

In the know Sotos

In this ISSUE...

Court of Appeal Clarifies and Strengthens Franchisees' Rights cover & 2

The Ontario Court of Appeal has clarified three important points under the Arthur Wishart Act
By Andy Seretis, Allan Dick and David Sterns

Motor Vehicle Issuers' Claim Certified 3 & 4

Ontario Superior Court of Justice certifies class action against Government of Ontario
By Allan Dick

Foreign Counsel 5 & 6

Factors to consider when retaining foreign counsel
By John Sotos

Quizno's 7

Court of Appeal confirms certification of class action in favour of Quizno's franchisees
By David Sterns

New Brunswick 7

NB introduces new disclosure regulations
By Stu Freen

Manitoba 8

Manitoba Act provides for strict disclosure with unique modifications
By John Yiokairs

"Franchisees cannot be forced to give up their statutory rights and releases given with that effect will not be upheld by the courts except in limited and well-defined circumstances."

Court of Appeal clarifies and strengthens franchisees' rights

By Andy Seretis, Allan Dick and David Sterns

The Ontario Court of Appeal has clarified three important points under the Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3 ("AWA") which had been the subject of debate among the franchise law bar. It is now clear that:

- releases given by franchisees in renewing or assigning their franchise agreements are unenforceable in certain respects;
- the statutory right of association in the AWA includes the right to bring a class proceeding; and
- a franchise agreement that is governed by Ontario law entitles a non-Ontario franchisee to the benefit of the AWA after the contract is signed.

Background

Midas franchisees commenced a class action against Midas, claiming Midas breached its statutory and common law duties when it outsourced product supply to a third-party supplier. After the certification of the class action, Midas attempted to obtain a release from the class representative as a condition for renewing the class representative's franchise agreement. The requirement to execute a release was just one of the several conditions found in the renewal provisions contained in the franchise agreement.

The class representative was successful in obtaining an order that any provision contained in the Midas franchise agreement requiring franchisees to release Midas from liability as a condition for the renewal or transfer of their rights under the franchise agreement was unenforceable and void for the pur-

poses of the class action proceeding. The decision was rooted in section 11 of the AWA which deems any waiver or release of a right under the AWA void and unenforceable. Midas appealed the decision to the Ontario Court of Appeal.

Renewal and Assignment Provisions Void under Section 11 of the AWA

The Court of Appeal considered an earlier case on section 11 of the AWA holding that section 11 did not apply to a release given by a franchisee, with the advice of counsel, in settlement of a dispute for existing and fully known breaches of the AWA that would otherwise have entitled the franchisee to a claim. However, the Court of Appeal held that on these facts where the franchisor attempted to obtain a release as a condition of renewal or transfer, where there was no settlement of the franchisees' rights but rather, where the fran-

Continued on pg. 2

Continued from pg. 1



chisees were trying to assert their rights, the release would be void.

In dismissing Midas' appeal, the Court of Appeal held that 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" and is "simply contrary to the spirit, intent and letter of the Act."

Renewal and Assignment Provisions Void under Section 4(4) of the AWA

While releases of rights under the AWA may not always be enforced pursuant to section 11, requiring a franchisee to execute a release which has the effect of prohibiting participating in a class action violates the right of association under section 4 of the AWA. The Court of Appeal was clear that the statutory right of association includes the right to participate in a class action and that the right is concerned with more than a franchisee's ability to associate socially or recreationally. For franchisors that try to restrict or preclude class actions by having franchisees execute individual releases of class action claims, the Court of Appeal

decision is clear that such releases may be set aside when they interfere with the franchisee's right to associate.

Applying the AWA to Franchise Agreements where the Businesses are Operated Outside of Ontario

The Midas franchise agreement used throughout Canada states that the laws of Ontario shall govern. While Ontario (and certain other provinces) provides statutory protection to franchisees, the non-regulated provinces do not.

The Court of Appeal ruled that all franchisees across Canada, including franchisees in non-regulated provinces, are entitled to the protection of the AWA because Ontario law was designated as the law of the contract.

Midas Decision Provides Much Needed Clarity

Although the Court of Appeal decision was made in the class action context, the

principles have wide-spread application to common-place franchise practices. Many franchise agreements require releases from franchisees at various stages of the franchise relationship. This decision means that franchisees cannot be forced to give up their statutory rights and releases given with that effect will not be upheld by the courts except in limited and well-defined circumstances.

Further, franchise agreements that stipulate that the laws of a regulated province apply now mean that franchisees in non-regulated provinces have the same protection as those in regulated provinces. Finally, it is worth noting that once again the Court of Appeal has made it abundantly clear that the purpose of the AWA is to protect franchisees and that the provisions of the AWA are to be interpreted in that light. Sotos LLP represents the plaintiff class in the Midas class proceeding.



On June 30, 2010, the Ontario Superior Court of Justice certified a class action against the Government of Ontario in which our firm represents the plaintiff class of private businesses appointed by Ontario to issue and process drivers licenses, vehicle registrations and similar services for Ontarians. The private issuers comprise a network established by Ontario known as the "PIN". The case name is *Mayotte v. Her Majesty the Queen in Right of Ontario*.

The PIN is in all respects a franchise system. The provisions of Ontario's franchise legislation, the *Arthur Wishart Act (Franchise Disclosure), 2000*, however do not apply to the PIN because the government exempted itself out of the application of the legislation.

Each member of the PIN is a party to one of several forms of contract which it entered into with Ontario depending on when it entered the PIN. Regardless of the form of contract, the compensation of each member of the PIN is determined solely by Ontario.

The issues which the court certified as common issues to be determined in the class action by way of a common issues trial centre around the complaint by the PIN that Ontario has been under-compensating the PIN since August, 2003. The members of the class are seeking adjustments to the compensation paid to them by Ontario since that time.

In 1987, Ontario issued a memorandum advising the PIN that the existing system of compensation would be modified to a basis that was "fairer" and "more rational" than the previous method. The new compensation formula would compensate the private issuers based on the time and complexity of the various transactions they performed rather than on a flat-fee basis



Ontario's Motor Vehicle License Issuers' Claim Against The Government Certified As A Class Proceeding

By Allan Dick

which did not reflect the effort and time involved in processing the transaction. The new method, according to the 1987 memorandum, would ensure compensation which was "proportional to the effort required to do each transaction", and "derived from an objectively determined standard time taken to do a transaction."

In 1988, Ontario published the applicable rates for the formula and retroactively adjusted the PIN's compensation to the date of the 1987 memorandum.

Although there have been several minor adjustments in the amounts paid by Ontario to the PIN since 1988, it is claimed that the adjustments do not match the cost to the PIN of carrying out their duties or providing other services as these duties and services have been modified by Ontario over time.

Specially, it is argued that Ontario has been in breach of its obligations to the PIN based on the following three propositions of law:

(i) the standards which Ontario set for itself in the memoranda to the issuers form part of the binding contractual relationship with the private issuers and are enforceable by private action;

(ii) whenever a contracting party reserves to itself the discretion to set another party's compensation, the common law holds that party to a standard of good faith and commercial reasonableness in the manner in which it performs that function; and

(iii) in the alternative, Ontario has been unjustly enriched by virtue of its under-compensation of the private issuers and must compensate the private issuers on a quantum meruit basis.

Continued on pg. 4

Continued from pg. 3

Upon finding that the claim satisfied all of the criteria necessary in order for an action to be certified as a class proceeding, Justice Perell certified the following common issues to be determined:

- (a) Does the contractual relationship between Ontario and the private issuers include a duty on Ontario to ensure that Issuer compensation is, and remains fair, rational, objectively determined, and proportional to the effort required to do each transaction?
- (b) Does Ontario have one or more of the following contractual obligations to the private issuers in respect of compensation:
 - (i) to adequately increase the standard commission rate table,
 - (ii) to update the time series analysis on which compensation was and continues to be based,
 - (iii) to take into consideration all steps required to perform the required transactions, and
 - (iv) to sufficiently increase the annual stipend?
- (c) If so, has Ontario breached and is it continuing to breach any such contractual obligation?
- (d) Was Ontario under a duty to increase compensation to the private issuers following the conclusions of the report of the Ministry of Transportation dated August 28, 2003?
- (e) Has Ontario satisfied its duties by the increases in compensation which it has put into effect since August 28, 2003?
- (f) If Ontario has not breached its contractual duties to the private issues in respect of compensation, has Ontario been unjustly enriched by having undercompensated the private issuers?
- (g) If Ontario has breached its contractual duties, or has been unjustly enriched, what is the appropriate measure of past damages or compensation, including pre-judgment and post-judgment interest thereon?

Ontario has filed a motion for leave to appeal to the Divisional Court. Although Ontario disputed at the certification hearing that the claim satisfied any of the criteria for certification, the motion for leave to appeal is only challenging the court's finding on the first of the necessary criteria, namely whether the claim discloses a cause of action. It is Ontario's position that, as government, it is immune from certain of the claims being put forward. For Ontario to have been successful in making this argument at the certification stage of the case, it had to have been plain and obvious that Ontario's position was correct. The certification judge did not agree that it was.

This case is expected to be legally significant as it has the potential to assist in defining the parameters of the evolving duties of good faith under Canadian law and the application of the principle to government if the case is permitted to proceed to trial.



Working with Foreign Counsel

By John Sotos

For franchisors seeking to expand into foreign markets, selection of outside local counsel is a crucial decision. Franchising is now regulated in many jurisdictions, and each country has its own legal peculiarities regarding disclosure, trade-marks, tax planning, competition/antitrust law, currency issues and more. Even for large franchisors with in-house legal departments it is essential to retain outside local counsel who are well connected and know the lay of the land of the target market. It should not be assumed that a business model and franchise agreement that works well domestically will work abroad without modification; local counsel is needed to adapt the franchise to the new market. Great care must be taken to find and select lawyers who are experienced in franchise law and will be able to work cooperatively to overcome the specific legal hurdles associated with international franchising. In fact, depending on the country it can be hard to even know where to look for local counsel.

Before retaining foreign lawyers, it is important for franchisors and their domestic lawyers to understand the nature of the legal services local counsel will be required to perform. Will they be required for a long-term relationship dealing with a variety of matters, or for one-time advice on a contractual or litigation matter? The nature of the work required will inform the search process. For more complex, long-term matters it will be preferable to find an experienced franchise lawyer with connections to local industry and government who can guide the client through the process of expanding their business. For one-time legal issues, however, it may be equally effective to retain a well-respected generalist such as an international law firm with experience in the country.

Franchisors can easily find themselves at a loss when searching for local counsel. Assessing the experience and competence

of foreign lawyers can be difficult, particularly when thousands of kilometers and a myriad of cultural differences stand in the way. However, there are some basic tools available to aid in the search:

1. Consult as many sources as possible and look for lawyers' names that keep coming up.

Good lawyers tend to maintain a high profile in their home jurisdictions and command recognition among clients and colleagues. Legal ranking systems/directories such as Martindale-Hubbell and Who's Who Legal, while not the last word, can provide a prospective client with a general idea of who is out there. Good lawyers also tend to appear in trade publications regularly and are actively involved in relevant industry associations such as the International Franchising Association and local trade groups. Clients should review as many sources as possible and try to find out which lawyers are writing articles, delivering seminars and are consistently recommended by their peers.

2. Word of mouth.

Clients should speak with their contacts both at home and in the foreign country – they may already have a good idea of who the go-to lawyers are for franchise law in that area. Any lawyer can join an industry association or get listed in a legal directory. Word of mouth helps to weed out counsel who look good on paper but are not well known or well respected amongst those who know.

3. Seek recommendations from other law firms or companies that have experience in the jurisdiction.

Chances are good that other franchisors or businesses have tried to move into the same foreign market before and they will have accrued some know-how along the way, either positive or negative. These other businesses may be very willing to share their own experiences. Do not overlook asking other professionals such as accounting or consulting firms for recommendations. Major accounting offices

are particularly good sources as they tend to have offices in most countries of the world. Domestic franchise counsel also make a good source of information. Law firms that are experienced in international franchising tend to build up networks of foreign lawyers that they trust and respect.

4. Embassy / Consular Offices/ Chambers of Commerce.

Canadian embassies and trade commissions abroad maintain lists of lawyers, bar associations, and other organizations for their respective countries. Similarly, local Chambers of Commerce often provide business directories, including for legal services. Should the franchisor be doing business in the U.S., do not hesitate to tap the U.S. diplomatic or trade office in the target country as they tend to be pro-active in helping businesses establish abroad, and their local business intelligence is often second to none.

Prospective clients will need to consider whether they should opt for a large, multi-national full-service law firm or go with a smaller local firm. In developed countries, a local firm that is familiar with franchising will most likely be the best fit. The wealth of know-how that is associated with a dedicated franchise lawyer simply cannot be beat, where available. In developing countries, however, clients are most likely to get value from a multi-national with extensive knowledge of the country's laws and culture. Developing countries typically do not have franchise law specialists in the same way developed countries do. Due to sheer depth of transactions multi-nationals are likely to have some experience in the area, and franchisors may feel more comfortable dealing with a well-known western style law firm.

Several factors should be considered when retaining foreign counsel, including:

a) Education.

Does the target lawyer possess any foreign

Continued on pg. 6

Continued from pg. 5

training? Standards for legal education vary widely across jurisdictions, so the prospective client should be satisfied that foreign counsel will be sufficiently trained and accredited. U.S. training is also a benefit; the greater foreign counsel's knowledge of western legal concepts, the simpler it will be to export a franchise into their own unique culture.

b) Profile in the jurisdiction.

Is the prospective foreign counsel well known and well connected in the business and government of the country? Beyond merely providing legal advice and services, good foreign counsel can act as liaison to the foreign industry and culture. Franchising is a relatively new concept in some countries and the legal framework is often poorly understood. Good foreign counsel can help bridge the culture gap by making the right connections and translating ideas and concepts.

c) Language skills.

Can the prospective foreign counsel communicate well, both orally and in written English? Even where foreign counsel does speak English, cultural differences can nevertheless result in a lack of understanding. A different legal system in a foreign country can lead counsel to consider a whole other set of issues when approaching a problem. It is not uncommon for franchisors or their domestic lawyers to request what they think is a relatively straightforward legal opinion, only to have foreign counsel come back with what appears to be a complete non sequitur. Clients should be sure to instruct foreign counsel with extreme clarity, perhaps

rewording the same instruction multiple ways to make sure the meaning is not lost in translation.

d) Understand who will be working on your file.

Clients should determine how a file will be staffed and whether any other lawyers will be working on the file. If a franchisor has gone to lengths to select a particular lawyer, they should be satisfied that it will actually be that lawyer working the file. To avoid billing surprises, clients should be clear when they think they are asking for a simple oral opinion versus, say, a complex written analysis. Particularly if English is their second language, foreign counsel may end up spending an inordinate amount of time on something the client considers unimportant.

e) Fees.

Understand what the fees are going to be and how they will be charged – and put it in writing. Clients should insist on regular billing. Determine in advance who will be responsible for paying foreign counsel's invoices. If it is not the franchisor's domestic law firm, the retainer letter should clearly outline that. Otherwise, the assumption is that the lawyer hiring the foreign counsel will pay those bills.

One factor that is occasionally overlooked by domestic lawyers is differences in how solicitor/client privilege is treated in other jurisdictions. In the U.S. and Canada, solicitor/client privilege is afforded great respect and is rarely compromised. This is not necessarily the case elsewhere. Make sure to understand local rules regarding

privilege and include confidentiality provisions in your retainer agreement. Similarly, foreign lawyers may not be bound by the same ethical standards as American and Canadian lawyers are. Clients should clarify their non-competition expectations at the outset and put them in writing.

The importance and potential impact of cultural differences should not be underestimated. Countries have widely varying standards regarding punctuality, etiquette, dress, etc. and these can have a surprisingly big effect on working relationships. Consider the effect that large gaps in time-zones may have, particularly if foreign counsel is unwilling to communicate at odd hours. Furthermore, holiday and weekend schedules will often be out-of-sync, causing yet more difficulties. Ideally foreign counsel will be sensitive to cultural differences and willing to accommodate and adapt to a western style of doing business. Clients should inquire as to whether foreign counsel will be available for early morning or late night conference calls, whether they possess the necessary technology for communication, and whether they are willing to travel.

In short, experienced local counsel forms an invaluable part of a franchisor's legal team when expanding internationally and should be sought out with great care and diligence. Though it can often be difficult to separate the stars from the rest, careful research will point to those lawyers who both understand franchising and can bridge the language and culture gap between the two countries.

Quizno's franchisees allowed to proceed as a class in their lawsuit

By David Sterns

The Ontario Court of Appeal released its decision on June 24, 2010 confirming the certification order of the Divisional Court in the Quizno's class action. The Court of Appeal affirmed each point in favour of the Quizno's franchisees represented by Sotos LLP. Wrote Justice Armstrong in the decision:

"I am also of the view that a class proceeding in this case will satisfy at least two of the objectives of the Class Proceedings Act of judicial economy and access to justice. It seems to me that this case involving a dispute between a franchisor and several hundred franchisees is exactly the kind of case for a class proceeding."

As a result, the Quizno's franchisees will be allowed to proceed as a class in their lawsuit against Quizno's Canada and Gordon Food Services. The lawsuit alleges that the Canadian franchisor of the Quizno's chain and others have illegally conspired to enhance and fix the prices of supplies purchased by Quizno's franchisees for their businesses.

New Brunswick Franchise Disclosure Regulations

By Stu Freen

On June 10, 2010, the New Brunswick legislature introduced the province's new disclosure document regulations. The regulations implement the disclosure requirements from the province's recently enacted Franchises Act, S.N.B. 2007, c. F-23.5.

The regulations seek to balance the at-times competing interests of franchisees and franchisors by setting up a complete and transparent disclosure regime for the benefit of franchisees on the one hand, while at the same time not making the process so onerous as to dissuade franchisors from entering into the relatively small market of New Brunswick. The regulations are essentially an amalgam of the current regulations in place in Ontario and Prince Edward Island with the Uniform Law Commission of Canada draft franchise regulation.

For those familiar with the Ontario disclosure regulation, the New Brunswick regulation will appear similar with some key differences. Some points to keep in mind are:

- franchisors may use disclosure documents that have been prepared for other jurisdictions, provided they provide sup-

plementary information to bring them into accordance with the New Brunswick regulations (s. 4). Financial statements prepared for other jurisdictions may be used so long as they are "equivalent" to the ones specified in s. 7;

- a disclosure document may be delivered by electronic delivery so long as the documents do not include any hyperlinks, i.e. the documents must be self contained and printable (s. 3);

- franchisors with a net worth of at least \$2 million and with 25 franchises in Canada do not have to disclose their financial statements;

- franchisors must disclose why they are not including certain optional information, such as estimates of operating costs (pt 3, s. 4), earnings projections (pt 3, s. 5), training (pt 3 s. 7), and territory (pt 3, s. 12);

- the regulations set out specific information related to statements of material change. Section 9 deals with who may sign and date a statement of material change and prescribes that statements must be drafted according to a standard form;

- the regulations require that additional franchise information beyond what is required in Ontario be disclosed. Franchisors must disclose information about "other fees" (pt 3, s. 2), guarantees and security interests (pt 3, s. 3), operations manuals (pt 3, s. 8), distances sales (including internet-based sales) (pt 3, s. 14) and the franchisor's ability to make unilateral amendments to the franchise agreement (pt. 3, s. 20);

- the "Lists of Franchisees and Businesses" section reflects the reality that very few franchisors will ever operate more than 20 franchises in New Brunswick. The franchisor must first provide information about other franchisees in New Brunswick, then Ontario, Quebec, Prince Edward Island, Nova Scotia or the State of Maine, then the rest of Canada, and finally everywhere else until 20 franchisees are listed (pt 4).

Overall, disclosure documents prepared by franchisors for Ontario or Prince Edward Island markets should be readily adaptable for New Brunswick under the new regulations.

Manitoba Introduces Franchise Legislation

By John Yiokaris

Manitoba is set to be the next province with franchise regulation as Bill 15, *The Franchises Act*, was recently introduced in the Manitoba legislature. The Manitoba Act is modeled after the Uniform Law Conference of Canada's Uniform Franchises Act (which was co-chaired by John Sotos of our firm), and closely resembles the statutes already in place in Ontario, Prince Edward Island, and New Brunswick.

Similar to other provinces that have enacted franchise legislation, the Manitoba Act provides for strict disclosure obligations along with a right of rescission for non-compliance with the disclosure obligations; a statutory duty of fair dealing and a statutory right to associate; and a right to sue for misrepresentation without the common law requirement to prove reliance.

However, unlike the *Arthur Wishart Act* in Ontario, the Manitoba Act also provides, among other things, that the disclosure document may be delivered in tranches over a period of time; that confidentiality and location agreements do not constitute franchise agreements if their sole purpose is to retain confidential information or assign a territory; and includes a provision for substantial compliance in disclosure requirements as opposed to strict compliance.

The Manitoba Act, while years in the making, marks a trend towards increased franchise regulation in Canada. Given the growth of franchise regulation in Canada, franchisors are well advised to keep current of all developments and to ensure that their disclosure documents meet all requirements.



Contact List...

David Sterns: dsterns@sotosllp.com

Andy Seretis: aseretis@sotosllp.com

Allan Dick: adjdick@sotosllp.com

John Sotos: jsotos@sotosllp.com

Stuart Freen: sfreen@sotosllp.com

John Yiokaris: jyiokaris@sotosllp.com