RELEASE ME: ONTARIO COURT OF APPEAL CLARIFIES WHEN FRANCHISORS CAN ENFORCE RELEASES

Posted on July 11, 2017

Categories: Insights, Publications

The Ontario Court of Appeal's recent decision in *Trillium Motor World Ltd. v. General Motors of Canada Limited*[1] clarifies when franchisors can enforce releases given by franchisees without offending the *Arthur Wishart Act (Franchise Disclosure), 2000*[2] (the "***AWA***"). Section 11 of the *AWA* deems any waiver or release by a franchisee of any of its statutory rights or a franchisor's statutory obligations void. This section generally precludes a franchisor from obtaining a release of a franchisee's claims under the *AWA* except in very limited circumstances. The Court of Appeal's decision in Trillium provides clear guidance on what is required for a franchisor to enforce a release of a franchisee's claims under the *AWA*.

The *Trillium* decision addressed in this bulletin is one of two decisions in the case that were released concurrently by the Ontario Court of Appeal. Both appeals arise out of the Canadian government's bailout of General Motors of Canada ("**GMCL**") and the subsequent class action commenced against GMCL by its former dealers that accepted Wind-Down Agreements ("**WDAs**") to close their franchises during the bailout. In this decision, the Court of Appeal upheld the trial judge's finding that the releases contained in the WDAs were valid and enforceable to the extent they released known claims. The Court also upheld the trial judge's decision to sever from the WDAs the covenant not to sue and to indemnify GMCL if any dealer commenced a class proceeding on the basis these covenants were void and unenforceable.[3]

Background and the Lower Court Decision

In the spring of 2009, GMCL was on the edge of insolvency. Its share of the Canadian auto market was in decline, and the financial crisis of 2008 highlighted structural weaknesses in its dealer network, which had too many dealer points operating in single markets. As part of a bailout agreement with the Canadian government to avoid CCAA proceedings, GMCL was required to restructure and reduce the number of its dealers. GMCL advised 240 of its 705 dealers in Canada that it would not be renewing their dealership contracts, and at the same time offered WDAs those dealers which provided for a series of payments in exchange for a release of all claims against GMCL and the end of the business relationship between the parties. The WDAs included covenants that the dealers would not sue GMCL and an indemnity in favour of GMCL should a dealer sue notwithstanding the WDA. The dealers were required to respond within 6 days and were required to obtain

independent legal advice. 202 of the 240 dealers who were offered the WDAs accepted.

After the payments were made, a class proceeding was commenced on behalf of dealers that had signed the WDAs claiming that the WDAs breached a number of obligations to the dealers under both common law and the *AWA*. GMCL counterclaimed for damages pursuant to the term of the WDAs in which the dealers had covenanted not to sue GMCL and to indemnify GMCL for any class proceedings they brought.

The trial judge dismissed both the dealers' claims and GMCL's counterclaim. The trial judge held that GMCL had acted honestly and fairly, did not breach the dealers' rights under the AWA, and furthermore that the dealers' suit was barred by the releases in the WDAs. However, the trial judge also held that the covenant not to sue and the obligation to indemnify GMCL were void on the basis of public policy and severed them from the WDAs. Our previous bulletin on the GMCL trial decision can be found *here*. Both parties appealed from the trial judge's decisions.

The Court of Appeal Decision

The common issue in the class proceeding was whether the waiver and release in the WDAs was "null, void and unenforceable" regarding the dealers' rights under sections 4 and 11 of the *AWA*, which protect franchisees' rights to associate with each other and restrict the waiver of franchisees' rights and franchisors' obligations.[4]

The dealers challenged the trial judge's decision on the enforceability of the release on four grounds:

1. the trial judge erred by failing to consider the *AWA*'s purpose of protecting franchisees in making his determination;
2. the trial judge construed the common law exception to s.11 of the *AWA* too broadly and that the WDAs did not actually satisfy the test under *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC* ("***Tutor Time***")[5];
3. GMCL had breached its duty of fair dealing with its franchisees due to the way it obtained the WDAs; and
4. the covenant and indemnity were not severable and that as they are void, so too are the WDAs generally.

The Court of Appeal dealt with each ground in turn and merged their discussion of the fourth ground of appeal with its analysis of GMCL's cross-appeal.

1. Trial Judge Considered the Purpose of the *AWA*

The Court of Appeal disagreed with the dealers' arguments regarding the purpose of the *AWA* and the duty of fair dealing. The Court of Appeal noted that the trial judge had expressly recognized the protective, remedial purpose of the *AWA*. The trial judge specifically considered the role of the AWA in mitigating the "power imbalance" between parties to a franchise contract.[6] Nonetheless, the Court of Appeal noted that the dire

financial status of GMCL was also an important part of the factual context considered by the trial judge. On this basis, the trial judge properly found that reducing GMCL's dealer network was a "rational business decision" in the interests of both GMCL, its franchisees and other stakeholders.[7]

2. Court of Appeal Expressly Endorses the Tutor Time Exception to Section 11 of the *AWA*

The Court also rejected the dealers' argument that the exception in *Tutor Time* did not apply, and expressly endorsed that decision in the process. In *Tutor Time*, the motion judge held that section 11 of the *AWA* did not void releases given by franchisees when they received independent legal advice and the releases were used to settle an existing, known claim under the *AWA* or its regulations.

From *Tutor Time*, the *Trillium* Court reasoned that section 11 of the *AWA* does not bar a voluntarily negotiated settlement of existing statutory claims if: (1) it is entered into with the benefit of legal advice; (2) it is in settlement of a dispute; and (3) the settlement relates to existing and known breaches of the *AWA*.

In *Trillium*, the Court of Appeal found that the release contained in the WDAs generally satisfied the above-noted test, as:

1. Each dealer that signed a WDA had received independent legal advice. Notably, the dealers did not challenge the sufficiency of the independent legal advice that they had received;
2. The WDAs were settlements of claims arising from GMCL's decision not to renew those dealers' franchise agreements. The trial judge found that the dealers must have understood that this was their purpose and the Court of Appeal affirmed this finding, noting that a settlement is a "voluntary arrangement that brings a dispute or potential dispute to an end".[8] The Court also emphasized the fact that the WDAs expressly stated that the dealers thereby "absolutely and irrevocably… settle[d]… all claims, demands, complaints… and causes of action"[9]; and
3. The dealers knew that the intent of the WDAs was to terminate the dealership agreements in breach of GMCL's obligations and thus had knowledge of their own claims. This was even found to extend to claims stemming from the procurement of the WDAs themselves, such as the breach of disclosure obligations under the *AWA* that arose from the expedited process of obtaining the WDAs.

3. No Breach of Duty of Fair Dealing

The Court of Appeal also dismissed the dealers' argument that GMCL had breached its duty of fair dealing under section 3 of the *AWA*, noting that the trial judge's finding to the contrary was reasonably open to him and should thus stand. The Court of Appeal also noted, in any event, that whether the release contained in the WDAs was contrary to GMCL's duty of fair dealing was not certified as a common issue.

4. Non-Suit and Indemnification Covenants Void, But Severable

Lastly, the Court of Appeal addressed GMCL's cross-appeal together with the dealers' final ground of appeal. The issue on the counterclaim was whether the dealers had breached the covenant not to sue and indemnity clause of the WDAs by commencing the class action, or failing to opt out of the class action.

GMCL challenged the trial judge's holding on the invalidity and severability of the WDAs' covenant and indemnity clauses on the grounds that the settlement agreement would be impossible to enforce without these mechanisms. GMCL further argued that the trial judge's decision led to an absurd outcome in which individual dealers suing GMCL would have to indemnify GMCL, but would have no obligation to do so as participants in a class proceeding.

The Court of Appeal rejected these arguments, and held that such an outcome was in fact consistent with costs awards under the *Class Proceedings Act, 1992*[10], whereby class members are only responsible for the costs of their own claims except when they are the representative party. GMCL's damages claim was accordingly contrary to express legislative policy and as such, the trial judge made no error in invalidating these covenants.

As to the sub-issue of severability, the dealers argued that the covenant and indemnity clauses were not severable and thus the entirety of the WDAs should be void. Following the Court of Appeal's decision in *2176693 Ontario Ltd. v. Cora Franchise Group Inc.*[11], the Court considered three factors affecting the severability of provisions in the franchise context: (1) whether the purpose or policy of section 11 of the *AWA* is undermined by severance; (2) the relative bargaining positions of parties and their conduct; and (3) the potential of a franchisee enjoying an unjustified windfall.

The Court of Appeal noted that the trial judge in this case favoured the public policy of giving effect to the WDAs as settlements and that he found that GMCL had acted fairly and honestly. On these grounds, the Court of Appeal found no reason to intervene with the trial judge's decision, and noted: a) the WDAs' releases addressed known and existing claims; b) the dealers who signed the WDAs were enriched by doing so; and c) the dealers knew that GMCL was relying on their decisions with regards to whether to enter a *CCAA* proceeding.

Key Takeaways

The Court of Appeal's decision in this case offers clear guidance for franchisors seeking commercially reasonable releases upon settlement of a dispute with franchisees.

First, releases and waivers can be effective in disclaiming franchisees' rights and claims under the *AWA*, but franchisors must insist that their franchisees obtain independent legal advice and structure releases as settlements of current and recognizable claims. They cannot be used proactively, to protect the franchisor

against potential future claims.

Second, while such waivers and releases may be able to protect franchisors against certain class action claims, they will not allow a franchisor to seek damages or indemnification to undermine such claims in the first place through contract.

by Brad Hanna, Geoff Moysa, Mitch Koczerginski and Graham Bevans, Summer Student

[1] *Trillium Motor World Ltd. v. General Motors of Canada Limited*, 2017 ONCA 545 [*Trillium*].[ps2id id='1' target='/]
[2] *Arthur Wishart Act (Franchise Disclosure), 2000*, SO 2000, c 3.[ps2id id='2' target='/]
[3] This bulletin does not address the appeal decision regarding the dealers' conflict of interest claims against Cassels Brock, the law firm that providing advice to both GMCL dealers and the Canadian government.[ps2id id='3' target='/]
[4] *Trillium,* supra note 1 at para 16.[ps2id id='4' target='/]
[5] *1518628 Ontario Inc v Tutor Time Learning Centres, LLC*, 2006 CanLII 25276 (ON SC).[ps2id id='5' target='/]
[6] *Trillium*, supra note 1 at para 33.[ps2id id='6' target='/]
[7] *Ibid* at paras 34-35.[ps2id id='7' target='/]
[8] *Ibid* at para 47.[ps2id id='8' target='/]
[9] *Ibid* at para 48.[ps2id id='9' target='/]
[10] *Class Proceedings Act, 1992*, SO 1992, c 6.[ps2id id='10' target='/]
[11] *2176693 Ontario Ltd v Cora Franchise Group Inc*, 2015 ONCA 152.[ps2id id='11' target='/]

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.