

Franchising in Canada

2018 Year in Review

2018 was an eventful year for franchise-related issues being considered by Canadian courts and lawmakers. The following is a brief summary of highlights from court decisions, legislative updates and notable emerging franchise markets and trends.

Case Law Highlights

Availability of Rescission and Strict Compliance

Raibex Canada Ltd v ASWR Franchising Corp, 2018 ONCA 62

Raibex was one of the most talked about decisions in 2018. The Ontario Court of Appeal reversed the lower court's decision granting a franchisee rescission under the *Arthur Wishart Act (Franchise Disclosure), 2000* ("**AWA**") and clarified when rescission under the AWA is available. This case suggests that courts will interpret disclosure obligations under the AWA practically and in light of the facts and commercial circumstances surrounding the grant of the franchise. The 2-year rescission remedy will only be available where a franchisee has been deprived of the opportunity to make an informed investment decision.

Giroux et al v 1073355 Ontario Ltd et al, 2018 ONSC 143

The *Giroux* decision reinforced the need of franchisors to strictly comply with all applicable franchise legislation. The Court granted the franchisee's rescission claim on the basis that

the financial statements provided by the franchisor did not meet the required accounting standards and the earnings projection was not substantiated.

The Court also provided commentary suggesting that the delivery of a second disclosure document may, in certain circumstances, not contravene the requirement to provide a single disclosure document at one time.

Availability of Injunctions

10313033 Canada Inc v 2418973 Ontario Inc et al, 2018 ONSC 2406

This decision confirmed that, in the context of a royalty strike, a franchisor may obtain an interim injunction requiring franchisees to pay royalties while litigation is pending.

MTY Tiki Ming Enterprises v Azmy Enterprises Inc, 2018 NLSC 169

In this case, the court refused to order an injunction to enforce a post-termination restrictive covenant. The court's analysis emphasized that franchisors should ensure they maintain clear procedures for recording franchisee renewals and extensions.

Additionally, the court found that including statements acknowledging an entitlement to injunctive relief will not always be sufficient to obtain such orders.

526901 BC Ltd v Dairy Queen Canada Inc, 2018 BCSC 1092

This decision highlighted the courts' willingness to enforce the terms of mutual cancellation and release agreements freely entered into by franchisors and franchisees. Franchisors should consider using such agreements when ending a franchise relationship, even when granted a unilateral option to terminate the relationship under the franchise agreement. Mutual cancellation and release agreements provide certainty of termination and may serve as a defence against future claims brought by the franchisee.

Azmoon Trading Inc v Caffe Demetre Franchising Corp 2018 ONSC 2868

This decision provided guidance on circumstances in which courts will refrain from granting interlocutory injunctions to franchisees challenging a franchisor's termination decision. Franchisees will have difficulty obtaining such orders where (i) franchisors are willing to operate the relevant franchise location after termination (and during the dispute), (ii) the franchise agreement is nearing expiry; or (iii) the franchisor can show that the franchisee has breached the franchise agreement.

Dispute Resolution Provisions in Franchise Agreements

Graves v Correacology Health Care Group Inc, 2018 ONSC 4263

The court's refusal to stay a franchise dispute in favour of arbitration highlighted the perils of ambiguous dispute resolution clauses. Courts will often interpret ambiguity in franchise agreements in favour of the franchisee. Following this decision, franchisors should be diligent in ensuring that their dispute resolution provisions are demonstrably clear and unambiguous.

PQ Licensing SA v LPQ Central Canada Inc, 2018 ONCA 331

This decision highlighted the importance of ensuring that dispute resolution provisions in franchise agreements achieve their intended objective. The court considered whether mandatory mediation provisions in a franchise agreement affected the limitation period applicable to a franchisee's claim for rescission. The court found that the operation of the mandatory mediation provision prevented the limitations period from running, allowing a franchisee's claim for rescission to succeed notwithstanding that the franchisee's notice of rescission had been delivered nearly a decade earlier.

New Examples of Accidental Franchising

Fyfe v Stephens, 2018 ONSC 5066 and Diduck v Simpson, 2018 MBQB 76

These two similar decisions added to the growing body of case law on unintentional franchises. In *Fyfe v Stephens*, the court awarded damages to a franchisee notwithstanding that the franchisor denied that the parties had entered into a franchise agreement. In *Diduck v Simpson*, the

court came to the same conclusion when faced with similar facts. These cases confirmed that when determining whether a franchise relationship exists, substance prevails over form.

Franchisee Liability for Costs in Class Actions

Pet Valu Canada Inc. v. Rodger, 2018 ONSC 3353

In this case, the court found the sole shareholder of the representative plaintiff franchisee liable for a costs award in an unsuccessful class action against Pet Valu Canada Inc. This decision demonstrates the courts' unwillingness to allow individuals that have received benefits under a franchise agreement to escape the security and indemnification obligations they have entered into in connection therewith.

Choice of Law Provisions in Franchise Agreements

McMichael v The New Zealand & Australian Lamb Company, 2018 ONSC 5422

The Court accepted a choice of law provision in favour of Ontario as evidence of the parties' intention to be governed by legislation as if they were in Ontario. This decision emphasizes the care that must be taken when drafting choice of law provisions in franchise agreements. Franchisors should be wary of inadvertently submitting to the onerous legislation of unfamiliar jurisdictions or of submitting to franchise legislation that would not otherwise apply.

Protecting Franchisor Intellectual Property Rights

Milano Pizza Ltd. et al. v. 6034799 Canada Inc., 2018 FC 1112

The court found that a franchisor did not own any copyright interest in its logo. This decision reinforces the need for franchisors to take all necessary steps in protecting their intellectual property rights. The Court cited a lack of evidence of assignment of the logo's copyright from the original designer to the franchisor as the primary reason for its decision.

The Supreme Court's Impending Decision Regarding Franchisees as Employees

Comité paritaire de l'entretien d'édifices publics de la région de Québec c. Modern Concept d'entretien inc, 2017 OCCA 1237

On May 18, 2018, the Supreme Court of Canada granted leave to appeal the judgement of the Quebec Court of Appeal, which found that a franchisee providing certain services for a franchisor was that franchisor's employee and thereby entitled to protections under employment standards legislation. The Supreme Court's decision is expected to have significant implications on a franchisor's liability under labour and employment statutes.

Notable Legislative Changes Impacting Franchisors

Amendments to the Fair Trading Act (Alberta)

In January 2018, Alberta announced significant amendments to its **Fair Trading Act**. These changes affected the treatment of, among other things, arbitration clauses in consumer agreements, the unilateral amendment of terms in ongoing consumer transactions and the treatment of negative reviews.

Amendments to the Consumer Protection Act (Ontario)

On January 19, 2018, the Ontario Ministry of Government and Consumer Services (the "**Ministry**") released a consultation paper, seeking feedback on proposed changes to the **Consumer Protection Act** (the "**CPA**") as it relates to gift cards. The Ministry is seeking to clarify the scope of application of the Gift Card Rules under the CPA. Franchisors operating franchise systems that offer gift cards in Ontario should monitor for developments in this area.

The New Construction Act (Ontario)

On July 1, 2018, Ontario's **Construction Act** modernized lien and holdback provisions. Franchisors that engage in construction should

be aware of these new requirements as well as amendments respecting prompt payment and adjudication expected to come into force in October 2019.

The European Union Implements the General Data Protection Regulation

The European Union's General Data Protection Regulation came into force on May 25, 2018. These regulations apply to Canadian franchisors to the extent that they offer goods or services to or process the personal information of data subjects in the European Union. Canadian franchisors should determine whether their activities are within the scope of these regulations and if so, ensure that they are compliant with its requirements.

The Child Health Protection Act Moves towards Implementation

On September 19, 2018, Bill S-228 (short title: **Child Health Protection Act**) passed its Third Reading in the House of Commons. When implemented, this bill will prohibit any person from advertising "unhealthy food in a manner that is directed primarily at children." While not yet in force, franchisors in the food and restaurant industry should be aware that these restrictions are one-step closer to becoming law.

NAFTA Replaced with the USMCA

On October 1, 2018, Canada, the United States and Mexico reached an agreement in principle to replace the North American Free Trade Agreement with the United States-Mexico-Canada Agreement (“**USMCA**”). USMCA may provide significant benefits to certain franchisors’ supply chains. Franchisors, especially those in the food and restaurant industry, should carefully monitor future developments regarding the implementation of this agreement.

The Future of Franchising

Franchise Opportunities in Cannabis Retail

In 2018, provinces across Canada implemented regulations regarding the retail distribution of recreational cannabis. In many provinces, these regulations limit retailers’ ownership to a maximum number of stores. While ownership limits exist, these regulations generally do not prohibit franchising. Franchising is an interesting method through which cannabis retailers can scale their operations in the current regulatory environment.

Private Equity’s Increasing Interest in Franchise Systems

Private equity investors continue to show growing interest in Canadian franchise systems. Attracted to franchise systems’ predictable revenue streams, existing market penetration, proven business concepts and opportunities for growth, private equity firms will likely continue focusing on this space for the foreseeable future.

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