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Good Faith in Franchising

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Introduction

Courts have described the franchisor-franchisee relationship as "akin to that of a partnership".[1] While the franchisor-franchisee relationship does not create a fiduciary duty on part of the franchisor, it requires mutual respect "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".[2]

Courts have also found that the franchisor-franchisee relationship is similar to the employer-employee relationship.[3] In particular, the Ontario Court of Appeal in *Shelanu Inc. v Print Three Franchising Corp.* stated the following:

> 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, …[of] 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.[4]

This imbalance has been addressed by a duty of good faith under the common law[5] and a statutory duty of fair dealing under Canadian franchise legislation.[6]

In *Bhasin v Hrynew*,[7] the Supreme Court of Canada expanded the reach of good faith as a source of contractual obligations by imposing a specific duty, "which applies to all contracts, to act honestly in the performance of contractual obligations".[8] This general duty of honesty in

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[1] *Jirna Ltd. v. Mister Donut of Canada Ltd*., 1971 CarswellOnt 572, [1972] 1 O.R. 251, 22 D.L.R. (3d) 639, 3 C.P.R. (2d) 40 at para 12 affd 1973 CarswellOnt 580, 1973 CarswellOnt 581, [1975] 1 S.C.R. 2, 12 C.P.R. (2d) 1, 40 D.L.R. (3d) 303

[2] *Ibid*; See also *Shelanu Inc. v. Print Three Franchising Corp*., 2003 CarswellOnt 2038, [2003] O.J. No. 1919, 123 A.C.W.S. (3d) 267, 172 O.A.C. 78, 226 D.L.R. (4th) 577, 38 B.L.R. (3d) 42, 64 O.R. (3d) 533 at para 70 [***Shelanu***]

[3] ***Shelanu*** at para 64

[4] *Ibid* at para 66

[5] *Ibid* at paras 63 and 66; *1201059 Ontario Inc. v. Pizza Pizza Ltd*., 2013 CarswellOnt 11333, 2013 ONSC 5200, 18 B.L.R. (5th) 298, 231 A.C.W.S. (3d) 663 at para 96

[6] SO 2000, c 3; CCSM, c F156; SNB 2014, c 111; PSPEI, c F-14.1; RSA 2000, c F-23

[7] 2014 CarswellAlta 2046, 2014 CarswellAlta 2047, 2014 SCC 71, 2014 CSC 71, [2014] 11 W.W.R. 641, [2014] 3 S.C.R. 494, [2014] A.W.L.D. 4738, [2014] A.W.L.D. 4740, [2014] A.W.L.D. 4828, [2014] A.W.L.D. 4829, [2014] S.C.J. No. 71, 20 C.C.E.L. (4th) 1, 245 A.C.W.S. (3d) 832, 27 B.L.R. (5th) 1, 379 D.L.R. (4th) 385, 464 N.R. 254, J.E. 2014-1992 [***Bhasin***]

[8] *Ibid* at para 33

contractual performance "does not impose a duty of loyalty, duty of disclosure, or require a party to forego advantages flowing from the contract".[9] Rather, this means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.[10] There is an organizing principle of good faith that parties generally "must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily".[11] In other words, "in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While appropriate regard for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith."[12]

The Supreme Court of Canada held that "this organizing principle of good faith manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance. Generally, claims of good faith will not succeed if they do not fall within these existing doctrines…this list is not closed."[13] For example, "good faith also plays a role in the law of implied terms"[14] which "redress power imbalances in certain classes of contracts such as employment, landlord-lessee, and insurance contracts."[15]

The Supreme Court of Canada mentioned numerous times that the franchisor-franchisee relationship is one of the pre-existing relationships where a duty of good faith has been found to exist. As such, the decision arguably has no immediate impact on the current state of franchise law. However, it has been generally accepted that the statutory obligation of fair dealing is a codification of the common law[16] and courts have turned to other areas of law for guidance in the franchise context. Accordingly, if the duty of good faith is expanded at common law, an expanded interpretation of the statutory duty may follow. Consequently, *Bhasin v Hrynew* may have future implications for the franchisee-franchisor relationship as its application is judicially considered.

This paper will describe the statutory duty of fair dealing and general principles of good faith under the common law. This paper will then provide a review of case law where the duty of fair dealing and good faith has been considered.

Statutory Duty of Fair Dealing

[9] *Ibid* at para 73
[10] *Ibid* at para 73
[11] *Ibid* at para 63
[12] *Ibid* at para 65
[13] *Ibid* at para 66
[14] *Ibid* at para 44
[15] *Ibid* at para 44
[16] *Landsbridge Auto Corp. v Midas Canada Inc.*, 2009 CarswellOnt 1655, [2009] O.J. No. 1279, 176 A.C.W.S. (3d) 38, 73 C.P.C. (6th) 10 at paras 24, 59 [***Landsbridge***]; *1117304 Ontario Inc. v. Cara Operations Ltd*., 2008 CarswellOnt 6444, [2008] O.J. No. 4370, 172 A.C.W.S. (3d) 96, 54 B.L.R. (4th) 244 [***Cara Operations***]; *Machias v. Mr. Submarine Ltd*., 2002 CarswellOnt 1176, [2002] O.J. No. 1261, 113 A.C.W.S. (3d) 987, 24 B.L.R. (3d) 228 at para 114 [***Machias***]; *Country Style Food Services Inc. v. Hotoyan*, 2001 CarswellOnt 2566, [2001] O.J. No. 2889, 106 A.C.W.S. (3d) 640 at para 54

In Alberta, Manitoba, New Brunswick, Ontario and Prince Edward Island, the franchisor-franchisee relationship is subject to a statutory duty of fair dealing in the performance and enforcement of every franchise agreement. Section 3 of the Ontario *Arthur Wishart Act (Franchise Disclosure), 2000* (the "**Ontario Act**")[17] provides that:

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

2. A party to a franchise agreement has a right of action for damages against another party to the franchise agreement who breaches the duty of fair dealing in the performance or enforcement of the franchise agreement.

3. For the purpose of this section, the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

Substantially similar provisions exist in section 3 of the Manitoba *Franchises Act* (the "**Manitoba Act**"),[18] section 3 of the New Brunswick *Franchises Act* (the "**New Brunswick Act**"),[19] and section 3 of the Prince Edward Island *Franchises Act* (the "**PEI Act**").[20]While section 7 of the Alberta *Franchises Act* (the "**Alberta Act**")[21] also provides that every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement, it does not explicitly provide for a right of action for damages nor define what is meant by "duty of fair dealing".

This obligation of fair dealing arises from the franchise agreement and applies only to performance and enforcement thereof. In *Beer v Personal Service Coffee Corp*.,[22] the Ontario Court of Appeal found that the language of section 3 of the Ontario Act "contemplates the existence of an agreement and speaks in terms of the performance and enforcement of such an agreement" when such agreement is in force and effect. As such, it does not relate to an agreement that has been rescinded.[23] Similarly, in *Payne Environmental Inc. v Lord & Partners Ltd.*,[24] the Ontario Superior Court of Justice held that section 3 of the Ontario Act does not apply to the period prior to the execution of the franchise agreement.[25]

Common Law Duty of Good Faith

While the scope of the duty of good faith and fair dealing in the franchise context continues to develop, Canadian courts have considered it at length and in some instances turned to other areas of law for guidance. In *1117304 Ontario Inc. v Cara Operations Ltd.*,[26] the Ontario Superior

[17] SO 2000, c 3
[18] CCSM, c F156
[19] SNB 2014, c 111
[20] PSPEI, c F-14.1
[21] RSA 2000, c F-23
[22] 2005 CarswellOnt 3099, [2005] O.J. No. 3043, 141 A.C.W.S. (3d) 410, 200 O.A.C. 282, 256 D.L.R. (4th) 466
[23] *Ibid* at para 37
[24] 2006 CarswellOnt 392, [2006] O.J. No. 273, [2006] O.T.C. 73, 14 B.L.R. (4th) 117
[25] *Ibid* at paras 24-25
[26] *Supra*, *Cara Operations*

Court of Justice summarized the content of the duty of good faith in the franchise context as follows:

- a party may act self-interestedly, however in doing so that party must also have regard to the legitimate interests of the other party;

- 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;

- good faith is a minimal standard, in the sense that the duty to act in good faith is only breached when a party acts in bad faith. Bad faith is conduct that is contrary to community standards of honesty, reasonableness or fairness (e.g. serious misrepresentations of material facts); and

- good faith is a two way street. Whether a party under a duty of good faith has breached that duty will depend, in part, on whether the other party conducted itself fairly.[27]

In *Fairview Donut Inc. v. TDL Group Corp.* [28] and *Spina v. Shoppers Drug Mart Inc*.[29] the Ontario Superior Court of Justice further summarized the content of the duty of good faith and fair dealing to include the following:

- to require the franchisor to exercise its powers under the franchise agreement in good faith and with due regard to the interests of the franchisee;[30]

- to require the franchisor to observe standards of honesty, fairness and reasonableness and to give consideration to the interests of the franchisees;[31]

- a franchisor cannot exercise its power or discretion out of vindictiveness, or to gain leverage or a bargaining advantage over the franchisee;[32]

- where the franchisor is given a discretion under the franchise agreement, the discretion must be exercised reasonably and with proper motive, and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties;[33]

- to ensure that the parties do not act in such a way that eviscerates or defeats the objectives of the agreement that they have entered into[34] or destroy the rights of the franchisees to enjoy the fruits of the contract; and[35]

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[27] *Ibid* at para 68
[28] *Fairview Donut Inc. v. TDL Group Corp*., 2012 CarswellOnt 2223, 2012 ONSC 1252, [2012] O.J. No. 834, 212 A.C.W.S. (3d) 635 at para 502 [***Fairview Donut***]
[29] 2012 CarswellOnt 12295, 2012 ONSC 5563, 223 A.C.W.S. (3d) 20 at para 149 [***Spina***]
[30] *Shelanu* at paras 66, 69
[31] *Ibid* at paras 5, 68-71; *Landsbridge* at para 15
[32] *Shelanu* at paras 76
[33] *Ibid* at para 96; *Landsbridge* at para 17 citing *Carvel Corp. v. Baker*, 79 F.Supp.2d 53 (U.S. D. Conn. 1997), at para 69; *CivicLife.com Inc. v. Canada (Attorney General)*, 2006 CarswellOnt 3769, [2006] O.J. No. 2474, 215 O.A.C. 43

- to ensure that neither party substantially nullifies the bargained objective or benefit contracted for by the other, or causes significant harm to the other, contrary to the original purpose and expectation of the parties.[36]

The duty of good faith and fair dealing and the duty to act in accordance with reasonable commercial standards are imposed in order to secure the performance of the contract the parties have made. As the Ontario Superior Court of Justice held in *Spina v. Shoppers Drug Mart Inc*., "the duty of good faith is not intended to replace that contract with another contract or to amend the contract by altering the express terms of the franchise contract."[37] Further, as the Ontario Superior Court of Justice held in *Fairview Donut Inc. v. TDL Group Corp*., "it is not a stand-alone duty that trumps all other contractual provisions."[38] Consequently, when considering whether a party has demonstrated good faith and fair dealing in the performance and enforcement of the agreement, the impugned conduct must be assessed in the context of and in conjunction with the agreement that the parties have made.

Since the duty does not override unambiguous provisions of a franchise agreement, the scope and effect of this duty may be moderated by the terms of a well-drafted franchise agreement. However, these principles must be balanced with the holding that "the fact that contractual terms are ultimately complied with, does not mean that there has been no breach of the duty of good faith."[39]

Situations where Duty has been Breached

1. Unreasonable System Standards

Subject to the terms of the franchise agreement, franchisors are free to introduce system-wide changes, even where such changes do not result in financial benefits to the franchisees. Moreover, where the franchise agreement requires franchisees to purchase inventory, supplies and equipment from a designated supplier, franchisors are not required to ensure that the prices paid by franchisees are below the prevailing market rate. Similarly, a franchisor is not prohibited from selling inventory, supplies and equipment to its franchisees for a profit.

In *Landsbridge Auto Corp. v. Midas Canada Inc*.[40] the franchisor ceased distributing products to its franchisees as it entered into an agreement with a distributor to exclusively supply franchisor-branded products. The Ontario Superior Court of Justice certified a class action on behalf of the franchisees who claimed breach of the franchise agreement, breach of the duty of fair dealing and derogation of grant. The causes of action for breach of contract depended entirely on the requirement of good faith and not on express terms of franchise agreement. The Ontario Superior

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[34] *Transamerica Life Canada Inc. v. ING Canada Inc*., 2003 CarswellOnt 4834, [2003] O.J. No. 4656, [2004] I.L.R. I-4258, 127 A.C.W.S. (3d) 235, 234 D.L.R. (4th) 367, 41 B.L.R. (3d) 1, 68 O.R. (3d) 457 at para 53
[35] *Landsbridge* at para 17
[36] *Katotikidis v. Mr. Submarine Ltd*., 2002 CarswellOnt 1655, [2002] O.J. No. 1959, 118 A.C.W.S. (3d) 56, 26 B.L.R. (3d) 140 at para 72; *TDL Group Ltd. v. Zabco Holdings Inc*., 2008 CarswellMan 480, 2008 MBQB 239, [2008] M.J. No. 316, [2009] 1 W.W.R. 321, 169 A.C.W.S. (3d) 1005, 232 Man. R. (2d) 225 at para 272
[37] *Spina* at paras 148, 206
[38] *Fairview Donut* at paras 500-501
[39] *Shelanu Inc.* at para 71; See also *Spina* at para 210
[40] *Supra*, *Landsbridge*

Court of Justice held that the franchisor's "decision to negotiate an alternative distribution system with another supplier could not, by itself, be a breach of the duty of good faith."[41] The strength of the allegation would depend on the manner in which the decision to do so was implemented.[42] The Ontario Superior Court of Justice held that the issue would turn on whether "the changes in the product supply system implemented by the franchisor have been so radical and detrimental to the franchisees' commercial and financial interests, and have effected such a fundamental departure from the relationship between the parties that was contemplated by the franchise agreement, as to require a conclusion that there has been a breach of the duty of good faith and fair dealing."[43]

In *Fairview Donut Inc. v. TDL Group Corp*.[44] the plaintiffs were franchisees of the defendant franchisor, a quick service restaurant chain specializing in coffee and donuts. The franchisees' complaints stemmed from two system-wide changes implemented by the franchisor. First, the franchisor replaced in-store scratch baking of most of their baked goods with a system called "Always Fresh" in which dough was partially baked and frozen at a centralized facility, then delivered frozen to the franchisees' stores, where baking would be completed as needed. The Always Fresh donuts franchisees were required to buy were supplied by a joint venture in which the franchisor had an interest. Second, the introduction of the "Lunch Menu" of soups, sandwiches, etc. which were to be sold 24/7.

The franchisees alleged that the franchisor's conduct relating to the Always Fresh Conversion and the Lunch Menu breached their contracts, breached the franchisor's common law obligation of good faith and breached the statutory duty of good faith and fair dealing under the Ontario Act. The alleged breaches of the duty of good faith and fair dealing included the following:

- misrepresenting the cost of the Always Fresh donut as being 11 to 12 cents when the franchisor knew it would be 16 cents and that distribution costs would bring it to 18 cents;

- exploiting the "captive supply" provisions of the franchise agreement by imposing mark-ups that generated "extraordinary gains" without corresponding value to franchisees;

- failing to analyze the effect of Always Fresh Conversion on franchisee profitability and disregarding the interests of franchisees;

- misrepresenting that increased food costs would be offset by labour and other savings;

- imposing unreasonably high food costs for Always Fresh baked products;

- refusing to take reasonable steps to address franchisees' concerns; and

[41] *Ibid* at para 36
[42] *Ibid* at para 36
[43] *Ibid* at para 37
[44] *Supra*, *Fairview Donut*

- requiring franchisees to sell Lunch Menu items at a cost that prevented them from earning a profit.[45]

The Ontario Court of Appeal affirmed the Ontario Superior Court of Justice's finding that there was no breach of the franchise agreement as "the Always Fresh Conversion and the Lunch Menu were reasonable commercial decisions that [the franchisor] was entitled to make, having regard to its own interests and to the interest of its franchisees."[46] Further, there was no evidence that such "decisions were motivated by improper or extraneous considerations,"[47] nor were there "express terms of the franchise agreement that required the franchisor to supply ingredients or other inputs at prices lower than what they could obtain on the market or that were commercially reasonable."[48] The Ontario Superior Court of Justice also noted that pricing was within the reasonable discretion of the franchisor, and there was no evidence that the franchisor's discretion was exercised arbitrarily, capriciously or for an improper motive.[49] The decision to move to Always Fresh and to implement Lunch Menu was made honestly and reasonably, with due consideration for the interests of franchisees.

The Ontario Superior Court of Justice held that there was no evidence of a custom in the business that the franchisor supplies inputs at prices lower than market prices and it would not be reasonable to imply such a term into the contract between the parties. There was no basis on which to imply a term based on the business efficacy or officious bystander test. Such a term was not required in order to make the contract commercially effective, "nor would it be consistent with the express terms of the contract or the regulatory framework."[50]

Overall, the Ontario Superior Court of Justice held that it is not the court's responsibility "to recalibrate the financial terms of the agreement made by the parties."[51] Having regard to the franchise agreement as a whole and the benefits of such agreement to the franchisees, the Always Fresh Conversion, and the pricing of donuts and the Lunch Menu were not breaches of the franchisor's duty of good faith and fair dealing.[52]

2. Withholding Information and Lack of Support and Disclosure

The duty of fair dealing "does not impose a continuous post-sale disclosure regime and there is no obligation on part of the franchisor to provide ongoing disclosure for routine or non-material information."[53] However, hiding or refusing to disclose information that was material to matters ultimately contracted for in the franchise agreement and "information that was clearly related to the performance of the agreement" is evidence of the franchisor not dealing fairly or in good

[45] *Ibid*, para 488
[46] *Ibid* at para 437
[47] *Ibid* at para 437
[48] *Ibid* at par 439
[49] *Ibid* at para 522
[50] *Ibid* at para 483
[51] *Ibid* at para 679
[52] *Ibid*, para 516
[53] *1250264 Ontario Inc. v. Pet Valu Canada Inc.*, 2014 CarswellOnt 15206, 2014 ONSC 6056, 246 A.C.W.S. (3d) 575 [***Pet Valu 2014***]

faith with its franchisee.[54] This duty is applicable whether non-disclosure is on part of the franchisor or franchisee.[55] Courts have also found that the duty of fair dealing and good faith is breached where the franchisor has made misrepresentations and fails to provide ongoing support to the franchisee.[56] Further, in the case of a class action, the duty of good faith and fair dealing does not require an individual inquiry into the materiality for each plaintiff franchisee,[57] making it easier for franchisees to obtain certifications of class actions.

In *Machias v. Mr. Submarine Ltd*.[58] the Ontario Superior Court of Justice found that the franchisor breached its duty of good faith and fair dealing when it engaged in a pattern of "selective and inaccurate disclosure [creating] a grossly misleading picture of the history and financial viability of the franchise,"[59] and when it made "serious written and oral pre-contractual, as well as post contractual misrepresentations with respect to both history and financial issues."[60] The franchisor was under a clear obligation to advise the franchisee of the history of the franchise and the failure of several franchise locations[61] to allow the franchisee "to consider the proposed investment in light of the facts."[62] The franchisor was also under a duty to provide accurate financial information. The franchisee requested financial statements. The requested information was readily available but was not provided. Instead, the franchisee was provided with a pro forma financial statement, which underestimated the actual expenses of the franchise. Further, the franchisee was warned not to contact the existing operators, as the franchisor suggested that they would try to undermine the deal by disclosing to the franchisee the truth about the financial difficulties of the franchise.[63] As well, the franchisor took advantage of its position to inflate the purchase price. After the franchise opened, the franchisor failed to fulfil its obligations to complete the renovations in a timely manner, to provide bilingual menus and promotional material, and to support the new franchise.[64]

Similarly, in *8150184 Canada Corp. v Rotisseries Mom's Express Ltd*.,[65] the Ontario Superior Court of Justice found that the franchisors breached their duty of fair dealing in the performance of the franchise agreement. The representations with respect to the anticipated cost of opening the operation, the size of the restaurant, the ability to sell the operation in six months for a certain amount and failure to provide adequate architectural drawings, menus, signage and training evinced bad faith and failure to act in a commercially reasonable manner. The franchisors

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[54] *1250264 Ontario Inc. v. Pet Valu Canada Inc*., 2015 CarswellOnt 39, 2015 ONSC 29, 249 A.C.W.S. (3d) 270 [***Pet Valu 2015***]
[55] *2 for 1 Subs Ltd. v. Ventresca*, 2006 CarswellOnt 2361, [2006] O.J. No. 1528, 147 A.C.W.S. (3d) 404, 17 B.L.R. (4th) 179, 48 C.P.R. (4th) 311 [***2 for 1 Subs***]
[56] *Supra, Machias*
[57] *Trillium Motor World Ltd. v. General Motors of Canada Ltd*., 2012 CarswellOnt 4166, 2012 ONSC 463, [2012] O.J. No. 1578, 214 A.C.W.S. (3d) 348, 37 C.P.C. (7th) 19, 92 C.C.L.T. (3d) 193 affm'g 2011 CarswellOnt 1286, 2011 ONSC 1300, [2011] O.J. No. 889, 198 A.C.W.S. (3d) 910, 7 C.P.C. (7th) 388, 82 C.C.L.T. (3d) 292 [***Trillium***]
[58] *Supra, Machias*
[59] *Ibid*, para 186
[60] *Ibid*, para 183
[61] *Ibid* at para 122
[62] *Ibid* at para
[63] *Ibid*, para 184
[64] *Ibid*, para 185
[65] 2014 CarswellOnt 1426, 2014 ONSC 815, [2014] O.J. No. 587, 237 A.C.W.S. (3d) 364, 27 B.L.R. (5th) 141; additional reasons at 2014 CarswellOnt 3287, 2014 ONSC 1602, 238 A.C.W.S. (3d) 573

repeatedly failed to provide adequate services, support, guidance and training and misrepresented the expansion of the franchise system with the addition of six franchises. The Ontario Superior Court of Justice was also satisfied that the franchisors knowingly and willingly breached their contractual obligations and their duty of fair dealing.

In the case of non-disclosure on part of a franchisee, in *2 for 1 Subs Ltd. v. Ventresca*,[66] the Ontario Superior Court of Justice held that a franchisee's refusal to provide the franchisor with requested financial information and the franchisee's sale of the franchised business to a third party within the period that the franchisor could exercise its right of refusal constituted not only breaches of the franchise agreement, but also breaches of the duty of fair dealing under section 3 of the Ontario Act.[67]

In *Shelanu Inc. v Print Three Franchising Corp*.[68] the Ontario Court of Appeal affirmed the Ontario Superior Court of Justice's finding that the franchisor breached its duty of good faith towards the franchisee. In one respect, the franchisor unilaterally changed the terms and conditions upon which the franchisees agreed to participate in an Air Miles program, and in so doing, breached the representations made and acted upon by the franchisee. The franchise agreement provided that franchisees were to pay an annual three per cent advertising fee, which was suspended. Subsequently, the franchisor wanted to reintroduce the advertising fee and represented that the entire three percent advertising fee was required to qualify for the Air Miles program.[69] In order to get over the franchisees' opposition to the Air Miles program, the franchisor represented to the franchisees that any Air Miles purchased under the program and not distributed by the franchisees to their customers, could be used by the franchisees for their own purposes including personal travel.[70] Shortly after the Air Miles program began, however, the franchisor changed these arrangements and directed that all undistributed Air Miles for each outlet could only be used with its approval. The unused Air Miles were placed in accounts in the personal names of certain of its employees. The Ontario Court of Appeal found that such "unilateral change was a clear breach of the representations made to the franchisees" and constituted a breach of the duty of good faith.[71]

In *Spina v Shoppers Drug Mart Inc.*,[72] the plaintiff franchisees, who were drug store pharmacists, brought a claim that asserted, among other things, that the franchisor breached the common law duty of good faith and statutory duties of fair dealing under section 3 of the Ontario Act. The Ontario Superior Court of Justice certified a class action for the following: (1) failing to account for advantages of bulk purchasing; (2) failing to account for and remit professional allowances collected on behalf of the franchisees; (3) overcharging associates under the guise of cost recovery; (4) instituting systemic and punitive budgeting practices against franchisees; and (5)

[66] *Supra*, *2 for 1 Subs*
[67] *Ibid* at paras 30, 31, 82
[68] *Supra*, *Shelanu*
[69] *Ibid* at para 90
[70] *Ibid* at para 91
[71] *Ibid*, para 92
[72] *Supra*, *Spina*

imposing unfair inventory policies, including requiring franchisees to accept excess inventory and preventing franchisees from making inventory adjustment claims.[73]

In *Trillium Motor World Ltd. v. General Motors of Canada Ltd*.[74] the Ontario Superior Court of Justice dismissed an appeal by the franchisor to an order certifying the action as a class proceeding. The franchisor appealed only in respect to some of the common issues certified at first instance: (1) whether it owed a duty to disclose material facts to its franchisees with respect to its restructuring at the time of soliciting exit packages, and (2) if so, whether it failed to disclose material facts and thus breached its duty of good faith or unlawfully interfered with the franchisees' right to associate. The Ontario Superior Court of Justice held that the franchisor owed a duty to disclose these material facts and rejected the franchisor's submissions that the duty of good faith and fair dealing required an individual inquiry into materiality for each dealership. The Ontario Superior Court of Justice's rejection was based upon the parameters established in the statement of claim, the temporal boundary of the agreement, and that the common law test for materiality is objective.[75]

In *1250264 Ontario Inc. v Pet Valu Canada Inc.*,[76] the Ontario Superior Court of Justice decided five of seven common issues certified in a class proceeding brought by about 150 former franchisees against the franchisor. One of the issues was whether the good faith and fair dealing language in section 3 of the Ontario Act can be used to compel ongoing disclosure, specifically of information about volume rebates, such as the amounts received and the criteria for distribution. The Ontario Superior Court of Justice confirmed that section 3 of the Ontario Act "does not impose a continuous post-sale disclosure regime and there is no obligation on the part of the franchisor to provide ongoing disclosure, at least not for routine or non-material information."[77] The franchisees then argued that the franchisor failed to disclose material financial information that went to the very root of the franchise agreement and moved to amend the common issues to add a new common issue about purchasing power.

In its subsequent ruling in *1250264 Ontario Inc. v Pet Valu Canada*,[78] while the Ontario Superior Court of Justice dismissed the franchisee's motion to amend its statement of claim to add a new common issue, it proceeded to decide the question of whether a franchisor has a duty to truthfully disclose to franchisees whether it possessed significant purchasing power and whether it received significant volume discounts offered by suppliers. In its disclosure document and franchise agreement, the franchisor represented that it had significant purchasing power and was able to take advantage of volume discounts offered by suppliers and that this will translate into a meaningful pricing benefit to the franchisees. However, the franchisor failed to advise its franchisees that this was actually not the case. The fact that volume discounts were virtually non-existent was a material fact as defined in the Ontario Act.[79] The Ontario Superior Court of Justice held that by hiding or refusing to disclose information about the virtual non-existence of volume discounts, information that was material to matters ultimately contracted for in the

[73] 2012 CarswellOnt 12295, 2012 ONSC 5563, 223 A.C.W.S. (3d) 20 at para 52
[74] *Supra*, *Trillium*
[75] *Ibid* at paras 15-17
[76] *Supra*, *Pet Valu 2014*
[77] *Ibid* at para 34
[78] *Supra*, *Pet Valu 2015*
[79] *Ibid* at para 48

franchise agreement and "information that was clearly related to the performance of the agreement," the franchisor did not deal fairly or in good faith with its franchisees.[80]

3. Renewal of the Franchise Agreement

The duty of fair dealing does not go so far as to compel a party to renew an expiring relationship when it is not commercially reasonable to do so, and where there is no express right of renewal contained in the franchise agreement.[81] However, where a franchise agreement or sublease provides for a right of renewal, a franchisor cannot deliberately withhold information so as to prevent a franchisee from exercising its right of renewal.[82] Nor can a franchisor rely on a personal dispute with a franchisee as sufficient cause to deny a right of renewal. The duty of good faith requires a franchisor to give consideration to the interests of the franchisee in the exercise of its discretion. A decision by a franchisor not to renew for alleged good cause is an exercise of such discretion.

In *TDL Group Limited v. 1060284 Ontario Limited*,[83] the franchisor had refused to renew a franchise license agreement and sublease agreement it had with one of its franchisees. Those agreements were due to expire imminently with no provision for renewal. The franchisee brought an injunction to restrain the franchisor from taking any steps to evict the franchisee or from interfering with the ordinary course of its business or terminating its franchise license or sublease. The Ontario Superior Court of Justice refused to grant a mandatory injunction stating that the fact that the franchisor and franchisee "have been in a long-term profitable relationship does not convert into an obligation on the franchisor to renew the agreements. When a party enters into an agreement which contains no right to renew or option to renew on ascertainable terms there will be no renewal enforceable by a court."[84]

Similarly, in *530888 Ontario Ltd. v. Sobeys Inc*.,[85] a franchisee moved to restrain the franchisor from terminating the tenancy of the franchisee and to have the franchisor maintain, against its will, a sublease which was to expire in accordance with its terms the day after the hearing of the motion and with it that had no option to renew. The Ontario Superior Court of Justice adopted the reasoning in *TDL Group Limited v. 1060284 Ontario Limited* and dismissed the franchisee's motion. The Ontario Superior Court of Justice held that the franchisor had not breached its duty of fair dealing imposed by the Ontario Act as such duty applies to performance and enforcement of existing agreements and "does not compel one party to renew an expiring relationship when it considers it to be commercially unreasonable."[86]

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[80] *Ibid* at para 56

[81] *530888 Ontario Ltd. v. Sobeys Inc.*, 2001 CarswellOnt 600, [2001] O.J. No. 723, 103 A.C.W.S. (3d) 1037, 12 B.L.R. (3d) 267 at paras 10, 21, 22; *TDL Group Ltd. v. 1060284 Ontario Ltd.*, 2000 CarswellOnt 1210, [2000] O.J. No. 1239, [2000] O.T.C. 238, 6 B.L.R. (3d) 54, 96 A.C.W.S. (3d) 382 at para 21; *Empress Towers Ltd. v. Bank of Nova Scotia* (1990), 50 B.C.L.R. (2d) 126, 73 D.L.R. (4th) 400 (B.C. C.A.) at 403).

[82] *Salah v. Timothy's Coffees of the World Inc*., 2010 CarswellOnt 7643, 2010 ONCA 673, [2010] O.J. No. 4336, 193 A.C.W.S. (3d) 1151, 268 O.A.C. 279, 74 B.L.R. (4th) 161 at paras 20, 22 [***Salah***]

[83] 2000 CarswellOnt 1210, [2000] O.J. No. 1239, [2000] O.T.C. 238, 6 B.L.R. (3d) 54, 96 A.C.W.S. (3d) 382

[84] *Ibid* at paras 16-17

[85] 2001 CarswellOnt 600, [2001] O.J. No. 723, 103 A.C.W.S. (3d) 1037, 12 B.L.R. (3d) 267

[86] *Ibid* at paras 10, 21, 22

In *Sultani v. Blenz The Canadian Coffee Co.*,[87] the franchisee claimed specific performance against the franchisor for renewal of a franchise agreement or, alternatively, for damages for misrepresentation that the franchisee had a right of renewal on the franchise agreement and for breach of duty of good faith and fair dealing. Both the franchise agreement and sublease were in writing and there was no express right of renewal in the franchise agreement or sublease. The British Columbia Supreme Court found that any pre-contractual representation not included in the written agreements was inadmissible under the parol evidence rule because it was inconsistent with the written agreement. As such, the representation alleged, that there was a right to renew for ten years, would not be an enforceable term of the contract without more.[88] The franchisee's claim was dismissed.

Robert Moore Pharmacy Ltd. v. Shoppers Drug Mart Inc.[89] confirms that the implied covenant of fair dealing provided for in section 3 of the Ontario Act 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 agreement provided for an original one-year term and the potential for two one-year renewal terms. The renewal terms were to come into existence automatically if neither party took steps to terminate the agreement during its existence by giving notice as required by the agreement. Neither the franchisor nor the franchisee took any such steps and the agreement was thus extended. The franchise agreement also provided that should it expire by effluxion of time, the franchisor shall have the right to assume control. In denying the franchisee's motion for an injunction requiring the franchisor to reinstate the franchisee, the Ontario Superior Court of Justice stated that:

> Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into.[90]

In *Salah v Timothy's Coffees of the World*,[91] the Ontario Court of Appeal affirmed the Superior Court of Justice's finding that the franchisor breached the franchise agreement by denying the franchisee's conditional right of renewal of which the franchisee was entitled. In the fall of 2001, the franchisee entered into a franchise agreement with the franchisor to operate a store in a shopping mall. Concurrent with the execution of the franchise agreement, the individual franchisee assigned the agreement, the sublease, and the general security agreement to his newly incorporated corporation. This was permitted by the franchisor but with the condition expressed

[87] 2005 CarswellBC 877, 2005 BCSC 571, [2005] B.C.W.L.D. 2971, [2005] B.C.W.L.D. 3022, [2005] B.C.J. No. 846, 138 A.C.W.S. (3d) 653, 3 B.L.R. (4th) 93 affd 2005 CarswellBC 877, 2005 BCSC 571, [2005] B.C.W.L.D. 2971, [2005] B.C.W.L.D. 3022, [2005] B.C.J. No. 846, 138 A.C.W.S. (3d) 653, 3 B.L.R. (4th) 93
[88] *Ibid* at para 27
[89] 2012 CarswellOnt 16810, 2012 ONSC 7351, [2012] O.J. No. 6172, 224 A.C.W.S. (3d) 186
[90] *Ibid* at para 12
[91] *Supra*, *Salah*

in the assignment and guarantee that the franchisee remained personally liable for all franchisee obligations under the franchise agreement. The franchisor was a lessee and the franchisee was a sublessee under a head lease for a location on the third floor.

The franchisee was concerned about the short term of the lease and the franchise agreement. In response the franchisor proposed the inclusion of a schedule in the franchise agreement which provided that in the event that the franchisor entered into a new head lease with the landlord, the franchisee's franchise agreement would be renewed with a new sublease. In the event that the new head lease was to be for a period of less than five years, there would be no additional franchise fee payable. If the new head lease was for a period of more than five years, the franchisee would be required to pay an amount equal to 50% of the then current franchise fee.

Prior to the expiry date of the head lease on the third floor, the franchisor entered into a new lease on the second floor and signed an agreement with a new franchisee for that location. The franchisor then advised the franchisee that his franchise agreement would come to an end at the end of the term. The franchisor submitted that any right of renewal provided by the schedule only concerned the original location on the third floor of the shopping centre and since the franchisor could not renew its head lease on the third floor, the provisions of the schedule were inoperative. The franchisor also argued that because the franchisee had assigned his franchisee rights to the corporate franchisee, only that corporation could bring a claim against the franchisor.

The trial judge held (1) that both the individual and corporation were franchisees and could be treated as one entity for the purpose of enforcing rights or seeking remedies; (2) the proper interpretation of the schedule was that it related to the shopping mall in general and was not limited to the existing third floor location; (3) the franchisor breached the franchise agreement by failing to observe the terms of the schedule with respect to the new head lease on the second floor of the shopping mall; (4) the franchisor breached a duty of good faith, contrary to section 3 of the Ontario Act; and (5) the breach of the duty of good faith was an independent actionable wrong.[92]

On the first point, the Ontario Court of Appeal agreed that the franchisor maintained a relationship with both the individual franchisee and its assignee corporation. It never intended to accept the corporation in the place of the individual for all purposes. It was also the business model of the franchisor, as reflected in its franchise agreement, to treat a corporate franchisee and its personal owner as one and the same. Finally, the *de facto* relationship under the franchise agreement was between the franchisor and the individual franchisee. The Ontario Court of Appeal further held that "it would be incongruous…[and] unfair to the franchisee, if he and his corporation were treated as one entity for the purposes of franchise liabilities, but were treated as separate entities when the question of enforcing franchisee rights under the franchise agreement is at issue."[93]

On the second point, the only agreement that specifically referred to the third floor was the head lease between the shopping mall and the franchisor. The Ontario Court of Appeal held that "to

[92] *Ibid*, para 7
[93] *Ibid*, paras 11-13

the extent that any discrepancy exists between the head lease and the franchise agreement…the franchise agreement should be interpreted *contra proferentem*."[94]

On the issue of good faith, when the franchisor could no longer renew the head lease of the third floor location and was negotiating a new lease on the second floor, "the evidence showed that the franchisor deliberately kept the franchisee in the dark about its intentions" and "actively sought to keep the franchisee from finding out what was going on with the lease" and that the franchisor "deliberately withheld critical information and did not return calls," all of which supported the conclusion that there was a breach of the duty of good faith that franchisors owe franchisees under section 3 of the Ontario Act.[95]

In *760437 Alberta Ltd. v Fabutan Corp.*,[96] a franchisee brought an action for relief in connection with the refusal by the franchisor to renew its franchise agreement. The principals of the corporate parties were siblings. The franchisor held a contest amongst its franchisees to see who could achieve the highest number of sales within a defined period of time. At the end of the contest, the franchisor subtly alleged that the franchisee had cheated. The franchisee demanded a retraction of that remark but was not satisfied with the statement released by the franchisor. The personal and business relationships between the franchisor and franchisee deteriorated. The franchisee threatened to recall a loan it had made to the franchisor, and the franchisor threatened not to renew franchise agreement. With regards to the renewal of its franchise agreement, the franchisee took the position that the reasons for termination were insufficient to support non-renewal. The franchisor initially equivocated, but later confirmed the non-renewal decision. The franchisor equivocated again and offered renewal with the posting of a bond, which the franchisee refused to provide. The franchisor issued a notice of termination to the franchisee.

Under the franchise agreement, the franchisee had a right of renewal where the agreement had not been terminated and it was not in default. The Alberta Court of Queen's Bench held that where the franchisee met the relevant conditions for the right to renew, a personal dispute between siblings is not sufficient cause to deny that right. The franchise agreement stated that the agreement shall not be terminated except for good cause. Although the franchisor argued other grounds were sufficient to terminate the franchise agreement, the Alberta Court of Queen's Bench found those grounds to be unsubstantiated on the evidence and that the parties' personal dispute was the reason for termination. A franchisor "may not exercise its discretion not to renew out of vindictiveness, or to gain a bargaining advantage over the franchisee."[97] As the Alberta Court of Queen's Bench found that the reason for refusing to renew was their personal dispute, the decision by the franchisor was vindictive.[98] The franchisor made no reasonable offer of compensation and conducted the renewal negotiations inappropriately and in bad faith.

The Alberta Court of Queen's Bench found that the franchisor breached its obligation of good faith and stated that:

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[94] *Ibid*, para 18
[95] *Ibid*, paras 20, 22
[96] 2012 CarswellAlta 774, 2012 ABQB 266, [2012] A.W.L.D. 3134, 1 B.L.R. (5th) 302, 215 A.C.W.S. (3d) 632
[97] *Ibid* at para 96
[98] *Ibid* at paras 95-96

> Examples of bad faith in this case include the circumstances of the initial denial of the renewal, the flip-flopping of decisions on the renewal and the variety of largely unsubstantiated reasons for non-renewal, the attachment of onerous terms of renewal not imposed on other franchisees in the absence of reasonable or rationale grounds, the failure to provide…a proposed form of standard agreement until well into the process and then only when accompanied by onerous conditions, the imposition of unreasonable time periods for review of documentation, the unjustified linking of the renewal to the dividend and buy-out issue…and the misrepresentation of [the franchisee's] position to other franchisees.[99]

initially denying the franchisee's right of renewal, flip-flopping decisions on the renewal, providing largely unsubstantiated reasons for non-renewal, attaching onerous terms of renewal, and imposing unreasonable time periods.[100] The Alberta Court of Queen's Bench further held that the alleged inappropriate conduct of the franchisee, including making damaging comments to employees and other franchisees about the brand, did not disentitle it to specific performance of its right to renew. In the result, the Alberta Court of Queen's Bench directed an offer of renewal for 10 years upon the terms and condition of the standard form franchise agreement, at standard royalties, with no requirement of additional security as a condition of renewal. The Alberta Court of Queen's Bench held that specific performance was possible because the business relationship could continue despite the personal dispute.[101]

4. Termination of the Franchise Agreement

The duty of fair dealing and good faith restricts a franchisor's ability to exercise termination rights in an unfair, unreasonable or arbitrary manner.

In *Elliott v. Trane Canada Inc.*,[102] the franchisee claimed damages against the franchisor for wrongful termination of the franchise agreement. The New Brunswick Court of Queen's Bench had to determine whether the franchise agreement, which may be terminated by either party within thirty days' written notice, created a right to terminate with cause or without cause. The New Brunswick Court of Queen's Bench held that the franchisor, in exercising its right of termination, was subject to the duty of good faith, but nonetheless was permitted to terminate the franchise agreement without cause.[103] The termination provision clearly required that 30 days written notice of termination. The New Brunswick Court of Queen's Bench held that absent ambiguity, there is no implied requirement for cause.[104]

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[99] *Ibid* at para 97
[100] *Ibid* at para 97
[101] *Ibid* at para 101
[102] 2008 CarswellNB 105, 2008 NBBR 79, 2008 NBQB 79, [2008] N.B.J. No. 68, 164 A.C.W.S. (3d) 261, 333 N.B.R. (2d) 1, 855 A.P.R. 1
[103] *Ibid* at paras 133, 146-147
[104] *Ibid* at paras 153-155

In *Shelanu Inc. v Print Three Franchising Corp*.[105] the franchisor purported to deny the franchisee's request to terminate one of its franchises and to combine its operations. The franchisee informed the franchisor that it considered the franchise agreement terminated, but continued to operate the franchise and to pay royalties until the franchise ended according to the terms of the franchise agreement. The franchisee brought an action for a declaration that the franchise agreement was terminated as of the date of the franchisee's notice of termination, for repayment of the royalties paid subsequent to that date, and for the payment of overdue royalty rebates. The franchisor brought a counterclaim for damages for breach of contract and for an injunction requiring the franchisee to comply with the termination provisions of the franchise agreement. The Ontario Court of Appeal affirmed the Ontario Superior Court of Justice's finding that the franchisor's attempts to rescind the franchise agreement were not only a breach of that agreement but, in the circumstances, evinced a lack of good faith dealing by the franchisor.

In *1117304 Ontario Inc. v. Cara Operations Ltd*.[106] the Ontario Superior Court of Justice allowed an action brought by a franchisee for breach of good faith on part of the franchisor, and the counterclaim brought by the franchisor for payment of royalties owing. The franchisee operated a fast-food restaurant and had a separate license for a chicken restaurant. Some money was lost due to missing cash or voids, which the franchisee attributed to the manager. The manager made a complaint to the franchisor which resulted in an investigation of the franchise. The business encountered financial difficulties. At the request of the franchisee, the franchisor reduced certain amounts owing to it. The franchisee was unable to pay these reduced amounts. The franchisor ceased supplying product for the chicken restaurant license, effectively terminating the license. The franchisor offered a certain amount for the chicken license, on the understanding the amount would pay outstanding debts. The business failed and was taken over by the franchisor as a corporate store.

On the issue of good faith, the Ontario Superior Court of Justice decided the following:

- The franchisor acted in bad faith by ceasing to provide product and making an arbitrary offer to buy the license, which was operative for another two years. The franchisee was left without the use of the equipment.[107]

- The franchisor did not breach the duty of good faith in selecting the site. The franchisor had misgivings about the site which it made clear to the franchisee. The franchisor did not intend to choose a site likely to fail.[108]

- The financial projections shared with the franchisee were not a breach of the duty of good faith. No guarantee was contained in the projections, and the relevant documentation included a disclaimer. Any deficiencies in the projection regarding depreciation and payment of the loan balance were issues the franchisee should have taken up with his

[105] 2003 CarswellOnt 2038, [2003] O.J. No. 1919, 123 A.C.W.S. (3d) 267, 172 O.A.C. 78, 226 D.L.R. (4th) 577, 38 B.L.R. (3d) 42, 64 O.R. (3d) 533
[106] *Supra*, *Cara Operations*
[107] *Ibid* at para 218
[108] *Ibid* at para 86

accountant. The franchisee did not ask for changes to the licensing agreements. The franchisor did not have a duty to point out the financial risks in the projections.[109]

- The franchisor did not have a duty to advocate for the franchisee in a dispute with the landlord regarding the calculation of rent.[110] The franchisor did not breach its duty of good faith in providing training.[111] The loss of money and problems with management's bookkeeping were not due to the failure of the franchisor's training.

- The franchisor did not breach its duty by conducting an investigation after the manager's complaints, although the franchisor should not have dealt with the manager directly and should have involved the franchisee to a greater extent. The situation was resolved, and did not lead to losses or a permanent stigma on the franchisee as a bad operator. The inspections of the store's operations were fair, and once the issues at hand were addressed no lingering stigma existed which affected the relationship or caused any loss.[112]

- The franchisor had no obligation to provide the franchisee with financial assistance. The franchisor did not breach the duty of good faith by opening another store close by but outside of the protected area set out in the agreement.[113]

5. Rebates

One of the potential benefits for franchisees in purchasing and operating a business as a franchise is the volume purchasing power that can come with a collective of similar businesses all purchasing from the same suppliers. Most often, the franchisor requires in its franchise agreements that the franchisees purchase their inventories and supplies only from suppliers authorized by the franchisor. If this were not the case, the franchisor could not negotiate more favourable pricing from the suppliers. However, this is also fertile ground for abuse where the franchisor negotiates rebates or other benefits for itself from the suppliers, which simply gets reflected in the prices charged to the franchisees.

Franchisors need to be mindful of their behavior in light of their duty of fair dealing and good faith. However, good faith obligations do not override clear language in the franchise agreement entitling the franchisor to retain rebates and other benefits for its account.

In *Shelanu Inc. v Print Three Franchising Corp*.[114] the franchisor failed to make prompt payment of several royalty rebates and refused to pay a royalty rebate for the fourth quarter of a certain year. The Ontario Court of Appeal held that "denial of payment under an agreement should not be made in order to gain leverage or bargaining advantage in a dispute with the other party or out of vindictiveness."[115] In this case the evidence indicated that the franchisor's refusal to pay the franchisee royalty rebate pursuant to the oral agreement was linked to the franchisor's anger

[109] *Ibid* at para 100-103
[110] *Ibid* at para 122
[111] *Ibid* at paras 146-147
[112] *Ibid* at para 186
[113] *Ibid* at para 201
[114] *Supra*, *Shelanu*
[115] *Ibid* at para 76

concerning the franchisee's position respecting a points program.[116] The Ontario Court of Appeal held that:

> the fact that the royalty rebates were ultimately paid does not mean that the franchisor did not breach its obligations towards the franchisee. The duty of good faith comprises a time component which requires the party under a duty of good faith to respond promptly to a request from the other party and to make a decision within a reasonable time of receiving that request. Parties under a duty of good faith also have an obligation to make payment of any amounts that are clearly owed to the other party in a timely manner.[117]

In *578115 Ontario Inc. v Sears Canada Inc.*,[118] the Ontario Superior Court of Justice certified a class action brought by franchisees against a franchisor. The franchisees operated under franchise agreements which allowed independent retailers to operate under the Sears banner, required the franchisees to purchase floor coverings from suppliers approved by Sears, and the franchisees were to receive a rebate of 4% of the cost of these purchases. The franchisees claimed that unbeknownst to them, the franchisor secretly received rebates from these suppliers, which it kept for itself and did not pass on to the franchisees. The franchisees argued that this was contrary to the franchisor's duty of good faith and fair dealing under the Ontario Act and at common law. The franchisees also claimed that the rebates were secret commissions prohibited by criminal legislation. The statement of claim asserted causes of action in breach of contract, breach of a duty of good faith, unjust enrichment, and constructive trust. The pleading of breach of contract alleged that it was an implied term of the franchise agreements that the franchisor would disclose to franchisees any commissions, rebates, or other beneficial payments received by them. It plead that the franchisor owed the franchisees a duty of fair dealing and good faith, relying in part on the statutory duty.

6. Competition and Protecting the Franchise Brand

Where franchise agreements provide the franchisor with the discretion to operate other franchise systems within close proximity to existing locations, such discretion must be exercised in good faith. Franchisors cannot establish systems that compete directly with the system subject of an existing franchise agreement or establish locations in similar form that compete within the territory of an existing franchisee.

Further, when a franchise system is faced with increased competition, franchisors cannot sit back and take no steps to protect their franchise system where, either expressly or by implication, their franchise agreements impose upon them an obligation to protect and enhance their brand.[119]

In *Shelanu Inc. v Print Three Franchising Corp.*[120] the franchisor set up another business that was smaller in order to target individuals and small businesses. The cost to purchase these

[116] *Ibid*, paras 72, 76
[117] *Ibid*, para 78
[118] 2010 CarswellOnt 7016, 2010 ONSC 4571, [2010] O.J. No. 3921, 193 A.C.W.S. (3d) 1078, 325 D.L.R. (4th) 343
[119] *Dunkin' Brands Canada Ltd. c. Bertico inc.*, 2015 CarswellQue 3066, 2015 QCCA 624, J.E. 2015-692, EYB 2015-250660
[120] *Supra*, *Shelanu*

franchises was lower than the cost to purchase the existing franchise and some financing was also offered to potential franchisees.[121] The Ontario Superior Court of Justice held that the franchisor's establishment of a competing business "not only would but did take work and customers from existing franchises."[122] The Ontario Superior Court of Justice also held that "the establishment of such an enterprise by the very person who owned and controlled the franchisor was fundamentally at odds with the franchisor's obligations, including the obligation to deal in good faith, to its franchisees."[123]

However, the Court of Appeal did not uphold the trial judge's conclusions in this respect for the following reasons:

> (1) the different nature of the business engaged in by [the new business]; (2) [the franchisee's] delay in complaining about the establishment of that business; (3) the lack of evidence before the trial judge as to [the franchisee's] consequential loss of income; (4) the trial judge's findings that there had been no misrepresentation concerning what [the franchisor] was to provide in exchange for royalty payments and that the [franchisor] had done the minimum required to discharge those obligations; and (5) the trial judge's finding that the decline in [the franchises] was primarily due to prevailing economic conditions.[124]

In *Metro-Pacific Cellular Inc. v. Rogers Cantel Inc*.[125] a dealer entered into an agreement to be a non-exclusive dealer in a particular territorial area to market subscriptions and to sell, lease, install and provide service for cellular telephone equipment for use in connection with the franchise system. The franchisor proposed to market subscriptions within the franchisee's territory under a different name. Under the agreement, the franchisor was required to provide all customer sales leads received by the franchisor with a billing address located in the territory to the franchisee. The franchisee complained about the franchisor competing directly with it. The franchisor attempted to sell additional services to the franchisee's customers; attempted to have the franchisee sign a new form of agreement (in which the franchisor did not need to forward sales leads to the franchisee) and developed two plans for direct sales campaigns to bypass the franchisee and, in effect, compete with it. It was when the franchisor sought to develop a marketing campaign aimed at business customers that the franchisee sought an injunction. The injunction was granted as the British Columbia Supreme Court found that the franchisor was proposing to compete with the franchisee in its territory and the loss of business and goodwill could not be adequately determined in damages.[126]

In *1291079 Ontario Limited v Sears Canada Inc*.,[127] the Ontario Superior Court of Justice certified a class action by dealers of a national home furnishings company (the "putative franchisor") pursuant to a standard dealer agreement. The dealers alleged, among other things, that the putative franchisor owed the proposed class members a duty of fair dealing in the

[121] *Ibid*, para 99
[122] *Ibid* at para 72
[123] *Ibid*, para 72
[124] *Ibid* at para 107
[125] 1994 CarswellBC 2669, [1995] B.C.W.L.D. 832, 57 C.P.R. (3d) 538
[126] *Ibid* at paras 35 and 46
[127] 2014 ONSC 5190, 245 A.C.W.S. (3d) 523

performance and enforcement of the dealer agreement under section 3 of the Act, which the putative franchisor breached. One of the issues was whether the putative franchisor, by engaging in direct sales, through mail order catalogues and online shopping, within a dealer's local market area, was actively competing and thereby failing to take into account the dealers' reasonable commercial interests or comply with the duties of good faith and fair dealing. Since the dealer agreement appears to provide the putative franchisor with discretion to conduct these sales, the matter will turn on whether that discretion was exercised by the putative franchisor in compliance with the duty of good faith. The issue concerned the right of the putative franchisor to set the compensation that it will pay to its dealers for their sales of goods. The dealers alleged that the putative franchisor breached its duty of good faith by using its discretionary powers under the dealer agreement to make it virtually impossible for a dealer to realize a profit unless it achieves unattainable revenues, and that the putative franchisor realizes high profit margins on sales made through the dealers while imposing high costs onto the dealers. The Ontario Superior Court of Justice certified this as a common issue to the extent that it involves an examination of how the putative franchisor exercised its discretion to set compensation. The court will need to determine whether in fact the duty of good faith can provide franchisees with a substantive right to be economically viable in a competitive market.

In *Dunkin' Brands Canada Ltd*.,[128] the Quebec Court of Appeal upheld the trial court decision which held the franchisor liable for failing to protect its brand, but reduced the damages awarded to franchisees. The Quebec Court of Appeal rejected the franchisor's argument that the trial judge had imposed a new unintended obligation to protect and enhance the brand, outperform the competition and maintain market share. It concluded that the trial decision applied, rather than extended, the franchisor's duty of good faith.[129] The Quebec Court of Appeal made the following conclusions:

Express Terms of the Agreement: Explicit terms in the franchise agreements obliging the franchisor "to protect and enhance" its brand was not merely a "hoped-for result" but a binding contractual obligation.[130] While "the franchisor did not guarantee that the reputation of the brand would be enhanced, it undertook to adopt reasonable measures to that end."[131]

Implied Obligations Incidental to the Nature of the Franchise Agreements: The franchisor's "obligations were based not just in the text of the franchise agreements but also on duties that it had implicitly assumed in respect of the whole network of franchisees."[132] The franchise agreements "established a relationship of cooperation and collaboration between the franchisor and its franchisees, reflecting both common and divergent interests, over a long period of time."[133] In other words, "the character of the specific franchise arrangement was an on-going one in respect of a system that the parties agreed to sustain as critical to the success of the brand."[134] Given the role the franchisor assigned to itself in "overseeing the on-going operation of the network" and the uniform system of standards, the Quebec Court of Appeal held that it

[128] 2015 CarswellQue 3066, 2015 QCCA 624, J.E. 2015-692, EYB 2015-250660
[129] *Ibid* at para 76
[130] *Ibid* at para 44
[131] *Ibid* at para 86
[132] *Ibid* at para 59
[133] *Ibid* at para 62
[134] *Ibid* at para 63

was fair to hold that the franchisor had implicitly agreed to undertake reasonable measures to help the franchisees, over the life of the arrangement, to support the brand.[135] This included "a duty to assist them in staving off competition in order to promote the on-going prosperity of the network as an inherent feature of the relational franchise agreement."[136]

Implied Obligation of Good Faith: The Quebec Court of Appeal confirmed that a franchisor's obligation of good faith "is not confined to the circumstances of franchisors that compete unfairly with their franchisees."[137] Rather, a franchisor owes an obligation of good faith and loyalty to its franchisees requiring a franchisor, by reason of "superior know-how and expertise" upon which the franchisees rely, to support individual franchisees and the whole of the network through its on-going assistance and cooperation.[138] This duty is "not on the basis of the duty to perform contracts in good faith but rather on the distinct theory of implied obligations" from the nature of the franchise agreement and equity.[139] The nature of the agreement and equity "provide two distinct normative justifications for this implied obligation of good faith."[140]

Implied Obligations owed by the Franchisor to the Network of Franchisees: The franchisor also had a duty to assist and co-operate that includes an obligation to take reasonable measures to protect them from the new market challenges presented by the entry of an aggressive competitor into the market. Beyond the duty not to take actions that would wrongfully cause them harm, the franchisor assumed, on the basis of this implied duty of good faith a duty to assist and cooperate with the franchisees by taking certain active measures in support of the brand.

The agreements created, through express language and by necessary implication, a duty owed to the franchisees collectively to take reasonable measures to support and enhance the brand. This included the duty to respond with reasonable measures to help the franchisees as a group to meet the market challenges of the moment and to assist the network of franchisees by enforcing the uniform standards of quality and cleanliness it holds out as critical to the success of the franchise. It is up to the franchisor to enforce the authority it has given itself under the franchise agreement. The undertaking to take reasonable measures to protect and enhance the network, owed to the network, can best be thought of as an implicit duty in each contract upon which an individual franchisee can take action in the event of breach.

Continuing to adopt a business as usual approach in the face of a competitive threat is not sufficient to satisfy the franchisor's contractual obligations. The franchisor did not take reasonable measures, in particular, to protect and enhance the brand in the face of the competition. Had the franchisor taken proper measures to protect and enhance the brand and, notwithstanding those efforts, a competitor had encroached on some of the franchisees' market share, the latter would have had no basis for complaint.

[135] *Ibid* at para 64
[136] *Ibid*
[137] *Ibid* at para 69
[138] *Ibid* at para 71
[139] *Ibid* at para 70
[140] *Ibid* at para 71