OSLER

No Good News for Franchisors in Midas Appeal

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Many franchisors found the Ontario Superior Court of Justice's decision in *405341 Ontario Limited v. Midas Canada Inc.* (Midas) troubling as it called into question some practices common to many franchisors. The Ontario Court of Appeal's July 6, 2010 ruling upheld the lower court's decision on all points, including the following issues:

Requiring Releases on Transfer or Renewal: The lower court's decision cast into doubt the enforceability of releases that franchisors commonly require franchisees to provide upon renewal or transfer of the franchise agreement. Not only did the Court of Appeal confirm that such releases are *prima facie* unenforceable, but that the provisions in the franchise agreement requiring such releases "offend and are contrary" to the *Arthur Wishart Act (Franchise Disclosure), 2000* (the Wishart Act).

Requiring Releases of Class Proceedings: The Court of Appeal also upheld the lower court's finding that requiring franchisees to provide such releases on renewal or transfer of the franchise agreement violated the franchisees' rights of association under Section 4(4) of the Wishart Act.

Using Ontario as governing law: The lower court found that selecting Ontario as the governing law in franchise agreements for franchises operated outside of Ontario effectively expanded the jurisdictional application of the Wishart Act to such provinces. This, despite Section 2 of the statute which states that the legislation applies only to franchises operated wholly or partly within the province. The Court of Appeal upheld the lower court's finding on this issue, meaning that franchisors who use Ontario as the governing law for franchises operated outside of that province do so at the risk of having the Wishart Act apply.

Facts and Discussion

The facts of the case and the practical take-aways are summarized in our earlier Osler Update on the Ontario Superior Court of Justice's decision. The Court of Appeal borrows heavily from the lower court's decision, quoting many passages at length. Those franchisors looking for a reversal or limitation on some of the contentious points will be disappointed by the Court of Appeal's decision which upholds the lower court's rulings on all points and provides very little independent legal consideration of these contentious issues.

Requiring Releases on Renewal or Transfer

In discussing the releases provided by Midas franchisees upon the transfer or renewal of their franchise agreements, the Court of Appeal confirmed the reasoning of the motion judge. In reproducing lengthy excerpts of the lower court decision, the Court of Appeal found that such releases by franchisees are unenforceable due to Section 11 of the Wishart Act and do not fall within the exceptions to that section as set out in the *Tutor Time* decision (i.e., that Section 11 will not apply to releases given by a franchisee, with independent legal advice, in the course of the settlement of a dispute of existing, known breaches of the Wishart Act).

The Court of Appeal left little doubt in its opinion of the practice requiring franchisees to provide releases of the franchisor upon the renewal or transfer of the franchise agreement, stating that requiring a release as a condition precedent to permitting a franchisee to exercise a contractual right "is simply contrary to the spirit, intent and letter of the [Wishart] Act," and that requiring a franchisee to release any claims in order to renew the franchise agreement "unequivocally runs afoul of the [Wishart] Act." The Court of Appeal concluded by saying that not only would any releases obtained pursuant to such sections be void, but the provisions in the franchise agreement requiring such releases would be unenforceable.

Tutor Time is discussed at length in the Court of Appeal's decision, as it was at the lower court level. The Court of Appeal distinguished *Tutor Time* from the facts of the Midas case, saying that the reasoning in *Tutor Time* upholds releases of known breaches of the Wishart Act that are provided with independent legal advice, not general, indiscriminate releases that were at issue in Midas. Interestingly, the court quotes from the *Tutor Time* decision, which upholds releases of "existing, known breaches." However, when applying the reasoning to the facts at hand, the Court of Appeal refers to "existing and fully known breaches" (emphasis added). Whether this was intentional, and whether "fully known" has raised the bar to upholding so-called "*Tutor Time*" releases, remains an open issue.

Requiring Releases of Class Proceeding Claims

The Court of Appeal agreed with the trial judge that the releases obtained automatically upon renewal or transfer of the franchise agreement also violate Section 4(4) of the Wishart Act by preventing franchisees from participating in class proceedings. On appeal, Midas likened the franchisees' provision of the release to electing to opt out of class proceedings. The Court of Appeal was unequivocal in disagreeing with this argument, stating that the franchisees should not be required to decide between exercising a contractual right to renew or transfer the agreement and being able to participate in class proceedings. Again, the court says that obtaining a release in this context is far from the voluntarily negotiated settlement of known claims that is required to uphold a "*Tutor Time*" release.

As noted in our previous update, whether a release is struck down for non-compliance with Section 11 or Section 4(4) of the Wishart Act is not merely an academic issue. Section 4(4) provides a right of action for damages for any breach of that section, where no parallel right of action exists under Section 11.

Accordingly, franchisors who require obtaining releases from franchisees must carefully consider both Section 4(4) and Section 11 of the Wishart Act to evaluate the possibility that the releases are not only unenforceable, but also potentially raise liability for a claim for damages under Section 4(4).

Using Ontario as the Governing Law

Midas's standard form franchise agreement provides that Ontario is the governing law for franchises in Ontario, Alberta, British Columbia, Manitoba, New Brunswick and Nova Scotia. Before the lower court, the plaintiff successfully argued that this meant that the Wishart Act applied in all of those jurisdictions, despite Section 2 of the statute, which provides that it applies only to franchises operated wholly or partly within the province.

Before the Court of Appeal, the appellant argued that this interpretation required a substantial re-writing of the agreement, by either adding "as if the business of the franchise was operated in Ontario" and/or "notwithstanding the terms of Section 2 of the [Wishart Act]," and that such a revision was not intended by the parties. The Court of Appeal disagreed and upheld the motion judge's decision with only a brief explanation, stating that parties are generally free to adopt the governing law of any jurisdiction for their commercial arrangement, subject only to public policy reasons to the contrary. The Court of Appeal did not discuss the application of Section 2 of the Wishart Act with the facts at hand, nor did the Court of Appeal address how an Ontario governing law clause will be interpreted with respect to franchises operated in one of the other regulated provinces.

Franchisors can manage this concern on a go-forward basis with relative ease by simply changing the governing law clause in their franchise agreements. However, a greater challenge exists with respect to franchise agreements that have already been executed for franchises operating outside Ontario that have set Ontario as the governing law. Franchisors should consult with their counsel for options on how to manage the risks for such existing franchise agreements.

Significance

The decisions in both the lower court and in the Court of Appeal have significant impact not only on franchisors with franchisees operating in Ontario, but also in Alberta, Prince Edward Island (and very shortly, New Brunswick and Manitoba), as the legislation in those provinces is similar to that in Ontario. Further, the decisions at both levels will also impact franchisors with franchisees in other regulated provinces if the governing law provision in the franchise agreement imports the laws of any of those provinces.

Franchisors using Ontario (or the governing law of another regulated province) as the governing law outside of the province must be aware of the risks of doing so, although there are some ways to mitigate this risk. Similarly, the Court of Appeal has left no doubt about the enforceability of releases obtained from franchisees as a matter of course upon renewal or transfer of the franchise agreement, and franchisors must carefully consider both the form and content of such releases and the circumstances in which they are required in order to put themselves in the best possible position considering the Midas decision.

Please contact any member of our Franchise Group for more information.