



10th Annual Franchise Law Conference:
What We Can Expect in the Next Decade

**Franchise Renewals: Issues surrounding the franchisor's right to
accept a franchisee's exercise of a renewal option**

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**FRANCHISE RENEWALS:
ISSUES SURROUNDING THE FRANCHISOR'S RIGHT TO ACCEPT
A FRANCHISEE'S EXERCISE OF A RENEWAL OPTION**

by

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1. Introduction to Renewals

The term "renewal" is actually a bit of a misnomer in the franchising context since it typically implies that two separate parties will *extend* the term of an existing contract without modifying any of its terms. However, very few, if any, franchise agreement renewal clauses operate as straight ahead renewals in this manner. Franchise agreement renewals will typically permit the franchisor to make substantial amendments to the franchise agreement. Furthermore, a franchisee's right of renewal will often be contingent upon the franchisee fulfilling certain express terms and conditions set out in the franchise agreement.

The use of the term "renewal" throughout this paper is intended as a generic term covering both the "renewal" and "extension" of a franchise agreement. In law, differences exist between a "renewal" of an agreement and an "extension" of an agreement. For the latter, the original contract terms are extended for a specific period of time (i.e the expiry date is pushed to a later date but the original contract is otherwise unchanged). For the former, more than just the expiry date is changed (e.g for a franchise agreement the royalty and advertising fund contributions are often changed to match whatever rates the franchisor then charges new franchisees and for a sublease, base rent is often changed to match then current market rents).

Renewal provides a key opportunity for franchisors to institute changes to their business systems and move franchisees over to the then-current form of their franchise agreement and system standards (i.e. trade-dress, equipment, and signage). Such changes can be vital to a franchise system's continued success in the marketplace. Consumer tastes change over time, markets evolve, facilities age, and demographics shift. It is essential that franchisors be able to

adapt their business format to current situations and ensure compliance from their franchisees, both practically and legally.

However, for the reasons discussed below, franchisors must be cautious not to introduce sweeping changes that are materially disadvantageous to their franchisees. The renewal process should be seen as a balancing act between modernizing the franchise agreement on the one hand, while not modifying it in such fundamental ways so as to make it unpalatable to franchisees; even if the franchisor is contractually permitted to do so by the franchise agreement.

Generally, there are many different types of provisions that deal with the renewal of a franchise agreement. These provisions can be summarized as follows:

- 1) indefinite term (i.e. there is no express term stated in the franchise agreement contract but one party can terminate the franchise agreement in certain listed circumstances);
- 2) perpetual term (i.e. the franchise agreement expressly states that the franchise agreement itself is a perpetual agreement);
- 3) fixed term with an automatic renewal of the franchise agreement (but one or both parties may opt out of the renewal, otherwise the renewal provision is either for an indefinite term or perpetual term described above);
- 4) fixed term but the franchise agreement is silent on whether it can be renewed;
- 5) fixed term but the franchise agreement expressly states that there will be no right of renewal of the franchise agreement;
- 6) fixed term but the franchise agreement expressly states that one or both parties may renew the franchise agreement unconditionally; and

- 7) conditional renewal (i.e. the franchise agreement is for a fixed term but renewal is conditional upon one or both parties satisfying specific terms and conditions set out in the franchise agreement).

All of the above described renewal provisions usually permit one party or the other or both to terminate the franchise agreement early for a breach of the franchise agreement or other expressly stated reason. The last type of provision described above (the “conditional renewal”) tends to be the most common provision used by franchisors.

This paper will focus primarily on conditional renewals, however, some commentary on the other renewal provisions is warranted. With respect to perpetual terms, indefinite terms, and automatic renewals, two decisions are of interest. In *Hillis Oil & Sales v. Wynn's Canada*¹, the manufacturer purported to terminate a distributorship agreement with immediate effect pursuant to clause 23 of the agreement which provided that the manufacturer and distributor could terminate the agreement at any time with or without cause. In contrast, clause 20 of the distributor agreement provided that in the event of breach of the agreement by the distributor, insolvency of the distributor or change in partnership of the distributor, the manufacturer could give notice of termination of the agreement and that "upon the giving of such notice, this Agreement shall be cancelled, terminated and at an end". The issue was whether, in view of the inclusion of the underlined words in clause 20 and their omission in clause 23, the latter clause should be construed as impliedly requiring reasonable notice of termination.

The Supreme Court of Canada held that if it stood alone as the only termination clause in the distributorship agreement, clause 23 would have to be construed as permitting termination with or without cause by either party with immediate effect. However, clause 23 could not be regarded as standing alone and must be construed in the light of the agreement as a whole, including the other termination provision in clause 20. The Supreme Court of Canada held that the inclusion of the words "upon the giving of such notice, this Agreement shall be cancelled, terminated and at an end" in clause 20 and their omission in clause 23 created an ambiguity as to whether the agreement may be terminated pursuant to clause 23 with immediate effect. Thus, it

¹ [1986] 1 S.C.R. 57.

was held that if the agreement did not contain a provision for termination without cause it was so terminable only upon giving reasonable notice of termination. Accordingly, a right to terminate a distributorship agreement without cause with immediate effect must be expressly provided for in the agreement. In light of the ambiguity as to whether the distributorship agreement may be terminated pursuant to clause 23 with immediate effect or only upon reasonable notice, it was held that the ambiguity should be resolved in favour of the distributor and against the manufacturer by application of the *contra proferentem* rule of construction.

In *Treen Gloves & Safety Products Ltd v Degil Safety Products*² one issue before the Supreme Court of British Columbia was the interpretation of the renewal provision found in the agreement between the parties. The renewal provision read as follows: “*This agreement shall remain in effect for an initial term of ten months ending December 31, 1987 and subject to the provisions of Sections 5, 6 and 7 hereof, shall renew itself automatically from year to year thereafter for succeeding renewal terms of one year each, under the same terms and conditions.*” Before the Court was an agreement that granted the sub-distributor an exclusive territory and which contained no termination clause that allowed the distributor to terminate the agreement without cause upon the giving of a reasonable notice. The sole provisions for termination in the agreement applied only in the event of a default as defined in the agreement and there were mechanisms in the agreement to address the situation should sales fall below a minimum level. Skipp J. stated that “*The concept of a perpetual distributorship agreement is difficult to entertain.*” In rendering its decision, the Court held that the agreement was terminable without cause on reasonable notice. As such, *Treen Gloves* stands for the proposition that generally, in cases where agreements are for an indefinite term and are silent as to the rights of the parties to terminate, courts will imply a right of termination without cause upon reasonable notice.

With respect to franchise agreements which contain a fixed term but expressly state that there will be no right of renewal of the agreement, it should be noted that, absent special circumstances (e.g. an enforceable oral side agreement about renewal that induced the signing of the written agreement), the common law "good faith and fair dealing" principle enunciated

² (1989) Inc. (1990) 33 CPR (3d) 74.

in *Transamerica Life v. ING Canada*³ applies to such agreements. In *Transamerica Life*, the Ontario Court of Appeal held that “good faith and fair dealing” can only be used to limit an *existing* contractual right or discretion, never to *create* a new contractual right where none existed before.

(i) Duty of Good Faith: Common Law and Statutory Duty

In Ontario, franchisors owe a common law duty of good faith to franchisees in how they carry out their contractual obligations. In *Shelanu Inc. v. Print Three Franchising Corp.*,⁴ the Ontario Court of Appeal held that the common law duty of good faith recognized by the Supreme Court in *Wallace v. United Grain Growers Ltd.*⁵ in the employment context applies equally in the franchising context. Franchisees are typically in a position of unequal bargaining power vis à vis franchisors, and franchise agreements are, like most employment contracts, take-it-or-leave-it contracts of adhesion. It was on this basis that Weiler J.A. held in *Shelanu* that franchisors have a duty to deal with franchisees “honestly and reasonably” and also with “mutual respect”.

Shelanu draws from the more general common law duty of good faith present in any contractual relationship where one party holds a discretionary power over the other. In *Gateway Realty Ltd. v. Arton Holdings Ltd.*, a case concerning a commercial lease, Kelly J. described the duty as such:

In matters of contract and other legal relationships the courts have frequently imposed changes to protect weaker persons and given relief from unconscionable penalties and unequal bargaining power. Judges have used devices such as restitution, waiver, estoppel, and unjust enrichment to force terms on at least one unwilling party, terms unexpressed in the oral or written contract. These are only some of the devices utilized by the courts to restrict conduct or results that are unjust, inequitable or in bad faith.⁶

³ (2003), 68 O.R. (3d) 457 (C.A.).

⁴ [2003] 64 O.R. (3d) 533.

⁵ [1997] 3 S.C.R. 701.

⁶ [1991] 106 N.S.R. (2d) 180, 29 A.C.W.S. (3d) 262.

Essentially, there is an implied covenant in every contract that says that one party will not exercise its discretion in such a way as to injure the right of the other party to receive the benefits of the agreement.

The principle of good faith in contracts does not extend so far as to require a franchisor to renew a franchise agreement in absence of any major reasons not to. In *Esmail v. Petro-Canada*,⁷ the plaintiff was a gas station franchisee of Petro-Canada. After a term filled with disagreement and animosity, the franchisor declined to renew the franchise agreement. The franchisee argued that due to the nature of the franchise relationship, the franchisor was effectively exercising a right of termination rather than declining to accept the franchisee's exercise of its right to renew the franchise agreement. The Court did not agree, instead applying the *Transamerica* principle that since the franchise agreement conferred no right to renew, the common-law duty of good faith could not be used to force the franchisor to remain in the relationship if it did not want to.

The common law duty of good faith does not require franchisors to act solely *in the interests* of their franchisees; that would be a fiduciary duty, which is a stronger and more difficult relationship to establish. It does, however, mean that franchisors cannot take advantage of their inherent position of power by using a discretion conferred on them by the franchise agreement to force franchisees to either accept unreasonable renewal terms or face termination of their franchise agreement. With respect to the differences between the duty of good faith and a fiduciary duty, *Shelanu* speaks to one significant distinction between the two duties. Paragraph 69 of *Shelanu* states that where a contract gives a franchisor an express right or discretion, the franchisor need not *always* prefer the interests of the franchisee over its own, but it must always fairly consider the franchisee's interests before exercising the right or discretion. Having said that, this principle does not apply if the franchise agreement expressly allows the franchisor to be arbitrary - in which case one must consider two different issues:

⁷ [1995] O.J. No. 924 (Gen. Div.), aff'd (1995), 86 O.A.C. 385 (Div. Ct.), leave to appeal to C.A. refused, [1996] I.H. Ni, 33 (C.A.), leave to appeal to S.C.C. refused (1996), 199 N.R. 400 (note).

was the arbitrary feature properly brought to the prospective franchisee's attention, and does the common-law doctrine of unconscionability apply?⁸

In *Jirna Ltd. v. Mister Donut of Canada Ltd.*⁹, the Ontario Court of Appeal considered whether a franchising relationship can give rise to a fiduciary duty. The plaintiff franchisees in that case alleged that the franchisor had made what amounted to a fraudulent representation regarding the supply of goods to the franchisees and the extent to the franchisor would pass on the benefits of its substantial buying power. The trial judge found that the relationship between the franchisor and the franchisees was essentially a paternal one, and that there existed a fiduciary duty. This fiduciary duty created a higher standard for the franchisor, and the court held that franchisor had committed a “constructive fraud”. However, this decision was overturned on appeal. The Court of Appeal found that the plaintiffs were sophisticated businessmen who had entered into the franchise agreement with their eyes open, and therefore the parties were within their rights to contractually define the nature of their relationship, which in this case was characterized in the franchise agreement as one of “independent contractors”. On this basis, the Court of Appeal declined to find a fiduciary relationship and the plaintiffs’ claim failed. Note, however, that at Paragraph 22 of the decision the Court did say (in *obiter*) that in proper circumstances a franchise relationship *could* well be fiduciary; see also *Shelanu* at Paragraph 70 of the decision to the same effect.

Similarly, in *909787 Ontario Ltd. v. Bulk Barn Foods Ltd.*¹⁰ the Divisional Court held that on the facts of that case there was no fiduciary relationship between the franchisor and franchisee. The case was an appeal from a certification order made under the *Class Proceedings Act*. The representative plaintiff alleged that Bulk Barn, the franchisor, had been selling food to the franchisees at an inflated price. Bulk Barn had been selling its franchisees supplies at approximately market value, offering them little or no competitive advantage. However, the franchise agreements in that case did not obligate the franchisees to purchase

⁸ See, for example, *Canadian Kawasaki Motors Ltd. v. McKenzie et. al.* (1981), 126 D.L.R. (3d) 253 (Co. Ct.) (“*Canadian Kawasaki Motors*”), and *A&K Lick-A-Chick Franchises Ltd. v. Cordiv Enterprises Ltd.*, [1981] 44 N.S.R. (2d) 159 (N.S.S.C.) (“*A&K Lick-A-Chick*”).

⁹ [1972] 1 O.R. 251, *aff'd* [1975] 1 S.C.R. 2.

¹⁰ [2000] 138 O.A.C. 180.

supplies exclusively from Bulk Barn; the franchisees were free to purchase from any supplier. The Divisional Court found that the relationship in that case was simply one of vendor-purchaser, not one of purchasing agent-principal (i.e. a fiduciary relationship), and the defendant therefore had no obligation to pass on the benefits of its significant bargaining power to the franchisees. The Court overturned the certification partly on the basis that the plaintiff's claim disclosed no cause of action.

Jirna and *Bulk Barn* suggest that in absence of legislative direction, in most circumstances Courts will consider franchisors and franchisees to be independent contracting parties and not subject to any type of fiduciary relationship. In the context of renewal, this suggests that franchisors do not need to exercise their discretion to renew on terms that are favourable to the franchisees. Rather, they can treat them as arms-length contracting parties according to the contractual terms of the franchise agreement itself (subject, of course, to the need to fairly consider the franchisee's interests *per Shelanu* unless the franchise agreement expressly allows the franchisor to act arbitrarily).

The absence of a fiduciary duty should be read in conjunction with the decision in *Shelanu* and the common law duty to treat franchisees in good faith. While franchisors cannot be opportunistic or deceitful in the renewal process, they are nonetheless free to exercise the terms of renewal in their own favour.

Ontario,¹¹ Alberta,¹² and Prince Edward Island¹³ have all enacted franchise legislation that further impacts how franchisors may treat franchisees. As of September 2010, New Brunswick has drafted legislation that has been given royal assent but has not yet come into force¹⁴ and Manitoba recently introduced draft legislation in its legislature. Each of the provincial statutes in force imposes a statutory duty of fair dealing that affects how franchisors may exercise their discretion to renew (or not renew) a franchise agreement and what types of terms and conditions they may impose on the renewal of a franchise agreement. Our Ontario

¹¹ *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c. 3 ("Arthur Wishart Act").

¹² *Franchises Act*, R.S.A. 2000, c. F-23 ("Alberta Franchises Act" or "Alberta Act").

¹³ *Franchises Act*, R.S.P.E.I. 1988, c. F-14.1 ("P.E.I. Franchises Act" or "P.E.I. Act").

¹⁴ *Franchises Act*, S.N.B. 2007, c. F-23.5 ("New Brunswick Franchises Act" or "New Brunswick Act").

courts have consistently held that Section 3 of the *Arthur Wishart Act* (and so by implication, its equivalents elsewhere) merely codifies the existing common law "good faith/fair dealing" principle.¹⁵

The Ontario *Arthur Wishart Act* provides that the "duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards." Similar provisions in the United States of America have been interpreted to give rise to a "good cause" requirement on the part of franchisors. In other words, franchisors must have a valid business reason for making changes to the franchise agreement beyond just increasing profitability at the franchisee's expense. It will be particularly difficult for a franchisor to show "good cause" when they stand to benefit from the termination or non-renewal of a franchise.

Good cause tends to focus on franchisee conduct, not franchisor business reasons. Poor franchisee performance or non-compliance with the franchise agreement may constitute good cause. A franchisor's decision to withdraw entirely from a regional market may also constitute good cause. However, it would likely not be good cause for a franchisor to terminate a franchisee in order to replace the franchise with a newer, more affluent franchisee in the same geographic area.

(ii) Conditional Renewal

Renewal clauses often include a set of specific terms and conditions which the franchisee must fulfill in conjunction with its exercise of its right of renewal. If the franchisee fails to fulfill all of the franchisor's terms and conditions, the franchisee will not be granted a renewal of its franchise agreement. Typical renewal terms and conditions to be satisfied by the franchisee include the following:

- i. providing the franchisor with written notice of its intention to renew the franchise agreement during a specific time period interval (i.e. 6 to 12 months prior to the expiry of the current franchise agreement);

¹⁵ See, for example, *Machias v. Mr. Submarine Ltd.* [2002] O.J. No. 1261.

- ii. paying the franchisor a renewal fee, which renewal fee is typically a stated dollar amount or a percentage of the franchisor's then current franchise fee. Additionally, franchisees are also commonly required to reimburse the franchisor for all reasonable legal fees and other costs and expenses incurred by the franchisor as a result of the franchisee's exercise of the renewal option;
- iii. executing the franchisor's then current form of franchise agreement, which may differ in form from the original franchise agreement, and which may, in particular, provide for higher amounts of royalty and advertising contributions;
- iv. implementing changes or updates to the franchised business to ensure that the franchisee satisfies the then current image, system standards, and specifications of the franchisor regarding the franchise system. This often requires that the franchisee make significant capital expenditures during a very short period of time in order to satisfy this condition;
- v. acting in accordance with the terms and conditions of the franchise agreement throughout the previous term and at the time of renewal, i.e. that the franchisee is not in material default in the performance or observance of any of its obligations under the franchise agreement; and
- vi. executing a general release of any and all claims against franchisor. However, as discussed below, such releases are now of questionable enforceability.

(iii) Contractual Right to Renew a Franchise Agreement

A right of renewal for a franchise agreement can very rarely be inferred from the surrounding circumstances of the franchise relationship and the statutory duty of fair dealing.¹⁶ With respect to express rights of renewal, the recent decision in *Salah v. Timothy's Coffees of the World Inc.*,¹⁷ the plaintiff was a franchisee operating a Timothy's coffee shop franchise in

¹⁶ The only times this will happen is if there is a written side agreement to renew that has not been superseded or if the franchisee can overcome the parole evidence rule to prove such an oral agreement exists.

¹⁷ [2009] 65 B.L.R. (4th) 235, O.J. No. 4444 (QL).

the food court of an indoor Ottawa shopping complex. The franchisee entered into a franchise agreement and a sublease agreement with the defendant franchisor for a term commencing in 2001 and expiring in 2005. The franchisee had an *express* right of renewal, albeit one spread across the franchise agreement and sublease agreement. Prior to signing the agreements, the franchisor represented to the plaintiff that if it was able to renew the head lease at the same location within the shopping complex it would extend an offer to renew the franchise documentation to the plaintiff. Upon expiry of the head lease, the franchisor terminated the franchise documentation and entered into new franchise documents with a new franchisee in another location within the same shopping complex.

The plaintiff argued that it had a right to renew its franchise agreement at the new location, or at the very least, it was entitled to damages due to the defendant franchisor's breach of the duty of good faith and fair dealing. The plaintiff submitted that so long as the franchisor was able to secure a head lease in the same shopping complex that was sufficient to trigger any promise of renewal. The defendant franchisor argued that there was no right of renewal in the franchise agreement and if in fact there was a right of renewal, it was contingent upon the franchisor securing a head lease at the exact same location within the shopping complex and did not extend to other parts of the complex. The franchisor argued that since it was unable to secure a head lease in the exact same location within the shopping complex, it was entitled to treat the franchise agreement as terminated and enter into a new franchise agreement with a new third party franchisee.

The Ontario Superior Court of Justice agreed with the plaintiff, holding that the franchisor breached its duty of good faith by failing to communicate adequately with the franchisee and by actively misleading the franchisee into thinking that the franchisor would permit the franchisee to renew its franchise agreement. In the period leading up to the expiration of the franchise agreement, the franchisor was lackluster in its communications. The franchisor did not advise the franchisee that it would be unable to secure a new head lease in the franchisee's food court location until very late in the term of the franchise agreement. Even then, it was only by accident that the franchisee discovered that a new location in the

shopping complex was being considered by the franchisor. The Court held that the franchisee was given insufficient notice that its franchise agreement was going to be terminated and was misled into thinking that the relationship was going well and that it would have an opportunity to renew its franchise agreement and sublease agreement.

Furthermore, the sublease agreement in *Timothy's* was unclear as to whether it referred to the entire shopping mall as the "location" or whether it referred only to the specific location in the food court where the plaintiff's business was originally located. The Court chose to interpret the head lease in favour of the franchisee, finding that the right of renewal was triggered if a head lease was secured anywhere in the shopping complex. On the topic of the interpretation of the franchise agreement, Métivier J. wrote:

80 In applying rules of contract interpretation to a franchise agreement, it must be noted that there are significant differences between a franchise agreement and an ordinary commercial contract.

81 A franchise agreement is a contract of adhesion. It involves, in essence, a "take it or leave it" position adopted by the franchisor. Therefore, this type of contract is subject to being interpreted against its author, in this case, the franchisor, as was the case in *Aamco Transmissions Inc. v. Kunz* (1991), 97 Sask. R. 5 (Sask. C.A.) at para. 7. In that case, the Saskatchewan Court of Appeal, referring to *Chitty on Contracts*, 24th ed. at p. 334, stated that a franchise agreement is one which is subject to being interpreted against the grantor.

Timothy's stands for the proposition that renewal clauses will be interpreted in favour of franchisees where there is ambiguity in their drafting. Franchise agreements are contracts of adhesion and they will undoubtedly be interpreted against the party who drafted them. Keeping this in mind, franchisors must be forthright and unambiguous when communicating with franchisees about the opportunities for renewal from the outset or else they risk having their own franchise agreements turned against them.

In *TDL Group Ltd. v. 1060284 Ontario Ltd.*¹⁸, the Court held that the parties' long term profitable relationship did not impose an obligation upon the plaintiff franchisor to renew

¹⁸ [2000] O.J. No.1239 (S. C. J.).

certain franchise agreements and the franchisor's failure to renew these agreements did not amount to bad faith. In this case, the plaintiff franchisor moved for an Order declaring that the franchise agreements it had entered into with various defendant franchisees would expire on their expiry date. Although the franchise agreements in question did not contain any provisions for an automatic renewal, they did contain a provision that the franchisor had an option to offer a renewal of the franchise agreement to the franchisees. Accordingly, the franchisees argued that the franchisor had a good faith obligation to make an offer of renewal to the franchisees. The Courts stated that the duty of good faith prevents a party from exercising in bad faith a right or obligation it already has; however, this duty does not convert an option to renew a franchise agreement into an obligation to actually renew the agreement.

Wright J. referred to the decision in *C Corp. (Ontario) v. Wesbru Holdings Ltd.* (1988), 91 A.R. 210 (Alta. Master), which decision involved a franchisor advising its franchisee that upon the expiry of the then current (and final) extension, the franchise would be assigned to a new franchisee. In that decision, Master Funduk commented on the fact that the franchisee had no contractual right to any extension and held:

The simple answer is that for the Respondent to remain in the premises there must be a 'renewal' or 'extension', or whatever label one wants to use, which a court of equity would enforce by a decree of specific performance. In short, there must be a contract.

The Applicant's 'policy' of renewing leases cannot of itself create a contract. There still must be a common intention by both parties to enter into a new contract and its terms must be certain or ascertainable.

The Court in *TDL Group Ltd.* held that the franchisor was under no duty to renew the franchise agreements and stated that when a party enters into a franchise agreement which contains no right to renew or an option to renew on ascertainable terms, there will be no renewal enforceable by a Court. If, however, the evidence disclosed that a commitment made to renew on terms certain or ascertainable has been agreed to by the parties, or by the parties' conduct, then a court could infer that a contract to renew had indeed been formulated.

In *530888 Ontario Ltd. v. Sobeys Inc.*¹⁹, the franchisee sublet its franchise premises from the franchisor pursuant to a sublease agreement that was set to expire and which contained no options to renew. The plaintiff franchisee brought an action against the franchisor for breach of the franchise agreement and the franchisor gave the franchisee notice of termination its franchise agreement and sublease agreement. The plaintiff franchisee brought a motion for an interlocutory injunction restraining the defendant franchisor from terminating its sublease agreement.

The Court held that no inherent right exists to force a franchisor to enter into a new sublease agreement with a franchisee where the sublease agreement has expired and contains no option to renew. If it did force the franchisor to enter into a new sublease agreement, the Court stated that the effect of the injunction would be to force the franchisor to continue a leasing arrangement that it did not want. As there was no practical reason for the Court to compel and supervise an involuntary lease arrangement pending the final disposition of the action on its merits, the Court rejected the franchisee's request for an interlocutory injunction. Further, the Court also held that while the duty of fair dealing imposed by the *Arthur Wishart Act* applies to the performance and enforcement of existing agreements, it does not compel one party to renew an expiring relationship when it considers it to be commercially unreasonable.

2. Enforcement of the Usual Conditions Imposed by the Franchise Agreement

As discussed above, a franchisee must fulfill several terms and conditions in conjunction with its exercise of its right of renewal. Of those, the most common, executing a new form of franchise agreement, the execution of a general release of the franchisor, and the payment of fees and other costs associated with the renewal are discussed below.

(i) Execution of a New Form of Franchise Agreement

Courts have generally been willing to permit franchisors to make renewal conditional upon the adoption of a new franchise agreement (the "then-current form" of the franchisor's franchise agreement). However, this does not give franchisors an unfettered discretion to

¹⁹ (2001, 12 B.L.R. (3d) 267 (Ont. S.C.J.)).

insert any terms or conditions they want, forcing the franchisee to take-it-or-leave-it. Such an arrangement would effectively create a new contract and would not be a renewal at all. Rather, if the parties have bargained for a renewal clause to appear in the franchise agreement, then the franchisor will be subject to the common law/statutory duty to act in good faith unless the clause expressly permits the franchisor to act arbitrarily, in which case the clause will still be subject to the doctrine of unconscionability.²⁰ If a franchisor introduces terms and conditions that are prejudicial to franchisees to the point of being unacceptable to any reasonable franchisee (for example, if the franchisor significantly increases the royalties to be paid to it under the franchise agreement requires the franchisee to make a significant capital investment into the business that will not be recouped over the term of the renewal period), a court may very well view the offer as a *de facto* termination.

(ii) Execution of a General Release

Recent jurisprudence suggests that courts will not enforce the contractual provisions of a franchise agreement requiring a franchisee to provide a general release in favour of its franchisor as part of any renewal of the franchise agreement, particularly in the face of franchisee protection legislation like the *Arthur Wishart Act*.

*405341 Ontario Limited v. Midas Canada Ltd.*²¹ was an appeal from an order declaring that any provision contained in the franchise agreement requiring franchisees to release the defendant franchisor from liability for purported breaches of the *Arthur Wishart Act* as a condition for the renewal or transfer of their rights under the franchise agreement was unenforceable and void for the purposes of the class proceeding of a group of Midas auto-shop franchisees, which proceeding had been previously certified as a class proceeding. The representative plaintiff in that case was required by the franchise agreement to grant a general release in favour of the franchisor as part of the renewal of its franchise agreement. The defendant franchisor sought to enforce this requirement and restrict the representative plaintiff from renewing its franchise agreement without providing a general release of the franchisor

²⁰ See, for example, *Canadian Kawasaki Motors and A&K Lick-A-Chick Franchises*.

²¹ 2010 ONCA 478.

(which release would capture the claims being asserted in the class proceeding). At trial, Cullity J. of the Superior Court of Justice held that the releases offended the purpose and letter of the *Arthur Wishart Act* and were therefore unenforceable.²² The Court of Appeal agreed. Writing for the Court, MacFarland J.A. held:

[30] The purpose of the Act is to protect franchisees. The provisions of the Act are to be interpreted in that light. Requiring franchisees to give up any claims they might have against a franchisor for purported breaches of the Act in order to renew their franchise agreement, unequivocally runs afoul of the Act. To suggest that by accepting the terms of the Agreement, the respondents have in effect “settled” their claims within the meaning of *Tutor Time*, in my view, misapprehends and misstates the ratio of that case.

The Court of Appeal held that Section 11 of the *Arthur Wishart Act* voided the release requirement in the franchise agreement and that Section 4(1) of the *Arthur Wishart Act* voided the “no class actions” requirement in the franchise agreement. Both the Court of Appeal and the Ontario Superior Court of Justice distinguished between the situation in *Midas* where the franchisee was forced to release any claims under the *Arthur Wishart Act* than it perhaps may have in the future from the decision in *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC*.²³ where the franchisee’s rights under the *Arthur Wishart Act* had already arisen and were being voluntarily released.

The Court of Appeal’s decision leaves little doubt as to the enforceability of franchise agreement provisions aiming to release franchisors of liability under the *Arthur Wishart Act* before it arises upon the renewal of the franchise agreement. Until recently it had been common practice for franchisors to make the right of renewal conditional upon the franchisee signing a general release in favour of the franchisor. However, the Court has now signaled that such provisions are *prima facie* unenforceable since they run afoul of the spirit, intent, and letter of the *Arthur Wishart Act* and in particular, Section 11 of the *Act*. As is the case with, for example, the *Employment Standards Act*, the *Arthur Wishart Act* creates a floor set of rights in favour of franchisees that cannot be unilaterally defeated. Even if franchisees wanted

²² *405341 Ontario Ltd. v. Midas Canada Inc.*, [2009] 64 B.L.R. (4th) 251, O.J. No. 4354 (QL).

²³ *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC*. [2006] O.J. No. 3011.

to contract up front out of some of their rights under the *Arthur Wishart Act* they would not be able to do so; any provision aiming to do so would be voided by s.11. The *Arthur Wishart Act* exists primarily to protect current and prospective franchisees from franchisor opportunism, since franchisors typically operate with both an economic and informational advantage. Allowing franchisors to insist upon release requirements in the face of a known dispute under the *Arthur Wishart Act* would run anathema to the protectionist undercurrent of the legislation.

Midas has broad implications for franchisors in Ontario and, by analogy, to franchisors in other jurisdictions with similar franchise legislation. Where franchisees claim that a franchisor has breached a section of the relevant franchise legislation, including the right of association and the broad duty of good faith and fair dealing, courts will not enforce releases that would deny the right to sue on those claims unless the releases are both informed and voluntary.

(iii) Money Matters

Courts will, generally speaking, permit franchisors to make renewal conditional upon the payment of a renewal fee and certain additional fees to the franchisor and the expenditure of money by the franchisee on the franchise itself. For instance, it is common for franchisors to require payment of renewal fees which easily exceed the franchisor's expenses relating to the renewal. Renewal fees are typically a stated dollar amount or a percentage of the franchisor's then current franchise fee. In addition to the renewal fee, some franchisors also require their franchisees to reimburse the franchisor for all reasonable legal fees and other costs and expenses incurred by the franchisor as a result of the franchisee's exercise of the renewal option. Additionally, Franchisors also often require franchisees to spend money remodeling or modernizing their businesses to match the current image, system standards, and specifications of the franchise.

A right of renewal implies that the franchisee will pay fewer fees to renew than a fresh franchisee would have to pay since the franchise relationship already exists. The recent *Timothy's* decision supports this position. In that case, the franchisor offered the existing

franchisee the new franchise location within the shopping complex, but at the same price (or higher) that was being offered by the franchisor to other fresh prospective franchisees. The Superior Court of Justice held that this was not a renewal. Franchisors should be mindful not to make renewal fees and conditions so expensive or cost prohibitive when compared to the costs of opening a brand new franchise.

3. Franchisor's Internal Renewal Procedures

From the discussion above it should be clear that a franchisor's decision to exercise its discretionary powers on renewal is a complex one and due regard must be given to the franchisee's interests: unless the contract specifically permits the franchisor to act arbitrarily a decision not to renew a franchisee must be made in good faith, and franchisors who terminate or refuse to renew a franchisee in bad faith may find themselves liable under the *Arthur Wishart Act* and comparable provincial franchise legislation elsewhere.

Franchisors should institute sound business practices to ensure that franchisees are dealt with fairly and consistently at renewal. Effective franchise renewal practices should address the following factors:

- **Assessment.** Franchisors should seek to standardize their methods of assessing the performance and compliance of franchisees when considering renewal. Franchisors should be able to identify problem areas with their franchisees using a consistent standard that can be applied across the franchise system. If the assessment reveals any issues, the franchisor will then need to consider its options (refusing to grant the renewal of the franchise agreement, enforcing compliance with the franchise agreement, temporary management of the franchised unit, facilitating an exit for the franchisee from the system, etc.).
- **Application of discretion.** Franchisors should institute and abide by measurable standards for when and how discretion is applied in the renewal process. This minimizes the perception of franchisee favouritism and streamlines the decision-making process.

- **Notification. Communication** with franchisees is an essential factor in the renewal process. If a franchisor intends to exercise its discretion and force the franchisee to spend large sums of money in connection with a renewal (e.g. remodeling their franchise premises or investing in costly new equipment or machinery) or even to refuse to accept the franchisee’s exercise of its renewal option, providing the franchisee with a long notice period becomes even more vital. Franchisors should institute standards for when and how franchisees are to be notified about renewal; best practices dictates that franchisors adhere to reasonable commercial standards when establishing their standards.

4. Disclosure Obligations

In the provinces that have enacted franchise legislation, franchisors are required to provide disclosure documents to prospective franchisees prior to the franchisees signing any franchise-related agreement with, or making any franchise-related payment to, the franchisor or its associate. The rationale is that franchisees should be given sufficient information prior to buying a franchise to be able to make a fully-informed investment decision, and all of the key information relating to buying and operating a franchised business should be contained in a single document.²⁴ The form and content of these disclosure documents is defined by the Acts themselves, along with the accompanying regulations.

Section 5(7)(f) of the *Arthur Wishart Act* provides that a franchisor is not obligated to provide a franchisee with a disclosure document upon the renewal or extension of a franchise agreement “...where there has been no interruption in the operation of the business operated by the franchisee under the franchise agreement and there has been no material change since the franchise agreement or latest renewal or extension of the franchise agreement was entered into.” The franchise legislation in Prince Edward Island and New Brunswick contain almost identical renewal or extension exemption provisions to that found in Section 5(7)(f) of the *Arthur Wishart Act*; however, the renewal or extension exemption set out in the *Alberta*

²⁴ Unlike the *Arthur Wishart Act*, *P.E.I. Franchises Act*, and *New Brunswick Franchises Act*, the *Alberta Franchises Act* does not require a franchisor to deliver its disclosure document as one single document.

Franchises Act simply provides that a franchisor is not obligated to provide a franchisee with a disclosure document upon the renewal or extension of a franchise agreement.²⁵ In practice, the exemption found in Section 5(7)(f) of the *Arthur Wishart Act* is virtually useless, because rarely will there have been no material changes

Franchisors must be careful of how they word their renewal clauses for disclosure purposes. Some franchisors prefer to frame renewals as brand new franchise agreements, rather than continuations or extensions of past agreements. While this approach has some advantages from a bargaining point of view, it will require the franchisor to deliver a fresh new disclosure document to the franchisee (in addition to disclosing the requirement for new franchise documents in its original disclosure document to the franchisee).

A disclosure document must disclose all of the restrictions or conditions in the franchise agreement relating to the renewal of the agreement itself. Although these terms are inevitably included in the franchise agreement, they must be stated both clearly and concisely in the disclosure document.²⁶ Practically speaking, the "clear and concise" requirement, coupled with the futility of merely "parrotting" what is already in an attached contract, means that O. Reg. 581/00 s.6.18 of the *Arthur Wishart Act* and its equivalents require one to use more or less "plain" English to disclose the renewal (and transfer and termination) restrictions and conditions. Additionally, the disclosure documents must also list the names and contact information of all former franchisees within the past year that were terminated, or not renewed, or who chose not to renew, or who otherwise left the system. Finally, since franchisors have an obligation to disclose all "material facts" (as defined by the relevant franchise legislation), the disclosure document itself must disclose information about the renewal practices of both the franchisor and its franchisees that are in fact material, e.g. has the franchisor consistently waived the renewal fee, have franchisees routinely negotiated the renewal documents, etc.

²⁵ *Alberta Franchises Act*, s. 5(1)(d).

²⁶ O. Reg. 581/00 s. 6.18; Alta. Reg. 240/1995, Sch. 1 - 17; P.E.I. Reg. EC232/06, Sch. 1, part 3.15; N.B. Reg. 2010-92, Sch A part 3.18.

5. Concluding Remarks

Inevitably the parties to most franchise agreements will be faced with the issue of the renewal of the franchise agreement at one point during their business relationship. The contractual requirements set out in the franchise agreement, along with the requirements and expectations of the parties, all factor in both the triggering of the right to renew and how the renewal is carried out. Parties that are mindful of their commercial relationship and the practical realities of running a business are apt to avoid disputes arising from the renewal of a franchise agreement. Those franchisors and franchisees who unknowingly or unwillingly refuse to be mindful of the issues discussed in this paper, may find themselves in the middle of an unwanted dispute regarding the renewal of their business relationship and documentation.