

COMMON LAW TREATMENT OF RENEWAL RIGHTS IN COMMERCIAL AGREEMENTS: A SPECIAL LOOK AT FRANCHISES, DISTRIBUTORSHIPS AND THE DUTY OF GOOD FAITH

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I. INTRODUCTION

The right to renew or extend a commercial agreement beyond its initial term can play an essential role in any sophisticated business arrangement that contemplates longer-term performance obligations between the parties. Alongside contractual term clauses, renewal and extension rights determine the temporal scope of the benefits and burdens that flow between the parties under the agreement and the rights and duties that are enforceable through the courts. Renewal and extension rights also help define the commercial efficacy of the relationship, since the extent of a party's investment of financial and human capital into a business arrangement will depend on the temporal scope of their underlying contractual rights. Therefore, renewal clauses are often subject to directed negotiation and cautious drafting.

Term renewal and extension rights can take many forms. As a starting premise, there is an important legal distinction between the right to renew and the right to extend an agreement. At common law, a right of extension, once exercised, literally extends the contractual term of an existing agreement while, by contrast, a renewal right establishes a new agreement either by reviving an expired contract or providing a mechanism for creating a new agreement to replace the old.¹ While renewals and extensions can be expressed as rights that stand alongside the other covenants in an agreement, they are also often drafted as options that can be exercised at the will of the grantee, which means they will

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1. *Manulife Bank of Canada v. Conlin*, [1996] 3 S.C.R. 415 (S.C.C.), at para. 29; *TA & K Enterprises Inc. v. Suncor Energy Products Inc.*, 2010 ONSC 7022 (Ont. S.C.J.) at para. 50, affirmed 2011 ONCA 613 (Ont. C.A.); *1497777 Ontario Inc. v. Leon's Furniture Ltd.* (2003), 232 D.L.R. (4th) 552, [2003] O.J. No. 3708 (Ont. C.A.) at para. 50, additional reasons 238 D.L.R. (4th) 574, leave to appeal refused 332 N.R. 200 (note) (S.C.C.); *Avlor Investments Ltd. v. J.K. Children's Wear Inc.* (1991), 85 D.L.R. (4th) 239 (Ont. Gen. Div.), at paras. 20-23.

sometimes be treated as separate agreements at common law.² Renewal and extension rights are also often drafted as being subject to different types of conditions precedent, a practice that frequently leads to disputes.³ While these distinctions in the *form* of renewal and extension rights can be important,⁴ for ease of reference I employ the phrase “renewal right” throughout the remainder of this article to denote the larger legal concept that embraces all these different permutations.

In Canada, renewal rights in commercial agreements have been subject to extensive litigation, particularly in the commercial leasing context, with a large volume of Supreme Court and provincial appellate decisions spanning more than 100 years.⁵ What emerges from this case law is a set of common law principles and doctrines that govern the enforcement of renewal rights not just in commercial leases, but in all commercial agreements. The case law reveals three principal prerequisites to the enforcement of a purported renewal right at common law, and these will be the main focus of this article:

(a) First, a right to renew must be rooted in contract, either the primary or a collateral agreement.⁶

2. See *Sail Labrador Ltd. v. “Challenge One” (The)* (1998), 169 D.L.R. (4th) 1, [1999] 1 S.C.R. 265 (S.C.C.), where the Supreme Court of Canada summarizes the common law distinction between covenants and options, and reforms the law in this area. This decision is discussed further below, beginning at the text accompanying footnote 93.

3. See below, beginning at the text accompanying footnote 79.

4. For example, in *1259286 Ontario Ltd. v. Kardish Food Franchising Corp.* (2007), 167 A.C.W.S. (3d) 79, [2007] O.J. No. 5429 (Ont. S.C.J.), the franchise agreement provided that the term would automatically “extend” for the period of any “renewal” of the franchisor’s head-lease with the landlord. The agreement further provided that it would terminate automatically if the head-lease terminated or expired. The court’s reasons are difficult at times to interpret, but the result strongly suggests that the court applied the strict meaning of what constituted a “renewal” and “extension.” In this case, while the head-lease expired, the franchisor subsequently secured a new lease with the landlord. However, the court determined that the franchise agreement came to an end when the head-lease expired and could not be extended on the basis of the new head-lease. This was presumably because there could be no “extension” of an expired franchise agreement and because the court may have implicitly concluded that there had not been a true “renewal” of the head-lease.

5. See *e.g.*, *infra*, footnotes 11, 41, 49, 52, 57 and 82.

6. This paper will not consider the scope of equitable doctrines, such as promissory estoppel, to create what is akin to an enforceable renewal right in the face of an unequivocal representation followed by detrimental reliance. While such an outcome is theoretically possible, I have not seen such a situation in the case law reviewed in the process of preparing this article. Instead, that type of a fact

- (b) Second, a renewal clause in any agreement must provide certainty as to the essential terms that will govern the parties during the renewal term.
- (c) Third, a renewal clause, and any conditions precedent expressed therein, must be properly exercised by the grantee in accordance with its terms, subject however to certain common law rules that avoid undue forfeiture of rights.

In franchise and distribution relationships, rights of renewal carry added importance compared to ordinary commercial arrangements. Franchises and distributorships are generally intended to be, or at a minimum contemplate the possibility of, long-term relationships. Franchise and distribution agreements establish ongoing performance obligations for both parties, often necessitate significant up-front investment by the franchisee/distributor, and frequently involve the shared use of trade-marks and confidential information that the franchisor/supplier may protect through non-competition clauses or other forms of restrictive covenant.⁷ In many instances, the requirement for the franchisee/distributor to make up-front expenditures of significant capital only makes business sense with some security of tenure provided through a right of renewal.⁸ From the perspective of the franchisor/supplier, rights of renewal can also provide stability and continuity throughout their distribution systems.⁹

When considered in the context of a franchise and distribution relationship, the common law principles that govern the enforcement of renewal rights are subject to an additional complexity. All franchise agreements, and some distribution agreements,¹⁰ give rise

pattern is more likely to be determined by reference to other contractual doctrines, such as collateral contract where the claimant asserts a separate collateral agreement on this issue, with detrimental reliance acting as consideration.

- 7. Adam Ship, "Specific Performance of Franchise and Distribution Agreements in Canada" (2012), 39 *Advocates' Q.* 407.
- 8. The courts have begun to recognize this reality: see e.g., *Boston Pizza International Inc. v. 395047 B.C. Ltd.*, 2008 BCSC 1016 (B.C. S.C. [In Chambers]), at para. 16.
- 9. Frank Robinson, "Renewal of a Franchise – Legal Considerations" (July, 2010), 1 *Focus on Franchising* 3 (Ontario Bar Association).
- 10. See e.g., *Agribrands Purina Canada Inc. v. Kasamekas*, 2010 ONSC 166, [2010] O.J. No. 84 (Ont. S.C.J.) at para. 103, varied on other grounds 2011 ONCA 460 (Ont. C.A.), additional reasons 2011 ONCA 581; *Erinwood Ford Sales Ltd. v. Ford Motor Co. of Canada Ltd.* (2005), 6 B.L.R. (4th) 182, [2005] O.J. No. 1970 (Ont. S.C.J.) at para. 71 ("whether or not the relationship in this case is truly a franchise relationship, it certainly is akin to that type of relationship"), additional reasons 6

to a common law duty of good faith that creates additional burdens for the franchisor/supplier to which they would not otherwise be subject in a normal commercial contract.¹¹ In Ontario, Alberta, Manitoba, New Brunswick and P.E.I., this duty also arises by statute.¹² The duty of good faith constrains franchisors/suppliers in the exercise of contractual discretion and creates additional scope for potential liability even where strict contractual rights are respected.¹³ Viewed in the context of a renewal clause, the courts are beginning to treat the enforcement of conditions precedent by franchisors/suppliers as an exercise of discretion that can be subject to the duty of good faith.¹⁴ The exercise of discretion for an improper or ulterior motive, out of vindictiveness, or before any consideration of the interests of one's franchisee/distributor, may well place the franchisor/supplier offside the duty of good faith and, therefore, possibly in breach of the renewal clause.¹⁵ In addition, two well-known franchise renewal cases, *Salah v. Timothy's Coffees of the World Inc.* and *1159607 Ontario Inc. v. Country Style Food Services Inc.*, establish that franchisors must conduct themselves fairly throughout the renewal process; this obligation may be breached when vital information is intentionally withheld from the franchisee.¹⁶

The aim of this article is to consider the common law principles that govern renewal rights in ordinary commercial contracts

B.L.R. (4th) 205. The full extent to which the common law duty of good faith extends beyond "franchise" relationships to "distributorships" (and the common law test for defining these terms) is outside the scope of this article.

11. The seminal case on point is *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 226 D.L.R. (4th) 577, [2003] O.J. No. 1919 (Ont. C.A.), additional reasons 269 D.L.R. (4th) 152.
12. Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3; Franchises Act, R.S.A. 2000, c. F-23; The Franchises Act, C.C.S.M. c. F156; Franchises Act, S.N.B. 2007, c. F-23.5; Franchises Act, R.S.P.E.I. 1988, c. F-14.1.
13. *Shelanu*, *supra*, footnote 11, at paras. 71 and 96 ("the fact that contractual terms are ultimately complied with, does not mean that there has been no breach of the duty of good faith"; "[franchisor] obliged to exercise the discretion in a reasonable manner"); *760437 Alberta Ltd. v. Fabutan Corp.*, 2012 ABQB 266 (Alta. Q.B.), at paras. 95-97.
14. *Fabutan*, *supra*, footnote 13, at paras. 95-96.
15. *Shelanu*, *supra*, footnote 11, at paras. 71 and 96 ("the fact that contractual terms are ultimately complied with, does not mean that there has been no breach of the duty of good faith"; "[franchisor] obliged to exercise the discretion in a reasonable manner"); *Fabutan*, *supra*, footnote 13.
16. *Salah v. Timothy's Coffees of the World Inc.* (2009), 65 B.L.R. (4th) 235 (Ont. S.C.J.), additional reasons 2010 ONSC 516 (Ont. S.C.J.), affirmed 2010 ONCA 673, [2010] O.J. No. 4336 (Ont. C.A.); *1159607 Ontario Inc. v. Country Style Food Services Inc.*, 2012 ONSC 881, [2012] O.J. No. 1241 (Ont. S.C.J.), additional reasons 2012 ONSC 2150 (Ont. S.C.J.).

through the lens of the franchise/distribution relationship and the duty of good faith that arises as an incident to that relationship. The goal is to illustrate the manner in which the duty of good faith, in practice, alters and refines the legal principles that would otherwise operate in its absence. Part II of this article will consider the common law requirement that a renewal right be rooted in the contract. Part III will consider the common law principle that a renewal clause must define the essential terms that will govern the parties during the renewal term. Finally, Part IV will consider the common law treatment of conditions precedent to the exercise of renewal rights. As the analysis in these sections will illustrate, the duty of good faith will sometimes complicate the assessment of the enforcement of a renewal clause in a franchise/distribution dispute, obscuring an already complex question.

II. RIGHTS MUST BE ROOTED IN CONTRACT

Renewal rights are purely consensual rights, which means that their genesis must be traced to, and rooted in, the express words of an enforceable agreement between the parties.¹⁷ While the requirement at common law for a contractual basis for renewal rights is intuitive and almost obvious, it has been subject to extensive litigation in the franchise-distribution context.¹⁸ In most of these cases, the franchisee/distributor has attempted to set up the duty of good faith as the mechanism to establish a renewal right that is not founded in the express words of the agreement. As a result of the principle established in this case law, a franchisee/distributor cannot invoke the duty of good faith (whether at common law or under one of the provincial statutes) to assert or

17. See e.g., *C Corp. (Ontario) v. Wesbru Holdings Ltd.* (1988), 91 A.R. 210, [1988] A.J. No. 1020 (Alta. Master), at paras. 30 and 34; *TDL Group Ltd. v. 1060284 Ontario Ltd.* (2000), 6 B.L.R. (3d) 54, [2000] O.J. No. 1239 (Ont. S.C.J.), at paras. 16-17 (“When a party enters into an agreement which contains no right to renew or an option to renew on ascertainable terms there will be no renewal enforceable by a court”).

18. See e.g., *C Corp.*, *supra*, footnote 17, at paras. 20-34; *3317447 Manitoba Ltd. v. Beaver Lumber Inc.*, 2006 SKQB 414 (Sask. Q.B.), at paras. 22-26; *530888 Ontario Ltd. v. Sobeys Inc.* (2001), 12 B.L.R. (3d) 267, [2001] O.J. No. 723 (Ont. S.C.J. [Commercial List]), at paras. 10 and 22; *Beaucage v. Grand & Toy Ltd.* (2001), 19 B.L.R. (3d) 196, [2001] O.J. No. 5128 (Ont. S.C.J.) at para. 23, additional reasons 2002 CarswellOnt 49 (Ont. S.C.J.); *Sultani v. Blenz The Canadian Coffee Co.* (2005), 3 B.L.R. (4th) 93, 2005 bcsc 571 (B.C. S.C.) at para. 25, affirmed 2005 BCCA 578, [2005] B.C.J. No. 2560 (B.C. C.A.); *Pointts Advisory Ltd. v. 754974 Ontario Inc.*, 2006 O.T.C. 787, [2006] O.J. No. 3504 (Ont. S.C.J.), at para. 55.

enforce a right of renewal that lacks an independent, contractual basis.¹⁹

One of the leading early cases, *C Corp. (Ontario) Ltd. v. Wesbru Holdings Ltd.*, brings the confines of this principle into sharp focus. In *C Corp.*, the Alberta Court of Queen's Bench made clear that, without an express renewal right in the agreement, the franchisor's subjective reasons for not pursuing a renewal were completely irrelevant to the issue.²⁰ As we know from the leading modern case law on good faith, subjective motivations are highly relevant when assessing the exercise of contractual rights and discretion against the standard of good faith.²¹ *C Corp.* strongly suggests that such inquiries, and even evidence of bad faith, are irrelevant in the renewal context without an express contractual right. The court in *C Corp.* also found that a previously-stated policy by the franchisor in favour of renewal was irrelevant without an underlying contractual right.²²

A recurrent issue in the franchise context is the relationship between the franchise agreement and leasing arrangements for the franchise location. In many franchise relationships, the franchisor holds the head-lease with the landlord, and subleases the franchise location to the franchisee at the same time as entering into the

19. *C Corp.*, *supra*, footnote 17, at paras. 43-44 ("The reason why [the franchisor] refused to enter into a 5 year renewal with the [franchisee] is irrelevant . . . Only if [the franchisor] [was] legally obligated to enter into a 5 year renewal would [its] reason for not doing so be relevant . . ."); *3317447 Manitoba Ltd. v. Beaver Lumber Inc.* (2006), 21 B.L.R. (4th) 209, 2006 SKQB 414 (Sask. Q.B.), at paras. 22-26 (finding that the duty of good faith, if applicable to the relationship, cannot create a right of renewal where the contract does not); *530888 Ontario Ltd. v. Sobeys Inc.* (2001), 12 B.L.R. (3d) 267, [2001] O.J. No. 723 (Ont. S.C.J. [Commercial List]), at paras. 23-24 ("there is no inherent right to force a franchisor to enter into a new sublease agreement with one of its franchisees that has expired on its own terms with no option to renew . . . [The duty of good faith] surely does not compel one party to renew an expiring relationship when it considers it to be commercially unreasonable"); *Beaucage v. Grand & Toy Ltd.* (2001), 17 C.P.R. (4th) 125, [2001] O.J. No. 5128 (Ont. S.C.J.) at para. 23, additional reasons 2002 CarswellOnt 49 (Ont. S.C.J.) ("A general duty of fair dealing without more cannot turn a written term of expiry into a right to renew"); *Sultani*, *supra*, footnote 18, at para. 25, ("the duty of fair dealing does not compel a party to renew an expiring relationship when it is not considered commercially reasonable to do so . . . Here, [the franchisor] explained that it had a new commercial programme to introduce at this . . . location and that it wanted to do so on its own and not through a franchisee."); *Pointts*, *supra*, footnote 18, at para. 55 (duty of good faith does not alter the interpretation of the renewal clause, only its implementation).

20. *C Corp.*, *supra*, footnote 17, at paras. 43-46.

21. See e.g., *Shelanu*, *supra*, footnote 11, at para. 76.

22. *C Corp.*, *supra*, footnote 17, at paras. 60-63.

franchise agreement.²³ As a consequence of the common law requirement for a contractual genesis for renewal rights, where the head-lease in such situations contains a renewal right, but the sublease and franchise agreement do not, the franchisee has no enforceable right of renewal.²⁴ In other words, the duty of good faith does not require the franchisor in such circumstances to extend a right of renewal to the franchisee just because the landlord saw fit to extend such a right in the head-lease.²⁵

The question of legal enforcement becomes more difficult where the putative renewal “right” is only triggered at the election of the franchisor, such as in *Esmail v. Petro-Canada*.²⁶ In *Esmail*, the agreement required the franchisor to elect whether or not to provide the franchisee with a renewal and, if electing in the affirmative, to determine the terms of that renewal. The Ontario Superior Court held that, because the franchisor had the right to choose whether to enter into a renewal, the franchisee had no reasonable expectation, or enforceable legal right, to a particular outcome. Moreover, according to the court, because the clause accorded the franchisor the right to elect one way or the other whether to renew, that decision was not, and could not be, subject to the duty of good faith.²⁷ While a majority of the Divisional Court upheld the court’s decision not to award an injunction to the franchisee, only one justice in the majority specifically endorsed this reasoning, with the dissenting justice finding a triable issue with respect to whether the franchisor had a duty to act in good faith.²⁸

Esmail predates the Ontario Court of Appeal’s seminal decision on good faith in franchise agreements in *Shelanu*, and it is an open question whether the analysis respecting good faith in *Esmail* remains good law. One way of assessing this question is to decide whether the franchisor’s act of electing not to renew in *Esmail* is properly characterized as an exercise of the franchisor’s contractual discretion, which *Shelanu* strongly suggests would always be subject to the duty of good faith.²⁹ It is clear that the reasoning in

23. Ross Bain, “Franchise Renewals: An In-House Counsel’s Perspective” (2011), 3 *Focus on Franchising* 1 (Ontario Bar Association), at p. 1.

24. See generally, *C Corp.*, *supra*, footnote 17; *Sultani*, *supra*, footnote 18.

25. *C Corp.*, *supra*; *Sultani*, *supra*.

26. *Esmail v. Petro-Canada*, 1995 CarswellOnt 4375, [1995] O.J. No. 924 (Ont. Gen. Div.), affirmed 86 O.A.C. 385, [1995] O.J. No. 3515 (Ont. Div. Ct.), leave to appeal refused 1996 CarswellOnt 38, [1996] O.J. No. 33 (Ont. C.A.), leave to appeal refused [1996] S.C.C.A. No. 38 (S.C.C.).

27. *Esmail*, *supra*, at paras. 20-24.

28. *Esmail*, *supra*.

Esmail does not apply where the agreement provides for “automatic” renewal subject to termination, as the court in *Esmail* made clear that this form of agreement would require the franchisor to exercise its power of termination in good faith.³⁰ *Esmail* also clearly doesn’t apply where the agreement expressly obliges the franchisor to accord due process to the franchisee when electing whether or not to renew.³¹

Sometimes the question of whether or not a renewal right is actually rooted in the agreement arises when the renewal clause was previously exercised and there is a dispute over whether that clause, itself, carried over into the renewal term. Occasionally, this raises the question of whether the renewal clause, properly interpreted, creates a perpetually-renewing agreement.³² At common law, there must be clear contractual language to this effect in order for a renewal clause to carry forward and apply to the subsequent term of the agreement, especially for perpetual renewals.³³ For example, in an early decision on this issue, the Ontario High Court would have refused to recognize a subsequent right to renew where the contract simply provided that the “same terms and conditions” would apply to the renewal term, since the agreement did not expressly provide that the renewal clause would carry forward.³⁴ In the more recent franchise case of *Boston Pizza International Inc. v. 395047 B.C. Ltd.*, the B.C. Supreme Court

29. *Shelanu*, *supra*, footnote 11, at para. 96; see also *Fabutan*, *supra*, footnote 13, at para. 95.

30. *Esmail*, *supra*, footnote 26, at para. 23 (“It is understandable that . . . the reasonable expectation to be drawn from an agreement that renews automatically unless terminated is that the agreement will not be terminated in bad faith. Such a reasonable expectation would constitute a very persuasive reason to insist on the application of the good faith principle”).

31. *Parker v. Canadian Tire Corp.* (1998), 67 O.T.C. 196, [1998] O.J. No. 1720 (Ont. Gen. Div.), at para. 10.

32. *Boston Pizza International Inc. v. 395047 B.C. Ltd.*, *supra*, footnote 8, at paras. 13-16 (franchise agreement allowed for perpetual renewals given the contractual phrase “any subsequent renewal term” (emphasis added)).

33. *Wilson v. Kerner* (1912), 3 D.L.R. 11, [1912] O.J. No. 366 (Ont. H.C.), at para. 2 (“a proviso in general terms that the renewal lease shall contain the same covenants and agreements as the lease containing the covenant for renewal has been repeatedly held not to extend to the covenant for renewal”); *Gill v. McIntosh Limousine Service Ltd.*, (2001), 105 A.C.W.S. (3d) 970, [2001] O.J. No. 2168 (Ont. S.C.J.), at para. 31 (“the intention to permit renewal for more than one term must be clearly expressed to be effective. I conclude that the language ‘a further period’ is much more consistent with one renewal”). The courts in the United States appear to require extremely precise language in order to find a perpetually-renewing agreement: *H & R Block Tax Services, LLC v. Franklin*, 691 F.3d 941 (Fed. 8th Cir., 2012).

34. *Wilson v. Kerner*, *supra*, at para. 2.

concluded that the renewal clause created a perpetually-renewing agreement, focusing on the plain text of the renewal clause as well as what the court termed the “commercial reality” that the franchisee was required to make significant capital investments into the franchise.³⁵

The relationship between the duty of good faith and the common law requirement for a contractual basis for renewals has been instructive to the franchise bar. In an important sense, the duty of good faith has helped define the common law principle, as the latter has been most clearly expressed by the courts in response to attempts by franchisees/distributors to invoke the duty of good faith to supply a renewal right otherwise lacking in the contract. In a similar way, the results in these cases have also helped make clear the essential point that the duty of good faith cannot alter the express terms of the agreement or create new substantive rights that had not been bargained for. This point was expressed clearly in *Pointts Advisory Ltd. v. 754974 Ontario Inc.*³⁶ In the end, the common law requirement for an express contractual renewal is the starting premise for any assessment of a renewal problem that may arise in practice and this starting premise is not affected by the duty of good faith.

III. THE COMMON LAW REQUIREMENT FOR CERTAINTY OF TERMS

While the legal concept of “certainty of terms” as a prerequisite to contract formation is well known in theory, at first blush it does not fit nicely into the practical reality facing franchises and distributorships. It is common, for example, for renewal clauses in franchise and distribution agreements to expressly provide that the renewal term will be governed by the “then-standard” form of agreement employed by the franchisor/supplier at the time of renewal.³⁷ While there is no doubt that this practice may be essential for franchisors/suppliers to adapt their distribution

35. *Boston Pizza International Inc. v. 395047 B.C. Ltd.*, *supra*, footnote 8.

36. *Pointts*, *supra*, footnote 18, at para. 55 (“The interpretation of the renewal provision in this case is not affected by the statutory duty of fair dealing . . . It was not the intention that the Act change the terms of an agreement entered into by the parties”); see also *Transamerica Life Canada Inc. v. ING Canada Inc.* (2003), 234 D.L.R. (4th) 367, [2003] O.J. No. 4656 (Ont. C.A.), at para. 53.

37. Bain, *supra*, footnote 23, at p. 4; John Yiokaris, “Franchise Renewals: Issues Surrounding the Franchisor’s Right to Accept a Franchisee’s Exercise of a Renewal Option” (paper presented to the Ontario Bar Association 10th Annual Franchise Law Conference, November 4, 2010), at p. 10.

systems to market changes,³⁸ it necessarily means that the terms of renewal will be somewhat uncertain, in the vernacular sense at least, until such time as the parties are within the vicinity of the renewal term. Another frequent source of potential uncertainty arises in the context of the leasing arrangements that are often put into place alongside a franchise agreement. Many franchisors hold the head-lease to the franchise location which they sublease back to the franchisee, in many cases with the term of the franchise agreement and sublease expressly linked.³⁹ The uncertainty in this regard arises where the franchisor's renewal right in the head-lease with the landlord fails to define the renewal rent or other terms with certainty, often using language like "fair market rent" and/or providing for binding arbitration close to the date of renewal.⁴⁰ While we will soon see that these types of provisions will generally *not* be offside the common law requirement for certainty of terms, there are subtleties in this area of the law that are important to appreciate when drafting renewal clauses.

At common law, a contractual right of renewal, like any other contractual right, must provide certainty as to the essential terms that will govern the parties during the renewal. In *McDonald Estate v. Canadian Department Stores Ltd.*, the Supreme Court of Canada held that a renewal clause was void for uncertainty on the basis that the duration of the renewal was neither expressly defined nor ascertainable by reference to some objective benchmark.⁴¹ The clause at issue in *McDonald Estate* provided a right of renewal to the lessee for as long as she "may require" the premises. The Supreme Court held that, properly interpreted, the clause contemplated a renewal for as long as the lessee would, in fact, require the premises, which was not a matter that could be objectively determined at the time the right was exercised. Had the renewal term been defined as being for as long "as demanded" by the lessee, the Supreme Court would have enforced the clause, as in that context the demand itself would have rendered the renewal term certain. The problem with the clause as drafted in *McDonald Estate* was that the renewal term depended on some future crystallization of circumstances that could not be determined at the time the right was exercised.

38. Yiokaris, *ibid.*, at pp. 1-2.

39. Bain, *supra*, footnote 23, at p. 1.

40. *Ibid.*, at p. 2.

41. *Gourlay v. Canadian Department Stores Ltd.*, [1933] S.C.R. 329 at pp. 331-332, (*sub nom. McDonald Estate v. Canadian Department Stores Ltd.*) [1933] S.C.J. No. 23 (S.C.C.).

McDonald Estate was recently applied by the Ontario Court of Appeal in *Holt v. Thunder Bay (City)*,⁴² where the governing test of certainty was described as “hardly . . . exacting.”⁴³ According to the court, the first step in such cases is to interpret the renewal clause within the agreement as a whole, in accordance with modern principles of contractual interpretation, to determine whether certainty of terms “can be ascertained . . . by reference to the express terms . . . or by reference to some collateral matter that is itself certain or capable of being made certain before the [renewal] takes effect.”⁴⁴ In *Holt*, the court held that the duration of the renewal term was rendered certain by the express terms of the clause, which provided that all the same terms and conditions of the lease (which implicitly included the original term of 13 years) would carry forward to the renewal.

As noted in both *McDonald Estate* and *Holt*, for the purposes of enforceability, if an essential term is not expressly defined in the agreement itself, it must be ascertainable by “reference to some collateral matter” by the time the renewal takes effect. For example, in the commercial leasing context, it is common for leases to provide that the quantum of rent to be payable during the renewal term is to be “fair market rent”, as determined through some prescribed process. As discussed above, this is also common in the context of leases for franchised businesses, with the franchisee’s sublease typically adopting by reference the quantum of rent determined under the head-lease.⁴⁵ According to the courts that have considered these clauses, because “fair market value” is itself an objective concept, it provides sufficient certainty to allow the court to determine the content of this missing essential term for the parties (for example, with the help of expert evidence).⁴⁶ In *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*, the Supreme Court of Canada confirmed that “[a]n option to be exercised at ‘fair market value’ is valid and enforceable” as the concept is an

42. *Holt v. Thunder Bay (City)* (2003), 65 O.R. (3d) 257, [2003] O.J. No. 2401 (Ont. C.A.), at para. 15.

43. *Holt v. Thunder Bay (City)*, *supra*, at para. 20.

44. *Holt v. Thunder Bay (City)*, *supra*, at paras. 19.

45. See generally Bain, *supra*, footnote 23, at p. 2.

46. *Mampar Enterprises Ltd. v. Canada*, 1999 BCCA 239, [1999] B.C.J. No. 850 (B.C. C.A.), at paras. 52-54 and 61; *EdperBrascan Corp. v. 177373 Canada Ltd.* (2000), 50 O.R. (3d) 425 (Ont. S.C.J.), at paras. 14 and 47-49, additional reasons 53 O.R. (3d) 331 (Ont. S.C.J.), affirmed 22 B.L.R. (3d) 42 (Ont. C.A.), leave to appeal discontinued (August 12, 2002), Doc. 29184, [2002] S.C.C.A. No. 184 (S.C.C.); *Mitsui & Co. (Canada) Ltd. v. Royal Bank*, [1995] 2 S.C.R. 187, [1995] S.C.J. No. 37 (S.C.C.), at paras. 31-32.

“objective matter capable of discernment” by the courts.⁴⁷ The Ontario Court of Appeal recently broadened this principle in *Henly Capital Corp. v. Cable Atlantic Inc.* when it affirmed a lower court decision in which the concept of “normal commercial terms”, as applied in the context of a particular industry in which its ambit was circumscribed, was held to be a sufficient objective benchmark to allow the court to determine an essential term in an agreement.⁴⁸

A related and derivative principle to that set out in *McDonald Estate* arises from the general reluctance of Anglo-Canadian courts to enforce “agreements to agree”, including renewal clauses that defer one or more essential terms to some future agreement between the parties. This principle has commonly arisen in the leasing context, where the quantum of renewal rent — instead of, or in addition to, being based on “fair market” value — is deferred to some future agreement or negotiation process between the parties. According to the Supreme Court of Canada, this form of agreement will be enforceable where it expressly provides that the missing essential term will be referred to binding arbitration in the event that the future negotiations fail.⁴⁹ Similarly, the Ontario Court of Appeal has enforced an agreement that contemplated future negotiation, but which expressly stipulated the content of the missing term in the event that the negotiations failed.⁵⁰ In the cases of binding arbitration or express stipulation of the missing term, certainty is ultimately provided despite there being an agreement to attempt negotiation in advance. By contrast, in *Young v. Van Beneen*, the B.C. Court of Appeal was faced with a renewal option that deferred the quantum of rent to future agreement without any arbitration or similar provision to determine the issue in the event no agreement was concluded.⁵¹ The court refused to enforce the renewal option.⁵²

47. *Mitsui*, *supra*, at para. 32.

48. *Henly Capital Corp. v. Cable Atlantic Inc.* (2006), 19 B.L.R. (4th) 6 (Ont. C.A.) (an agreement to pay a success fee based on “normal commercial terms” for the investment banking industry was a sufficient objective benchmark).

49. *Calvan Consolidated Oil & Gas Co. v. Manning*, [1959] S.C.R. 253 (S.C.C.), at pp. 259-260.

50. 435935 *Ontario Ltd. v. Thames Valley Ambulance Ltd.* (1999), 24 R.P.R. (3d) 175, [1999] O.J. No. 2041 (Ont. C.A.), at paras. 9-10.

51. *Young v. Van Beneen*, [1953] 3 D.L.R. 702, [1953] B.C.J. No. 127 (B.C. C.A.), at para. 14. The renewal clause in *Van Beneen* had a second defect: it also failed to define with any certainty the terms and conditions that would apply during the renewal term. On this basis, it was also void for uncertainty on the basis of the principle set out in *McDonald Estate*.

52. *Van Beneen*, *supra*, at para. 12, citing *Murphy v. McSorley*, [1929] S.C.R. 542 (S.C.C.). *Murphy* has been cited frequently by appellate courts in Canada,

It is helpful at this point to pause and consider the state of binding authority in Canada, from which the following principles emerge:

- (a) A renewal clause that fails to define an essential term for the renewal will nevertheless be enforceable if it provides an objective benchmark to allow the court to determine that essential term (*e.g.*, fair market value).⁵³
- (b) A renewal clause that defers the content of an essential term to some future negotiation between the parties will also be enforceable if it ultimately provides for the determination of the essential term in the event of a breakdown in the future negotiation (*e.g.*, through binding arbitration or express stipulation).⁵⁴
- (c) A renewal clause that fails to define or defers to future negotiation an essential term is void for uncertainty unless it otherwise falls within the principles set out in (a) or (b).⁵⁵

With these three principles in mind, it is useful to turn to the Supreme Court's leading early decision in *Murphy v. McSorley*, which addresses the more complex question of the extent to which the common law will enforce a duty to negotiate in the context of a renewal right. At issue in *Murphy* was an option to purchase contained in a lease which provided that the option price would be \$45,000, with \$15,000 to be paid in cash and the balance to be paid on terms "to be arranged" at some future date. The parties ultimately failed to agree on the terms to apply to the payment of the balance, but the trial judge nevertheless enforced the option. According to the trial judge, during the negotiations to settle the payment terms, "[t]he attitude taken by the [landlord] was . . . not reasonable or fair", and this was fatal to the landlord's position.

A majority of the Supreme Court of Canada, *per* Mignault J., reversed this decision, refused to enforce the option, and found

including in more recent times; see *e.g.*, *Ko v. Hillview Homes Ltd.*, 2012 ABCA 245 (Alta. C.A.) at para. 88, leave to appeal refused 2013 CarswellAlta 9 (S.C.C.); *Mannpar*, *supra*, footnote 46, at para. 38. *Murphy* has also recently been applied by the Ontario Superior Court of Justice in *Simpson v. Canada (Attorney General)*, 2011 ONSC 5637, [2011] O.J. No. 4407 (Ont. S.C.J.), at para. 62.

53. See *e.g.*, *Mitsui*, *supra*, footnote 46; and *Henly*, *supra*, footnote 48.

54. *Calvan*, *supra*, footnote 49, at pp. 259-260; *Thames Valley*, *supra*, footnote 50, at paras. 9-10.

55. *Murphy*, *supra*, footnote 52; *McDonald Estate / Gourlay*, *supra*, footnote 41; *Van Bienen*, *supra*, footnote 51. See also *Great Atlantic & Pacific Co. of Canada Ltd. v. Topostar (Aurora) Inc.*, 2006 CarswellOnt 1418, [2006] O.J. No. 945 (Ont. S.C.J.), at paras. 51-52.

that the negotiating position of the landlord was legally irrelevant:⁵⁶

It is no answer to say that [the landlord's] attitude was not "fair" or "reasonable." As it takes two to make a bargain, the only way this bargain could have been made would have been by acceptance of [the landlord's] terms at the [final negotiation meeting before the option expired] . . . The court cannot make for the parties a bargain which they themselves did not make in proper time.

Mignault J. reached a similar conclusion in *Godson v. Burns*.⁵⁷ *Godson* involved a renewal clause in which the terms of the renewal were to be mutually agreed, failing which the tenancy would end and the landlord would be obliged to compensate the tenant for certain leasehold improvements. The parties could not agree as to the terms of the renewal, and the tenant brought suit to collect his compensation for the leasehold improvements. One of the factual issues was whether the lessee, who may have been motivated to collect his compensation rather than to secure a renewal, had made a *bona fide* attempt to negotiate the renewal.⁵⁸ The Supreme Court unanimously held that the tenant was entitled to its compensation, but with each member of the five-justice panel writing separate concurring reasons. The only justice whose decision addressed the issue of good faith negotiations head-on was Mignault J., who in line with his later decision in *Murphy*, held that it was "entirely immaterial whether the lessor and the lessee, or either of them, were unreasonable in the discussion of terms and conditions of renewal."⁵⁹

56. *Murphy*, *supra*, footnote 52, at p. 546.

57. *P. Burns & Co. v. Godson* (1919), 58 S.C.R. 404 (S.C.C.).

58. At the B.C. Court of Appeal, two separate concurring judgments of the majority took different views as to the relevance of this issue: *P. Burns & Co. v. Godson* (1918), 26 B.C.R. 46 (B.C. C.A.), at para. 1, *per* McDonald C.J.A. ("That the lessee *bona fide* endeavoured to bring about an agreement on reasonable terms cannot, in my opinion, be doubted"); at para. 5 *per* Martin J.A. ("whether the failure to grant [the renewal] is attributable to the rapacity of the landlord or the unreasonableness of the tenant makes no difference").

59. *P. Burns & Co. v. Godson*, *supra*, footnote 57, at p. 413. Three of the five justices ignored the issue of good faith negotiation entirely: Davies C.J.C., at p. 405, adopted the reasons of both concurring majority judgments in the Court of Appeal (which were inconsistent on this point); and Idington and Brodeur JJ. (at pp. 405 and 407, respectively) wrote separate concurring judgments that did not address the issue. One of the two remaining justices addressed the issue tangentially: Anglin J. at p. 407 held that "If reasonableness of conduct [during the negotiations] were a consideration that should enter into the matter I would agree . . . 'that the lessee (had) *bona fide* endeavoured to bring about an agreement'" (emphasis added).

On the authority of the Supreme Court's decision in *Murphy*, it is submitted that a renewal right in an ordinary commercial agreement is void for uncertainty where it defers an essential term to future negotiation without arbitration or other binding determination, whether or not one or more of the parties ever attempt to negotiate the essential term in good faith and whether or not one of the parties acts in bad faith during any negotiations. In other words, there is no enforceable duty to negotiate in such circumstances, even in the presence of an express clause in the agreement contemplating such negotiation. The Alberta Court of Appeal has very recently confirmed these principles as the law in Alberta, even going as far as to suggest that uncertainty as to non-essential or ancillary terms may have the same effect.⁶⁰ The Manitoba Court of Appeal, taking a more nuanced approach, has adopted these principles but carved out a potential exception where the evidence demonstrates a complete "unwillingness to negotiate at all", in which case the duty to negotiate *may* be enforceable against the unwilling party.⁶¹

The current state of the law in British Columbia in this regard is more difficult to discern. In *Empress Towers Ltd. v. Bank of Nova Scotia*,⁶² the B.C. Court of Appeal was faced with a renewal clause that provided that the renewal rent "shall be the market rental prevailing at the commencement of that renewal term as mutually agreed." On the basis of clear authority cited above, the court recognized that the clause would probably have been unenforceable if it had only stipulated mutual agreement as the sole basis for determining the renewal rent.⁶³ Moreover, the court would have had no trouble enforcing the provision had it only stipulated the prevailing market value as the sole basis for determining the renewal rent as in that case it would have provided an objective benchmark.⁶⁴ The challenge that arose from the provision at issue

60. *Ko v. Hillview Homes Ltd.*, *supra*, footnote 52, at paras. 90 and 135-136. By contrast, both the Manitoba and B.C. Courts of Appeal have emphasized the requirement that the uncertain term be fundamental to the bargain: *Fraser v. Van Nus* (1985), 22 D.L.R. (4th) 459, 67 B.C.L.R. 285 (B.C. C.A.), at para. 18; *P.P. (Portage) Holdings Ltd. v. 346 Portage Avenue Inc.* (1999), 177 D.L.R. (4th) 358, [1999] M.J. No. 354 (Man. C.A.), at paras. 26-28.

61. *P.P.*, *supra*, at paras. 24 and 36.

62. *Empress Towers Ltd. v. Bank of Nova Scotia* (1990), 73 D.L.R. (4th) 400, [1990] B.C.J. No. 2054 (B.C. C.A.), leave to appeal refused 79 D.L.R. (4th) vii (S.C.C.).

63. *Empress Towers*, *supra*, at p. 403 (D.L.R.) ("[I]t is well established that if all that the parties say is that they will enter into a lease at a rental to be agreed, no enforceable lease obligation is created").

64. *Empress Towers*, *supra*, at p. 404 (D.L.R.) ("If nothing more had been said then the market rental could have been determined on the basis of valuations and, if

in *Empress Towers* was that it contained two seemingly inconsistent indicia for determining the renewal rent: (a) the prevailing market rental (b) as mutually agreed between the parties. Moreover, the clause expressly provided that, failing mutual agreement between the parties on the market rental, the agreement would terminate on its own, which by necessary implication ousted the jurisdiction of the court to determine the market value of the rent for the parties. Rather than finding the provision void for uncertainty, however, the court held that the clause in question contained an implied term requiring the parties to negotiate the rent in good faith. The court then went on to find that the landlord had failed to negotiate in good faith and therefore dismissed its claim for possession of the premises.

In 1999, the B.C. Court of Appeal in *Mannpar Enterprises v. Canada* was called upon to consider the ambit of its previous decision in *Empress Towers*.⁶⁵ *Mannpar* concerned a renewal clause in a government permit for the extraction of sand and gravel from certain Aboriginal lands. The right of renewal was expressly “subject to . . . renegotiation of the royalty rate and annual surface rental.” When the government refused to renew the agreement, the applicant invoked *Empress Towers* to assert that the government had failed to negotiate the renewal price in good faith as required. The B.C. Court of Appeal clarified the ambit of the duty to negotiate in *Empress Towers*, noting that there were two prerequisites:

- (a) First, a duty to negotiate the missing term in good faith would only be enforceable if there was an “objective benchmark” from which to measure the content of the missing term.⁶⁶ Under the renewal clause in *Mannpar*, no objective benchmark was provided.
- (b) Second, the strict common law test for implying contractual terms must be met unless the contract expressly provides for the duty to negotiate in good faith.⁶⁷ On the facts of *Mannpar*, no express duty was provided and the test to imply a contractual term was not met.

Given the Court of Appeal’s decision in *Mannpar*, it is submitted that the common law of B.C. applies a modified version of the rule set down by the Supreme Court in *Murphy*. In British

necessary, a court could have made the determination. It would have been an objective matter.”).

65. *Mannpar*, *supra*, footnote 46.

66. *Mannpar*, *supra*, at paras. 52 and 61.

67. *Mannpar*, *supra*, at paras. 56-61.

Columbia, an enforceable duty to negotiate a missing essential term in good faith may in fact be recognized in the narrow circumstances approved by the B.C. Court of Appeal in *Empress Towers* as refined in *Mannpar*. In other words, to be enforceable, the duty to negotiate must either be expressed, or properly implied under the common law test for implication of contractual terms, and it must be measurable by an objective benchmark provided by the agreement.

While the state of the law in Ontario is somewhat more difficult to discern, as discussed below, the better view is that there is no enforceable duty to negotiate in good faith in the context of ordinary commercial agreements. In *Cedar Group Inc. v. Stelco Inc.*, the Ontario Court of Appeal affirmed the conclusion of a lower court that an *express* duty to negotiate a definitive agreement, contained in a shorter letter agreement, was unenforceable at common law.⁶⁸ In the first instance decision in *Cedar Group*, the lower court had applied the leading House of Lords decision in *Walford v. Miles*, which had emphasized the inherently adversarial nature of commercial negotiations as precluding an enforceable obligation to negotiate in good faith.⁶⁹ In *Cedar Group*, since there was no objective benchmark from which to determine the essential terms, and no binding arbitration clause, the court held that the clause was void for uncertainty and the Court of Appeal agreed.

In *EdperBrascan Corp. v. 117373 Canada Ltd.*,⁷⁰ the Ontario Court of Appeal affirmed a lower court decision that had refused to find an implied duty to negotiate in good faith. In

68. *Cedar Group Inc. v. Stelco Inc.* (1995), 59 A.C.W.S. (3d) 1096, [1995] O.J. No. 3998 (Ont. Gen. Div.), affirmed 66 A.C.W.S. (3d) 867, [1996] O.J. No. 3974 (Ont. C.A.). See also *Peel Condominium Corp. No. 505 v. Cam-Valley Homes Ltd.* (2001), 196 D.L.R. (4th) 621, 53 O.R. (3d) 1 (Ont. C.A.) at paras. 40-42, *per* Finlayson and Labrosse J.J.A. (no duty to negotiate in good faith in pre-contractual phase of relationship); *Oz Optics Ltd. v. Timbercon Inc.* (2011), 343 D.L.R. (4th) 443, 2011 ONCA 714, [2011] O.J. No. 5029 (Ont. C.A.), at paras. 61-71 (noting that the Supreme Court's decision in *Martel Building Ltd. v. Canada*, [2000] 2 S.C.R. 860, 2000 SCC 60 (S.C.C.) militated against finding a duty of good faith in the pre-contractual phase), additional reasons 2012 ONCA 735 (Ont. C.A.).

69. *Cedar Group*, *supra*, at paras. 4, 29 and 32, citing *Walford v. Miles*, [1992] 2 A.C. 128 (H.L.), at pp. 138-139. The court in *Cedar Group* also cited the earlier Ontario High Court decision *L.C.D.H. Audio Visual Ltd. v. I.S.T.S. Verbatim Ltd.* (1988), 40 B.L.R. 128, [1988] O.J. No. 633 (Ont. H.C.) (no binding agreement, as the parties only agreed to negotiate toward a subcontracting agreement, with essential terms missing), affirmed 1991 CarswellOnt 1918 (Ont. C.A.).

70. *EdperBrascan*, *supra*, footnote 46.

EdperBrascan, the implied duty of good faith was asserted to apply in the context of a dissolution agreement containing a pricing formula that, in part, contemplated mutual agreement between the parties. Because of the reference to mutual agreement, and the lack of an arbitration clause, there was no objective benchmark, or third-party process, for determining the applicable price. While the Court of Appeal's decision is short, it expressly endorsed both the conclusion and underlying analysis of the lower court. Given the court's adoption of the reasoning of the court below, it is arguable that those reasons represent the binding law of Ontario. In this regard, it is important to emphasize the following aspects of the lower court's reasons:

- (a) First, the court treated *Cedar Group* as representing the law in Ontario, such that even an *express* contractual duty to negotiate is unenforceable.⁷¹
- (b) Second, the court adopted the statement of the House of Lords in *Walford v. Miles* that a duty of good faith was completely unworkable in the context of commercial negotiations.⁷² According to the House of Lords:⁷³

[T]he concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact, in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms. . . . There can be thus no obligation to continue to negotiate until there is a "proper reason" to withdraw.

- (c) Third, the court refused to apply its previous decision in *Canada Trustco Mortgage Co. v. 1098748 Ontario Ltd.*,⁷⁴ finding that decision inconsistent with *Cedar Group*. *Canada Trustco* concerned a renewal option that deferred the content of the renewal terms to mutual agreement, with no objective benchmark or binding third party determination. The court implied into the agreement "a duty on both parties to make a good faith attempt to negotiate renewal terms" which the court

71. *EdperBrascan*, *supra*, at paras. 49, 54 and 56.

72. *EdperBrascan*, *supra*, at para. 53.

73. *Walford v. Miles*, *supra*, footnote 69, at pp. 138-139.

74. *Canada Trustco Mortgage Co. v. 1098748 Ontario Ltd.* (1999), 97 O.T.C. 282, [1999] O.J. No. 963 (Ont. Gen. Div.).

interpreted to require the absence of “malice or fraud.”⁷⁵ Given *EdperBrascan*’s rejection of *Canada Trustco*, it is doubtful the latter case remains good law.

While it is possible that an Ontario court will find a way to distinguish *EdperBrascan* in the future,⁷⁶ perhaps to go as far as the B.C. Court of Appeal has gone in *Mannpar* and *Empress Towers*, *EdperBrascan* currently remains the most reliable expression of the law in Ontario.

IV. DOES THE DUTY OF GOOD FAITH MODIFY THE COMMON LAW RULE REGARDING NEGOTIATIONS?

It is currently unclear to what extent, if any, the franchise/distribution context and the duty of good faith modify the common law principles set out above in relation to the duty to negotiate. As a starting premise, the issue of uncertainty is one of pure enforceability, so there is no contractual discretion to be exercised in good faith. The duty of good faith is commonly understood to be restricted to the performance or enforcement of a contractual right or duty, rather than as a doctrine that can support an otherwise unenforceable agreement. Indeed, it would be difficult to transplant the lessons taught in the main franchise cases in which the courts have delineated the scope of the duty of good faith to the commercial leasing cases that question the enforceability of a duty to negotiate.

That having been said, the underlying premise of the commercial leasing cases rejecting a duty to negotiate seems incompatible with the main premises that flow from the foundational cases on good faith. The House of Lords suggested in *Walford* that the notion of good faith negotiations was “unworkable” and contrary to the “adversarial” position of the parties. We know from *Shelanu*, however, that one of the main imports of the duty of good faith is to ensure that franchisors do not treat franchisees as adversaries — instead, they are to be treated as stakeholders whose legitimate interests must be considered before significant decisions are made and before contractual discretion is exercised. There is a rich volume of case law in which the courts have provided

75. *Canada Trustco Mortgage Co. v. 1098748 Ontario Ltd.*, *supra*, at paras. 25-26.

76. In *Molson Canada 2005 v. Miller Brewing Co.*, 2013 ONSC 2758 (Ont. S.C.J.), at paras. 89-108, the Ontario Superior Court recently suggested that a duty to negotiate in good faith might be enforceable depending on the factual record. See also *Barclays Bank v. Devonshire Trust PLC*, 2013 ONCA 494 (Ont. C.A.), at para. 133, suggesting that a duty to negotiate in good faith may be enforceable.

franchisors with indicia for determining whether they are complying with the duty of good faith, which means that it surely cannot be an “unworkable” concept outside the negotiation context.

The unanswered question is whether the duty of good faith that arises under all franchise, and some distribution, agreements will require parties to negotiate renewal terms in good faith in circumstances where their renewal clauses fail to provide certainty as to one or more essential terms. This may well depend on whether the courts treat negotiation of a renewal agreement as a fundamentally different type of activity than mere performance of duties under an existing agreement. To date, this legal question does not appear to have arisen in any franchise litigation. This is probably because of the two practical realities that face franchise renewals introduced above. As mentioned, a common renewal clause in a franchise arrangement requires the franchisee to sign the “then-current” franchise agreement, which itself provides an objective location for all the essential terms. Where this outcome is expressly stipulated in the renewal clause,⁷⁷ it is an enforceable right and duty,⁷⁸ and the only question that may arise is whether the franchisor has, *in fact*, presented the franchisee with the “then current” agreement.⁷⁹

The second practical reality is the use of “fair market” rent in renewal clauses that govern the head-lease between the franchisor and landlord. In this context, while the franchisor would probably need to consider the interests of the franchisee before agreeing on the renewal rent with the landlord, the duty of good faith has really no other role to play in determining the enforceability of the renewal rent. The determination of fair market rent will be made by the court (through expert evidence) or by an arbitrator.

77. It has been observed that without such an express provision, a franchisor is precluded from requiring the franchisee to sign the “then-current” provision: Robinson, *supra*, footnote 9.

78. Where a franchisor fails to comply with its contractual obligation to provide the franchisee with its “then current” form of franchise agreement at the time of renewal, it has breached the renewal clause and the franchisee is entitled to relief: *Pointts*, *supra*, footnote 18, at paras. 57, pp. 65-66. See also *Fabutan*, *supra*, footnote 13 (court also found breach of the duty of good faith).

79. In three separate franchise cases, the parties could not agree on the terms that were supposed to govern their relationship during the renewal period. In all three of these cases, the courts were required to review the entire record, including where appropriate the franchisor’s wider practice in its network with respect to “then current” forms of agreement, in order to determine the form of agreement that applied: *Pointts*, *supra*, footnote 18, at paras. 51-52 and 55-56; *Fabutan*, *supra*, footnote 13, at para. 84; *Country Style*, *supra*, footnote 16, at para. 96.

V. CONDITIONS PRECEDENT TO THE EXERCISE OF RENEWAL RIGHTS

Conditions precedent are a common mechanism for controlling access to renewal terms, especially in the context of commercial leases and franchise-distribution systems. Typical conditions precedent under franchise agreements include advance notice provisions,⁸⁰ clauses requiring the franchisee to have been compliant with, or not be in default under, the other covenants in the agreement, and provisions requiring the franchisee to undertake “re-imaging” or renovations of their franchise location.⁸¹ Advance notice provisions and clauses requiring “no default” in the covenants of the wider agreement are also common to commercial leases.⁸² These types of conditions have given rise to a large volume of litigation in the provincial appellate courts and the Supreme Court of Canada. In this section of the article, I will highlight the key principles that arise from these cases.

One of the most frequently-litigated issues in the context of renewal rights is whether the grantee has met the condition requiring that she not be in default under the other terms of the agreement. In many of these cases, the outcome will depend on the time period from which the court assesses compliance. For example, in the early Supreme Court of Canada decision of *Loveless v. Fitzgerald*,⁸³ the landlord refused to recognize the renewal on the basis that one of the co-tenants had assigned his half-interest to the other co-tenant without seeking the landlord’s consent as required by the lease. The tenant acknowledged that this was a default under the lease, but argued that the operative time for considering whether it was in default for purposes of renewal was the time at which it provided the landlord with notice of renewal, which was before the assignment had taken place. The Supreme Court of Canada interpreted the renewal option and held that the time from which to assess whether the tenant had observed the covenants in the lease was when the renewal would take effect, rather than when notice of renewal was delivered. Viewed in this

80. Where no notice is required, and the original agreement expires, the renewing party is still entitled to exercise the right to renew provided it is operating under a “month-to-month” extension: *Hensall District Co-operative Inc. v. Oud-Boyes Inc.* (1991), 3 O.R. (3d) 455, [1991] O.J. No. 959 (Ont. C.A.), at para. 7.

81. Bain, *supra*, footnote 23, at p. 3; Yiokaris, *supra*, footnote 37, at pp. 3 and 9-10.

82. See the case law discussed throughout this section.

83. *Loveless v. Fitzgerald* (1909), 42 S.C.R. 254, [1909] S.C.J. No. 43 (S.C.C.).

light, the tenant had violated the “no default” condition precedent and lost its right to renew.

The current law in Ontario on this issue has been clarified through several decisions of the Ontario Court of Appeal. These cases have confirmed a doctrine commonly referred to as “spent breach”, under which a condition precedent requiring the renewing party to have complied with the covenants of the wider agreement will generally be interpreted as only requiring compliance as at the time the renewal term begins.⁸⁴ For example, where a renewing party was late in paying the rent under a lease, the court nevertheless enforced the right to renew where the rent had been paid by the time the new term had commenced, despite a condition precedent requiring compliance with all the terms of the lease.⁸⁵ In the recent decision of *1290079 Ontario Inc. v. Beltsos*, the renewing party had failed to obtain an insurance policy for the premises naming the landlord as beneficiary as required by lease. After a slip and fall at the location, both the tenant and the landlord were sued in an action for personal injury. The tenant subsequently corrected the insurance policy, but the personal injury litigation remained outstanding at the time the tenant exercised the right to renew. The Ontario Court of Appeal held that the tenant had lost the right to renew.⁸⁶

[An] historical breach, once remedied, will not preclude a tenant from exercising an option to renew so long as the lease is ‘effectively clear’ on the renewal date. If a landlord has a subsisting cause of action against the tenant that is rooted in the breach, the lease is not effectively clear.

The [personal injury] claim was filed . . . [in] 2009 . . . At the stipulated renewal date in . . . 2010, the [landlord] had a cause of action against the [tenant] for failing to perform a term of the lease [regarding insurance] . . . Therefore, the breach subsisted and the [tenant] forfeited its right to renew.

The substance of the doctrine of spent breach has been adopted by the B.C. Court of Appeal⁸⁷ and, in the context of options to

84. In two cases, *Fingold v. Hunter*, [1944] 3 D.L.R. 43, [1944] O.J. No. 105 (Ont. C.A.), at paras. 8 and 12; and *Spiegel v. Modernage Furniture Ltd.* (1971), 23 D.L.R. (3d) 665, [1971] O.J. No. 1829 (Ont. C.A.), at paras. 8-9, *per* Arnup J.A. (Jessup J.A. concurring), the date on which to assess the grantee’s compliance was held to be the first day on which the grantor refused to recognize the renewal or otherwise refused to do the thing the grantee now asserts ought to have been done.

85. *Spiegel v. Modernage Furniture Ltd.*, *supra*, at paras. 8-9.

86. *1290079 Ontario Inc. v. Beltsos* (2011), 4 R.P.R. (5th) 171, 2011 ONCA 334 (Ont. C.A.), at paras. 29-30.

87. *McLaughlin v. Bodnarchuk* (1957), 8 D.L.R. (2d) 596, [1957] B.C.J. No. 131 (B.C.

purchase, by both the New Brunswick Court of Appeal and the Manitoba Court of Appeal.⁸⁸ The purpose of the doctrine of spent breach is to prevent grantors of renewal rights from setting up minor defaults that have long since been cured as a bar to the exercise of those rights. Since the doctrine will necessarily be ousted by clear language in the renewal clause requiring strict and absolute compliance with all conditions for the entire term of the agreement, the text of standard-form renewal clauses ought to be reviewed with this case law in mind.⁸⁹ Importantly, depending on how the renewal clause is drafted, it is still possible that a court would find that the operative time to assess compliance with the other terms of the agreement will, in fact, be the date on which notice to renew is delivered. In *1383421 Ontario Inc. v. Ole Miss Place Inc.*, the court made such a finding where the renewal rent was subject to arbitration to take place several months before the new term commenced. The court emphasized that it would make no sense to have the arbitration proceeding take place before the condition precedent was even satisfied.⁹⁰

So far, I have focused on conditions precedent that require compliance with the covenants in the larger agreement. It is only in respect of these types of conditions that the doctrine of spent breach has normally applied. The courts have historically treated as very different conditions precedent that require the grantee to provide notice to the grantor that he/she is exercising the renewal right or to take other concrete and well-defined steps to effect the renewal. In a number of decisions, the appellate courts in Canada have held that failure to provide notice of renewal within the time periods stipulated in the renewal clause is fatal to the renewing party, such that the right to renew is forfeited.⁹¹ In each of these

C.A.), at paras. 7-9; *SME Holdings Ltd. v. Cappeech Coffee Corp.*, 2000 BCCA 524, [2000] B.C.J. No. 1915 (B.C. C.A.), at para. 10 (“the time when the tenant must not be in default is at the date of the expiry of the existing term”).

88. *Burlock v. Steeves* (1990), 13 R.P.R. (2d) 38, [1990] N.B.J. No. 857 (N.B. C.A.); *Birchmount Furniture Ltd. v. Loewen* (1978), 84 D.L.R. (3d) 599, [1978] M.J. No. 27 (Man. C.A.).

89. *Birchmount Furniture Ltd. v. Loewen*, *supra*, at para. 5; *Sail Labrador*, *supra*, footnote 2, at para. 50; *Pacella v. Giuliana* (1977), 16 O.R. (2d) 6 (Ont. C.A.), at p. 8 (the renewal clause contained an express “condition precedent . . . that the [optionees] not be in default at any time or times during the term of the mortgage” [emphasis added]).

90. *1383421 Ontario Inc. v. Ole Miss Place Inc.* (2003), 231 D.L.R. (4th) 193, 67 O.R. (3d) 161 (Ont. C.A.), at para. 65.

91. *120 Adelaide Leaseholds Inc. v. Oxford Properties Canada Ltd.*, 1993 CarswellOnt 5327, [1993] O.J. No. 2801 (Ont. C.A.), at paras. 5-6; *Saint John Shipbuilding & Dry Dock Co. v. Canada (National Harbours Board)* (1983), 126 A.P.R. 27, [1983]

cases, it appears that the reasoning flowed from the starting premise that the renewal right was an option — and therefore a unilateral contract — with advance notice constituting the communication of “acceptance” by the grantee in relation to which time was presumed to be of the essence. In two more recent franchise decisions, the courts have also strongly suggested that compliance with notice provisions would be strictly enforced in the renewal context, although the characterization of the right as an “option” does not appear to have been necessary to the courts’ reasoning.⁹² The strict enforcement of notice provisions may nevertheless be subject to the court’s jurisdiction to provide relief from forfeiture. To receive such relief, the renewing party would need to establish that it made diligent efforts to comply with the condition with the failure occurring through no fault of her own.⁹³

The legal certainty provided by the doctrine of spent breach and the strict enforcement of notice periods has unfortunately been brought into question by the Supreme Court of Canada’s decision in *Sail Labrador Ltd. v. “Challenge One” (The)*.⁹⁴ *Sail Labrador* involved an option to purchase contained in a charter-party which, as a condition precedent, required full performance by the grantee of the other covenants in the agreement. When the grantor purported to exercise the option to purchase, the grantee refused on the basis that one of the rent payments had previously been made late. Rather than simply deal with the issue through the lens of the doctrine of spent breach, the Supreme Court of Canada made a series of holdings that purported to change the law in this area. The court held that the option to purchase was not, in fact, a unilateral contract subject to conditions precedent but, instead, simply one clause within a larger bilateral agreement. According to the court, this meant that the grantor could only avoid the option

N.B.J. No. 214 (N.B. C.A.), at paras. 4 and 9; *Ross v. T. Eaton Co.* (1992), 11 O.R. (3d) 115, [1992] O.J. No. 2239 (Ont. C.A.), at para. 32.

92. *Duhigh Holdings Ltd. v. 24 Hour Entertainment Group Ltd.*, 2004 BCSC 1689 (B.C. S.C.), at paras. 79 and 101 (sublease / franchisee’s failure to provide notice of renewal held to be material); *Boston Pizza International Inc. v. 395047 B.C. Ltd.*, *supra*, footnote 8, at paras. 18-19 (court likely would have refused to find a renewal; however, franchisor had “waived” the requirement for notice).

93. *Ross v. T. Eaton Co.*, *supra*, footnote 91, at p. 125; *120 Adelaide Leaseholds Inc. v. Oxford Properties Canada Ltd.*, *supra*, footnote 91, at para. 9; *1383421 Ontario Inc. v. Ole Miss Place Inc.*, *supra*, footnote 90, at para. 80. Interestingly, the Ontario High Court at one point expressed great doubt about whether the doctrine of relief from forfeiture applied in the context of a condition precedent to an option, but this decision appears to have not been followed: *Sparkhall v. Watson*, [1954] 2 D.L.R. 22 (Ont. H.C.), at pp. 25-26.

94. *Sail Labrador*, *supra*, footnote 2.

if it established that the grantee's failure to comply with the covenant constituted substantial non-performance of the agreement.⁹⁵ The court ultimately enforced the option on the basis that the one late payment did not meet this test.

Given the court's reasoning in *Sail Labrador*, it will now be difficult to attempt to characterize a renewal right in a franchise agreement or sublease as a unilateral option subject to strict conditions precedent,⁹⁶ unless very clear language is used to this effect. *Sail Labrador* strongly suggests that, without express language requiring strict compliance with all covenants in the larger agreement, the doctrine of substantial non-performance applies to the question of whether the grantor is entitled to treat the option as void or expired.⁹⁷ Moreover, because the Supreme Court expressly held that there is no presumption that time is of the essence in a bilateral agreement,⁹⁸ the decision in *Sail Labrador* potentially brings into question the strict enforcement of notice provisions in renewal options, unless the agreement expressly provides that time is of the essence. Nevertheless, *Sail Labrador* does not appear to have been applied extensively in subsequent renewal cases and it may be possible to restrict its reach away from notice provisions to simply conditions requiring compliance with the covenants in the larger agreement.⁹⁹

VI. HOW DOES THE DUTY OF GOOD FAITH INTERACT WITH THE COMMON LAW PRINCIPLES?

The duty of good faith may inject additional uncertainty into the question of whether conditions precedent have been properly satisfied. This flows from the fact that the courts may be inclined to characterize a franchisor's strict enforcement of a condition precedent as an exercise of the franchisor's contractual discretion.

95. *Sail Labrador, supra*, at paras. 41-50.

96. The three factors that led the court to conclude that the option to purchase was part of the larger bilateral agreement would appear to apply just as strongly to renewal rights. The court focused on: (a) the fact that the consideration for the option was the fees payable under the larger agreement; (b) the fact that exercise of the option required compliance with the covenants in the larger agreement; and (c) the fact that both the larger agreement and the option related to the same property or interest: *Supra*, at paras. 41-45.

97. *Sail Labrador, supra*, at para. 50.

98. *Sail Labrador, supra*, at paras. 54-55.

99. Keith Evans, "The Law of Options" (2002), 25 Dal. L.J. 47, at p. 60 ("It should only be in the context of deciding whether such a condition of linked performance has been met that the concept of substantial performance of those other obligations should be able to be examined by the courts").

For example, in 760437 *Alberta Ltd. v. Fabutan Corp.*, the Alberta Court of Queen's Bench held that, where a renewal clause accorded the franchisor the right not to renew for good cause, the franchisor's exercise of that right was subject to the duty of good faith.¹⁰⁰ To the extent that this analysis would apply to more formal conditions precedent, where a franchisor has failed to exercise such a discretion reasonably, it may well be found to be offside the clause in question.¹⁰¹ Therefore, depending on the overall factual context, it may be risky for a franchisor to assume that a court would strictly enforce an advance notice provision, for example where effective (but not formal) notice was provided by the franchisee and/or where the franchisor is enforcing the notice requirement for an improper or unreasonable motive.

The manner by which franchisors enforce conditions precedent may also be important and the court may consider whether the franchisor "conducted itself fairly throughout the process."¹⁰² While at common law the grantor of a renewal right need only provide notice of default where the agreement expressly requires it,¹⁰³ it may be risky for a franchisor not to bring to the attention of the franchisee a default on which it intends to rely to resist a renewal. Of course, all questions of this type will depend on the particular facts of the case and may not be relevant where the court is inclined to treat the clause in question as creating a true condition precedent rather than an area of discretion subject to good faith. Subject to some additional guidance from the courts regarding the role of good faith in the context of conditions precedent, the safest course at present is to assume that the enforcement of a condition precedent is subject to the duty of good faith.

VII. CONCLUSION

This article has considered the common law principles that govern the enforcement of renewal rights in ordinary commercial agreements through the lens of the franchise-distribution relationship and the duty of good faith. In the case of the common law requirement that renewal rights find their genesis in the contract, the duty of good faith has actually played an important role in the very decisions that have delineated this principle. In terms of the

100. *Fabutan, supra*, footnote 13, at paras. 95-97.

101. *Shelanu, supra*, footnote 11, at para. 96.

102. *Shelanu, supra*, at para. 74.

103. *1383421 Ontario Inc. v. Ole Miss Place Inc., supra*, footnote 90, at paras. 50-52.

common law position that the duty to negotiate is unenforceable, it remains an open question whether this would apply in the context of a franchise-distribution relationship subject to its own separate duty of good faith. Finally, in the context of the common law treatment of conditions precedent to the exercise of renewal rights, the duty of good faith has the potential to add an additional layer of analysis insofar as the franchisor's enforcement of the condition is characterized as an exercise of discretion.