acquiring, setting up and operating the franchise" under section 6(6)(d).[22] In this case, the court allowed for the recovery of a lost income opportunity of the individual franchisee owner, despite the fact that the franchisee appears to have been a corporation. Specifically, the franchisee owner resigned his employment to enter into a franchise agreement that was eventually rescinded under section 6 of the Act. The court permitted the loss of his income from his resigned job to be recovered. It is unclear how such an alleged loss falls under section 6(6)(d), which on its face addresses losses suffered by the franchised business.

Beyond these cases, however, there is little analysis of damages claims under section 6(6).[23] In fact, in many cases, franchisors have not disputed the amounts sought in the notice of rescission and the actual quantum of damages is an afterthought to other legal arguments made in the cases.[24] Franchisors can argue that there may be an obligation on franchisees to mitigate losses claimed under section 6(6). Reliance for this argument could be found in the Court of Appeal's decision in *Dig This Garden* held that:

> It is...no answer to suggest that the franchisor would be obligated to pay such costs or expenses to the franchisee under s. 6(6) or in an action for damages under s. 7 of the Act. In my view, it is preferable for a franchisee to make reasonable efforts for an orderly winding down of the business and to minimize its losses where possible.

However, franchisees may counter that there is no mitigation obligation due to their right under section 6 to rescind "without penalty or obligation."

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[22] *1706225 Ontario Ltd. v. Grill It Up Holdings Inc.*, 2011 CarswellOnt 3378 (S.C.J.).

[23] For a helpful accounting-based analysis of section 6(6) claims, see "Clarifying Financial Remedies Under the Arthur Wishart Act" by Ephraim Stulberg, *The Lawyers Weekly*, May 13, 2011.

[24] See, for example, *MAA Diners Inc. v. 3 for 1 Pizza & Wings (Canada) Inc.* (2003), 30 B.L.R. (3d) 279 (S.C.J.); *Beer v. Personal Service Coffee Corp.*, 2005 CarswellOnt 3142 (S.C.J.); *Ahmed v. 3 for 1 Pizza & Wings (Canada) Inc.*, 2004 CarswellOnt 255 (S.C.J.); *Khachikian v. Williams*, [2003] O. J. No. 5876 (S.C.J.).

Franchisors resisting rescission claims should pay close attention to whether franchisees have indeed made the "reasonable efforts" of mitigation alluded to in the Court of Appeal's decision. There are many ways in which a franchisee can mitigate its losses while winding down the operation of its business. If the franchisee has a lease, the franchisee could negotiate a break fee with the landlord or work with the franchisor to have the franchisor assume the lease. Similarly, franchisors should also examine any claim for the purchase of inventory to ensure that the purchases by the franchisee have been reasonable and are not excessive in the circumstances of a business that is winding-down.

Franchisors faced with claims for rescission should pay close attention to the specific amounts being claimed by franchisees. Specifically, franchisors should examine two important issues in these claims:

(a) Are there any losses being claimed that are not "market rate" losses?

If a franchisee is claiming losses from their operation of their franchise, franchisors should examine whether the losses allegedly suffered are inflated. There are various circumstances in which such inflation could arise. For example, if the franchisee owns the property on which they operate their franchise business, they could be charging above-market rents to the franchise, which would increase the loss suffered by the franchise. Franchisees can structure their assets and businesses for tax- and business-efficiency, but these structures can also result in inflated losses. Another area to carefully examine is the salaries paid to the franchisee (and the franchisee's family members, where applicable). If these salaries are above-market salaries, this could cause increased losses to the franchise that the franchisee might claim as rescission damages. Franchisors can argue that damages should be "normalized" and reflective

of a standard franchise rather than structured around the idiosyncrasies and self-interested business practices of the aggrieved franchisee.

(b) Are there non-business-related expenses being run through the franchise business?

Franchisors should closely examine the rescission damages claimed by franchisees to determine whether the franchisee's personal expenses are being claimed through the franchise business. Because financial statements are so important to any analysis of this sort, franchisors must be diligent in ensuring that franchisees consistently deliver copies of their financial statements to the franchisors if it is a requirement under the franchise agreement between the parties.

5. Responsibilities of lawyers when advising on rescission

While the Act and Regulation are relatively short pieces of legislation, they are detailed and nuanced. Lawyers who advise in the area of franchise disclosure should know the relevant legislation and be familiar with the pantheon of franchise cases which have evolved since the introduction of the legislation. In order to protect the interests of both franchisee and franchisor clients, as well as their own interest in avoiding negligence claims, the franchise bar should exercise care and caution in dealing with franchise rescission claims.

It is important to advise the client about the requirements of disclosure and the rescission remedy regardless of whether the retainer arises at the outset of a franchise acquisition or sale or during the operation of the franchise. The issue of proper disclosure may be relevant in a variety of different circumstances.

In the case of franchisee claims, it is crucial for the advising lawyer to be aware of the limitation periods contained in the Act and to ensure that a notice of rescission is served within the appropriate time frame. Enforcement proceedings must be commenced in accordance within the limitation period that would apply after proper service of a notice of rescission within the applicable limits set out in section 6(1) or 6(2) of the Act. With respect to franchisors, limitation periods provide the strongest defence to section 6 claims and can give rise to Rule 21 motions to strike the claim. As such, this should be the starting point for any defence analysis.

Both franchisee and franchisor counsel should discuss with their client the steps that may be required to litigate a rescission claim under section 6 of the Act. Moreover, both parties should consider any forum clauses in the franchise agreement which may require the parties to proceed through arbitration.

In the case of franchisee counsel, before serving a notice of rescission, counsel should conduct a thorough analysis of the nature of the defects of disclosure in a purported disclosure document and discuss with the client the rescinding client's section 6(6) losses. Counsel should ensure that their retainer is sufficient to carry out this work. With respect to franchisor counsel, the alleged defects in the disclosure document should be examined to see if there is any factual merit to the franchisee's claim, and an analysis should be done to determine whether the defects constitute either a valid 6(1) or 6(2) claim, taking into account the different limitation periods for these claims. Franchisor counsel should take steps to ensure that any obvious defects are immediately remedied for the purposes of future disclosure documents.

One of the limitations of the Act is that it does not provide immediate protection to the rescinding franchisee from the claims of third party creditors. Thus, service of a rescission claim

can be a catalyst for demands made from lenders (often Small Business Loan lenders) or landlords for payments from the franchisee who has ceased operation of its business. One may request a stay of these claims from the court in the rescission enforcement proceeding while claiming over against the franchisor and related parties, or choose to negotiate with third parties outside of the enforcement claim. Accordingly, it may be helpful to have a discussion with the rescinding client of the effects of rescission on third parties prior to proceeding with a statutory rescission claim in order to devise a proper strategy for dealing with potential third party liabilities and claims. For franchisor counsel dealing with rescission claims where the franchisee abandons the franchised business, it may be necessary to contact and negotiate with suppliers, landlords and customers where appropriate in order to ensure the continued operation of the business (if desired) and to maintain ongoing commercial relationships.

The subject disclosure document will be a central piece of evidence on a rescission claim and thus is important to both franchisors and franchisees. It is incumbent on franchisee and franchisor counsel to emphasize to their respective clients the importance and integrity of that document, to carefully examine and assess the original document, and to question the client thoroughly about the circumstances in which it delivered or received the document. When acting for franchisor counsel, it is vital to stress the importance of disclosure procedures and updating the disclosure document. As discussed above, there may be serious consequences for a franchisor if it neglects basic document management protocols established with the assistance of counsel.

6. Conclusion

Rescission claims will continue to be a mainstay of franchise litigation as long as the Act is in force, so franchise counsel must understand section 6 and its interaction with the rest of the

Act and the Regulation to ensure that their franchisee and franchisor clients are able to properly exercise their statutory rights. Further litigation arising out of the Act may clarify the remaining ambiguities in the statute. In the meantime, franchise counsel should strive to develop a full knowledge of the cause of action, process, and defences available to section 6 claims.

RESCISSION 101: AN INTRODUCTION TO THE STATUTORY RESCISSION REMEDY UNDER THE *ARTHUR WISHART ACT (FRANCHISE DISCLOSURE), 2000*

ONTARIO BAR ASSOCIATION INSTITUTE 2012 – FRANCHISE LAW
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Rescission 101

1. **The Statutory Right to Rescind**
2. **Initiating A Claim**
3. **Common Defences To A Rescission Claim**
4. **Losses Under Section 6(6)**
5. **Responsibilities of Lawyers In Dealing With Rescission Claims (Best Practices)**

1. The Statutory Right To Rescind

- **Section 6 of the *Wishart Act*.**
- **The aim of statutory rescission is the compensate a franchisee who receives either defective or no disclosure by restoring the franchisee to its pre-contractual provision.**
- **There are differences between rescission under s.6(1) and s.6(2).**
- **Disclosure can be likened to a "strict liability" regime.**

2. Initiating A Claim For Statutory Rescission

- A claim begins with the service of a notice of rescission.
- No prescribed form of notice, but must be in writing and delivered personally, by registered mail or by fax.
- Notice should detail why disclosure document is non-compliant.
- Records should be kept regarding the service of notice.

2. Initiating A Claim For Statutory Rescission

- A rescission claim may be brought against a "franchisor's associate".
- A notice of rescission can contain an estimate of franchisee losses under section 6(6).
- The franchisor is required to pay the amounts owed within 60 days of the effective notice of rescission.
- If the amount is not paid, a franchisee often brings a claim or application.
- The parties may seek declaratory relief concerning whether there is an entitlement to rescission.

3. Common Defences

- The Disclosure Document meets the requirements of the *Wishart Act* and its regulation.
- Limitation periods under the *Wishart Act* (and the *Limitations Act*).
- Statutory exemptions under section 5(7) of the *Wishart Act*.
  - Most commonly, the franchise resale exemption.

4. Losses Under Section 6(6)

- The four categories of damages are:
  - Refund any money received (other than money for inventory, supplies and equipment);
  - Purchase inventory;
  - Purchase supplies and equipment;
  - Compensate for any losses incurred in acquiring, setting up and operating the franchise, minus the other amounts.
- This is a drastic remedy – "puts franchisee back in its pre-franchisee position."

4. Losses Under Section 6(6)

- Very little guidance from courts on how section 6(6) damages are to be calculated.
  - See *Payne Environmental* (2006, S.C.J.) to see court's comments on preventing double counting.
  - *Melnychuk* (2010, S.C.J.) – How losses should be calculated.
  - *Grill It Up* (2011, S.C.J.) – Can individuals claim for personal losses?

4. Losses Under Section 6(6)

- Is there an obligation to mitigate?
  - See *Dig This Garden* (Ont. C.A.).
- Are the losses being claimed that are not at "market rate"?
- Are there non-business-related expenses being run through the franchise business?

5. Best Practices

- Advise clients about the requirements of disclosure and the consequences for failing to disclose.
- Disclosure obligations may continue throughout the franchise relationship.
- Watch out for limitation periods, particularly with respect to sections 6(1) and 6(2).
- Address the steps involved in a rescission claim with clients. Costs may be significant.
- Realistically, most rescission claims are not directly paid – disputes over quantum, compliance, limitation periods, exemptions.

5. Best Practices

- Thoroughly analyze disclosure defects and potential damages before proceeding.
- Franchisors should shore up disclosure documents if problems are identified.
- Rescission claims may impact third parties – make sure this is considered.
- Ensure documents regarding disclosure are maintained.

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Jonathon Baker
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February 9-11, 2012

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Other Remedies and Dispute Resolution Mechanisms

Injunctions & Summary Judgment

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Wardle Daley Bernstein LLP

1 Injunctions

1.1 Equitable Remedy

Whether proceeding by action or application, the parties have available the remedy of the interim and/or interlocutory injunction. An injunction is an *in personam* remedy (*i.e.*, involving or determining the personal rights and obligations of the parties) which commands or forbids an action.

It emerged out of the English High Court of Chancery the jurisdiction of which was complementary to the formalism of the medieval system of common law. The Lord Chancellor, as 'keeper of the King's conscience', could be petitioned to have recourse to principles of justice – what is fair and right - to correct or supplement the common law to see that equity was done between the parties. These separate jurisdictions of common law and equity merged long ago in our courts, but the distinction remains as reflected in section 96(1)[1] of the *Courts of Justice Act*.

1.1.1 Clean Hands

Over time the equitable concept of an injunction has been incorporated into statute[2] and the *Rules of Civil Procedure*[3], but there are two equitable concepts – the 'clean hands doctrine' and laches - that are frequently raised in injunction cases and bear some discussion.

The 'clean hands doctrine' is the principle that a party cannot seek equitable relief or assert an equitable defence if that party has violated an equitable principle, such as good faith. Given that the duty to act in good faith is imposed on both franchisor and franchisee by section 3 of the *Arthur Wishart Act (Franchise Disclosure), 2000*[4], the

[1] Courts shall administer concurrently all rules of equity and the common law.
[2] Section 101 of the Courts of Justice Act – "In the Superior Court of Justice, an interlocutory injunction or mandatory order may be granted … by an interlocutory order, where it appears to a judge of the court to be just or convenient to do so."
[3] Rule 40 engrafts various procedural restrictions. 40.01 requires that it be sought by motion to a judge in an existing or intended action or application. 40.02 limits the length of an initial *ex parte* order to 10 days. 40.03 requires the party seeking the order to give an undertaking to compensate the party against whom the order is sought if they suffer damages unnecessarily.
[4] S.O. 2000, c.3

principle that a party seeking equitable relief "must come to equity with clean hands"[5] is clearly relevant.

It is not, however, a licence for the court to scrutinize all aspects of a party's behaviour to ensure that it has led a blameless life: "[W]rongdoing will not deprive the plaintiff of a specific performance or an injunction unless it bears directly upon the appropriateness of the remedy."[6] As stated by the Court of Appeal in *Toronto (City) v. Polai*[7], "The misconduct charged against the plaintiff as a ground for invoking the maxim against him must relate directly to the very transaction concerning which the complaint is made, not merely to the general morals or conduct of the person seeking relief."

1.1.2 Laches

The doctrine of laches provides that if delay is unreasonable and prejudicial, it is a bar to equitable relief. It is an expression of the more general principle that it is unjust to grant relief against a party who will be prejudiced because of their change in position occasioned by the acts or omissions of the party seeking relief.

The equitable defence of laches has been described by the Supreme Court of Canada in *M.(K.) v. M.(H.)*[8] as follows:

> A good discussion of the rule and of laches in general is found in Meagher, Gummow and Lehane, supra, at pp. 755-65, where the authors distill the doctrine in this manner, at p. 755:
>
> > It is a defence which requires that a defendant can successfully resist an equitable (although not a legal) claim made against him if he can demonstrate that the plaintiff, by delaying the institution or prosecution of his case, has either (a) acquiesced in the defendant's conduct or (b) caused the defendant to alter his position in reasonable reliance on the plaintiff's acceptance of the *status quo*, or otherwise permitted a situation to arise which it would be unjust to disturb…
>
> Thus there are two distinct branches to the laches doctrine, and either will suffice as a defence to a claim in equity. What is immediately obvious from all of the authorities is that mere delay is insufficient to trigger laches under either of its two branches. Rather, the doctrine considers whether

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[5] *BMO Nesbitt Burns Inc. v. Wellington West Capital Inc*. (2005), 77 O.R. (3d) 161 (C.A.)
[6] Robert J. Sharpe, "Injunctions and Specific Performance" (2008 looseleaf ed.), Canada Law Book at ¶1.1070.
[7] (1969), [1970] 1 O.R. 483 at ¶25. See also *Silverberg v. 1054384 Ontario Ltd*., 2008 CarswellOnt 6772 (S.C.J.) at ¶120-121; *Singh v. 3829537 Canada Inc.*, 2005 CarswellOnt 2391 (S.C.J.)
[8] [1992] 3 S.C.R. 6 at 77-78. See also *Parker v. Canadian Tire Corp*., 1998 CarswellOnt 1633 (Gen. Div.) and Robert J. Sharpe, "Injunctions and Specific Performance" (2008 looseleaf ed.), Canada Law Book at ¶1.820-1.850.

> the delay of the plaintiff constitutes acquiescence or results in circumstances that make the prosecution of the action unreasonable. Ultimately, laches must be resolved as a matter of justice as between the parties, as is the case with any equitable doctrine.

The equitable remedy of injunctive relief and the equitable principles surrounding it have evolved through centuries of case law. The Supreme Court of Canada relieved us of the burden of reviewing that history by defining the modern test in *RJR-MacDonald v. Canada (Attorney General)*[9] as adapted from the House of Lords' decision in *American Cyanamid Co. v. Ethicon Ltd.*.[10]

1.2 The Modern Three-Part Injunction Test

In *RJR-MacDonald v. Canada (Attorney General)* the Supreme Court of Canada defined the familiar three-part test for an interlocutory injunction: (i) strength of the case; (ii) irreparable harm; and (iii) balance of convenience. However, it bears some brief review before turning to its application specifically within the franchise context.

1.2.1 Strength of the Case

Prior to *American Cyanamid Co. v. Ethicon Ltd.*, a party moving for either a prohibitory or mandatory interlocutory injunction was required to show a "strong *prima facie* case". However, Lord Diplock revised this for the prohibitory injunction, in most circumstances, to being a requirement merely to show a "serious question to be tried" – that the proceedings were not frivolous or vexatious.

Accepting the foregoing, the Court in *RJR-MacDonald v. Canada (Attorney General)* set out the court's task as follows:

> There are no specific requirements which must be met in order to satisfy this test. The threshold is a low one. The judge on the application must make a preliminary assessment of the merits of the case. … Once satisfied that the application is neither vexatious nor frivolous, the motions judge should proceed to consider the second and third tests, even if of the opinion that the plaintiff is unlikely to succeed at trial. A prolonged examination of the merits is generally neither necessary nor desirable.[11]

There is, however, an important exception to the "serious question to be tried" element of the test. It arises when the practical result of granting the interlocutory injunction will be the determination of the action, in which case the party seeking the relief must show a "strong *prima facie* case". Examples noted by the Court in *RJR-MacDonald v. Canada (Attorney General)* were, "when the right which the applicant seeks to protect can only be

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[9] [1994] 1 S.C.R. 311.
[10] [1975] 1 All E.R. 504.
[11] [1994] 1 S.C.R. 311 at ¶54-55.

exercised immediately or not at all, or when the result of the application will impose such hardship on one party as to remove any potential benefit from proceeding to trial."[12]

Therefore, for the purposes of obtaining interlocutory relief, it must be borne in mind that there remain two branches to the "strength of the case" element of the test – "serious question to be tried/not frivolous or vexatious" and "strong *prima facie* case".

The party seeking relief has the higher burden of "strong *prima facie* case" if (a) they are seeking a mandatory rather than a prohibitory injunction[13]; or (b) granting a prohibitory interlocutory injunction will have the practical effect of a premature determination of the dispute[14]. The party seeking a mandatory injunction must establish to a high degree of assurance that the injunction will appear to have been properly granted at the conclusion of the trial or that they have a significant likelihood of success. Otherwise, in the case of the party seeking an interlocutory prohibitory injunction, they need only meet the standard of "serious question to be tried" or "not frivolous or vexatious".

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[12] [1994] 1 S.C.R. 311 at ¶56.

[13] See *Struik v. Dixie Lee Food Systems Ltd.*, 2006 CarswellOnt 4932 (S.C.J.); *1460904 Ontario Inc. v. MDG Computers Canada Inc.*, 2006 CarswellOnt 6744 (S.C.J.); *Sumlach Enterprises Ltd. v. Oil Changers Inc.*, 2006 CarswellOnt 1842 (S.C.J.); *Esmail v. Petro-Canada*, 1995 CarswellOnt 4375 (Gen. Div.); *Parker v. Canadian Tire Corp.*, 1998 CarswellOnt 1633 (Gen. Div.); *TDL Group Ltd. v 1050284 Ontario Ltd.*, 2001 CarswellOnt 3304 (Div. Ct.); *Ticketnet Corp. v. Air Canada*, 1987 CarswellOnt 473 (H.C.J.) at ¶14-15: "The application to require Air Canada to deliver the research material, all counsel agree, is a request for a mandatory injunction, and the law dealing with that subject is reviewed by Megarry J. in *Shepherd Homes Ltd. v. Sandham*, [1970] 3 All E.R. 402 (Ch. D.) and his comments are endorsed by the Court of Appeal in the *Locabail International Finance Ltd. v. Agroexport, The Sea Hawk*, [1986] 1 All E.R. 901, [1986] 1 W.L.R. 657, case. The applicable law is stated by Megarry J. at p. 412 [All E.R.]:

> Third, on motion, as contrasted with the trial, the court is far more reluctant to grant a mandatory injunction than it would be to grant a comparable prohibitory injunction. In a normal case the court must, *inter alia*, feel a high degree of assurance that at the trial it will appear that the injunction was rightly granted; and this is a higher standard than is required for a prohibitory injunction. Fourth, it follows that the statement in 21 Halsbury's Laws (3rd Edn) p. 369, para. 774, founded on *Morris v. Grant*, namely:
>
> > ... if the defendant, after express notice, has committed a clear violation of an express contract ... a mandatory injunction will be granted on an interlocutory application,
>
> is too wide. Both the case itself and the statement founded on it have to be qualified in the light of the other authorities to which I have referred, especially *Bowes v. Law* and *Kilbey v. Haviland* (which, although decided earlier, do not seem to have been cited) and *Sharp v. Harrison*. No doubt a mandatory injunction may be granted where the case for one is unusually sharp and clear; but it is certainly not a matter of course.

I am of the view that the law, as referred to by Megarry J., applies and in the absence of my being able to find that there was a binding software development agreement between Air Canada and Ticketnet that I cannot have a "high degree of assurance that at trial it will appear that the injunctions was rightly granted". So, the application for a mandatory injunction brought by Ticketnet fails."

[14] *Second Cup Ltd. v. Niranjan*, 2007 CarswellOnt 5285 (S.C.J.)

In *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*[15], Justice Perell described what is entailed by the test of a "strong *prima facie* case":

> The strong *prima facie* case standard involves a more intensive examination of the merits of the plaintiff's case. Since a "*prima facie* case" is established when on the balance of probabilities it is likely that the plaintiff will succeed, I understand a "strong *prima facie* case" to involve a higher level of assurance at the interlocutory stage that it is likely that the plaintiff will succeed at the trial. …
>
> I do not, however, understand the requirement of showing a strong *prima facie* case to go so far as to require the plaintiff to actually prove his or her case. If this were true, a trial would be superfluous and the interlocutory motion would move from being an examination of the strength of the case to an actual determination of the merits of the case.[16]

The fact that the courts have made a distinction between mandatory and prohibitory injunctions for the purpose of determining the test to be applied has been the focus of considerable dispute. The courts have recognized that virtually any relief sought can be framed in either mandatory or prohibitory language and they have chosen to consider "function" rather than "form" in determining what test to apply.[17]

> A mandatory injunction is one which requires the defendant to act positively. A mandatory injunction may be given to remedy wrongs and require the defendant to undo some wrong he or she has committed. Such orders are restorative in nature, requiring the defendant to take whatever steps are necessary to repair the situation in a manner consistent with the plaintiff's rights. In other cases, mandatory injunctions look to the future and require the defendant to carry out some unperformed duty to act.[18]

1.2.2 Irreparable Harm

The next element of the test is the requirement for evidence supporting the contention that the party seeking the injunction will suffer irreparable harm if it is not granted. The Court in *RJR-MacDonald v. Canada (Attorney General)* was of the view that consideration of any harm that might be done to the party against whom the injunction was sought should be left to consideration under the balance of convenience element of the test. Therefore, the only question is whether the moving party's interests would be harmed so irrevocably that no remedy at trial would be satisfactory.

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[15] 2009 CarswellOnt 2280 (S.C.J.)
[16] 2009 CarswellOnt 2280 (S.C.J.) at ¶39-40
[17] See *Bark & Fitz Inc. v. 2139138 Ontario Inc.*, 2010 ONSC 1793 (S.C.J.) at ¶5-10
[18] Robert J. Sharpe, "Injunctions and Specific Performance" (2008 looseleaf ed.), Canada Law Book at ¶1.10

The irreparable nature of the harm is of more import than its magnitude. Irreparable harm, "is harm which either cannot be quantified in monetary terms or which cannot be cured, usually because one party cannot collect damages from the other."[19] By way of example the Court referred to instances where one party will be put out of business by the court's decision or where one party will suffer permanent market loss or irrevocable damage to its business reputation.

In *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*, Justice Perell summarized the analysis to be undertaken by the court: "In determining whether the plaintiff would suffer irreparable harm, the court will consider whether damages awarded after a trial will provide the plaintiff with an adequate remedy without the need for an interlocutory remedy … If damages or some other trial remedy would come too late or be inadequate to repair the harm or to do justice, then the harm may be said to be irreparable." [20]

It is important to note, however, the Court's qualification that the impecuniosity of the party against whom the injunction is sought, such that the party seeking the injunction would be unable to collect on a money judgment, although a relevant consideration, is not determinative of the issue.

1.2.3 Balance of Convenience

What is referred to as the "balance of convenience" element of the test might more accurately be referred to as the "balance of inconvenience" as did the Court in *RJR-MacDonald v. Canada (Attorney General).* It is an assessment of which of the parties will suffer the greatest harm if the relief sought is granted or refused pending trial.

In discussing the application of this part of the test, the Court accepted the essence of what Lord Diplock's comments in *American Cyanamid Co. v. Ethicon Ltd.* – the factors to be considered are numerous and will vary in each individual case.

> In *American Cyanamid* , Lord Diplock cautioned, at p. 408, that:
>
> > [i]t would be unwise to attempt even to list all the various matters which may need to be taken into consideration in deciding where the balance lies, let alone to suggest the relative weight to be attached to them. These will vary from case to case.
>
> He added, at p. 409, that "there may be many other special factors to be taken into consideration in the particular circumstances of individual cases."[21]

[19] [1994] 1 S.C.R. 311 at ¶64
[20] 2009 CarswellOnt 2280 (S.C.J.) at ¶44
[21] [1994] 1 S.C.R. 311 at ¶68.

In *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*, Justice Perell stated:

> In considering the balance of convenience, it is appropriate to reconsider the comparative strength of the parties' cases. If the plaintiff's case seems weak, then the undoubted convenience of an injunction may not balance the inconvenience of the defendant suffering the interference with his or her rights based on a doubtful claim. Conversely, if the merits of the plaintiff's case seem quite strong then the plaintiff's inconvenience of being denied an interlocutory remedy may seem to outbalance the inconvenience of the defendant having to suffer a restraint on his or her rights.[22]

1.2.4 Not Water-Tight Compartments

Finally, it must be borne in mind that, as the three-part test forms the basis for an equitable remedy, it is flexible. It is not a series of hurdles, or boxes to be ticked off. must be overcome. As stated by Justice Sharpe in "Injunctions and Specific Performance", "[T]hey ought not to be seen as separate, water-tight categories. These factors relate to each other, and strength on one part of the test ought to be permitted to compensate for weakness on another."[23] This approach as been widely accepted by the courts in the franchising context in cases such as *Osiris Inc. v. 1444707 Ontario Ltd.*[24], *Struik v. Dixie Lee Food Systems Ltd.*[25], *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*[26] and *Paul Sadlon Motors Inc. v. General Motors of Canada Ltd.*[27]

1.3 Application of the Three-Part Test in the Franchise Context

Aside from *RJR-MacDonald v. Canada (Attorney General)*, there are several cases which are repeatedly referred to in the injunction cases concerning franchises: *Esmail v. Petro-Canada*[28], *Parker v. Canadian Tire Corp.*[29] and *TDL Group Ltd. v 1050284 Ontario Ltd.*[30]. We will not discuss those cases directly in this paper. Instead we will review how *RJR-MacDonald v. Canada (Attorney General)* and those cases have been applied more recently in three particular contexts – restrictive covenants, terminations and system changes.

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[22] 2009 CarswellOnt 2280 (S.C.J.) at ¶46
[23] Robert J. Sharpe, "Injunctions and Specific Performance" (2008 looseleaf ed.), Canada Law Book at ¶2.600
[24] 2004 CarswellOnt 376 (S.C.J.)
[25] 2006 CarswellOnt 4932 (S.C.J.)
[26] 2009 CarswellOnt 2280 (S.C.J.)
[27] 2011 ONSC 4432
[28] 1995 CarswellOnt 4375 (Gen. Div.)
[29] 1998 CarswellOnt 1633 (Gen. Div.)
[30] 2001 CarswellOnt 3304 (Div. Ct.)

1.3.1 Restrictive Covenant Injunctions

There is a body of case law suggesting that if the party seeking prohibitory injunctive relief can show a clear breach of a negative or restrictive covenant – in effect, a strong *prima facie* case then the Court disposes the requirement for the party to demonstrate irreparable harm and balance of convenience.[31] If they cannot, then they revert to the regular three-part *RJR-MacDonald v. Canada (Attorney General)* test.[32]

In *Singh v. 3829537 Canada Inc.*[33], Justice Horkins stated that, "There is a principled basis for the modified approach. It flows from the fact that, unlike typical injunction cases, by issuing injunctive relief in these circumstances, the court is simply enforcing a contractual provision, which is not the product of an inequality of bargaining power, by which the responding party has already agreed to be bound."

In *Canpark Services Ltd. v. Imperial Parking Canada Corp.*[34], the court held that a negative covenant will give rise to a presumption of irreparable harm and an injunction will issue unless the responding party can satisfy the burden of proving that the covenant is itself invalid.

However, in *J.G. Collins Insurance Agencies v. Elsley*[35], the Supreme Court of Canada pointed out that there is a distinction to be made between an ordinary commercial agreement for, perhaps, the sale of a business, which may contain a restrictive non-competition covenant, and an employment agreement, which may also contain such a covenant. In the latter case, an employer seeking to enforce a non-competition covenant against an employee would be required to satisfy the three-part test.

> The distinction made in the cases between a restrictive covenant contained in an agreement for the sale of a business and one contained in a contract of employment is well-conceived and responsive to practical considerations. A person seeking to sell his business might find himself with an unsaleable commodity if denied the right to assure the purchaser that he, the vendor, would not later enter into competition. Difficulty lies in definition of the time during which, and the area within which, the non-competitive covenant is to operate, but if these are reasonable, the courts will normally give effect to the covenant.
>
> A different situation, at least in theory, obtains in the negotiation of a contract of employment, where an imbalance of bargaining power may

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[31] See *Rothmans, Benson & Hedges v. Hard Rock Café*, [2002] O.J. No. 3117 and *Bell Canada v. Manitoba Telecom Services Inc.* (2004), 49 B.L.R. (3d) 17 (Ont. S.C.J.).
[32] Bell Canada v. Manitoba Telecom Services Inc. (2004), 49 B.L.R. (3d) 17 (Ont. S.C.J.) at ¶102
[33] 2005 CarswellOnt 2391 (S.C.J.)
[34] (2001), 56 O.R. (3d) 102 (S.C.J.). See also *Montreal Trust Co. of Canada* (1988), 48 D.L.R. (4th) 385 (B.C.C.A.) and *Gulf Islands Navigation Ltd. v. Seafarers International Union of North America (Canadian District)* (1959), 18 D.L.R. (2d) 216 (B.C.S.C.)
[35] [1978] 2 S.C.R. 916

> lead to oppression and a denial of the right of the employee to exploit, following termination of employment, in the public interest and in his own interest, knowledge and skills obtained during employment. Again, a distinction is made. Although blanket restraints on freedom to compete are generally held unenforceable, the courts have recognized and afforded reasonable protection to trade secrets, confidential information and trade connections of the employer.[36]

The Court of Appeal in *Shelanu Inc. v. Print Three Franchising Corp.*[37] held that the circumstances giving rise to a duty of good faith in an employer-employee relationship are equally present in a franchisor-franchisee relationship – they are relational contracts - and therefore, analogizing from *Wallace v. United Grain Growers Ltd.*[38], a franchisor has an obligation to have regard to a franchisee's legitimate interests and to deal promptly, honestly, fairly and reasonably with them. This brings us back to the common law concept of duties of good faith and fair dealing arising from the inequality of bargaining power associated with an imbalance of means, information, experience or control.

> The relative position of the parties as outlined by Iacobucci J. in [*Wallace v. United Grain Growers Ltd.*[39]] also exists in the typical franchisor-franchisee relationship. First, it is unusual for a franchisee to be in the position of being equal in bargaining power to the franchisor. … The second characteristic, inability to negotiate more favourable terms, is met by the fact that a franchise agreement is a contract of adhesion. As I have indicated, a contract of adhesion is a contract in which the essential clauses were not freely negotiated but were drawn up by one of the parties on its behalf and imposed on the other. Further, insofar as access to information is concerned, the franchisee is dependent on the franchisor for information about the franchise, its location and projected cash flow, and is typically required to take a training program devised by the franchisor. The third characteristic, namely that the relationship continues to be affected by the power imbalance, is also met by the fact the franchisee is required to submit to inspections of its premises and audits of its books on demand, to comply with operation bulletins, and, often is dependent on, or required to buy, equipment or product from the franchisor.[40]

In light of such findings, it is not surprising that the distinction set up by the Supreme Court of Canada in *J.G. Collins Insurance Agencies v. Elsley* in the employer-employee relationship context, would be applied to the franchisor-franchisee relationship, at least insofar as the franchisor seeks to enforce a restrictive, negative covenant. This is particularly so, given franchising's entrepreneurial business model, with franchisees

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[36] [1978] 2 S.C.R. 916 at ¶15-16
[37] [2003] O.J. No. 1919 (Q.L.) (C.A.) at ¶118
[38] [1997] 3 S.C.R. 701
[39] [1997] 3 S.C.R. 701
[40] [2003] O.J. No. 1919 (Q.L.) (C.A.) at ¶66

investing their own capital, taking a significant financial risk and effectively creating their own employment. Bearing this in mind, we turn to several cases.

***Second Cup Ltd. v. Niranjan*, 2007 CarswellOnt 5285 (S.C.J.)**

A husband and wife owned and operated a Second Cup coffee franchise through a holding corporation. They entered into a franchise agreement with an approximate four year term which concluded on May 30, 2007. The franchisees were notified by letter in February 2007 that the franchise agreement would not be renewed, confirming discussions in late 2006.

They were reminded of the non-competition and confidentiality provisions of the franchise agreement. In particular, they were prohibited from being involved in any business which is the same or similar to their Second Cup franchise for a period of 15 months after termination of the franchise agreement within a three mile radius of their former franchise premises.

In late April 2007, even before the expiry of the Second Cup franchise agreement, the husband, through a different holding corporation, opened a new specialty coffee shop, "Urbana Coffee" within the prohibited three mile radius.

Second Cup sought a prohibitive injunction to enforce the non-competition covenant. It encountered difficulties with the strength of its case branch of the test. Justice Lederman determined that the "strong *prima facie* case" version of the test applied because it involved the enforcement of a negative covenant and because if the injunction were granted it effectively disposed of the issues, the 15-month non-competition period having expired before trial could ever take place.

Applying the "strong *prima facie* case" analysis, Justice Lederman found it problematic that none of the parties, and particularly the franchisor, was able to produce an executed copy of the various franchise agreements. Further, the husband was not even named as a signatory to the draft agreements produced.

Justice Lederman noted that, "Second Cup, through its solicitor, made it clear and expressly represented that no parties would have any rights nor would there be approval under any of the franchise documentation including the franchise agreement and assignment agreement except upon execution of all documents by all of the parties. In essence, Second Cup expressly required acceptance of its offer by execution of all documents by all parties. There is no evidence that this ever occurred."[41]

Nevertheless, Justice Lederman acknowledged that the parties had conducted themselves for four years as if there was a properly executed franchise agreement and that in those circumstances the courts will enforce the *de facto* contract's terms, because the parties' conduct represents an assent to its terms. This did not resolve the difficulty of the lack of signed agreements, however, because in carrying on the business over four years, none of

[41] *Second Cup Ltd. v. Niranjan*, 2007 CarswellOnt 5285 (S.C.J.) at ¶15

the parties' conduct was directed towards the non-competition provisions, such that it could be suggested that they clearly assented to those particular terms of the franchise agreement.

In the circumstances, Justice Lederman determined that the franchisor had not been able to make out a "strong *prima facie* case" and therefore turned to the question of irreparable harm. He found there to be material differences in the businesses carried on by Second Cup and Urbana Coffee and therefore he discounted the suggestion that there would be any material adverse effect on Second Cup's franchise system. Further, he was of the view that, to the extent that Second Cup suffered direct competitive losses, they were readily calculable in terms of money damages. Therefore, Second Cup could not demonstrate irreparable harm.

Finally, with respect to the balance of convenience element, Justice Lederman concluded that, "[G]iven that the Draconian effect of an interlocutory injunction would be to shut down the business of Urbana Coffee at premises on which it has a lease, the adverse effect of an interlocutory injunction upon the defendants would be much greater than the prejudice to Second Cup."[42]

The motion was dismissed.

***W.A.B. Bakery Franchising Ltd. v. Canam Advertising Ltd.*, 2007 CarswellOnt 8989 (S.C.J.)**

This case arose out of the continued operation, after the expiry of the franchise agreement, of what had been a "What A Bagel" franchise. The franchisees continued to operate a full-service bakery in the same premises under the trade name "Bagel Nash". The franchisor sought an injunction to enforce the non-competition covenant, as well as to prevent the continued use of its business system.

The franchisor took the position that, because it was seeking to enforce a negative covenant, it was not required to demonstrate either that it would suffer irreparable harm or that the balance of convenience favoured granting the injunction. Justice Wilton-Siegel disagreed, relying on the principle that, in order for this exemption to be available to the moving party, they had to show a "strong *prima facie* case" – a "clear breach" of the negative covenant.

Justice Wilton-Siegel had two issues with the non-competition covenant. First, it was structured with five alternative time periods and four different radii of restraint from the former franchise premises, with possible combinations ranging from five years and 50 miles to one year and 5 miles. Presumably this was done in order to assist the court if it ultimately sought to 'read down' the restraint of trade provision.

Justice Wilton-Siegel considered that the covenant may have been unenforceable as being too vague or as being contrary to public policy, or that a court may accept its least

[42] 2007 CarswellOnt 5285 (S.C.J.) at ¶32

restrictive parameters. In any event, it was not clearly enforceable and therefore it could not be the subject of a "clear breach".

The second issue with the non-competition covenant is that it referred to "termination" and not "expiration". The agreement was structured in several places to distinguish between its termination and expiration. Justice Wilton-Siegel concluded, "There is, therefore, a good argument that the restriction of section 14.2 to circumstances involving the termination of the Agreement is intentional and evidences an understanding that the non-competition covenant would not operate after expiration of the Agreement."[43]

Thus the franchisor was required to satisfy the regular three-part *RJR-MacDonald v. Canada (Attorney General)* test. In that regard, Justice Wilton-Siegel was content that the franchisor had met the "serious question to be tried" threshold with respect to the non-competition covenant as well as with respect to whether the former franchisee was continuing to use the franchisor's business system.

Turning then to the irreparable harm aspect of the test, Justice Wilton-Siegel largely accepted the principle of the franchisor's argument, that permitting the former franchisee to continue to carry on business would undermine the integrity of the franchise system, because other franchisees would do the same upon the expiry of their franchise agreements and prospective franchisees might be reluctant to join. There was also the potential loss of goodwill associated with a failure to maintain product quality. His Honour's difficulty with this argument was simply that there was no evidence supporting it.

With respect to the balance of convenience, Justice Wilton-Siegel was of the view that it favoured maintaining the *status quo – i.e.*, allowing the former franchisee to continue to operate pending trial. His Honour felt that the problems associated with both the enforceability and applicability of the non-competition covenant weighed heavily against the franchisor. Further, he considered that if the covenant was ultimately held to be both applicable and enforceable, that would mitigate any concerns with respect to other franchisees' conduct, and the calculation of damages should be relatively straightforward.

With respect to the former franchisees, "[T]he consequences of an injunction … are immediate and probably irreversible. An injunction would result in a shut-down of the full-service bakery currently run under the name Bagel Nash … [T]here will be a loss of employment to third party employees, … [E]ven if the respondents are ultimately successful, they would have to start over again building up the Bagel Nash business after any period of shut-down … [T]here is a serious risk to the respondents of an irreparable loss of business."[44]

The motion was dismissed.

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[43] *W.A.B. Bakery Franchising Ltd. v. Canam Advertising Ltd.*, 2007 CarswellOnt 8989 (S.C.J.) at ¶12
[44] 2007 CarswellOnt 8989 (S.C.J.) at ¶26

1.3.2 Termination Injunctions

***Struik v. Dixie Lee Food Systems Ltd.*, 2006 CarswellOnt 4932 (S.C.J.)**

This was a motion by a franchisee for an interlocutory injunction to restrain the franchisor from interfering with the operation of a master franchise agreement and offsetting amounts alleged to be owed by the franchisee against the area franchise income.

The franchisee was a master franchisee for Northern Ontario, with an individual franchise agreement for Angus, Ontario. He had been involved in the business for almost 30 years and had negotiated uniquely favourable terms on the renewal of the master franchise agreement. These terms included the right to add products if a store was underperforming, for franchise royalties to be paid directly to him, and he would distribute the franchisor's share to the franchisor and the franchisor's agreement not to set-off against or withhold monies owed to him under the master franchise agreement.

Aside from his obligations as master franchisee to promote and supervise the operation of the franchise system in his territory, he also had the exclusive right to find new franchisees and was responsible for their training. He was in negotiations with prospective franchisees at the time the master franchise agreement was purportedly terminated.

The dispute arose around the franchisee's decision to change the type of potato products sold in his territory restaurants from frozen to fresh under his right to add products. The franchisor was unenthusiastic, although it permitted tests of the fresh potato products to be carried out at the franchisee's Angus restaurant.

The franchisee subsequently learned that the franchisor was profiting on the rebates from the frozen potato supplier. He raised this with the franchisor, purportedly as a concern that it reflected a misrepresentation in the franchise disclosure document with respect to volume rebates benefiting individual franchisees through group purchasing, although he may have considered it leverage with the franchisor.

With this background dispute, the franchisor demanded payment of $5,674.96 in royalties claimed to be owed from the Angus franchise. The franchisee disputed that any amount was owed. When the amount was not paid, the franchisor advised that it would set-off the amount claimed to be owed against the franchisee's master franchise income. The franchisee responded by collecting royalties under the master franchise agreement directly and passing on the franchisor's share. The franchisor purported to terminate the master franchise agreement half an hour later on the basis of failure to operate the business consistent with its standards and reasonable expectations.

Perhaps attempting to take advantage of the implications of *Shelanu Inc. v. Print Three Franchising Corp.*[45], the franchisor sought to characterize its relationship with the franchisee as akin to employer-employee. The franchisee was, in effect, seeking a mandatory interlocutory injunction, returning him to his role as master franchisee. Therefore, he would have to meet the "strong *prima facie* case" test.

Justice Whalen dismissed this out of hand, holding that the relationship between the parties was "a commercial one – not an employment or personal service arrangement." Moreover, he referred directly to the following provision of the master franchise agreement:

> The Area Franchisee is and will at all times remain an independent contractor and is not and shall not represent himself to be the agent, joint venturer, partner or employee of the Franchisor or to be related to the Franchisor other than as its independent area franchisee. No representations will be made or acts taken by the Area Franchisee which could establish any apparent relationship of agency, joint venture, partnership or employment...

It does not appear that Justice Whalen was referred to *Shelanu Inc. v. Print Three Franchising Corp.*[46]

Justice Whalen easily found that the franchisee met the "serious question to be tried" element of the test. His responses to the allegations supporting termination of the master franchise agreement – failure to provide adequate training, monitor standards or attend to customer complaints - were neither frivolous nor vexatious.

> [I]t is difficult to imagine that JS would not have encountered some difficult, contrary-minded or inept franchisees and numerous equally difficult customers in his many years as area franchisee. In his role, JS must be teacher, mentor, inspector and enforcer. His overall track-record of selling and maintaining 16 franchises in this less populated and less developed region of Ontario suggests success. So many of Dixie's complaints are so dated they will be difficult to prove one way or another, and they are probably beside the point by now in any event.[47]

Moreover, there was compelling evidence that no monies were owed with respect to the Angus franchise and that the franchisee was within his rights to have royalties owed under the master franchise agreement for Northern Ontario paid directly to him.

With respect to "irreparable harm", the franchisor took the position that this was clearly a case where the franchisee was compensable by quantifiable monetary damages calculated with relative ease and precision – there was a balance of a term of years with a share of

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[45] [2003] O.J. No. 1919 (Q.L.) (C.A.)
[46] [2003] O.J. No. 1919 (Q.L.) (C.A.)
[47] 2006 CarswellOnt 4932 (S.C.J.) at ¶47

royalties and other fees that could be projected, adjusted actuarially and capitalized for present value at trial.

Again, Justice Whalen dismissed this out of hand as well:

> JS's age was not stated, but he was introduced to the court at the hearing. He is obviously a man of at least 60 years. He has therefore devoted the better part of his working life to this franchise. He now finds himself cut out completely, with the result that he has lost the majority of his income. His other income is also related to the individual franchises under his supervision — apparently with Dixie's knowledge and approval. The circumstance of his termination can only disrupt his relationship with the franchisees in respect of these secondary relationships. The issue is the loss of long-established means to pursue a rewarding livelihood, not proving financial hardship or destitution.
>
> If the termination has not deprived JS of his livelihood, I do not know what deprivation of livelihood is. JS will not likely, or easily, find another livelihood of a comparable nature or magnitude given his age and the fact of having focused exclusively for so many years on Dixie's commercial enterprise. I also note that Section 10.02 of the Area Franchise Agreement imposes a non-competition obligation. If the termination is effective, JS is prohibited for two years post-termination from any involvement (direct or indirect) "in any restaurant business competitive with or similar to the Franchised Business within the Exclusive Territory". It is not just the finite number of dollars involved, but as importantly, the broad generic loss of JS's usual means of earning a living. This is the work JS has invested himself in for so long.[48]

In light of the foregoing, it is not surprising that Justice Whalen had no difficulty finding that the "balance of convenience" favoured the franchisee's injunctive relief. While the franchisor would only be required to abide by the terms of a long-standing agreement, if the injunction was not granted the franchisee would be deprived of his livelihood. It is somewhat surprising, however, that Justice Whalen seems not to have applied his conclusion that the relationship was purely commercial to this aspect of the test.

The motion was granted.

***674834 Ontario Ltd. v. Culligan of Canada Ltd.*, 2007 CarswellOnt 1564 (S.C.J.)**

The plaintiff had been a distributor of Culligan bottled water and water coolers in the Greater Toronto Area under a one year written trade mark licence agreement. After expiry the plaintiff and defendant continued to do business with each other for another 12 years without a further written agreement.

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[48] 2006 CarswellOnt 4932 (S.C.J.) at ¶73-74

Although the plaintiff was the *de facto* exclusive distributor for the Greater Toronto Area, it did not fit within the bifurcated sales and distribution model of the defendant – company-owned and franchised. However, over the years, it appeared as though the defendant had treated the plaintiff as if it was a franchisee.

For instance, it had received information and access to an intranet site pertaining to litigation with franchisees in the United States. Settlement of this litigation resulted in the development of a new form of franchise agreement to which both American and Canadian franchisees were to become parties. Copies of this franchise agreement and related documents were provided to the plaintiff who advised the defendant that it agreed to its terms. Moreover, the defendant's franchise disclosure document listed the plaintiff as a franchisee. The plaintiff's position was simply that all of the foregoing was done in error.

In February 2006, the defendant advised the plaintiff that it intended to terminate their business relationship effective May 2006 and any rights under the licence agreement were at an end. The termination date was extended on a without prejudice basis to November 2006.

The defendant's explanation for the termination was simply that the plaintiff's operations no longer fit into its business plan. Thus the plaintiff sought an interim and interlocutory injunction maintaining the *status quo* of their pre-existing business relationship with the defendant pending trial to determine whether a franchisor-franchisee relationship had been established. The defendant brought a cross-motion to restrain the plaintiff's use of its trademarks.

With respect to the strength of the case aspect of the test, the defendants argued that what the plaintiff was seeking, in effect, was a mandatory injunction requiring them to continue to do business with the defendant after termination of their relationship. Therefore, the plaintiff ought to be held to the standard of a "strong *prima facie* case".

Justice Pattillo held that, "In order to determine whether what is being sought is a mandatory order it is necessary to look at the factual matrix of the case. An order that establishes a new right never agreed to is mandatory, while an order requiring the parties to act in accordance with an agreement is prohibitive and not mandatory."[49]

Based on the foregoing, Justice Pattillo had no difficulty reaching the conclusion that at the time of the termination there was an existing agreement of some indeterminate nature and content, and that the defendant was merely seeking to continue rights already the subject of agreement for many years. The fact that the defendants had already terminated the agreement was of no moment.

He therefore concluded that the appropriate test was whether there was a "serious issue to be tried" and that the plaintiff had met that test.

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[49] 2007 CarswellOnt 1564 (S.C.J.) at ¶33

With respect to "irreparable harm", the evidence before the court was that approximately 90 percent of the plaintiff's sales derived from the defendant's product and, absent being able to supply that product, the plaintiff would go out of business. Justice Pattillo accepted this as adequate evidence of irreparable harm.

Turning to "balance of convenience" the principal argument advanced by the defendant was that it too would suffer irreparable harm because the plaintiff did not sell its full line of products and its market presence and sales would therefore be compromised. Justice Pattillo did not accept that the defendant would suffer irreparable harm, largely because of the relatively unproblematic 13-year business relationship and that the defendant's business model provided for it to market directly its full line of products to customers in the Greater Toronto Area.

The motion was allowed.

***1323257 Ontario Ltd. v. Hyundai Auto Canada Corp.*, 2009 CarswellOnt 88 (S.C.J.)**

In this case, the franchisee sought to enjoin its franchisor from terminating its temporary dealer agreement, which had arisen from the settlement of a prior dispute, as well as interfering with its business relations by opening another dealership in the plaintiff's market area.

Justice Brown gave short shrift to the franchisor's argument to apply the more strenuous strength of case test – "strong prima facie case" – as there was no creation of a new right, but rather preservation of the status quo. Therefore the applicable standard was whether the franchisee's case gave rise to a "serious issue to be tried".

The franchisee's case revolved around two principal issues. First, the validity of the Minutes of Settlement under which the temporary dealer agreement was established. Second, if the Minutes of Settlement were valid, whether the termination of the temporary dealer agreement had been carried out in accordance with its terms. Justice Brown concluded that there were serious questions concerning whether the Minutes of Settlement should be set aside by reason of misrepresentation and, although weaker, that the claim relating to the termination was not frivolous or vexatious. Therefore, the strength of test aspect of the *RJR-MacDonald v. Canada (Attorney General)* was met.

With respect to "irreparable harm", Justice Brown found quite simply that, "If an injunction is not granted in this case, Thornhill will close its doors. Not only will the company lose the opportunity to earn a profit, but its 25 employees risk losing jobs at a time when it is common knowledge that the Canadian economy, particularly the automotive industry, is in real trouble."[50] The "irreparable harm" test was met.

The franchisor argued that the franchisee could rely on a decade of earnings history to facilitate the quantification of damages at trial. Justice Brown rejected this for two primary reasons. First, being forced to close its doors, the franchisee would suffer the

[50] 2009 CarswellOnt 88 (S.C.J.) at ¶114

most extreme loss of market share, one of the examples cited in *RJR-MacDonald v. Canada (Attorney General)* as a harm that cannot be quantified in monetary terms. Second, if the franchisee succeeded at trial, the appropriate time horizon for calculating its damages would be difficult to determine.

Turning to the "balance of convenience" aspect of the test, having already found that the franchisee would suffer irreparable harm if the injunction was not granted, what remained was for Justice Brown to consider whether the potential harm to the franchisor and the other prospective dealer would be greater if the injunction was granted.

He concluded that the harm to the franchisor was speculative at best. This franchise was one of 172 dealers nationwide and it met its sales targets. While it may have hoped to have greater success with the new dealer, there was no evidence to support this conclusion, particularly in light of the poor economic climate for the automotive industry. With respect to the new dealer itself, it had secured contractual protection of its financial and legal interests from the franchisor in light of the known litigation risks and there was scant evidence with respect to projected lost profits, which Justice Brown discounted in any event because of the challenges faced by the automotive industry.

The motion was allowed.

***Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*, 2009 CarswellOnt 2280 (S.C.J.)**

This case involved the franchisor bringing a motion for mandatory injunctive relief to close three franchises and prohibitory injunctive relief to restrain the franchisees in accordance with their non-competition covenants.

The franchisor alleged that the franchisees had breached their franchise agreements in three principal ways. First, by selling under-portioned sandwiches. Second, by failing to participate in promotions. Third, by failing to provide delivery service. Therefore, it was within its contractual rights to terminate the franchises and enforce the negative covenants.

The franchisees brought a cross-motion for an injunction restraining the franchisor from interfering with their businesses pending trial. It is worth noting that this proceeding was commenced during the currency of the franchisee class action against the franchisor.

Justice Perell first considered what the appropriate tests should be. With respect to the relief sought by the franchisor, His Honour determined that it would be required to satisfy the more challenging, "strong *prima facie* case" test for three reasons.

First, part of the relief being sought was mandatory in nature and, therefore, "Given the very intrusive nature of a mandatory injunction, there must be a high degree of assurance that the injunction would be rightly granted."[51] Second, practically speaking, granting

[51] 2007 CarswellOnt 8989 (S.C.J.) at ¶39

the injunction would make proceeding to trial pointless for the franchisees. Third, "The strong *prima facie* test standard is the measure used for determining whether it is appropriate to enforce a restrictive covenant by an injunction that would restrain an individual's cherished ability to make a living and to use his or her knowledge and skills obtained during employment."[52]

Applying the tests, Justice Perell concluded that the franchisor had met the evidentiary standard of a "strong *prima facie* case" that the franchisees had breached their franchise agreements by unilaterally implementing their own promotional programs which did not follow the specifications of the franchisor as to product and pricing and refusing to implement the delivery program.

Justice Perell did not feel that the quality of the franchisor's evidence with respect to under-portioning was sufficient to meet more that the "serious issue to be tried" standard. However, he did conclude that the franchisees had met that evidentiary burden that the franchisor had wrongfully terminated their franchise agreements, based on their interpretation of the franchise agreements and the effect of the *Arthur Wishart Act (Franchise Disclosure), 2000*.

Justice Perell was also satisfied that both the franchisor and the franchisees had demonstrated that they would suffer irreparable harm if their respective injunctions were not granted.

On the part of the franchisor, "It would appear that the franchisees would not be able to satisfy a damages award against them and, in any event, the irreparable harm suffered by the franchisor goes to its goodwill, its reputation, and its responsibility to the franchisees of the chain to maintain the integrity of the franchise system. Damages would not adequately address these harms."[53]

On the part of the franchisees, Justice Perell accepted that granting the franchisor's injunction would terminate their businesses, with a concomitant loss of reputation and goodwill. However, he was also of the view that, "[I]f the interlocutory injunction is granted and Quizno's Canada fails at trial, although the franchisees will have suffered irreparable harm, an award of damages and the enforcement of the undertaking as to damages would go some distance in providing a worthwhile remedy for the wrongful termination of their franchise agreements."[54]

With respect to the balance of convenience, Justice Perell's comments are very instructive:

> If the case at bar were just about alleged breaches of a franchise agreement with respect to the amount of meat, etc. on submarine sandwiches, then notwithstanding the franchisor's arguments that any under-portioning by a

[52] 2007 CarswellOnt 8989 (S.C.J.) at ¶41
[53] 2007 CarswellOnt 8989 (S.C.J.) at ¶93
[54] 2007 CarswellOnt 8989 (S.C.J.) at ¶97

franchisee(s) goes to the heart of its goodwill, reputation, and enterprise, nevertheless, I would have found that the franchisor would not suffer irreparable harm if an injunction were not granted, and I further would have found that the balance of convenience did not favour the franchisor. A zero-tolerance to perhaps inadvertent or only occasional harm caused by a breach of a franchise agreement by an individual franchisee or a small number of franchisees in a national franchise chain sets the bar much too low for irreparable harm and the balance of convenience.

…

By notoriously deciding to go its own idiosyncratic way in participating in promotions and by not participating in the delivery system, the franchisees challenge who has control over: the methods and systems of the franchisor (section 2.2); the content of and compliance with the operations manual (section 8.1); compliance with business operations (section 11.1) and the specifications of advertising and promoting the restaurants (section 12.1). These are matters fundamental to the integrity of the franchise system, and as noted in *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.*, [1997] O.J. No. 3773 (Ont. Gen. Div.) at p.15, rev'd on other grounds, [1998] O.J. No. 4368 (Ont. C.A.); *1017933 Ontario Ltd. v. Robin's Foods Inc.*, [1998] O.J. No. 1110 (Ont. Gen. Div.) at para. 43:

> The most precious possession of a franchisor is its trademark and systems. The practice is to protect those interests in the terms of contracts with the franchisees for the benefit of the franchisor and other franchisees.

In *Second Cup Ltd. v. Ahsan*, [2001] Q.J. No. 1763 (Que. S.C.), Justice Zerbisias stated at para. 60:

> Where a member of the franchise chain fails to uphold the policies, standards, and operating methods and system to which all of the franchisees have subscribed by executing their franchise agreement, and upon which they rely to advance their mutual interests, it is incumbent upon the franchisor to take measures against the infringing party to force it to cease from tarnishing the reputation of the chain and from diminishing the value of the trademark and the banner. The franchisor must act to protect the integrity of the chain.
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> …

The dispute in this case is not a localized dispute. It is about the franchisor's management rights across the chain of franchises, and this circumstance influences the calculus of irreparable harm and the balance of convenience. In my opinion, given the matters at stake and the strength of their comparative cases and the ineffectiveness of a damages award at trial should the franchisor succeed, the balance of convenience favours

> granting the franchisor an interlocutory injunction subject to the usual undertaking as to damages.[55]

The franchisor's injunction was granted. The franchisees' was not.

It is also worth pointing out an *obiter* procedural suggestion by Justice Perell. In his view, the dispute between the franchisor and franchisees was fundamentally one of interpretation of the franchise agreements that had gotten out of hand. The evidence of the factual matrix was not so complex that it could not be handled within the affidavit and examination context of an application. Therefore, the parties could have proceeded by way of application to have a definitive, binding court ruling concerning their pertinent rights and obligations without the risk of either party breaching their franchise agreements.

Justice Perell observed that, "An early judicial or arbitral determination avoids either party having to suffer irreparable harm by the granting or the refusing to grant an interlocutory injunction. Other franchisees and other franchisors might take a lesson from what happened in the case at bar and if they find themselves with a similar type of problem, they might consider obtaining a court ruling before taking steps that may be found to be breaches of the franchise agreements."[56]

Justice Perell's comments are somewhat at odds with Justice Wilton-Siegel's comments in *Invescor Restaurants Inc. v. 3574423 Canada Inc.*[57]. In that case, the defendants had brought a motion under Rule 21.01(1)(a)[58] of the *Rules of Civil Procedure* for the determination of the enforceability of the non-competition covenant in the franchise agreement. Justice Wilton-Siegel considered this properly to be a matter of mixed fact and law but the motion lacked the evidentiary context of the actual operation or proposed operation of a potentially competitive business.

> Except with respect to issues of contractual interpretation that are pure questions of law, I think this approach is wrong as a matter of law. Because the enforceability of a restrictive covenant can only be considered in the specific factual context in which a party seeks to enforce it, the issue of the enforceability of a restrictive covenant is inherently a matter of mixed fact and law. Indeed, while it is easy to identify the legal principles, the determination of the enforceability of any restrictive covenant is, as this proceeding amply demonstrates, very heavily influenced by the relevant factual matrix.[59]

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[55] 2007 CarswellOnt 8989 (S.C.J.) at ¶99-104
[56] 2007 CarswellOnt 8989 (S.C.J.) at ¶110
[57] 2011 ONSC 1609
[58] A party may move before a judge for the determination, before trial, of a question of law raised by a pleading in an action where the determination of the question may dispose of all or part of the action, substantially shorten the trial or result in a substantial saving of costs.
[59] *Invescor Restaurants Inc. v. 3574423 Canada Inc.*, 2011 ONSC 1609 at ¶19

***Bark & Fitz Inc. v. 2139138 Ontario Inc.*, 2010 ONSC 1793**

This case is in some respects the opposite of *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.* The franchisor was seeking an interlocutory injunction restraining 17 of a total of 20 franchisees from terminating and breaching their franchise agreements.

The franchisees' position was that the franchisor had fundamentally breached their agreements. The franchisees had stopped paying royalties and advised that they intended to remove all branded products and to de-identify and continue to operate as independent businesses, although they had not done so at the time of the motion.

Justice Karakatsanis first addressed the question of whether the relief sought by the franchisor was prohibitory or mandatory. The franchisor's position was that it simply sought to maintain the *status quo* without requiring any positive act by the franchisees or establishing any new right. The "essence of the matter"[60] was prohibitory not mandatory.

From Justice Karakatsanis's perspective:

> Obviously, almost any relief can be framed in the negative, as a prohibition against breaching the terms of the contract. However, whether or not an injunction is mandatory should not simple be a matter of semantics. The import of an order that the respondents comply with contract provisions that each party interprets differently is dependent upon the outcome of this litigation. Adherence to those provisions, in particular those that are not monetary, may well require supervision of the court and may be inherently difficult to supervise, especially in a relationship of mistrust. Fundamentally, the franchisor seeks to require the franchisees to take steps to restore this broken franchise relationship. The restorative nature of the order sought and the positive actions required to comply suggests to me that for the most part, this may well be a mandatory injunction.[61]

Therefore, the franchisor was required to meet the standard of a "strong *prima facie* case". While the franchisees were admittedly not abiding by the terms of the franchise agreement, the question remained whether it had been fundamentally breached and thus repudiated by the franchisor, thereby relieving the franchisees of an obligation to abide by its terms.

The franchisees alleged numerous improprieties on the part of the franchisor, imposing onerous and commercially unreasonable terms for its own benefit contrary to the franchise agreements and the duty of fair dealing set out in section 3 of the *Arthur*

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[60] *TDL Group Ltd. v. 1060284 Ontario Ltd.*, [2001] O.J. No. 3614 (Div. Ct.) at ¶9: "An order preventing the denial of a right previously agreed to is very different from an order establishing a new right never agreed to and requiring a party to act accordingly."

[61] 2010 ONSC 1793 at ¶9

Wishart Act (Franchise Disclosure), 2000, such as misuse of the advertising fund, delisting popular products in favour of own-brand products at greater cost, setting arbitrary inventory levels, imposing handling and delivery charges, and failing to remit rebates. These, taken together, they said deprived them of the benefit of the franchise system.

Referring to *Shelanu Inc. v. Print Three Franchising Corp.*[62], Justice Karakatsanis held:

> The crux of a franchise agreement is the use of the name and trademark in exchange for royalty payments and its exclusive territory. … As well, consistent quality and advertising and promotion are also critical benefits to a franchise agreement.
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> …
>
> I do not find that these claims are capable of amounting to a fundamental breach by the franchisor, even if proven and taken together. They do not deprive the franchisees of substantially the whole benefit of the agreement. The franchisees continued to operate with the brand, logo, marketing recognition and exclusive territory. While these claims may amount to set-off, that is relevant only to the issue of the balance of convenience.[63]

Therefore, Justice Karakatsanis concluded that the franchisor had met the higher onus of a strong *prima facie* case.

Justice Karakatsanis had no difficulty finding that the franchisor would suffer irreparable harm if the injunctive relief was not granted. If the 17 franchisees abandoned the system as proposed, there would remain two corporate stores and three franchises in the system. In that scenario the franchisor's evidence was that it would go bankrupt within two months – the franchise system would not survive pending trial, harming both the franchisor and the remaining franchisees.

With respect to the balance of convenience aspect of the test, however, Justice Karakatsanis was not satisfied that it favoured the full order sought by the franchisor. Her principle concern was that maintaining the *status quo* may cause financial hardship to the franchisees. She therefore invoked, although not expressly, the maxim "one who seeks equity must do equity" – the court has the jurisdiction to grant relief on terms[64]:

> I have a broad discretion to fashion a remedy that would be fair and equitable in the circumstances to preserve the legal rights being asserted until trial. The franchisees themselves are at some financial risk and should receive some relief relating to the core products pending a

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[62] [2003] O.J. No. 1919 (Q.L.) (C.A.) at ¶118
[63] 2010 ONSC 1793 at ¶15-20
[64] Robert J. Sharpe, "Injunctions and Specific Performance" (2008 looseleaf ed.), Canada Law Book at ¶1.1090

> determination of their set-offs and their ongoing obligations in relation to the products.
>
> …
>
> I am prepared to fashion an order that balances the interests of both parties in a way that does not threaten their financial survival, that minimizes the need for court supervision pending trial and that can be undone depending upon the outcome at trial.[65]

Justice Karakatsanis therefore ordered that, pending trial, the franchisees not terminate their franchise agreements and pay all advertising and royalty fees and that the franchisors not impose a mark-up on products supplied to the franchisees. Further, because there was some concern with respect to the enforceability of the franchisor's undertaking as to damages, 20 percent of the royalties were to be paid into court or counsel's trust account.

***C.M. Takacs Holdings Corp. v. 122164 Ontario Ltd.*, 2010 ONSC 3817**

The plaintiffs had been in business for approximately 24 years and had four franchises. The defendant, in addition to being franchisor, was the sub-landlord of each franchise premises. For more than three years the franchisees had not paid rent, franchise fees or other creditors on a timely basis.

The precipitating event for the termination of their franchise agreement and subleases was the delivery of a $17,000 cheque in respect of outstanding royalties, which was returned NSF. This prompted the franchisor to conduct searches for Writs of Seizure and Sale as well as *Personal Property Security Act*[66] searches.

These searches revealed serious arrears of Provincial Sales Tax and a writ filed by the Workplace Safety and Insurance Board. The franchisees had also granted security interests to a related corporation, a private mortgage lender and a restaurant supplier, all without obtaining the franchisor's prior consent, as required by the franchise agreements.

The franchisees moved for injunctive relief requiring the franchisor to return possession of their restaurants, relief from forfeiture, an accounting of profits made by the franchisor while in possession, and delivery of the gross revenues generated by the restaurants since termination.

With respect to the strength of the franchisee's case, the franchisor argued that they should be required to meet the higher standard of "strong *prima facie* case", because what they were seeking was mandatory relief, "to require the defendant to reinstate the plaintiffs' Franchise Agreements, return possession of the franchise location to the plaintiffs, reinstate the sublease agreements and continue in its business relationship. In other words, the plaintiffs were seeking an order that requires the defendant to take a

[65] 2010 ONSC 1793 at ¶38-40
[66] R.S.O. 1990, c. P.10

positive action."[67] Justice Leitch rejected this because the essence of the matter was not to create a right never agreed to, but to determine whether there was a right to continue a relationship. Therefore, the appropriate test was the lower one of whether there was a "serious issue to be tried".

Notwithstanding having decided to apply the lower threshold, Justice Leitch determined that the franchisees did not meet it. She stated:

> I am mindful of the lengthy relationship between the parties, however, the plaintiffs' assertion that the defendant has breached their contract and terminated the franchise is not factually correct. I do not find that the defendant has acted unfairly or in bad faith or commercially unreasonably in enforcing the terms of the Franchise Agreement. The explanations for the events of default do not cure the defaults. For example, seeking a meeting to discuss the franchise fee cannot be said to be a payment arrangement. The assertion that the financing, which led to the registration of the security interest replaced bank financing, does not reflect the prior consent of the franchisor to this financing arrangement.[68]

With respect to "irreparable harm" Justice Leitch concluded that the franchisees' difficulties had arisen from their cash flow problems, which had nothing to do with the franchisor. Further, the restaurants would be operated by the franchisor with existing employees, so the change in control would be invisible to the public, avoiding any risk of loss of good will or customers. Moreover, if the franchisees were ultimately successful at trial, damages would be easily quantifiable with a store by store accounting and any profits easily traceable. There would be no irreparable harm if the injunctive relief were not granted.

Justice Leitch also concluded that the balance of convenience favoured the franchisor because it was ultimately liable for unpaid rent with the legitimate prospect of significant rent arrears, as well as other risks to their ongoing operation, if the franchises remained in the franchisees' control.

The motion was dismissed.

***1318214 Ontario Ltd. v. Sobeys Capital Inc.*, 2010 ONSC 4141**

The franchisees in this case commenced an action against the franchisor with respect to the operation and administration of the programme under which they had acquired their franchises, alleging breach of contract, breach of the duty to act in good faith under section 3 of the *Arthur Wishart Act (Franchise Disclosure), 2000*, breach of fiduciary duty and negligence.

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[67] 2010 ONSC 3817 at ¶28
[68] 2010 ONSC 4771 at ¶33

The franchisees funded this litigation by each withdrawing $82,000 from their franchises. Their franchise agreements restricted annual legal and accounting expenses to $2,000 without the franchisor's consent. The franchisor issued notices of default requiring the return of the funds, failing which their franchise agreements would be terminated. The franchisees sought an interlocutory injunction restraining termination of their franchise agreements pending resolution of the underlying litigation.

In this case, there was no dispute that the regular *RJR-MacDonald v. Canada (Attorney General)* test applied. Therefore, the franchisees were required to establish that there case was not frivolous or vexatious but there was a serious issue to be tried. In that regard, Justice Conway agreed that there were serious issues to be tried on three fronts. First, with respect to the interpretation and enforceability of the provision restricting the franchisees' ability to withdraw funds from the business for legal and accounting expenses. Second, concerning whether the franchisor breached its common law and statutory duties of good faith in issuing the notices of default considering the timing of events related to the underlying litigation. Third, with respect to whether the restriction in the franchise agreement and the notice of default issued pursuant thereto amounted to interference with the franchisees' right to associate provided for in section 4 of the *Arthur Wishart Act (Franchise Disclosure), 2000*.

With respect to "irreparable harm", the franchisor submitted that actual operating results would be available for the stores after termination and therefore damages could be readily quantified if the franchisees were ultimately successful at trial. Moreover, it was prepared to waive the non-competition covenant in the franchise agreements so as not to impede the franchisees' ability to work elsewhere, and to forego enforcement of its security on their homes. Justice Conway did not accept that this adequately addressed the matter in issue.

> The Franchisees have been Price Chopper franchisees for many years. Sobeys marketed the business as one which was ideal for the involvement of the store owners' families. Most of the owners have spouses or children who work with them at their stores. This family business was reinforced by Sobeys' requirement of spousal guarantees and collateral mortgages on the family homes.
>
> If the injunction is not granted, the remaining four Franchisees will lose their businesses. Regardless of whether Sobeys continues to operate the stores, those Franchisees will lose the business that they had purchased, that they were operating, that their families worked in and that they expected to develop over the term of the franchise. That opportunity cannot be restored to them with a payment of monetary damages.
>
> Even with the waiver of the non-competition agreements, the Franchisees will likely become employees of another store, rather than operating their own businesses. That change is not compensable in damages.[69]

[69] *1318214 Ontario Ltd. v. Sobeys Capital Inc.*, 2010 ONSC 4141 at ¶37-39

Turning to the "balance of convenience" aspect of the test for interlocutory injunctive relief, Justice Conway concluded that it clearly favoured the franchisees. While the franchisor argued that it should not be forced to continue in business with franchisees with whom the relationship of trust had broken down, other franchisees would no longer respect the terms of their franchise agreements, and the withdrawal of funds meant that less money was available to satisfy its accounts payable for inventory purchases, this could not balance the inconvenience that would be suffered by the franchisees if their businesses were taken away from them.

> Sobeys does not dispute that the Franchisees are good operators. They are not in default under their Franchise Agreements (apart from the alleged default with respect to the withdrawn funds). There is no reason that they cannot continue to operate their stores within the system pending the outcome of their dispute with Sobeys. Mr. Adams acknowledged that in his cross-examination.
>
> The inconvenience to the Franchisees is that they will lose their family businesses, their employment and future prospects for their stores.
>
> The main inconvenience to Sobeys is that funds have been withdrawn for legal fees when, perhaps, they should not have been. However, I can restrict any future exposure to Sobeys by imposing restrictions on further withdrawals of funds until such time as the issue has been decided.[70]

The motion was granted.

1.3.3 System Change Injunction

***Paul Sadlon Motors Inc. v. General Motors of Canada Ltd.*, 2011 ONSC 4432**

This could almost be considered an encroachment case, however, the agreements at issue did not grant exclusive territories. Rather, it would more accurately be considered in the context of the implementation of franchise system changes.

The franchisor, General Motors, was planning to restructure its dealerships in the Barrie, Ontario area, where there had been two franchisee dealerships for some time in relative competitive parity. The plaintiff franchisee had been a Chevrolet, Oldsmobile and Cadillac dealer. The other franchisee had been a Pontiac, Buick and GMC truck dealer. As part of General Motors's internal restructuring, it had eliminated the Pontiac brand which had accounted for approximate 70 percent of that franchisee's sales. Therefore, the decision was made to divide the Barrie market area into north and south sectors, allowing the former Pontiac dealer to sell Chevrolet vehicles and the plaintiff franchisee

[70] 2010 ONSC 4141 at ¶43-45

to sell Buicks and GMC trucks. The plaintiff franchisee sought to enjoin this market restructuring.

The dealership agreement at issue provided for a geographical area of market responsibility within which a dealer should have an advantage but not exclusivity. It provided that the franchisor would consult with its dealers before modifying its distribution network policy, but General Motors retained final decision making authority in accordance with its business judgment. This policy provided that the number of dealers in a market area must be appropriate to ensure that products are represented competitively and that each dealer had the opportunity to make a reasonable return on investment.

There was no dispute that the regular *RJR-MacDonald v. Canada (Attorney General)* test applied and that the first condition for the plaintiff franchisee to meet was that its claim was not frivolous or vexatious and that there was a serious issue to be tried. Justice Perell concluded that it had done so concerning interpretation of key provisions of the dealership agreement, whether General Motors had breached its duty of good faith under section 3 of the *Arthur Wishart Act (Franchise Disclosure), 2000*, and the enforceability of the provisions in the dealership agreement with respect to General Motors's right to unilaterally change the vehicles that a dealer could order from time to time.

With respect to "irreparable harm", Justice Perell acknowledged that, "If an interlocutory junction is not granted, Sadlon Motors will suffer the loss of the competitive advantage of an excluded or neutered competitor, but I do not see this lost advantage as leading to an inevitable or irreparable or permanent loss of market share or of its business goodwill given that Sadlon Motors' market area is unchanged and it is entitled to compete for sales in the market for lower priced fuel-efficient non-luxury vehicles in all of Barrie."[71]

Further, it would be more difficult to calculate the proposed Chevrolet dealer's damages if it was enjoined from entering the market, than the plaintiff franchisee's damages should an injunction not be granted and it be determined at trial that it should have been. The latter should be quantifiable based on projections of historical performance and recorded sales by the new Chevrolet dealer.

On the other hand, looking to the "balance of convenience", Justice Perell noted that, "[I]f an interlocutory injunction is granted, Georgian cannot compete at all for a business it once had to sell lower priced fuel-efficient non-luxury vehicles. Because Georgian is excluded from the marketplace of lower priced vehicles, its loss of business from returning customers would be irreparable."[72]

With respect to General Motors, Justice Perell concluded that it would suffer irreparable harm if the injunction was granted, by deferring its plans to have two Chevrolet dealers in the Barrie area and, referring to his prior decision in *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*, "I think that the irreparable harm is intensified by the

[71] *Paul Sadlon Motors Inc. v. General Motors of Canada Ltd.*, 2011 ONSC 4432 at ¶79
[72] 2011 ONSC 4432 at ¶81

interference with General Motors' rights under the Dealership Agreement to shape its dealership network."

Justice Perell therefore dissolved the interim injunction granted by Justice Whitaker and continued by Justice Spence and refused to grant the plaintiff franchisee's requested interlocutory injunction. However, he did so on terms that the interim injunction should remain in place for a further two weeks in order for the original Chevrolet dealer to prepare for the entry into the market of another dealer of Chevrolet vehicles, and that the original Chevrolet dealer should be allowed to sell Buick vehicles without prejudice to its legal position, with a view to ensuring that the plaintiff franchisee was not ultimately competitively disadvantaged.

2 Summary Judgment

2.1 Background

There may have been no more challenging procedural issue for litigators in recent years than the application of Rule 20 of the *Rules of Civil Procedure* – summary judgment. There emerged a clear tension between the requirement for a means of disposing of meritless proceedings without incurring the time and expense of a full trial and the principle that parties ought not to be deprived of the opportunity to have their cases fully heard in court. The argument in favour of access to justice could be made in either case.

The principle applied to motions for summary judgment evolved such that the court could grant judgment if it was satisfied that there was no genuine issue requiring a trial with respect to a claim or a defence. However, in making this determination, the judge should not find facts, weigh evidence, assess credibility or decide questions of law.[73]

2.2 New Summary Judgment Rule

Effective January 1, 2010, Rule 20 was amended to its current form, with the intention of improving access to justice. Conceptually, the litigation system was to be made more accessible and affordable, by overcoming the limits to the rule's utility created by prior jurisprudence, in particular permitting a judge to weigh evidence, assess credibility and draw inferences from the evidence. The pertinent part of the Rule is 20.04:

> *General*
>
> 20.04(1) [Repealed O. Reg. 438/08, s. 13(1).]
>
> 20.04(2) The court shall grant summary judgment if,

[73] See *Pizza Pizza Ltd. v. Gillespie* (1990), 75 O.R. (2d) 225 (Gen. Div.), *Irving Ungerman Ltd. v.* Galanis (1991), 4 O.R. (3d) 545 (C.A.), *Dawson v. Rexcraft Storage & Warehouse Inc.*, [1998] O.J. No. 3240 (C.A.) and *Aguonie v. Galion Solid Waste Material Inc.*, [1998] O.J. No. 459 (C.A.)

(a) the court is satisfied that there is no genuine issue requiring a trial with respect to a claim or defence; or

(b) the parties agree to have all or part of the claim determined by a summary judgment and the court is satisfied that it is appropriate to grant summary judgment.

Powers

20.04(2.1) In determining under clause (2)(a) whether there is a genuine issue requiring a trial, the court shall consider the evidence submitted by the parties and, if the determination is being made by a judge, the judge may exercise any of the following powers for the purpose, unless it is in the interest of justice for such powers to be exercised only at a trial:

1. Weighing the evidence.

2. Evaluating the credibility of a deponent.

3. Drawing any reasonable inference from the evidence.

Oral Evidence (Mini-Trial)

20.04(2.2) A judge may, for the purposes of exercising any of the powers set out in subrule (2.1), order that oral evidence be presented by one or more parties, with or without time limits on its presentation.

Only Genuine Issue is Amount

20.04(3) Where the court is satisfied that the only genuine issue is the amount to which the moving party is entitled, the court may order a trial of that issue or grant judgment with a reference to determine the amount.

Only Genuine Issue is Question of Law

20.04(4) Where the court is satisfied that the only genuine issue is a question of law, the court may determine the question and grant judgment accordingly, but where the motion is made to a master, it shall be adjourned to be heard by a judge.

Only Claim is for an Accounting

20.04(5) Where the plaintiff is the moving party and claims an accounting and the defendant fails to satisfy the court that there is a preliminary issue to be tried, the court may grant judgment on the claim with a reference to take the accounts.

Despite the significant amendments to the Rule, the courts continued to adopt the view that it was not the judge's role to make findings of fact or to conduct a summary trial, only to take a "hard look" at the evidence based on the parties "putting their best foot forward" to determine whether there was a genuine issue requiring trial.[74]

Finally, the Court of Appeal determined to recast the case law interpreting the summary judgment rule by convening a five member panel to hear the appeal of four matters over three days in June 2011. On December 5, 2011, the Court of Appeal released its reasons in *Combined Air Mechanical Services Inc. v. Flesch*[75].

2.3 A Fresh Approach

***Combined Air Mechanical Services Inc. v. Flesch*, 2011 ONCA 764**

The Court of Appeal's introduction to its reasons is instructive. Referring to the January 1, 2010 amendments to the *Rules of Civil Procedure*, the Court states:

> Simply put, the vehicle of a motion for summary judgment is intended to provide a means for resolving litigation expeditiously and with comparatively less cost than is associated with a conventional trial. Although such motions have long been available in this province, their utility had been limited in part by a line of jurisprudence from this court that precluded a judge on a summary judgment motion from weighing the evidence, assessing credibility, or drawing inferences of fact. These powers were held to be reserved for the trial judge.
>
> The 2010 amendments to Rule 20 effectively overruled this line of authority by specifically authorizing judges to use these powers on a motion for summary judgment unless the judge is of the view that it is in the interest of justice for such powers to be exercised only at a trial. One of the objectives behind enhancing the powers available to judges on a summary judgment motion was to make this form of summary disposition of an action more accessible to litigants with a view to achieving cost savings and a more efficient resolution of disputes. Indeed, the principle of proportionality is advanced by the expansion of the availability of summary judgment.[76]

However, the Court is careful to emphasize that the purpose of summary judgment is to eliminate unnecessary trials – actions in which there is no factual or legal issue that requires a trial for its fair and just resolution, but not all trials.

The Court then proceeds to enumerate three types of cases that are amenable to summary judgment. First, where it is agreed by the parties, although one suspects that Rule

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[74] See *Cuthbert v. TD Canada Trust*, 2010 CarswellOnt 867 (S.C.J.)
[75] 2011 ONCA 764
[76] 2011 ONCA 764 at ¶2-3

20.04(2)(b) may be underutilized. Second, claims or defences that have no chance of success at trial. The third category is the one which is of most interest – where there is no "genuine issue *requiring* a trial". This is where the Court of Appeal begins to put its own new gloss on the summary judgment rule.

2.3.1 Genuine Issue Requiring Trial

The Court of Appeal states that the change of language from the old rule – no "genuine issue for trial" – to the new rule – no "genuine issue *requiring* trial" - "now permit the motion judge to dispose of the case on the merits where the trial process is not required in the 'interest of justice'."[77]

The Court of Appeal states that the phrase "interest of justice" operates as "limiting language" on whether the judge hearing the motion for summary judgment should exercise their powers. Thus, while the weighing of evidence, evaluating of credibility and drawing of reasonable inferences from evidence were almost entirely circumscribed under the former case law regime, those powers are now merely qualified by whether it is in the interest of justice to exercise them. Thus one must determine what is meant by the "interest of justice".

2.3.2 Interest of Justice

The Court of Appeal provides guidance in its discussion of the primary difference between a trial and a summary judgment motion – it is evidentiary. A trial will often provide a judge with a more comprehensive evidentiary record than the written record of a motion for summary judgment.

However, referring to the Supreme Court of Canada's decision in *Housen v. Nikolaisen*[78], the Court extracts certain pithy phrases as to when it may be in the "interest of justice" for a motion judge to weigh evidence, to evaluate credibility and to draw inferences from the written evidentiary record. That is when the judge is satisfied that they have "total familiarity with the evidence", "extensive exposure to the evidence", and "familiarity with the case as a whole", beyond merely mastering what is in the written evidentiary record.

2.3.3 Full Appreciation Test

The Court of Appeal defines this as the "full appreciation test":

> In deciding if these powers should be used to weed out a claim as having no chance of success or be used to resolve all or part of an action, the motion judge must ask the following question: can the full appreciation of the evidence and issues that is required to make dispositive findings be

[77] 2011 ONCA 764 at ¶44
[78] 2002 SCC 33 at ¶14 and 18

> achieved by way of summary judgment, or can this full appreciation only be achieved by way of a trial?[79]

Thus, the paradigm case that is not apt for summary judgment is one that requires multiple findings of fact, based on conflicting evidence, from several witnesses, in a voluminous record. On the other hand, cases susceptible to summary judgment would be those that are "document-driven" with limited testimonial evidence, where there are limited contentious facts or where the written evidentiary record can be supplemented by hearing oral evidence on discrete issues, such that the judge has a "full appreciation of the evidence and the issues".

> The point we are making is that a motion judge is required to assess whether the attributes of the trial process are necessary to enable him or her to fully appreciate the evidence and the issues posed by the case. In making this determination, the motion judge is to consider, for example, whether he or she can accurately weigh and draw inferences from the evidence without the benefit of the trial narrative, without the ability to hear the witnesses speak in their own words, and without the assistance of counsel as the judge examines the record in chambers.
>
> Thus, in deciding whether to use the powers in rule 20.04(2.1), the motion judge must consider if this is a case where meeting the full appreciation test requires an opportunity to hear and observe witnesses, to have the evidence presented by way of a trial narrative, and to experience the fact-finding process first-hand.[80]

2.3.4 Ordering Oral Evidence

Another interesting gloss placed on the summary judgement rule by the Court of Appeal is with respect to the motion judge's discretion to order that oral evidence be given at the hearing under Rule 20.04(2.2).

The Court emphasizes that this Rule is not intended to supplement the written evidentiary record and, in effect, convert a summary judgment motion into a trial. Rather, it is "no more than another tool to better enable the motion judge to determine whether it is safe to proceed with a summary disposition rather than requiring a trial."[81] In other words, the judge may order oral evidence on discrete issues where it will facilitate weighing evidence, evaluating credibility and drawing inferences from the written evidentiary record.

The Court of Appeal suggests a three-part, but non-exhaustive, test for when an order for oral evidence would be appropriate.[82] First, where it can be obtained expeditiously from a limited number of witnesses. Second, the issue with respect

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[79] 2011 ONCA 764 at ¶50
[80] 2011 ONCA 764 at ¶54-55
[81] 2011 ONCA 764 at ¶60
[82] See 2011 ONCA 764 at ¶103

to which evidence is given is likely to have a significant impact on the motion. Third, the issue is narrow and discrete.

2.3.5 Timing

The Court of Appeal also cautions against bringing summary judgment motions prematurely. While the proposition that all parties to a summary judgement motion have the obligation 'to put their best foot forward'[83] continues to apply, it will not be in the interest of justice to proceed "in cases where the nature and complexity of the issues demand that the normal process of production of documents and oral discovery be completed before a party is required to respond to a summary judgment motion."[84]

At the time of writing, the author was able to identify only six cases referencing the Court of Appeal's "new departure and a fresh approach", none of which are related to franchising. Therefore, it remains to be seen whether it will have as profound an effect on the law surrounding summary judgment as *RJR-MacDonald v. Canada (Attorney General)* did on the law surrounding injunctions.

[83] *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.* (1996), 28 O.R. (3d) 423 (Gen. Div.)
[84] 2011 ONCA 764 at ¶57

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Strategies in Franchise Litigation 2012 OBA Institute

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February 9, 2012

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- ADR (mediation & arbitration)
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STRATEGIC USE OF ADR

- Mediation
- Arbitration
- Can a Franchisor Make Arbitration Mandatory?
- Can a Franchisor Make Class Arbitration Mandatory?

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- Action v. Application
  - General Rule
  - Applications & Disputed Facts
  - Applications Without Disputed Facts
- Injunctions
- Summary Judgment: The New "Full Appreciation" Test

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STRATEGIC USE OF CLASS ACTIONS

- What Claims Have Been Certified?
  - Disclosure
  - Good faith and fair dealing
  - Right of association
  - Breach of the franchise agreement
  - Unjust enrichment
- What Franchise Class Actions Have Failed?

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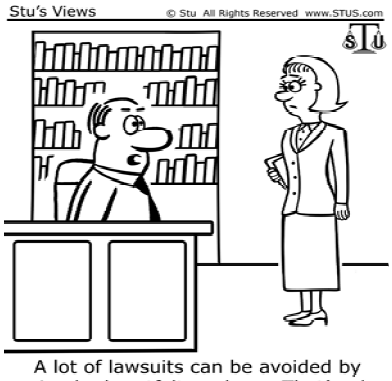
CONCLUSION



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Strategies in Franchise Litigation

Mary Paterson
Osler, Hoskin & Harcourt LLP

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Ontario Bar Association
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STRATEGIES IN FRANCHISE LITIGATION

Mary Paterson[1]

I. INTRODUCTION

Franchisors and franchisees generally ask their counsel to resolve disputes quickly so the parties can focus on their business. This paper highlights the strategies that counsel can use to achieve this goal, specifically:

- Designing a clear alternative dispute resolution process to efficiently handle routine disputes while leaving the flexibility to tailor the approach to non-routine disputes. This alternative dispute resolution process can include mediation and arbitration. I recommend including mediation but being more selective about using arbitration (Part II);

- Using procedural tools available in litigation, including bringing an application rather than an action, seeking an injunction, or seeking summary judgment (Part III); and

- Starting a class action rather than an action by a single franchisee (Part IV).

Each of these strategies has risks and must be considered in the context of the particular facts of each case to ensure that they will lead to faster and cheaper resolution of the dispute.

II. STRATEGIC USE OF ALTERNATIVE DISPUTE RESOLUTION PROCEDURES

A well-designed dispute resolution mechanism is critical to the health and success of any franchise network. The mechanism must be tailored to the character of the franchise network (i.e., its size, the nature of disputes that commonly arise, the relationship between the franchisees and the franchisor, etc.). In some systems, the character of the network makes a simple dispute resolution process more effective. For example, small systems with a high-degree of up-front franchisee participation in operational decisions will likely find a simple, more flexible process more effective. In more complex systems, the franchisor may choose to take a more nuanced approach.

Franchisors can design a dispute resolution mechanism that includes one or more of four dispute resolution techniques: (1) internal without prejudice meetings, (2) mediation, (3) arbitration, and (4) court proceedings. Each technique must be carefully considered and designed to ensure that disputes are effectively resolved in a manner that preserves the franchisee-franchisor relationship and the health of the franchise network. Generally, I recommend that franchisors include both an internal without prejudice meeting and mediation in their dispute resolution mechanism. Whether arbitration is appropriate and the types of disputes in which arbitration will be used depends on the character of the franchise network and the nature of its routine disputes.[2]

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[2] Note that section 5 of the Regulations to the *Arthur Wishart Act (Franchise Disclosure), 2000*, SO 2000, c.3 ["*Arthur Wishart Act*"] requires the franchisor to describe in its disclosure document any internal or external alternative dispute resolution mechanism it uses.

A. Mediation

I recommend including a properly designed and well-timed mediation as part of the dispute resolution mechanism. In parts of Ontario (including Toronto), parties are required to mediate before they can set an action down for trial. If the parties have to mediate anyway, it makes sense for parties to do so as soon as both sides have a clear understanding of the dispute and the key evidence that will be used at the hearing (be it by trial or arbitration). Parties that clearly understand the dispute and key evidence are in a good position to evaluate their case and speak reasonably about settlement, potentially avoiding the costs associated with litigation or arbitration. Mediation also has the benefit of an independent third party who can comment on the strengths and weaknesses of the case.

If the franchise system uses mediation to resolve disputes, it is best to establish the procedure for the mediation long before the dispute arises. Where the franchisee and franchisor are embroiled in a hotly contested dispute, it can be difficult to agree to a mediator and the deadlines for or the contents of the mediation briefs. These difficulties not only aggravate the dispute and increase the costs associated with it (affecting the parties' willingness to settle) but they also delay final resolution.

A well-designed mediation process will explain:

- How the mediator will be chosen (and may even provide a roster of a few mediators);
- Whether mediation briefs are required and the basic content of those briefs (for example, must the brief include an offer to settle?); and
- When and where the mediation will occur.

A well-designed and well-timed mediation mechanism has several benefits: it is confidential, can be designed to be quick, is often effective, can resolve disputes in creative ways, and is required before an action can go to trial in some jurisdictions. Given that mediation done well can be effective and may be mandatory, I recommend that franchisors consider including mediation in their dispute resolution mechanism.

B. Arbitration

The question of whether to include arbitration in the dispute resolution mechanism is more complicated. Arbitration is a more flexible process than litigation and it leads to a binding decision. It can be effectively used for routine disputes about required payments, termination and renewal of the franchise, and operational issues. However, a franchisor may not want to address other issues, such as the validity of its intellectual property, in an arbitration, especially if that arbitration has limited appeal rights.

Arbitration has the benefit of being confidential: franchisors are better able to protect sensitive commercial information in private arbitration than in open court, which benefits the franchise system as a whole. This confidentiality often has the practical effect of increasing the chance that the franchisor and franchisee can preserve their relationship and resolve the dispute. But confidentiality may not be absolute: the franchisor is required to disclose material facts including

whether it has been found liable in a civil action for various actions.[3] Although franchisors are not expressly required to disclose the results of arbitration, the general obligation to disclose material facts may require franchisors to disclose the results of arbitration as well. Even if it does, the parties maintain the confidentiality of the evidence (including sensitive commercial information) as well as any unproven allegations.

In the right conditions, arbitration can be cheaper, quicker and more flexible than litigation. In the wrong conditions, arbitration can be more expensive than litigation, have fewer rules to keep unreasonable parties or counsel in check, and add another dimension that can be disputed, namely whether the dispute is arbitrable at all.

Franchisors can help create the right conditions for arbitration by:

- Crafting an arbitration clause that clearly spells out what disputes can be arbitrated;
- Explicitly adopting a set of arbitration rules (such as the National Arbitration Rules of the ADR Institute of Canada, Inc., the Simplified Arbitration Rules of the ADR Institute of Canada, Inc., or the Arbitration Rules of the Canadian Foundation for Dispute Resolution, for example);
- Tailoring those rules to better serve the franchise system;
- Clearly stating the governing law;
- Clearly stating the remedies that the arbitrator can award;
- Providing a roster of a few arbitrators who have (or who develop) expertise in the franchise system;
- Expressly permitting the franchisee to remain in possession of the franchise until the dispute is resolved (if it relates to termination), subject to any interim relief that may be granted; and
- Expressly deciding whether to limit appeal rights.

Establishing these procedures before the dispute arises ensures that the franchisor and franchisee can spend their time and money resolving the dispute rather than being distracted by preliminary or procedural issues.

C. Can a Franchisor Make Arbitration Mandatory?

If the arbitration procedure is properly designed, it can effectively resolve routine disputes in the franchise context. The risk remains, however, that the franchisee will want his or her day in court and will start a court proceeding anyway.

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[3] *Arthur Wishart Act*, *ibid*, s 5(4); O Reg 581/00, s 2(5).

If the franchisee starts a court proceeding, the franchisor can move to stay the proceeding pursuant to section 7 of the *Arbitration Act*[4] and, if the matter is properly subject to the arbitration agreement and the exceptions listed in section 7(2) do not apply, then the court is obliged to stay the proceeding. The critical question is whether the arbitration clause in fact requires the parties to arbitrate the dispute.

Where the arbitration clause requires the parties to arbitrate the issue in dispute, Ontario courts have consistently stayed proceedings brought by franchisees in routine franchise disputes to permit arbitration. For example:

- In *MDG Kingston*, the Ontario Court of Appeal stayed an action by a franchisee for rescission based on failure to disclose and related damages. The Court noted that the dispute fell within the arbitration clause which remained effective even if the franchise agreement was ultimately declared rescinded.[5]

- In *Flexsmart*, the Superior Court stayed an action in which the franchisee alleged various breaches of the franchise agreement as well as deficient disclosure.[6]

- In *Nazarinia*, the Superior Court stayed an action in which the franchisee alleged that the franchise agreement was invalid for various reasons, including alleged fraudulent misrepresentations. The Court noted that the franchisee did not allege that the arbitration agreement in particular was invalid, held that there was not sufficient evidence of fraud to raise a serious question, and held that the arbitrator had the jurisdiction to decide whether the franchise agreement as a whole was invalid.[7]

- In *Lougheed*, the Superior Court stayed an action in which the franchisee sought damages arising out of an alleged breach of the franchise agreement. The Court refused to grant default judgment, holding that the mandatory arbitration clause was a complete answer to the relief sought.[8]

Despite the courts' favourable view of arbitration, they carefully construe arbitration clauses and will not stay proceedings where the subject matter does not fall within the arbitration clause. For example, in *Nafzaah International Ltd. v. RMCF Franchise Corp.*, a franchisee sought a declaration that the franchisor was not entitled to terminate and also sought an injunction preventing the termination. The court refused to stay the proceeding because the arbitration clause specifically precluded the arbitrator from granting the relief the franchisee requested.[9]

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4 SO 1991, c.17.

5 *MDG Kingston Inc. v. MDG Computers Canada Inc.*, 2008 ONCA 656.

6 *2162683 Ontario Inc. v. Flexsmart Inc*., 2010 ONSC 6493.

7 *Nazarinia Holdings Inc. v. 2049080 Ontario Inc.*, 2010 ONSC 1766, aff'd 2010 ONCA 739.

8 *Lougheed v. Garden City Entrepreneurs Inc.*, 2008 CarswellOnt 4536 (ONSC).

9 *Nafzaah International Ltd. v. RMCF Franchise Corp.* (2003), 40 BLR (3d) 304 (ONSC).

Similarly, in *Rosedale Motors Inc. v. Petro-Canada Inc*., a franchisee sued a franchisor for damages arising from alleged breaches of the franchise agreement and also from alleged misrepresentations. The arbitration clause did not cover allegations of negligent misrepresentations. The franchisor brought a motion to stay the breach of agreement claim in favour of arbitration and for summary judgment on the misrepresentations claim. The Court refused the stay because the two claims were so closely bound up with each other that it was more efficient to deal with them together thereby avoiding a multiplicity of proceedings.[10]

Finally, in *Stoneleigh Motors Limited v. General Motors of Canada Limited*, the Superior Court permitted the plaintiff dealers to pursue a group action against General Motors because the arbitration clause did not permit arbitration of group claims.[11]

The conclusion I draw from these cases is that the franchisor can require a franchisee to arbitrate a dispute if the arbitration clause is clearly drafted, covers the issue in dispute, and provides the arbitrator the power to award the relief sought. As I discuss below, it is less clear whether the franchisor can require a group of franchisees to participate in a group or class arbitration rather than in a class action before the court.

D. Can a Franchisor Make Class Arbitration Mandatory?

In two recent cases, the Supreme Court of Canada reinforced the value of arbitration and stayed purported class proceedings in favour of arbitration.[12] In *Telus*, the Supreme Court clarified that the principles supporting arbitration articulated in *Dell* (which was decided under Quebec law) also applied in common law provinces. The Court stayed most of the claims made by Seidel because her contract contained a mandatory arbitration clause. The Court affirmed that arbitration clauses would be enforced "absent legislative language to the contrary."[13]

However, the Court did not stay all of Seidel's claims. It permitted her claim under section 172 (but not section 171) of the *Business Practices and Consumer Protection Act*[14] to proceed because that section specifically permitted her to "bring an action in the [B.C.] Supreme Court" as a public interest litigant. As a result, section 172 relieved Seidel of her contractual commitment to arbitrate disputes.

In the franchise context, franchisees may be able to argue that section 4 of the *Arthur Wishart Act* operates in the same manner, i.e., that it confers a right to associate including a right to participate in a class action, and that an arbitration provision, even one that permits class or group arbitration, interferes with the right to participate in a class action and is void under section 4(4). This question has not been directly decided by the courts.

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[10] *Rosedale Motors Inc. v. Petro-Canada Inc.* (1998), 42 OR (3d) 776 (ONCJ), rev'd [2001] OJ No 5368 (Div Ct) ["*Rosedale Motors*"].

[11] *Stoneleigh Motors Limited v. General Motors of Canada Limited*, 2010 ONSC 1965 (Osler, Hoskin and Harcourt acted for General Motors).

[12] *Dell Computer Corp. v. Union des consommateurs*, 2007 SCC 34 ["*Dell"*]; *Seidel v. Telus Communications Inc*., 2011 SCC 15 ["*Telus*"].

[13] *Telus*, *ibid*, at para 42.

[14] *Business Practices and Consumer Protection Act*, SBC 2004, c.2 ["*BPCPA*"].

What has been decided is that a franchisor cannot require a franchisee to release claims in a class proceeding as a condition of renewing the franchise agreement.[15] The Ontario Court of Appeal held that such a release ran afoul of section 11 of the *Arthur Wishart Act*, which states that any release of a right under the Act is void. The Court then held (possibly in *obiter*) that the requirement of a release also violated rights of association because it prevented the franchisee from participating in the class action. The Court was not asked to consider an arbitration clause.

If section 4 of the *Arthur Wishart Act* gives a franchisee the right to participate in a class action, then the question under the *Telus* analysis is whether that statutory right manifests a legislative intent to interfere with arbitration agreements, which are also strongly supported by the legislature and the courts. As suggested above, franchisees will argue that section 4 is like section 172 of the BPCPA. On the other hand, franchisors will argue that section 4 of the *Arthur Wishart Act* is akin to section 171 of the BPCPA and that the court should stay a franchisee's purported class action seeking damages just like the Supreme Court stayed Seidel's private cause of action for damages under section 171 of the BPCPA. It is hard to predict which argument the courts will accept.

From the strategic perspective of resolving disputes quickly, franchisors should carefully consider what procedure they would like to use to resolve group claims. If franchisors are content with class or group actions, then the issue of arbitrability obviously does not matter. If, however, franchisors prefer to arbitrate class or group claims, then they must carefully review *Telus*, the jurisprudence interpreting section 4 of the *Arthur Wishart Act*, and the language of their arbitration clauses.

III. STRATEGIES FOR FAST(ER) LITIGATION

If the informal or alternative dispute resolution mechanisms fail and the dispute is placed before the court, the parties can use several strategies to resolve the dispute more quickly. First, counsel has to decide whether the dispute can be appropriately resolved in an application (which is usually faster than an action). Regardless of whether the dispute can be resolved by way of application or action, it may be possible to get an injunction.[16] If the dispute is not suited for an application such that an action is necessary, then the dispute could be resolved by a summary judgment motion. Whether any of these strategies are appropriate depends, of course, on the facts of each case.

A. Action v. Application

The general rule is that all proceedings should be started as actions unless an application is specifically permitted. Rule 14.05(3) permits applications where the relief claimed depends on the interpretation of contracts (including franchise agreements) or statutes (including the *Arthur Wishart Act*). Applications are usually resolved more quickly than actions, but there is a risk that the court will convert the application into an action under Rule 38.10, which, of course, increases the cost and time needed to resolve the dispute. Counsel should carefully consider whether the court can properly decide the dispute in an application to reduce the risk of conversion.

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15 *405341 Ontario Limited v. Midas Canada Inc.*, 2010 ONCA 478 ["*Midas*"].

16 My co-panellist, Jonathon Baker (a partner at Wardle Daley Bernstein LLP) prepared a thorough analysis of injunctions in the franchise context, so I will not consider the topic further in this paper.

1. *The General Rule*

According to Rule 14.02, every proceeding in Ontario is required to be by action except where a statute or the Rules provides otherwise. Actions have certain benefits: for example, parties have discovery rights and the ability to bring summary judgment motions under Rule 20 or motions to determine questions of law under Rule 21. These benefits must be weighed against the time it can take to have even the simplest action successfully mediated or tried as well as the numerous events that delay mediation and trial (for example, refusals motions and the court's docket).

In certain types of franchise cases, parties can start their proceeding by application under Rule 14.05(3). Applications also have benefits: they are (usually) completed more quickly than actions because the applicant's evidence is delivered with the notice of application and there is no discovery process, among other things.

Rule 14.05(3) provides a list of circumstances in which a proceeding may be started by application, three of which are common in the franchise context: a proceeding may be brought by application where the relief claimed is:

> (d) the determination of rights that depend on the interpretation of a...contract or other instrument, or on the interpretation of a statute...;
>
> (g) an injunction, mandatory order or declaration...or other consequential relief when ancillary to relief claimed in a proceeding properly commenced by notice of application;...or
>
> (h) in respect of any matter where it is unlikely that there will be any material facts in dispute.

2. *Applications and Disputed Facts*

In a 1991 decision made outside the franchise context, the Court of Appeal confirmed that a court can decide an application even where there are material facts in dispute.[17] In *McKay Estate v. Love*, Steele J. held that he had the power to hear an application in which material facts were disputed (unless, of course, the application was brought solely under Rule 14.05(3)(h), which requires that it be "unlikely that there be material facts in dispute"). The Court of Appeal affirmed Steele J.'s decision without commenting on his reasoning about applications with material facts in dispute.

In the franchise context, the court has decided an application with material facts in dispute. In *Cash Converters Canada Inc. v. 1167430 Ontario Inc.*,[18] the franchisor brought an application for an order directing the franchisees to comply with their obligations under the franchise agreement (including paying royalties) until the disposition of an arbitration between them. Faced with a "plethora of affidavits" put forward by the responding franchisees, O'Driscoll J. evaluated the credibility of the franchisees' evidence, made some findings, and concluded that he was not persuaded. He granted the order sought.

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[17] *McKay Estate v. Love*, [1991] OJ No 1972; aff'd 6 OR (3d) 519 (ONCA).

[18] *Cash Converters Canada Inc. v. 1167430 Ontario Inc.*, [2001] OJ No 5860 ["*Cash Converters*"].

The *Cash Converters* decision is the exception to the general approach as most courts have been hesitant to find facts on applications in the franchise context. In fact, several applications brought under Rule 14.05(3)(d) for the determination of rights based on the interpretation of franchise agreements or the *Arthur Wishart Act* have been converted into actions because there were material facts in dispute. The courts seem to have particular concerns about deciding applications where issues of credibility are involved or where *viva voce* evidence is required.

For example, in *W.A.B. Bakery Franchising Ltd.*,[19] the franchisor sought a declaration that the franchisees had breached the franchise agreement and that the franchise agreement was terminated. McMahon J. refused to grant the application, stating that he would have to make significant factual determinations to interpret the contractual documents and determine the parties' intentions. He converted the application into an action.

Similarly, Daley J. converted an application into an action in *Premier Cleaners*,[20] stating that he could not resolve the conflicting evidence regarding the leases and did not have enough evidence to decide whether the applicant as franchisor had any rights with respect to the leased business premises occupied by the franchisees. Daley J. was also concerned about the third-party landlords who had not received notice of the application and whose rights might be impacted by the application.

Finally, in *Lechuga 1 Ltd.*,[21] Penny J. found that there were disputed facts that were material to the resolution of the parties' claims and defences. The franchisee served a notice of rescission alleging the franchisor delivered a deficient disclosure document. Penny J. ordered a "hybrid proceeding" with limited *viva voce* evidence to supplement the affidavit evidence. I note that Penny J. may have taken a different approach to the "hybrid proceeding" if he had had the benefit of the Ontario Court of Appeal's decision about the new summary judgment rule (*Combined Air Mechanical Services Inc.*[22]), which is discussed in detail below.

Based on the comments in these cases, it seems that even though the court can hear applications where material facts are in dispute, it will nonetheless choose to convert the application into an action. To avoid unnecessary expense, counsel must carefully assess whether the dispute can be appropriately resolved on an application. Similarly, counsel responding to an application ought not manufacture factual disputes simply to delay resolution of the dispute.

3. *Applications Without Disputed Facts*

Where there are no disputed material facts, Ontario courts have heard and decided applications on various issues, including:

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19 *W.A.B. Bakery Franchising Ltd. v. 1359820 Ontario Ltd.*, [2005] OJ No 5393.

20 *2138689 Ontario Inc. (c.o.b. Premier Cleaners) v. Owasia Logistics Inc.*, 2011 ONSC 2754.

21 *Lechuga 1 Ltd. v. Lettuce Eatery Development Inc.*, 2011 ONSC 4851.

22 2011 ONCA 764.

- A franchisee's application for rescission of the franchise agreement for lack of disclosure where the franchisor admitted that the agreements were franchise agreements and that disclosure had not been made.[23]

- A franchisee's application for an order requiring the franchisor to renew the franchise agreement for 10-year term based on an interpretation of the franchise agreement.[24]

- A franchisee's application for a declaration that an individual was a franchisor's associate (which required the application judge to find some facts).[25]

- Several franchisees' application for an order that the dispute be submitted to arbitration.[26]

- A franchisor's application for the appointment of a receiver over the franchisee's business when the franchise was not making the required franchise payments to the franchisor nor the required PST payments to the provincial government. (Proceeding by way of application was authorized by the *Bankruptcy and Insolvency Act*[27].)[28]

In summary, although applications can be resolved more quickly than actions, there is a real risk that the application will be converted into an action if there are facts in dispute.

B. Summary Judgment: the New "Full Appreciation" Test

If counsel brings the claim as an action instead of as an application, then counsel can use the strategy of bringing a summary judgment motion. In January 2010, the summary judgment rule was amended to:

- replace the test of "no genuine issue for trial" with the more focused "no genuine issue requiring a trial" (Rule 20.04(2)(a));

- empower a judge to weigh evidence, evaluate credibility and draw inferences from evidence (Rule 20.04(2.1)); and

- allow a judge to order that oral evidence be presented for the purpose of weighing evidence, evaluating credibility and drawing inferences (Rule 20.04(2.2)).

In the months following the amendments, the court began to develop its approach to summary judgment under the new Rule 20. Although a consensus emerged that the new rule broadened the

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[23] *Personal Service Coffee Corp. v. Beer (c.o.b. Elite Coffee Newcastle),* [2005] OJ No 3043; *6792341 Canada Inc. et al. v. Dollar It Limited et al.* 2009 ONCA 385.

[24] *1259286 Ontario Ltd. v. Kardish Food Franchising Corp.,* [2007] OJ No 5429.

[25] *6862829 Canada Ltd. v. Dollar It Ltd.,* 2010 ONCA 34.

[26] *Adlakha v. Meehan,* 2011 ONSC 444.

[27] RSC 1985, c B-3.

[28] *1470568 Ontario Ltd. (c.o.b. East Side Mario's) v. Prime Restaurants of Canada Inc.,* [2011] OJ No 83; aff'd 2011 ONCA 9.

court's jurisdiction, the cases diverged on the question of whether it was appropriate for a motion judge to use the new powers to decide an action on the basis of the evidence presented on a motion for summary judgment, rather than simply using the new powers to decide whether a trial was ultimately needed.[29]

On December 5, 2011, the Ontario Court of Appeal released its long-awaited decision concerning Ontario's new summary judgment rule. In *Combined Air Mechanical Services Inc.*, the Court of Appeal expressly adopted a "fresh approach" to summary judgment that makes previous cases essentially irrelevant.[30]

The Court's new approach – described as the "full appreciation test" – requires the motion judge to conclude that he or she can fully appreciate the evidence and issues *in the case* (not just the motion) based on the motion record, as supplemented by limited oral evidence. In other words, the motion judge must determine whether this full appreciation can be obtained from the motion record or whether the advantages of the trial process are necessary to effect a full and fair resolution of the dispute. The Court suggested that summary judgment would not be appropriate (because a full appreciation could not be achieved) in cases where:

- the motion record is voluminous;
- there are many affiants;
- the moving party has different theories of liability for defendants;
- the court is asked to make numerous findings of fact;
- credibility is at the heart of the dispute;
- the evidence of key witnesses is disputed on critical issues; or
- assessing credibility is difficult because few reliable documentary yardsticks exist.

If the motion judge concludes that he or she can fully appreciate the evidence and issues in the case, he or she is permitted to weigh evidence, evaluate credibility or draw reasonable inferences to find facts on the balance of probabilities and dispose of the action.

This new approach to summary judgment gives both franchisors and franchisees an effective tool to draw the other party into settlement discussions because the risk posed by a summary judgment motion is so much higher. The risk is higher because if the court concludes that it can fully appreciate the issues and evidence in the case, then the court can make findings of fact on a balance of probabilities to finally resolve the case. The risk is higher for the moving party as well

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[29] See the discussion in *Mauldin v. Cassels Brock & Blackwell LLP*, 2011 ONCA 67 (CanLII), (http://canlii.ca/t/2fd7v), at paras 13-24.

[30] 2011 ONCA 764. We note that counsel for one of the parties is seeking leave to appeal to the Supreme Court.

because even if the responding party does not bring a cross-motion seeking summary judgment, the court can nonetheless grant summary judgment to the responding party.[31]

Because the risk is higher, counsel should consider seeking evidence in advance of the summary judgment motion using Rule 39.03. Rule 39.03 states:

> (1) Subject to subrule 39.02 (2), a person may be examined as a witness before the hearing of a pending motion or application for the purpose of having a transcript of his or her evidence available for use at the hearing.
>
> (2) A witness examined under subrule (1) may be cross-examined by the examining party and any other party and may then be re-examined by the examining party on matters raised by other parties, and the re-examination may take the form of cross-examination.
>
> (3) The right to examine shall be exercised with reasonable diligence, and the court may refuse an adjournment of a motion or application for the purpose of an examination where the party seeking the adjournment has failed to act with reasonable diligence.
>
> (4) With leave of the presiding judge or officer, a person may be examined at the hearing of a motion or application in the same manner as at a trial.
>
> (5) The attendance of a person to be examined under subrule (4) may be compelled in the same manner as provided in Rule 53 for a witness at a trial.

This rule is particularly powerful in the summary judgment context because the summary judgment motion judge can refuse counsel's request that oral testimony be permitted. Rule 39.03 does not depend on leave of the court but rather on counsel serving a timely summons.

IV. STRATEGIC USE OF CLASS ACTIONS

Bringing a claim with the intention of certifying it as a class action under the *Class Proceedings Act, 1992*[32] is another strategy that significantly impacts the cost and efficiency of dispute resolution. According to the Court of Appeal, a franchise claim "involving a dispute between a franchisor and several hundred franchisees is exactly the kind of case for a class proceeding."[33] In the past few years, the courts have certified several franchise class actions. Successfully certifying a class action or starting a case that is likely to be certified has several benefits, including:

- Levelling the playing field between a large, commercially sophisticated franchisor and individual franchisees;
- Allowing franchisees to litigate (and usually settle) issues that are too small for one franchisee to litigate but that impact the franchise system as a whole;

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[31] See *Manulife Bank of Canada v. Conlin*, [1996] 3 SCR 415, at p 448, per Iacobucci J. dissenting. The majority agreed with Iacobucci J. on this issue at p 421.

[32] SO 1992, c.6.

[33] *Quiznos Canada Restaurant Corporation v. 2038734 Ontario Ltd.*, 2010 ONCA 466 at para 62.

- Allowing parties to finally determine an issue in a manner that binds the franchise network (or the portion of it in the class);

- Allowing non-representative franchisees to participate in the legal proceeding without being seen to take steps against the franchisor, which helps franchisees protect their relationship with the franchisor;

- Increasing the representative franchisee's chances of retaining a law firm on a contingency basis; and

- Increasing the chance of settlement (as common issues trials seem to be even rarer than non-class action trials).

Despite their benefits, class actions are not appropriate in every case with common claims because they are more expensive, entail more risk for the representative plaintiff,[34] and take much longer to reach a final resolution than a claim brought by one franchisee or a small group of franchisees. Representative franchisees must be confident that their claims will be certified, at least in part, before taking the first step towards a class action.

A. What Claims Have Been Certified?

Representative plaintiffs' counsel have several precedent cases in which franchise claims were certified. In the past decade, the courts have certified franchise class actions addressing the following subjects:

1. Failure to disclose, misleading disclosure, or other negligent misrepresentations:

    - In *Trillium Motor World Ltd.*, the representative dealer alleged that a wind-down agreement, under which certain dealers agreed to wind down their dealerships, was a franchise document such that disclosure was required. As disclosure had not been provided, the representative dealer sought a declaration that he could rescind or cancel the wind-down agreement and seek damages. The Court also certified the question of whether General Motors is a franchisor.[35]

    - In *578115 Ontario Inc. v. Sears Canada Inc.*, the representative franchisee alleged that Sears improperly failed to disclose that Sears was only passing on to franchisees part of the rebate it received from suppliers.[36]

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[34] As Winkler J., as he then was, said in *A&P*, *infra*, at para 56: "Nonetheless, the plaintiffs will be the only class members exposed to costs in the litigation, up to the conclusion of that trial. For that matter, they are the only members of the proposed class exposed to costs on this application for certification. Under virtually any other procedure, they would be exposed to less costs individually."

[35] *Trillium Motor World Ltd. v. General Motors of Canada Ltd.*, 2011 ONSC 1300 ["*Trillium*"] (Osler, Hoskin & Harcourt LLP acted for General Motors of Canada Limited). GMCL obtained leave to appeal Justice Strathy's certification decisions with respect to certain issues, including whether two issues ought to have been certified as common issues (namely, whether GMCL had a duty to disclose material facts concerning its restructuring to franchisees and whether GMCL interfered with the class members' right to associate under): 2011 ONSC 3939.

[36] 2010 ONSC 4571, 325 D.L.R. (4th) 343 ["*Sears*"].

- In *1250264 Ontario Inc. v. Pet Valu Canada Inc.*, the representative franchisee alleged that the franchisor failed to disclose receiving volume-based rebates, its policy in respect of allocating those rebates to class members, the amount it received and the amount it retained.[37]

- In *Rosedale Motors*, (a pre-*Arthur Wishart Act* case), the representative franchisee alleged that the franchisor had misrepresented the profitability of the proposed franchise. The Divisional Court held that there were enough common issues to certify the class, including whether the representations were false and misleading.[38] If the case were brought under the *Arthur Wishart Act*, the representative franchisee might also have been able to rely on section 7, which allows franchisees to claim damages for misrepresentations in the disclosure document.

2. Breach of the duty of good faith and fair dealing or the common law duty of good faith:

- In *Trillium*, the representative dealer alleged that General Motors had breached the duty of fair dealing by offering a wind-down agreement without providing a disclosure document, giving dealers fewer than seven days to respond, and keeping them in the dark concerning GMCL's actual financial position.[39]

- In *Pet Valu*, the representative franchisee alleged that the franchisor breached the duty of good faith and fair dealing by failing to pass on to the franchisees volume-based rebates, allowances and discounts given by suppliers and manufacturers to Pet Valu or its affiliates.[40]

- In *Sears*, the representative franchisee alleged that Sears breached the duty of good faith and fair dealing by failing to disclose that Sears was only passing on to franchisees part of the rebate it received from suppliers, among other things.[41]

- In *405341 Ontario Limited v. Midas Canada Inc.*, the representative franchisee alleged that Midas had breached the duty of good faith and fair dealing by changing its system in a manner that eliminated both a centralized purchasing network for and the related discount on car parts without implementing a corresponding decrease in royalties.[42]

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37 2011 ONSC 287 ["*Pet Valu*"].

38 *Supra* note 10.

39 *Supra*, note 35.

40 *Supra*, note 37.

41 *Supra*, note 36.

42 *Landsbridge Auto Corp. v. Midas Canada Inc.* (2009), 73 C.P.C. (6th) 10 (Ont. S.C.J.) ["*Midas*"].

3. Breach of the right of association:

   - In *Trillium*, the representative dealer alleged that General Motors had breached the right of association by adopting a strategy that was designed to divide the franchisees and give them no time to make a unified response to GMCL's offer.[43]

4. Breach of the franchise agreement:

   - In *Pet Valu*, the representative franchisee alleged that the franchisor breached the franchise agreement by failing to pass on to the franchisees volume rebates given by suppliers and manufacturers to Pet Valu or its affiliates before Pet Valu resold the products to franchisees.[44]

   - In *Sears*, the representative franchisee alleged that Sears breached implied terms of the franchise agreement by failing to disclose that Sears was only passing on to franchisees part of the rebate it received from suppliers.[45]

   - In *2038724 Ontario Ltd. v. Quiznos Canada Restaurant Corp*, the representative franchisee alleged that Quiznos breached the franchise agreement by failing to assist franchisees in obtaining reasonable prices for supplies and for using contractual powers to maximize remittances. The representative franchisee also alleged breach of the then-operative price maintenance sections of the *Competition Act*[46] and conspiracy.[47]

   - In *Mont-Bleu Ford Inc. et al. v. Ford Motor Company of Canada, Limited*, the representative franchisees alleged that Ford had breached the dealer agreement by allowing Mercury/Lincoln dealers to sell Ford vehicles as well.[48]

   - In *1176560 Ontario Ltd. v. Great Atlantic & Pacific Company of Canada Ltd.*, the representative franchisee alleged that A&P breached the franchise agreement by changing the invoicing system to show "net billing" rather than separately identifying the rebates franchisees were entitled to receive.[49]

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[43] *Supra*, note 35.

[44] *Supra*, note 37.

[45] *Supra*, note 36.

[46] RSC, 1985, c C-34.

[47] *2038724 Ontario Ltd. v. Quiznos Canada Restaurant Corp.* (2009), 96 OR (3d) 252, aff'd 2010 ONCA 466 ["*Quiznos*"].

[48] [2000] 95 ACWS (3d) 230 (SCJ), rev'd [2000] 48 OR (3d) 753 (Div. Ct.).

[49] *1176560 Ontario Ltd. v. Great Atlantic & Pacific Company of Canada Ltd.* (2002), 62 OR (3d) 535 (SCJ) at para 5, aff'd (2004) 70 OR (3d) 182 (Div. Ct.), leave to appeal denied (CA). (Osler, Hoskin & Harcourt LLP acted for A&P.)

5. Unjust enrichment

- In *Pet Valu*, the representative franchisee alleged that the franchisor was unjustly enriched by retaining volume rebates that ought to have been paid to the franchisees.[50]

- In *Sears*, the representative franchisee alleged that Sears was unjustly enriched because it kept part of the rebate from supplies that it ought to have passed on to suppliers.[51]

- In *Midas*, the representative franchisee alleged that Midas was unjustly enriched by retaining an enhanced royalty while removing the related discount on car parts.[52]

The franchise bar is also waiting for certification decisions in two proposed class actions: (1) *Shoppers Drug Mart*,[53] in which the plaintiffs allege that Shoppers Drug Mart breached its duty of good faith and fair dealing, breached the franchise agreement, interfered with the franchisees' right to associate, failed to provide adequate disclosure and was unjustly enriched; and (2) *Fairview Donut Inc. et al. v. The TDL Group Inc. et al.*,[54] in which the plaintiffs seek to certify a class action against Tim Hortons alleging breach of the franchise agreement, breach of the duty of good faith, unjust enrichment, misrepresentations and breach of the *Competition Act*. Tim Hortons brought a motion for summary judgment that was heard at the same time as the certification motion. Both motions are under reserve.

B. What Franchise Class Actions Have Failed?

As the list of certified franchise class actions makes clear, representative plaintiffs' counsel have plenty of guidance on how to frame a claim that is likely to be certified. Although many franchise claims have been certified, some have not been certified or have failed for some other reason. As Strathy J. explained in *Pet Valu*, "it is wrong to simply say that because this is a franchise claim it is appropriate for class actions".[55] Two franchise cases have not been certified:

- *909787 Ontario Ltd. v. Bulk Barn Foods Ltd*., in which the representative franchisee alleged that the franchisor breached the franchise agreement by overcharging for supplies. Although certified at first instance, the Divisional Court de-certified the case because the franchise agreements tied the price of supplies to the prevailing prices in the franchisee's region. As a result, the allegedly overcharged prices were not

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50 *Supra*, note 37.

51 *Supra*, note 36.

52 *Supra*, note 42.

53 Osler, Hoskin & Harcourt LLP is acting for Shoppers Drug Mart in *Spina et al. v. Shoppers Drug Mart et al.* Note that the certification hearing is not scheduled until April 2012.

54 *Fairview Donut Inc. and Brule Foods Ltd. v. The TDL Group Corp. and Tim Hortons Inc*. The certification hearing and defendant's summary judgment motion were heard in August.

55 *Supra*, note 37, at para 104.

common and the individual calculation of damages would have overwhelmed the remaining common issues.[56]

- *TA&K Enterprises Inc. v. Suncor Energy Products Inc.*, in which a franchisor recently defeated a purported class action by filing a defence and bringing a successful summary judgment motion.[57] I note that with the Ontario Court of Appeal's recent decision on the new summary judgment rule, discussed above, franchisors may be able to rely more frequently on summary judgment to finally determine an action, including a class action.

On the whole, as Ontario courts have frequently commented, franchise claims that are properly framed are well-suited to the class action procedure. The question for the representative plaintiff is whether the increased risk, litigation time and cost exposure is worth the benefits associated with bringing a class action.

V. CONCLUSION

As you can see, counsel for franchisors and franchisees have many options and strategies that they can use to resolve disputes quickly so their clients can focus on their business. Each option has risks and the success of each strategy depends on the particular facts of each case and on how the courts apply the law. Some areas of legal uncertainty remain, particularly in the summary judgment and class action contexts. Fortunately, 2012 will give us decisions on the new summary judgment test and how it applies in the franchise context as well as on certification of franchise class actions and franchise class action common issues trials.

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[56] *909787 Ontario Limited v. Bulk Barn Foods Ltd.* (2000), 2 CPC (5th) 61 (ON Div Ct) (Osler, Hoskin & Harcourt LLP acted for Bulk Barn Food Ltd.). We note that since *Bulk Barn* was decided, the Supreme Court of Canada has emphasized the "low bar" for certification: see *Hollick v. Toronto (City)*, [2001] 3 SCR 158.

[57] 2010 ONSC 7022, aff'd 2011 ONCA 613 (Osler, Hoskin & Harcourt LLP acted for Suncor).