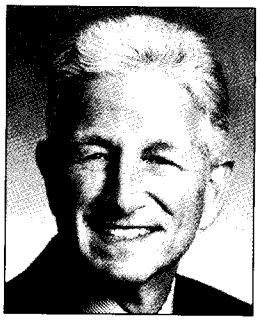

FRANCHISE LAW IN CANADA: WHERE WE ARE AND WHERE WE ARE HEADED

Edward (Ned) Levitt, Dickinson Wright LLP

Franchising continues to grow as a significant factor in the Canadian economy. It has long emerged from its status as a peculiar and unique distribution model to occupy its present position as one of the must-consider options for any distribution endeavour. Previously used almost exclusively in business-to-consumer enterprises, mostly in the retail sector and particularly in the restaurant industry, franchising is rapidly penetrating a wide variety of industries in Canada and the business-to-business sector. At the beginning of 2013, the Canadian Franchise Association identified six sectors of franchises that have grown significantly over the past five years. Over that period, business consultants/services/training saw an increase in franchise listings of 211 per cent; hair and nail salons/spas at 188 per cent; seniors/home care and services, 121 per cent; food restaurants/dining rooms, 88 per cent; home-based businesses, 83 per cent; and health and fitness, 82 per cent.

"At the beginning of 2013, the Canadian Franchise Association identified six sectors of franchises that have grown significantly over the past five years"

This transformation is being felt by a wide variety of professions and businesses, including landlords, bankers, accountants and suppliers of all types. However, the legal profession is being impacted more than any other. The day of the dabbler is over. With five (soon to be six) provinces having enacted franchise specific legislation and a rapidly evolving body of common law, franchise law has become a respected and challenging area of specialisation. Even the non-specialist, given the ubiquity of franchise scenarios in the marketplace, needs to be franchise savvy enough to spot the issues and call for help as required. Sadly, the evidence for this is patently obvious from the number and frequency of franchise negligence claims being reported to law insurers across the country.

FRANCHISE LEGISLATION IN CANADA

Constitutionally, franchise regulation in Canada is a provincial jurisdiction. As a result, national uniformity that comes from a single piece of federal legislation is not available and the fear has been that Canada would repeat the pattern in the US with its wide variety of state approaches to this increasingly crucial area of the economy. Fortunately, through a combination of the US example, the efforts of the Canadian Franchise Association and the thoughtful actions of provincial law makers, the Canadian franchise legislative landscape is amazingly uniform in the most important and fundamental ways. The differences that do exist, while a headache for those charged with compliance, are few and fairly minor.

In October 2012, Manitoba became the fifth province to enact franchise-specific legislation with the passage of its Franchise Act. Now half of Canada's 10 provinces have franchise legislation, with Manitoba joining Alberta, Ontario, New Brunswick and Prince Edward Island. It is widely believed that British Columbia will be the next province to enact franchise legislation. The British Columbia Law Institute (BCLI) released a consultation paper in spring 2013, in which they recommend that the province should enact franchise legislation based generally on the Uniform Franchises Act. The recommendations of the BCLI, if followed, would result in the British Columbia franchise legislation being very similar to the other provinces.

CASE LAW DEALING WITH FRANCHISE LEGISLATION

Along with the increasing number of provincial franchise statutes, there has been a proliferation of court decisions interpreting these statutes and their regulations and providing guidance to all on their application. More cases are needed, as there are a number of provisions of this legislation which are ambiguous or vague as to their applicability in a given fact situation. The following is a brief summary of some of the more significant decisions in this area.

The applicability and limits of the duty of good faith

Robert Moore Pharmacy Ltd v Shoppers Drug Mart Inc confirms that the implied covenant of fair dealing provided for in section 3 of the Arthur Wishart Act (Franchise Disclosure), 2000, cannot be used to imply a renewal right or a right to a new franchise agreement if such a term would be contrary to the parties' bargained-for rights as clearly worded in the contract. The *Moore* case further holds that good faith is not merely a one-way street, that franchisees must also perform their obligations under

franchise agreements in good faith and that their failure to do so may weigh against them when they go to court to seek relief.

"Franchisor's Associate" as defined in the Arthur Wishart Act

"Two recent Canadian cases have taken us as close as we have ever been to the creation of a true body of franchise specific common law principles"

Zwaniga v Johnvince Foods determined that "control", an important element of the definition of "Franchisor's Associate", over a franchisor involves something more than being important, being influential or having bargaining power or control over the "business fate" of a franchisor through exercising contractual rights. Rather, Justice Perell stated that "in the context of the Arthur Wishart Act, control connotes being in charge of or governing or directing or leading the franchisor". An appeal from this decisions was dismissed by the Ontario Court of Appeal in April.

The Opt-Out Period in a Franchise Class Action

Regarding case 1250264, *Ontario Inc v Pet Valu Canada Inc*, in his reasons Justice Strathy acknowledged the importance of franchisees' right of association in section 4 of the Arthur Wishart Act (Franchise Disclosure), 2000, SO 2000, c. 3 (AWA) (and their right to freely express themselves) but pointed out that the AWA is concerned with the relationship between franchisor and franchisee, as opposed to the rights of franchisees amongst themselves. The issue in this case was not whether or not the franchisee CPVF members have a right to associate (they clearly do) but whether the exercise of their individual rights to associate in effect interfered with the rights conferred on each class member by the Class Proceedings Act, 1992 SO 1992 c. 6 (CPA). The right to associate does not trump the right to be afforded protection under the CPA, nor does the right to be afforded protection under the CPA trump the right to associate. These two rights operated independently within the facts of this case.

DISCLOSURE EXEMPTIONS IN THE ARTHUR WISHART ACT

Case 2189205, *Ontario Inc v Springdale Pizza Depot Ltd*, held that the Act must be narrowly construed. The language used for the exemption from disclosure obligations on the resale of a franchise by the existing franchisee only provides an exemption when the franchisor is "not an active participant in bringing about the grant and does nothing more than 'merely' exercise its rights to consent to the transfer".

TA & K Enterprises Inc v Suncor Energy Products Inc brought clarity to the exemption from providing a disclosure document by virtue of s. 5(7)(g)(ii) of the Wishart Act, which excuses the franchisor from disclosure requirements where "the franchise agreement is not valid for longer than one year and does not involve the payment of a non-refundable franchise fee."

3574423 Canada Inc v Baton Rouge Restaurants Inc held that a waiver document was not a franchise agreement between the parties or any other agreement relating to the franchise as defined in the Act. The court decided that "section 5 disclosure requirements are linked to very specific acts – the signing of a franchise agreement or any other agreement relating to the franchise and the payment of a consideration". If these concrete actions are not taken, then a "prospective franchisee" does not become a "franchisee". A franchisor is liable only for not complying with disclosure requirements if the prospective franchisee becomes an actual franchisee, as relief under the Act is provided only to actual franchisees (and not prospective franchisees that do not ultimately become franchisees).

IS DEFICIENT DELIVERY ENOUGH TO TRIGGER A FRANCHISEE'S TWO-YEAR RIGHT OF RESCISSION?

Vijh v Mediterranean Franchise Inc determined that electronic delivery of a franchise disclosure document is not valid under the Arthur Wishart Act (Franchise Disclosure), 2000, but the franchisee's rescission remedy is available for only 60 days, not the extended period of two years for more egregious failures to provide disclosure through the prescribed methods of delivery.

COMMON LAW DEVELOPMENTS

Aside from the cases dealing with the various provincial franchise statutes, there is no "franchise law" in Canada. That is to say, there is no relevance at common law to the finding that a particular commercial relationship is a franchise. No rights and no obligations flow from that finding for either the franchisor or the franchisee, at least not as a matter of law. Of course, judicial attitudes are another matter and, in the final analysis, these attitudes produce almost the same result as though black letter franchise law existed.

However, two recent Canadian cases have taken us as close as we have ever been to the creation of a true body of franchise specific common law principles. Without a doubt, these cases will be analysed for years to come and attempts will be made to hold them up as not just fact-specific precedents, but as establishing some of the rules of engagement for franchisors and franchisees.

Tim Horton's

The Ontario Superior Court's decision in *Fairview Donut Inc v TDL Group Corp (Tim Horton's)* was recently upheld by the Ontario Court of Appeal. The Court of Appeal decision was an emphatic endorsement of Justice Strathy's ruling in a summary judgment application dismissing the class action launched by Tim Horton's franchisees challenging initiatives imposed by the

franchisor that were eating in to their profit margins. Leave to appeal to the Supreme Court of Canada was dismissed in May.

The language of Tim Horton's franchise agreement provided wide discretion for the franchisor to make business decisions for the financial benefit of the franchise system as a whole. The court ruled that:

> *The suggestion by the plaintiffs that the franchisor has an obligation to price every menu item so that they can make a profit on that particular item is not supported by the contract, by the law or by common sense. It is simply not the responsibility of the court to step in to recalibrate the financial terms of the agreement made by the parties.*

Dunkin' Donuts

In *Bertico v Dunkin' Donuts* (*Dunkin' Donuts*), the Quebec Superior Court ordered Dunkin' Donuts to pay nearly $16.5 million to a class of its franchisees for having failed "to protect and enhance the Dunkin Donuts brand in Quebec". The decision is currently under appeal to the Quebec Court of Appeal. The Canadian Franchise Association (CFA) was recently denied leave to intervene.

At issue in *Dunkin' Donuts* was the extent to which the franchisees were entitled to earn a reasonable profit. The franchisees alleged that the collapse of the Dunkin' Donuts brand in Quebec was the result of the franchisor's failure to meet its contractual obligation to protect and enhance its brand. The court accepted that the franchise agreement created a primary obligation for the franchisor to protect the brand and the failure to do so amounted to a breach of that obligation.

However, in the *Dunkin' Donuts* case, the Quebec Superior Court appeared to take the extra step of requiring a franchisor to actively protect its franchisees from economic hardship. Justice Tingley observed that:

> *Franchisors are bound by an obligation of good faith and loyalty towards their franchisees such that they are duty bound to work in concert with them and: [translation] 'provide them with the necessary tools, if not to prevent economic hardship from being caused, to at least minimize the impact.*

Class Actions

Over the last several years, a number of high-profile class proceedings were commenced by franchisees against their franchisors. Many of these cases settled shortly after the class action was certified as valid for proceeding. To date, not a single franchise class action has proceeded to trial. Recently, a number of franchisors defending such actions have signalled their intention to defend such lawsuits vigorously. The *Tim Horton's* case is indeed an example of that vigour.

***

The Canadian franchise market is growing and dynamic. The same can be said for the law affecting franchising. With many franchise systems operating in Canada, both foreign and domestic, the level of sophistication of franchisors, franchisees and those that serve them is increasing, as it should. The importance of this area of commerce on the Canadian economy cannot be overstated and will only increase in the years to come.