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Franchising in Canada

2019 Year in Review

In this update we highlight key judicial decisions and legislative developments in 2019 affecting the landscape of franchise law that may be of interest to franchisors.

Case Law Highlights

Franchisee or Employee?

***Modern Cleaning Concept Inc. v. Comité paritaire de l'entretien d'édifices publics de la région de Québec*, 2019 SCC 28**

Modern Cleaning Concept Inc. was one of the most anticipated decisions by the franchise community in 2019. In this case, the Supreme Court of Canada affirmed that a franchise agreement cannot serve to disguise an otherwise valid employer-employee relationship. Here, the Court characterized a franchisee who operated a cleaning business as an employee because it was the franchisor who assumed the business risk and had the opportunity to make a profit.

The decision serves as an important reminder to franchisors that the language of the franchise agreement, on its own, will not determine the nature of the relationship with their franchisees. Courts will examine the arrangement as a whole to decide whether an individual is an employee or an independent contractor.

As such, franchisors should carefully consider their relationships with their franchisees and any surrounding special circumstances to confirm whether a properly characterized franchisor-franchisee relationship actually exists.

Pleadings not Notice of Rescission

***2352392 Ontario v. MSI*, 2019 ONSC 4055**

This decision confirms the importance of statutory notice of rescission under section 6 of the *Arthur Wishart Act* (Franchise Disclosure), 2000 ("*AWA*"). The Court clarifies that a pleading does not constitute notice of a franchise's intention to exercise its statutory right of rescission. To make a claim for rescission, franchisees must first deliver to the franchisor a notice of rescission pursuant to the *AWA*.

Franchisors receiving a valid notice of rescission have a statutory obligation to compensate the franchisee in accordance with the *AWA*. However, franchise legislation in most provinces protect franchisors from litigation by first giving the franchisor an opportunity to provide disclosure to

its franchisees. A franchisee's right of action for non-compliance with the rescission notice cannot be formed until the franchisor has refused to compensate the franchisee or the time limitation within which it must do so has passed.

Sealing Orders to Protect Competition

Subway Franchise Systems v. CBC, 2019 ONSC 2584

This case serves as an illustration of when courts might grant a sealing order to preserve the confidentiality of sensitive documents that must be produced. This Court granted a sealing order over the franchisor's financial documents because making such information available to the public would bring significant advantage to the franchisor's competitors. In granting the order, the Court found that maintaining a free market among commercial competitors was a public interest consideration that outweighed the "open court" principle.

While the decision confirms that courts are open to grant sealing orders to protect commercial interests in the context of maintaining a competitive market, franchisors seeking this order should bear in mind that after the Supreme Court of Canada's decision in *Sierra Club v. Canada (Minister of Finance)*[1], courts carefully scrutinize the moving party's application before granting such orders. The commercial interest at stake must go beyond harm to the private commercial interests of the franchisor and be grounded with sufficient evidence. To obtain the order, a franchisor must do more than speculate that harm will result from disclosure simply because the business operates in a competitive marketplace.

Relief from Forfeiture

Booster Juice Inc. v. West Edmonton Mall Property Inc., 2019 ABCA 58

The Alberta Court of Appeal confirmed that a breach of contract that deprives the other party of "substantially the whole benefit of the contract" allows the innocent party to terminate the contract and discharges the parties from future contractual obligation. In this case, the landlord's unilateral changes to the location and orientation of a proposed second franchise entitled the franchisor-tenant to repudiate the lease agreement.

In particular, the landlord changed the location and orientation of the Booster Juice kiosk to a spot with a lower traffic flow and lighter traffic orientation. The Court found that this unilateral change was fundamental and that the franchisor was permitted to treat it as repudiatory. The *Booster Juice* decision is a good reminder that in the restaurant and retail industry, location may be everything.

No Disclosure Obligation, No Misrepresentation Claim

2101516 Ontario Inc. v. Radisson Hotels Canada Inc., 2019 ONSC 3302

The Court confirmed that franchisees are not entitled to sue for damages under section 7 of the AWA when franchisors voluntarily, but without any obligation under s.5 (7) of the AWA, provide a disclosure document that contains misrepresentations.

Franchisors may rely on this decision in resisting statutory misrepresentation claims when they voluntarily disclose documents if franchise legislation does not require such disclosure. However, franchisors will still face a common law claim for misrepresentation, although this may be more difficult to establish

Oral Contracts

6646107 Canada v. The TDL, 2019 ONSC 2240

This case serves as a cautionary note to franchisors who make oral representations to their franchisees outside the written franchise agreement. In this case, the franchise agreement explicitly contained a no-renewal clause. However, the parties had extensive oral negotiations with respect to renewing the franchise agreement. Based on the franchisor's oral representations during these discussions, the Court dismissed the franchisor's motion to strike the franchisee's statement of claim for breach of contract and breach of good faith and fair dealing in not renewing the franchise agreement.

While the decision related to a motion to strike and, therefore, was a high bar for the moving party to succeed, the franchisee raised enough issues for the Court to try the case on its merits. Contrary to express language, an entire agreement clause is not intended to cover all future contractual relations between the franchisor and franchisee. As such, the case reminds franchisors to be wary of both oral agreements and representations made after the execution of a franchise agreement and the enforceability of "entire agreement" provisions.

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Forum Selection Clauses

We Serve Health Care LP v. Onasanya, 2019 ONSC 355

This case illustrates the risks associated with not including a forum selection clause in the franchise agreement. Although the franchise agreement contained a choice of law selecting Ontario as the applicable law, it did not contain a forum selection clause. The Court found that while there was some evidence that the franchise agreement was made in Ontario, the connection between the subject-matter of the dispute and Ontario was weak. The Court accordingly held that Saskatchewan was the more appropriate forum.

The decision is a reminder to franchisors of the importance of including forum selection clauses in their franchise agreements (subject to applicable franchise laws). While courts may still decline to exercise jurisdiction based on the doctrine of *forum non conveniens*, forum selection clauses provide some level of certainty to franchisors that the matter will be litigated in a jurisdiction that is more convenient and appropriate for them

Injunctions in Franchise Disputes

Demonstrating sufficient "irreparable harm" continues to represent a significant obstacle for obtaining interim injunctive relief in franchise disputes. Courts require applicants to present clear and non-speculative evidence that harm will occur if interim relief is not granted. In weighing irreparable harm, courts will consider the nature of the harm to be more important than the quantity.

One Touch Wireless Ltd. v. Bell Mobility Inc., 2019 BCSC 813

This case stands as an example of how franchisors may rely on loss of goodwill to challenge a franchisee's injunction to prevent early termination of the franchise agreement by the franchisor. The Court confirmed that where established with appropriate evidence, a franchisor's loss of reputation, goodwill and integrity vis-a-vis its relationship with other dealers, may constitute irreparable harm.

In this case, Bell terminated the agreement with its franchisee following its determination that the franchisee had engaged in improper and fraudulent conduct. The franchisee sought an interim injunction which sought to enjoin the franchisor from terminating the agreement until after trial. The Court found that the degradation of Bell's brand and damage to its relationship with other dealers (that would occur if the agreement was not terminated immediately) was difficult to quantify and, therefore, could not be compensated by damages.

Although mere difficulty in quantifying damages does not entitle a party to an injunction, the decision is helpful to franchisors who are fighting off interlocutory injunctions where the goodwill and reputation of the franchisor is at stake.

Mandarin Restaurant Franchise Corporation v. Amalie Holdings Limited, 2019 ONSC 5085

This case illustrates how courts will narrowly construe exclusivity clauses in commercial leases in the absence of clearly defined terms. The Court denied the franchisor's request for an injunction to prevent the landlord from leasing the premises to a tenant whose principal business was not "largely similar" to that of the franchisor. In reaching this conclusion, the Court found that there was insufficient evidence to show that the tenant's ancillary food sales caused irreparable harm to the franchisor's sales or goodwill.

Exclusivity clauses are a tool for franchisors to protect the franchised business from competitors that may have similar business activities. Franchisors entering into commercial leases are advised to carefully consider the extent and scope of their exclusivity clauses. Absent clear terms, courts will construe such clauses narrowly and in favor of the party whose rights are being restricted

ServiceMaster of Canada Limited v. Meyer, 2019 ABCA 130

This decision is a reminder that injunctive relief is a discretionary exercise. Appellate court intervention is not justified solely because the appellate court would have exercised discretion differently. In this case, even though the Court of Appeal disagreed with aspects of the chamber judge's findings regarding irreparable harm and balance of convenience, it acknowledged that such findings were entitled to deference.

The chamber judge's decision also provides an example of how courts may interpret a non-compete provision where the franchise agreement is characterized as an employment-related contract. Franchisors should bear in mind that if an employer-employee is found to exist, courts will presume there is a power imbalance and will apply a more rigorous level of scrutiny in analyzing whether the non-compete is reasonable and necessary.

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Summary Judgment in Franchise Disputes

***2212886 Ontario Inc. v. Obsidian Group Inc.*, 2018 ONCA 670 (leave denied, 2019 SCC)**

The franchisee obtained summary judgment against the franchisor in respect of damages following rescission of the franchise agreement. The Ontario Court of Appeal reversed the summary judgment order on the basis that the central factual issue in dispute could not be fairly determined without a trial.

In denying leave to appeal, the Supreme Court of Canada confirmed that summary judgment is not appropriate where the record contains contested issues relating to credibility that have not been orally tested. Given the contradictory and inconsistent affidavit evidence, the Court of Appeal refused to make determinations of credibility as to whether the franchisor disclosed earning projections prior to execution of the franchise agreement.

Since *Obsidian Group Inc.*, lower courts have refused to grant summary judgment where there was dispute as to whether the franchisee reviewed and signed receipts for the disclosure document , and where there was a major dispute as to the legality and appropriateness of the franchisor's termination of the franchise agreement.

In recent years, franchisees have increasingly brought summary judgment motions to rescind their agreements based on deficient disclosure and alleged bad faith conduct by the franchisor. However, while the Supreme Court of Canada's decision in *Hyrniak v. Mauldin* represented a culture shift in the way commercial disputes have been conducted, courts will likely continue to scrutinize the suitability of summary judgement, particularly where there are issues of credibility that cannot be assessed on the documentary record.

Good Faith and Fair Dealing

***Westeinde (FNP) Inc. v. RE/MAX Core Realty Inc.*, 2019 ONSC 133**

This decision illustrates that allegations of breaches of the duty of good faith and fair dealing must be made out with full particulars and with specific references to the franchise agreement.

The Court struck allegations of bad faith against the franchisor for lacking reference to the breached contractual terms, the manner of the breach, and the damages flowing from the breach. In this case, the bad faith claim made under both the *AWA* and the common law failed to contain particulars tying the franchisor's actionable behaviour to the terms of the franchise agreement and did not specifically identify relevant clauses in the franchise agreement. Franchisors should be aware of this possible defence if faced with a claim alleging bad faith without sufficient particulars.

***0923063 B.C. Ltd. v JM Food Services Ltd.*, 2019 BCSC 553**

This case provides an example of a situation in which a court will award punitive damages to a franchisee for breach of the duty of good faith and fair dealing. Punitive damages are rare and awarded only where there has been malicious and high-handed misconduct. In this case, the franchisor conducted an unauthorized and malicious campaign to drive the franchisee out of business, invented causes for termination, and stopped supplying the franchisee with supplies its business was wholly dependent on.

Franchisors ought to be mindful of their duty of good faith in the performance and enforcement of their franchise agreements under the common law and franchise legislation. Broadly defined, while franchisors are permitted to act in their own interests,

the duty of good faith requires franchisors to exercise their powers under the franchise agreement fairly and reasonably with due regard to the legitimate interests of its franchisees

Notable Legislative Changes Impacting Franchisors

Cannabis Act

The production and sale of edible cannabis, cannabis extracts, and cannabis topicals became legal on October 17, 2019. These changes to regulations under the *Cannabis Act* include controls regarding legal THC limits, product additives, marketing, and packaging and labeling. While presently legal, the sale of these individual cannabis products is subject to approval from Health Canada and other provincial regulations. Franchisors selling applicable cannabis products should ensure they are compliant with the emerging cannabis regulatory framework.

Restoring Ontario's Competitiveness Act (Ontario)

Ontario's Bill 66: *Restoring Ontario's Competitiveness Act* received Royal Assent on April 3, 2019. It made two changes to the *Employment Standards Act*. First, employers no longer need approval from the Director of Employment Standards to allow

employees to either work 48 hours a week or average overtime for a period of up to 4 weeks. Second, employers no longer need to display an employment standards poster in their workplaces

Trademark Law

On June 17, 2019, Canada implemented significant changes to the Trademarks Act. The legislation integrates Canada with the international trademark regime, including joining the Madrid Protocol for the first time. Some highlights include allowing registrants to file international trademarks through a single application (rather than on a by-country basis), 10-year registration terms, and higher registration fees.

For a full summary of the changes, you can review our previous publication here.

Safe Food for Canadians Act

Franchisors in the food industry should familiarize themselves with the *Safe Food for Canadians Act*, which came into force on January 15, 2019. Under the new regulations, business that import food or prepare food for export are required to have licenses and "preventive controls" to ensure food safety. Franchisors may be required to update their food safety and record-keeping practices as a result.

Amendments to the *Canada Business Corporations Act*

As of June 13, 2019, franchise businesses incorporated under the *Canada Business Corporations Act* are required to establish and maintain a "transparency register" of "individuals" with significant control over the business. The amendments also require prescribed corporations to make information regarding diversity, claw back of benefits, and the remuneration approach for "members of senior management". More information about the amendments can be found here.

In British Columbia, comparable legislation will come into effect on May 1, 2020.

Franchisors that are private entities incorporated under Federal or British Columbia law should familiarize themselves with the new obligations under the new corporate amendments.

The Future of Franchising

Proposed Amendments to PIPEDA

A more comprehensive privacy compliance regime is on its way. In May 2019, the federal government released a proposed Digital Charter to balance technological innovation and public trust in the collection and disclosure of personal information. Canada is also proposing amendments to the *Personal Information Protection and Electronic Documents Act* in the spirit of the Digital Charter. Highlights of the amendments can be viewed here.

Franchisors who collect the personal information of their franchisees or general customer marketing information should be aware how to properly handle and protect personal information. They should also be aware of the potentially increased penalties for any misuse.

Better for People, Smarter for Business Act

Ontario introduced the latest legislative changes in a series a bills aimed at reducing businesses' regulatory burden in October, 2019 with the *Better for People, Smarter for Business Act*, 2019. The legislation affects a number of potential franchising areas.

Highlights include:

- allowing dogs on food premises (including outdoor patios);
- harmonizing women's garment manufacture employment standards; and
- expanding alcohol service hours at Ontario's international airports.

The *Act* has passed the legislature and received Royal Assent in December 2019.

New Jurisprudence on the Duty of Good Faith?

In December, the Supreme Court of Canada heard two appeals on the duty of good faith. One is *Greater Vancouver Sewage and Drainage District v. Wastech Services Ltd.*, which examines the scope of the duty of good faith and honesty in contractual performance. The Supreme Court will clarify whether a party exercising a contractual right in an honest and reasonable manner breaches its duty of good faith if it undermines the other party's business interest. The other is CM *Callow Inc. v. Zollinger*, which concerns whether the duty of good faith can displace express contractual terms.

Judgements in both of these cases are expected in 2020 and could help better define the recently developed contractual duty of good faith. For franchisors, these cases could help clarify parties' expectations in creating franchise agreements and what duties they owe beyond their express written agreements. Further appellate insight on the common law duty of good faith might also help inform the scope of the statutory duty of good faith under Canadian franchise legislation.

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