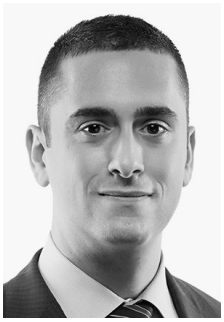
Franchise Renewals and Transfers in Canada's Common Law Provinces

Adam Ship and Mohammed Sohail



Mr. Ship

Mr. Sohail

Franchisee renewal and transfer rights are commonly included in franchise agreements in Canada. When provided, these rights play an important role in the franchise relationship.[1] From the perspective of franchisees, rights of renewal, together with initial terms, determine the period over which they can earn a return on their investment and, as a result, will directly impact the level of financial and other resources they will be prepared to devote to the business.[2] Franchisee transfer rights are similarly important to franchisees because they provide for the alienability and economic realization of the franchisees' interests in the business and can facilitate their transition out of the franchise system into other business ventures or even retirement.[3]

From the perspective of franchisors, however, renewal and transfer rights must be circumscribed to ensure that their interests and those of their franchise networks are protected. In the context of an expiring franchise agreement, franchisors have an interest in potentially reconsidering its relationships with poorly performing or default-

1. *E.g.*, Craig R. Tractenberg, Robert B. Calihan & Ann-Marie Luciano, *Legal Considerations in Franchise Renewals*, 23:4 FRANCHISE L.J. 198 (2004) ("Few provisions of the agreement are more important than the term of the agreement and the franchisee's renewal rights."); Adam Ship, *Common Law Treatment of Renewal Rights in Commercial Agreements: A Special Look at Franchises, Distributorships and the Duty of Good Faith*, 54 CAN. BUS. L.J. 177, 179 (2013).

2. Tractenberg et al., *supra* note 1 ("[franchisees] want a reasonable opportunity not only to recoup that investment, but to obtain a handsome return as well"); Ship, *supra* note 1, at 177; Allan Dick, *End of Term Dinner Program*, FRANCHISE RENEWALS AND EXTENSIONS: LEGAL, PRACTICAL AND DRAFTING GREY MATTERS, OBA 6 (2013).

3. Phyllis Alden Truby & David A. Beyer, *Fundamentals 201: Transfers and Assignments in Franchising*, presentation at American Bar Association's Annual Forum on Franchising, October 2014; FRANK ZAID, FRANCHISE LAW 190 (2005).

Adam Ship (ashipp@mccarthy.ca) is a litigation partner in the Toronto office of McCarthy Tétrault LLP, vice-chair of the firm's National Franchise & Distribution Group, and adjunct professor of franchise law at the University of Toronto Faculty of Law. Mohammed Sohail (mohammed.sohail@mail.utoronto.ca) (JD 2015) is an articling student at Fogler, Rubinoff LLP in Toronto.

ing franchisees.[4] For franchisee transfers, franchisors have a strong interest in vetting the qualifications and financial resources of prospective transferees before consenting to have them represent their brand in the retail marketplace.[5] Because franchise relationships require a high degree of mutual cooperation between the parties, contractual provisions that extend the temporal limits of the arrangement, or which allow the franchisee to sell the business to a third party, frequently raise critical legal issues for both franchisors and franchisees.

In this article, we review the principal legal issues and leading authorities that govern franchisee renewals and transfers in Canada's common law provinces. We have excluded the province of Quebec, the only province with a civil law tradition, from our analysis in order to focus on the key principles that apply in the common law jurisdictions. The article is split into three main sections. First, we focus on the common law principles that address the source and genesis of renewal and transfer rights. These principles make clear that, generally speaking, rights of renewal and transfer must find their source in the franchise agreement. Second, we canvass the principal conditions that franchise agreements typically impose on franchisee renewals and transfers and review the case law that has interpreted and applied these conditions. This section will explore the extent to which the duty of good faith and fair dealing circumscribes a franchisor's discretion when enforcing conditions precedent. Third, we discuss the statutory disclosure issues that arise in the context of renewals and transfers for the five Canadian provinces with franchise legislation.[6] As will be seen, franchise transfers and renewals raise unique disclosure issues.

I. Source and Genesis of Franchisee Renewal and Transfer Rights

Whether a franchisee has the right to renew the franchise agreement, or the right to transfer its rights and obligations under that agreement to a third party, will virtually always be a question of contractual intent.[7] Under Canadian common law principles, renewal and transfer rights must generally find

4. Tractenberg et al., *supra* note 1 ("[franchisors] want an opportunity to evaluate periodically less than successful relationships and extricate [themselves]").

5. Jane Langford, Adam Ship & Brooke MacKenzie, *Unilateral Assignment of Franchise Agreements in Bankruptcy: Economic Efficiency versus Freedom of Contract in Ford Motor Company v. Welcome Ford Sales*, 24 BANKING & FIN. L. REV. 723, 725 (2012); Truby & Beyer, *supra* note 3.

6. Five Canadian provinces have franchise legislation: Ontario: *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 (Can.) [*Ontario Act*]; Alberta: *Franchises Act*, R.S.A. 2000, c. F-23 (Can.) [*Alberta Act*]; Manitoba: *The Franchises Act*, C.C.S.M. c. F156 (Can.) [*Manitoba Act*]; New Brunswick: *Franchises Act*, S.N.B. 2007, c. F-23.5(Can.) [*New Brunswick Act*]; Prince Edward Island: *Franchises Act*, R.S.P.E.I. 1988, c. F-14.1 (Can.) [*Prince Edward Island Act*].

7. This article will not consider the scope of equitable doctrines, such as promissory estoppel, to create what is akin to an enforceable renewal or transfer right in the face of an unequivocal representation followed by detrimental reliance. Although such an outcome is theoretically possible, we have not seen any franchise or non-franchise cases in the case law reviewed in the process of preparing this article.

their source and genesis in the franchise agreement or some other agreement between the parties.

A. *Renewal Rights*

Common law courts across Canada have made clear that rights of renewal[8] must be found in the express terms of the franchise agreement or through a separate contract between the parties. This principle has most frequently arisen in the context of cases in which franchisees, lacking any express renewal right, claimed a right to renew on the basis of the duty of good faith and fair dealing. These cases required the courts to consider whether good faith principles can oblige a franchisor to renew the franchise agreement where the contract itself is silent on the issue.[9] In this context, the courts in Canada have concluded that the covenant of good faith cannot create a substantive renewal obligation that lacks an independent contractual basis.[10] The franchise statutes in force in Ontario, Alberta, Manitoba, New Brunswick, and Prince Edward Island (the Statutory Provinces) do not alter this fundamental common law principle because they do not directly regulate franchise renewals and the statutory duty of fair dealing is merely a codification of the common law duty of good faith.[11] In this regard,

8. For ease of reference, we generally use the term "renewal" in this article to include both renewals and extensions of franchise agreements. However, we note that at Canadian common law, there is a difference between a renewal and an extension. 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. *Manulife Bank of Canada v Conlin*, [1996] 3 S.C.R. 415, para. 29 (S.C.C.); *TA & K Enterprises Inc. v Suncor Energy Products Inc*., 2010 ONSC 7022 (Can.), para. 50, aff'd 2011 ONCA 613 (Can.); 1497777 *Ontario Inc. v Leon's Furniture Ltd*., [2003] O.J. No. 3708, para. 50 (Ont. C.A.), 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.), paras. 20–23.

9. *See generally* Ship, *supra* note 1, at 178.

10. *C Corp. (Ontario) Ltd. v Wesbru Holdings Ltd*. (1988), 91 A.R. 210, paras. 43–44 ("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 SKQB 414, paras. 22–26 (Can.) (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] O. J. No. 723, paras. 23–24 (Ont. Sup. Ct.) ("[T]here is no inherent right to force a franchiser 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), 19 B.L.R. (3rd) 196, para. 23 ("A general duty of fair dealing without more cannot turn a written term of expiry into a right to renew."); *Sultani v Blenz the Canadian Coffee Company Ltd.*, 2005 BCCA 578, para. 25 (Can.) (". . . 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 Advisory Limited v 754974 Ontario Inc*., [2006] O.J. No. 3504, para. 55 (Ont. Sup. Ct.) (duty of good faith does not alter the interpretation of the renewal clause, only its implementation).

11. *See*, *e.g.*, *Fairview Donut Inc. v The TDL Group Corp*., 2012 ONSC 1252, para. 495, aff'd 2012 ONCA 867 (Can.).

these statutes differ from the franchise relationship laws in force in certain U.S. states.[12]

In an early, foundational case dealing with renewal rights, the Alberta Court of Queen's Bench held that where a franchise agreement lacks any express right of renewal, there is no legal basis to inquire into the franchisor's subjective reasons for declining to renew, and it is irrelevant whether the franchisor's policy had previously been to elect to renew its franchisees.[13] This principle has also been applied in the context of subleasing arrangements between the franchisor and the franchisee where the franchisor holds the head-lease with the landlord. In this context, where the head-lease provides the franchisor with a renewal right, but the franchisee is accorded no similar right in the sublease and franchise agreement, the courts have made clear that the franchisor has no obligation to renew simply because the landlord has renewed the head-lease.[14]

As a practical matter, many modern franchise agreements in Canada provide express renewal rights to franchisees, often in the form of an option that can be exercised by the franchisee upon meeting certain conditions or conditions precedent.[15] Other examples of renewal rights include automatic renewals subject to either party's right to terminate on notice, a limited number of renewals on notice,[16] and limited rights to extend the initial term. In Part II below, we address how the courts have interpreted conditions precedent and automatic renewals.

B. *Franchisee Rights of Transfer and Assignment*

Unlike certain state franchise relationship statutes in the United States,[17] the franchise legislation in the Statutory Provinces does not directly regulate transfer rights. These rights are addressed through common law principles and the statutory duty of good faith that applies in those provinces. Under Canadian common law, if the franchise agreement is silent on the issue of transfer or assignment to a third party, there are two important consequences. First, the franchisor must provide its consent before a franchisee

12. *See* Theodore M. Becker & Michael J. Boxerman, *Franchise Renewals: Considerations for Franchisors and Franchisees*, 19:2 FRANCHISE L.J. 45, 64–65 (1999); Tractenberg et al., *supra* note 1, at 198–99 (noting that these "statutes have various permutations" with some requiring the franchisor to have "good cause" for non-renewal of a franchisee).

13. *C Corp.*, *supra* note 10, at paras. 43–46, 60–63.

14. *See generally C Corp.*, *supra* note 10; *Sultani*, *supra* note 10.

15. Edward (Ned) Levitt & Frank Robinson, *Legal and Business Considerations Affecting Franchise Transfers and Renewals*, O.B.A., 2 (2012) (presented at Ontario Bar Association's Annual Franchising Law Conference, November 2012); John Yiokaris, *Franchise Renewals: Issues Surrounding the Franchisor's Right to Accept a Franchisee's Exercise of a Renewal Option*, O.B.A., 1, 3 (2010) (presented at Ontario Bar Association's Annual Franchise Law Conference, November 2010).

16. Levitt & Robinson, *supra* note 15, at 2–3.

17. Truby & Beyer, *supra* note 3, at 6–7 (noting that "[t]en states have franchise relationship laws that deal directly with franchise transfers and impose restrictions on the franchisor's right to approve or disapprove a transfer request").

can transfer its obligations under the franchise agreement through an assignment to a third party. Second, and related, the franchisor's consent is *not* required where a corporate franchisee effects the transfer through a sale of its securities to a third party.[18] These consequences flow from the Supreme Court of Canada's early holding that an assignment of contractual duties to a third party requires the consent of the other party to the contract unless the agreement expressly provides otherwise.[19] As a result of this holding, which has been confirmed by other appellate courts,[20] if a franchisee wishes to assign the franchise agreement to a third party and the agreement is silent on this issue, the franchisor's consent is required unless the transfer is effected through a share sale since in that context the franchisee entity remains the same.

If consent is required but not obtained, the original franchisee may well continue to be bound by the burdens and duties in the franchise agreement, which cannot be effectively assigned without the franchisor's consent. If the franchisor does elect to provide its consent to an assignment, the common law will treat the transaction as a trilateral "novation" under which the previous agreement between the franchisor and the transferor is extinguished and replaced by a new agreement between the franchisor and the transferee.[21] In this respect, the law in Canada may diverge from the United States, which more readily favors the transfer of contractual rights.[22]

As a practical matter, franchise agreements in Canada often contain detailed provisions addressing a franchisee transfer, including transfers that are effected through share sales. Indeed, it is common and preferable that the franchise agreement expressly include share sales within the contractual definition of "transfer" to ensure that they are treated in the same way as assignments.[23] It is increasingly common for transfer rights to be structured so that the franchisee is required to meet specified requirements as conditions precedent to the transfer.[24] Where an agreement places restrictions on a prospective transferor's ability to transfer, Canadian courts will generally

18. *See also* Larry Weinberg & Andraya Frith, *Advanced Drafting Issues: Top 10 Tips to Help Draft Franchise Agreements and Disclosure*, O.B.A., 42 (2014) (presented at Ontario Bar Association's Annual Franchise Law Conference, November 2014).

19. *The Lounsbury Company Ltd. v Duthie*, [1957] S.C.R. 590, 596-597 (S.C.C.); *National Trust Co. v Mead*, [1990] 2 S.C.R. 410, paras. 30–32 (S.C.C.). While contractual rights and benefits alone may be assigned without consent as long as the burdens and obligations remain with the original party, as a practical matter franchisee transfers virtually always involve the assignment of burdens along with benefits and thus require the consent of the franchisor unless the agreement states otherwise.

20. *See Rodaro v Royal Bank of Canada* (2002), 59 O.R. (3d) 74, paras. 33–34 (Ont. C.A.); *Simex Inc. v Imax Corporation*, [2005] O.J. No. 5389, para. 50 (Ont. C.A.).

21. *National Trust Co.*, *supra* note 19, at paras. 30–32.

22. Frank Robinson & Debi Sutin, *Complex Franchise Transactions in Canada*, O.B.A., 17 (2013) (presented at Ontario Bar Association's Annual Franchise Law Conference, November 2013); Weinberg & Frith, *supra* note 18, at 45–46.

23. *See generally* Levitt & Robinson, *supra* note 15, at 11–13; Weinberg & Frith, *supra* note 18, at 42; *see also* Truby & Beyer, *supra* note 3, at 26–27.

24. *See*, *e.g.*, Truby & Beyer, *supra* note 3, at 35–41, App'x E.

enforce those restrictions and any noncompliant transfer should be legally ineffective.[25] Indeed, Canadian courts appear to be prepared to enforce non-transfer provisions in exclusive distribution and franchise agreements that expressly allow manufacturers to withhold their consent to transfers for any reason, including "arbitrarily,"[26] although in theory franchisees may attempt to challenge such clauses on the basis that they are unconscionable or constitute an unenforceable waiver of the statutory duty of good faith in the Statutory Provinces. It is common for franchise agreements to provide franchisors with the right to approve any franchisee transfer. However, some older franchise agreements simply provide that the franchisor will not unreasonably withhold its consent.[27] We further discuss the franchisor's ability to withhold consent in Part II below.

We note that in the context of a franchisee insolvency, the federal *Bankruptcy and Insolvency Act* contains specific provisions that potentially empower a trustee in bankruptcy to assign the franchise agreement to a third party purchaser without the franchisor's consent.[28] In a recent decision of the Alberta Court of Appeal, a dealer agreement of an insolvent automotive dealer was transferred to a new dealer against the express wishes of the manufacturer. In that case, the manufacturer failed to adduce any evidence at the hearing to demonstrate that the proposed transferee (a preexisting dealer with a strong track record) would have been unable to meet its obligations under the transferred agreement. The court held that the assignment was legally effective despite the manufacturer's objection.[29] This appears consistent with the law in the United States.[30]

II. Contractual Conditions Precedent to the Exercise of Renewal and Transfer Rights

Conditions precedent are commonly used in franchise agreements to control access to renewal and transfer rights and to ensure that minimum requirements are met. The types of conditions on which we will focus in this article are the ones that raise legal issues or which have been frequently litigated. These include advance notice provisions, the requirement for the

25. *See*, *e.g.*, *Brio Beverages Inc. v Koala Beverages Ltd.*, [1998] B.C.J. No. 2687, para. 7 (B.C. C.A.).

26. *Id.* at para. 10–13. This also appears to be the approach of U.S. courts unless a state franchise statute provides otherwise. Truby & Beyer, *supra* note 3, at 30.

27. For a similar observation, see Levitt & Robinson, *supra* note 15, at 12.

28. *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 84.1; *see generally* Langford et al., *supra* note 5.

29. *Ford Motor Company of Canada, Limited v Welcome Ford Sales Ltd.*, 2010 ABQB 199, aff'd 2011 ABCA 158 (Can.).

30. Jason Binford, *Assigning a Franchise Agreement over the Franchisor's Objection: Bankruptcy May Make It Possible*, 32:2 FRANCHISE L.J. 71 (2012) ("Franchisors therefore should be aware that, given the right set of circumstances, a franchisee in bankruptcy may be permitted to assign the franchise agreement over the franchisor's objection").

renewing franchisee or transferee to sign the franchisor's "then current" franchise agreement, the requirement for a general release to be executed in advance of the transaction, and a requirement that the franchisee not be in breach of the franchise agreement. We consider judicial treatment of these types of conditions precedent in the sections below. We will not address other common conditions in the renewal and transfer context, such as the payment of a renewal/transfer fee, a requirement for the renewing franchisee or transferee to undergo additional training, and a requirement that the franchised premises be reimaged or updated.[31]

A. *Advance Notice of the Exercise of the Renewal or Transfer Right*

It is common for contractual rights of renewal to require the renewing franchisee to provide written notice to the franchisor within a specified number of days prior to the end of the current term. Similarly, contractual transfer rights frequently require the franchisee to provide the franchisor with a defined period of notice so that the franchisor can evaluate the transaction. In Canada, appellate courts in non-franchise cases have frequently held that the failure to provide notice of renewal within the time periods stipulated in a renewal clause is fatal to the renewing party, such that the right to renew is forfeited.[32] Courts have also enforced notice requirements in the franchise context,[33] although in one case the franchisor was found to have waived the requirement for notice through representations to the franchisee.[34] In order to reduce the risks of waiver, franchisors should develop a consistent practice of enforcing notice provisions and should formalize and document any notice extensions they grant to franchisees.

In the renewal context, the notice period is linked to the fixed date on which the current term expires, a date that by definition cannot be adjusted. By contrast, in the context of transfer or assignment, the notice period is normally linked to the date of the proposed transaction, which can more readily be adjusted as needed. This likely explains why we could not find any cases in which courts were faced with the failure of a proposed transferee to satisfy contractual notice requirements in a transfer provision. Nevertheless, it is likely that the renewal decisions strictly enforcing notice provisions

31. For a more comprehensive list of the conditions typically imposed on franchisee transfer, see Truby & Beyer, *supra* note 3, at 35–41; Levitt & Robinson, *supra* note 15, at 14–16; ZAID, *supra* note 3, at 190–92.

32. *120 Adelaide Leaseholds Inc. v Oxford Properties Canada Ltd.*, [1993] O.J. No. 2801, paras. 5–6 (Ont. C.A.); *St. John Shipbuilding & Dry Dock Co. v Canada* (National Harbours Board), [1983] N.B.J. No. 214, paras. 4, 9 (N.B. C.A.); *Ross v T. Eaton Co.*, [1992] O.J. No. 2239, para. 32 (Ont. C.A.).

33. *Duhigh Holdings Ltd. v 24 Hour Entertainment et al.*, 2004 BCSC 1689, paras. 79, 101 (Can.) (franchisee's failure to provide notice of renewal under the sublease held to be material).

34. *Boston Pizza International Inc. v 395047 B.C. Ltd.*, 2008 BCSC 1016, paras. 18–19 (Can.) (court likely would have refused to find a renewal; however, franchisor had "waived" the requirement for notice).

would apply equally in the case of a proposed transfer where the transferor clearly breaches an express term requiring advance notice.

Historically, the strict enforcement of notice provisions flowed from the characterization of a renewal right as a contractual option.[35] This meant that the renewal provision was treated as a unilateral contract with advance notice constituting the communication of "acceptance" by the transferee and with time presumed to be of the essence. In two recent franchise renewal decisions, however, the courts suggested that compliance with advance notice provisions would be strictly enforced even though the court did not expressly characterize the right as an option.[36] The strict enforcement of notice provisions may nevertheless be subject to Canadian common law courts' equitable jurisdiction to provide relief from forfeiture. To receive such relief, the renewing or transferring party would need to establish that it made diligent efforts to comply with the condition with the failure occurring through no fault of their own.[37]

While the above cases suggest that advance notice provisions will be strictly enforced by Canadian courts, one decision of the Supreme Court of Canada casts some uncertainty onto this issue.[38] In *Sail Labrador Ltd. v Challenge One (The)*,[39] the court considered an option to purchase contained in a boat lease which, as a condition precedent, required full performance by the leasee of the other covenants in the agreement. When the leasee purported to exercise the option, the leasor refused on the basis that one of the rent payments had previously been made late. The Supreme Court of Canada held that the option to purchase was not, in fact, a unilateral contract subject to conditions precedent but, instead, simply one clause within the larger lease agreement. According to the court, this meant that the leasor could only refuse to perform its obligations under the option if it established that the leasee's previous breach constituted substantial non-performance of the agreement.[40] The court ultimately enforced the option on the basis that the one late payment did not meet the test for substantial non-performance.

Given the court's reasoning in *Sail Labrador*, it is now more challenging to attempt to characterize a renewal or transfer right in a franchise agreement

35. For a more detailed review of the Canadian case law on this issue, see Ship, *supra* note 1, at 181–85.

36. *Duhigh Holdings Ltd.*, *supra* note 33, at paras. 79, 101 (Can.); *Boston Pizza*, *supra* note 34, at paras. 18–19 (Can.).

37. *T. Eaton Co.*, *supra* note 32, at 125; *120 Adelaide Leaseholds Inc. v Oxford Properties Canada Ltd.*, [1993] O.J. No. 2801, para. 9 (Ont. C.A.); *1383421 Ontario Inc. v OLE Miss Place Inc.* (2003), 12 R.P.R. (4th) 169, para. 80 (Ont. C.A.). Interestingly, the Supreme Court of Canada 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, at 25-26 (S.C.C.).

38. *Sail Labrador Ltd. v Challenge One (The)*, [1999] 1 S.C.R. 265 (S.C.C.).

39. *Id.*

40. *Id.* at paras. 41–50.

as an option subject to strict conditions precedent[41] unless very clear language is used to this effect.[42] In this regard, it may be advisable for the franchise agreement to expressly provide that the franchisee's failure to satisfy any of the conditions will nullify the renewal or transfer at issue. Moreover, because the Supreme Court expressly held that there is no presumption that time is of the essence outside the context of an option,[43] the decision in *Sail Labrador* potentially brings into question the strict enforcement of notice provisions unless the agreement expressly provides that time is of the essence.[44] Interestingly, *Sail Labrador* does not appear to have been applied extensively in subsequent cases; it may be possible to restrict its reach away from notice provisions to conditions requiring compliance with the covenants in the larger agreement (discussed in Part II.D below).[45]

B. *Consent of the Franchisor Prior to Renewal or Transfer of the Franchise Agreement*

1. Express Renewal "Veto" Rights

In some franchise agreements, the renewal clause is drafted to provide for automatic renewal subject to the franchisor's right to deliver notice of non-renewal or termination within a specified number of days prior to the expiration of the term.[46] In this context, the franchisor effectively has the right to "veto" the renewal as long as it provides proper notice of termination or non-renewal within the specified time period. Canadian courts have strictly enforced the time requirements in these provisions with the result that where notice of termination is delivered past the specified date, the agreement will likely be found to have been renewed.[47]

The question remains as to whether the franchisor's exercise of its right not to renew or terminate the franchise agreement in the context of an automatic renewal is subject to the duty of good faith and fair dealing. In Canada, the common law recognizes that parties to a franchise agreement are

41. 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 the facts that: (1) the consideration for the option was the fees payable under the larger agreement, (2) exercise of the option required compliance with the covenants in the larger agreement, and (3) both the larger agreement and the option related to the same property or interest. *Id.* at paras. 41–45.

42. *See* Ship, *supra* note 1, at 199, 201.

43. *Sail Labrador*, *supra* note 38, at paras. 54–55.

44. *See* Ship, *supra* note 1, at 201.

45. Keith Evans, *The Law of Options*, 25 DALHOUSIE L.J. 47, 60 (2002) ("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.").

46. Frank Robinson, *Renewal of a Franchise–Legal Considerations*, 1 FOCUS ON FRANCHISING 3 (2010).

47. *See 652013 B.C. Ltd. v Don Wotherspoon & Associates Ltd.*, 2004 BCCA 557 (Can.); *Direct-Cash ATM Processing Partnership et al. v Rockwood Motor Inn*, 2015 MBQB 15, paras. 16–27 (Can.).

bound by the duty of good faith.[48] A similar principle may also apply to certain commercial distribution agreements that have similar features to franchise agreements.[49] In the Statutory Provinces, the duty of good faith and fair dealing is also imposed on parties to a franchise agreement through the franchise legislation in force in those jurisdictions.[50] The Ontario courts have held that the statutory duty codifies, and carries the same content as, the common law duty.[51] The courts have made clear that the exercise of discretionary contractual rights by a franchisor is subject to the duty of good faith and fair dealing.

Nevertheless, the applicability of good faith principles in the context of automatic rights of renewal is open to doubt. In two leading appellate decisions, the courts have held that an express right to terminate a distribution agreement prior to an automatic renewal is not subject to the duty of good faith. In *Agribrands Purina Canada Inc. v Kasamekas*, a distributor sought damages for unlawful termination of a distribution agreement that was subject to automatic renewal unless notice of termination was provided.[52] The Ontario Court of Appeal held that whether the manufacturer had complied with the duty of good faith was not legally relevant to its ability to exercise of the right to terminate. In this regard, the court held that the express right to terminate prior to the automatic renewal was "unconditional" and the duty of good faith could not alter this substantive right.[53]

Similarly, in the recent decision of the Supreme Court of Canada in *Bhasin v Hrynew*,[54] the court held that the right not to renew a distribution agreement in the context of an automatic renewal provision was not a "discretionary decision" that was subject to good faith principles. According to the court, to require the non-renewing party to act in good faith prior to exercising its express right of non-renewal would be tantamount to creating a perpetual contract despite the parties' clear understanding that there was no

48. The seminal case on point is *Shelanu Inc. v Print Three Franchising Corp*, [2003] O.J. No. 1919 (Ont. C.A.). For an excellent summary of the content of the duty of good faith, see *Fairview Donut*, *supra* note 11, at para. 502. By contrast, outside the franchise context, the common law recognizes a more modest duty of honesty that requires parties not to actively mislead each other when performing their obligations under the agreement. *Bhasin v Hrynew*, 2014 SCC 71 (Can.).

49. *See Agribrands Purina Canada Inc. v Kasamekas*, 2010 ONSC 166, para. 103 (Can.), varied on other grounds in 2011 ONCA 460 (Can.); *Erinwood Ford Sales Ltd. v Ford Motor Co. of Canada*, [2005] O.J. No. 1970, para. 71 (Ont. Sup. Ct.) ("whether or not the relationship in this case is truly a franchise relationship, it certainly is akin to that type of relationship"). 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.

50. *See Ontario Act*, *supra* note 6, s. 3; *Alberta Act*, *supra* note 6, s. 7; *Manitoba Act*, *supra* note 6, s. 3; *New Brunswick Act*, *supra* note 6, s. 3; *Prince Edward Island Act*, *supra* note 6, s. 3.

51. *See*, *e.g.*, *Fairview Donut*, *supra* note 45, at para. 495.

52. The first instance decision makes this aspect of the agreement clear. *Agribrands Purina Canada Inc. v Kasamekas*, 2010 ONSC 166, para. 97 (Can.).

53. *Agribrands Purina Canada Inc. v Kasamekas*, 2011 ONCA 460 (Can.) at paras. 50–51.

54. *Bhasin*, *supra* note 48. McCarthy Tétrault represented the appellant in the appeal to the Supreme Court of Canada.

automatic renewal if notice to terminate was provided in advance.[55] While the court found a breach of the common law duty of honest performance on the facts of *Bhasin*, the distributor's damages were significantly reduced by the court to account for the fact that the non-renewal itself was lawful.

Following *Agribrands* and *Bhasin*, it may be difficult to attempt to characterize the exercise of a non-renewal right in a franchise agreement as an exercise of discretion subject to good faith standards where that right is found in an automatic renewal provision. Where a party has the express right to terminate a franchise agreement prior to its automatic renewal, and there is no contractual language to suggest that the right was circumscribed in any way, it may well be interpreted by a Canadian court as an unconditional right to avoid the renewal, whether or not the franchisor had good cause or complied with the duty of good faith. Nevertheless, it may still be possible for a future court to distinguish *Bhasin* and *Agribrands* on the basis that they involved distribution agreements rather than franchise agreements. In the recent decision of *Trillium Motor World Ltd. v General Motors of Canada Limited*, the Ontario Superior Court recognized that the "principle of good faith, as it manifests in the franchise context, will reflect the circumstances of that context, including the power dynamics of the unique relationship between franchisor and franchisee."[56] Whether the unique context of the franchise relationship is truly a basis to distinguish *Bhasin* and *Agribrands* on this particular point remains to be seen, especially given the analogous power dynamics at play in those two cases.

2. Consent of the Franchisor Prior to Franchisee Transfer

It is common for franchisee transfer provisions to expressly provide the franchisor with the right to provide its consent as a condition to an effective transfer. From the perspective of the franchisor, this is an important condition as it allows for a proper evaluation of the proposed transaction, especially the identity, experience, and financial resources of the proposed transferee.[57]

Where the franchise agreement provides that a franchisee transfer is subject to the consent of the franchisor, but is silent on the standard that applies to that decision, the franchisor will be required to meet the standards of good faith and fair dealing before withholding its consent. Similarly, some older franchise agreements simply provide that the franchisor will "not unreasonably withhold" its consent to a transfer, which also requires the

55. *Bhasin*, *supra* note 51, at paras. 72, 90.

56. *Trillium Motor World Ltd. v General Motors of Canada Limited*, 2015 ONSC 3824 at para. 152 (Can.). For a similar type of analysis, see *1250264 Ontario Inc. v. Pet Valu Canada Inc.*, 2015 ONSC 29.

57. *See*, *e.g.*, *1518628 Ontario Inc. v Tutor Time Learning Centres, LLC*, [2006] OJ No 3011 (Sup. Ct. J.) (Can.), para. 25 ("It would not serve the best interests of [the franchise] or that of its network of franchisees to allow a franchise to be transferred without an assessment of the proposed transferee's character, experience and credit worthiness.").

franchisor to act in good faith. The common law has also developed principles to determine the reasonableness of withholding consent to a proposed transfer in the commercial leasing context.[58] Given the apparent lack of franchise cases in Canada where the courts have had to determine whether a franchisor has unreasonably withheld its consent to a transfer, the principles in the leasing and other commercial contract cases may be persuasive to a Canadian court facing this issue in the franchise context.

These cases make clear that the assessment of reasonableness is highly fact sensitive and will depend on the individual circumstances of the case.[59] This is consistent with the case law interpreting the duty of good faith in the franchise context, where the Ontario Court of Appeal has held that the historical relationship and the prior dealings between a specific franchisee and its franchisor will inform the "standard of fair dealing [that applies] between them."[60] Similarly, the court has confirmed that "[w]hether or not a party under a duty of good faith has breached that duty will depend on all the circumstances of the case."[61] As a general matter, however, a franchisor will always be permitted to consider the suitability of the proposed transferee in deciding whether to grant consent, including whether the transferee is able to satisfy the financial and other covenants in the agreement.[62]

One key principle that is consistently applied in the commercial leasing context is that consent to a proposed transfer cannot be denied for reasons that are wholly unconnected to the contract. This principle would likely apply in the franchising context as being subsumed within the duty of good faith. Under this principle, it is unreasonable for a landlord to withhold consent to an assignment solely because it is no longer satisfied with the financial or other terms provided for in the original lease and simply wants to extract better terms from the transferee.[63] In such circumstances, unless the

58. *See 1455202 Ontario Inc. v Welbow Holdings Ltd.*, [2002] O.J. No. 1785, para. 9 (Ont. Sup. Ct.) (setting out the principles in this area). These principles were held by the Ontario Court of Appeal to constitute "the applicable test" for whether a landlord is withholding consent unreasonably to a lease assignment in *Tradeage Inc. v Tri-Novo Group Inc.*, 2007 ONCA 562, para. 2 (Can.). These principles were also cited with approval by the B.C. Supreme Court in *Hayes Forest Services Ltd. (Re)*, 2009 BCSC 1169, para. 33 (Can.). The Alberta Court of Queen's Bench has also applied many of these principles in *IFP Technologies (Canada) Inc. v Encana Midstream and Marketing*, 2014 ABQB 470, paras. 155–61, 183–84 (Can.).

59. *Welbow Holdings Ltd.*, *supra* note 58, at para. 9; *FP Technologies (Canada) Inc. v Encana Midstream and Marketing*, 2014 ABQB 470, para. 166; *Zellers Inc v Brad-Jay Investments Ltd*, [2002] O.J. No. 4100, para. 26 (Ont. Sup. Ct.).

60. *3574423 Canada Inc. v Baton Rouge Restaurants Inc.*, 2013 ONCA 39, para. 20 (Can.). *See generally* Trillium, *supra* note 56.

61. Shelanu, *supra* note 45, at para. 74.

62. For analogous findings in the non-franchise context, see *Welbow Holdings Ltd.*, *supra* note 58, at para. 9; *Exxonmobil Canada Energy v Novagas Canada Ltd, 2002 ABQB 455*, paras. 54, 58–60 (Can.).

63. *Tri-Novo Group Inc.*, *supra* note 58, at paras. 38–39, aff'd 2009 ONCA 855 (Can.); *see also* Harvey Haber, Tenant's Rights and Remedies in a Commercial Lease 38–39 (2d ed. 1998) (citing cases where courts have found the refusal of consent to be unreasonable where the landlord was demanding a (1) higher rent than contemplated by the original lease, (2) a more robust restrictive covenant from the transferor, and (3) further and different security than it was entitled

lease expressly provides the landlord with the right to impose different terms on the transferee, the landlord has been found to have withheld its consent for a collateral purpose unconnected to the terms of the lease. This analysis would appear to be applicable in the franchise context where the franchise agreement does not expressly require the transferor to sign the "then-current" form of franchise agreement and ancillary documents. In this situation, where a franchisor refuses to consent to the transfer primarily because the transferee declines to sign these updated agreements, there may be a risk that the franchisor's refusal to consent will be found unreasonable. This does not preclude a franchisor from attempting to negotiate such an outcome, but may preclude the franchisor from refusing to consent solely for this reason. This provides an additional reason for the franchise agreement to expressly provide the franchisor with the right to require the transferee to sign the "then current" franchise agreement.

Similarly, courts in the commercial leasing context have occasionally held that a landlord is not acting reasonably when it refuses to consent for the purpose of obtaining the leased premises for itself, either to use on its own or to grant a lease to one of its larger tenants.[64] In this context, landlords have been found to have withheld their consent for a collateral purpose unconnected to the terms of the lease. These cases may be considered analogous to franchising where a franchisor refuses to consent to a transfer simply because it prefers to retain the transferring franchisee's territory for its own corporate location or for another larger franchisee. In such a context, there is a risk that the franchisor's refusal may be found to be commercially unreasonable and contrary to the duty of good faith.

C. *Requirement for the Renewing Franchisee or Transferee to Sign the "Then-Current" Franchise Agreement*

In practice, it is common for renewal and transfer clauses in franchise agreements to expressly require renewing and transferee franchisees to sign the "then-current" form of franchise agreement used by the franchisor prior to the renewal/transfer.[65] This requirement is important for franchisors to adapt their systems in response to external developments in the industry and marketplace, as well as to internal network changes, since the last

to under the original lease); *Welbow Holdings Ltd.*, *supra* note 58, at para. 9 ("The Landlord is not entitled to require amendments to the terms of lease that will provide it with more advantageous terms" unless such is expressly provided for in the lease.).

64. *See Loblaws Inc. v The General Store*, 2007 NLTD 160, para. 25 citing *Bromley Park Garden Estates Limited v Moss*, [1982] 2 All E.R. 890 (C.A.) ("[T]he landlord [in refusing to consent] was attempting to regain possession of the premises in order to gain a further advantage by letting the entire premise to one tenant."); *see also* HABER, *supra* note 63, at 38 (citing two decisions where the courts found against the landlord on the basis that he "refused to consent because he wanted to obtain possession of the premises for himself").

65. For a similar observation, see Ross Bain, *Franchise Renewals: An In-House Counsel's Perspective*, 1 FOCUS ON FRANCHISING 1, 2 (2011); Yiokaris, *supra* note 15, at 10; Truby & Beyer, *supra* note 3, at 36.

iteration of the agreement.[66] Courts in Canada, similar to the apparent practice among U.S. courts,[67] enforce the requirement for a renewing franchisee to sign the then-current form of franchise agreement and ancillary documents.[68] While we have not found any decision considering this issue in the context of a franchisee transfer, it is likely that courts would also enforce parallel provisions that require transferees to sign "then-current" agreements.[69] However, as discussed above in Part II.B, where there is no express provision to this effect in the franchise agreement, it is unlikely that the franchisor can unilaterally impose such a requirement as a condition of consenting to the renewal or transfer.

It is noteworthy that in two franchise cases, courts have been required to determine, as a matter of fact, whether the franchisor actually presented a renewing franchise with its "then-current" form of franchise agreement.[70] This suggests that the question of whether a particular agreement truly represents the "then current" form of agreement may become a contested matter in litigation, especially where multiple versions of franchise agreements are in force in a particular system. In order to avoid litigation uncertainty on this issue, franchisors should ensure that wherever possible there is only one version of the franchise agreement being used for grants, renewals, and transfers at any particular point of time because evidence regarding the practice of the franchisor in its wider network will likely be admissible in litigation considering this issue.

D. *Requirement for Franchisee to Sign a General Release Prior to Renewal or Transfer*

Franchisors have commonly sought general releases from renewing or departing franchisees as a condition of renewal or transfer.[71] From a business perspective, the release provides a clean slate between the parties before their relationship is renewed and eliminates the potential for costly litigation from departing franchisees that may be incentivized to delay litigation until after

66. For a similar observation, see Yiokaris, *supra* note 15, at 1–2; Tractenberg et al., *supra* note 1, at 205 ("The ability of a franchisor to change the franchise relationship upon renewal may be critical to the continued viability of a franchise system.").

67. Becker & Boxerman, *supra* note 12, at 67 ("[C]ourts generally will enforce those terms as contract rights, provided the franchise agreement does not conflict with a governing statute."); Tractenberg et al., *supra* note 1, at 205 ("Where the franchisor reserves the right to require upon renewal that the franchisee execute the current form of franchise agreement "then in effect," the requirement will be enforced.").

68. *Timothy's Coffees of the World Inc. v Switt*, [1996] O.J. No. 2398, paras. 34–37 (Ont. Gen. Div.); *Pointts Advisory Limited*, *supra* note 10, at paras. 57, 65–66; *760437 Alberta Ltd. v Fabutan Corp*., 2012 ABQB 266, paras. 84, 103 (Can.).

69. It appears that certain U.S. state statutes prohibit the requirement of imposing the "then current" franchise agreement on a transferee franchisee: Truby & Beyer, *supra* note 3, at 2.

70. *Pointts Advisory Limited*, *supra* note 10, at paras. 51–52, 55–57; *Fabutan Corp*., *supra* note 68, at para. 84 ("The issue remains whether the form of renewal contract and . . . that [franchisor] . . . attempted to foist on [franchisee] . . . met the requirement of being a standard form of renewal agreement in use at the time.").

71. *See*, *e.g.*, Truby & Beyer, *supra* note 3, at 41.

the franchisor approves the transfer. In Canada, this common practice has been modified in recent years in response to judicial interpretations of the franchise legislation in force in the Statutory Provinces. In light of this case law (discussed below), the common practice in Statutory Provinces is for franchise agreements to expressly exclude claims and rights arising under the applicable franchise legislation from the scope of the requirement for a release upon renewal and transfer.[72]

In the Statutory Provinces, franchise legislation imposes heavy restrictions on the release or waiver of the statutory rights of franchisees.[73] Under the *Ontario Act*, which is substantively identical to the other statutes on this issue, "[a]ny purported waiver or release by a franchisee of a right given under [the statute] or of an obligation or requirement imposed on a franchisor . . . by or under [the statute] is void."[74] To date, the courts have only recognized one circumstance where a franchisor can obtain an enforceable release of a franchisee's rights under franchise legislation: a release given by a franchisee, with the advice of legal counsel, in settlement of a dispute for existing and known breaches of the franchise legislation.[75]

In two decisions of the Ontario Court of Appeal, the court held that a requirement in a franchise agreement for a renewing or transferring franchisee to release rights and claims available under the *Ontario Act* was unenforceable. In *405341 Ontario Limited v Midas Canada Inc.*,[76] the court heard an appeal from an application by a franchisee that was the representative plaintiff in a certified class proceeding brought against the franchisor concerning alleged breaches of the *Ontario Act*. The franchisee sought a declaration that the provisions of the franchise agreement requiring renewing and transferring franchisees to sign a general release were unenforceable. The Court of Appeal held that members of the certified class cannot be required to release their claims under the *Ontario Act* as a condition of renewal or transfer. The court also held that any release given pursuant to those contractual provisions was void.

In its recent decision in *2176693 Ontario Ltd. v Cora Franchise Group Inc.*,[77] the Court of Appeal made clear that broadly worded release clauses

72. *See generally*, *e.g.*, Levitt & Robinson, *supra* note 15, at 10 ("A common practice has evolved to continue to require releases from franchisees as a condition to renewal, but to exclude from such releases any rights the franchisee may have under the [franchise legislation]."); Weinberg & Frith, *supra* note 18, at 7–8 (also identifying an additional option to attempt to obtain a release of statutory claims by requiring the franchisee to obtain independent legal advice, thus potentially bringing the release within the *Tutor Time* exception discussed above).

73. *Ontario Act*, *supra* note 6, s. 11; *Alberta Act*, *supra* note 6, s. 18; *Manitoba Act*, *supra* note 6, s. 11; *New Brunswick Act*, *supra* note 6, s. 12; *Prince Edward Island Act*, *supra* note 6, s. 12.

74. *Ontario Act*, *supra* note 6, s. 11.

75. *Tutor Time*, *supra* note 57. This decision was cited with approval, but distinguished on its facts, by the Ontario Court of Appeal in *405341 Ontario Limited v Midas Canada Inc.*, 2010 ONCA 478, paras. 17–31 (Can.). This exception was recently applied by the Ontario Superior Court in *Trillium Motors*, *supra* note 56.

76. *Supra* note 75.

77. *2176693 Ontario Ltd. v Cora Franchise Group Inc.*, 2015 ONCA 152 (Can.).

in franchise agreements cannot ordinarily be "read down" by the courts to their enforceable limits. In *Cora*, two franchisees sought to assign their franchise agreement to third parties and refused to sign a general release as required by their franchise agreements. In response, the franchisor delivered a form of release that expressly excluded from its ambit claims and rights under the *Ontario Act*. When the franchisees refused to sign the narrower release, litigation ensued. On appeal, the Ontario Court of Appeal held that the provision in the franchise agreement requiring a general release on transfer contravened the *Ontario Act*, per the reasoning in *Midas*, and declined to read down or sever the provision to allow for the release of common law claims as the franchisor sought. While the court left open the possibility that severance might be available in a future case where the offending language in the provision was clearly excisable,[78] it rejected the idea that franchisors can rely on the courts to read down general release clauses in franchise agreements to make them enforceable. The result in *Cora* was that the entire contractual provision requiring a release was unenforceable and thus the franchisor was unable to obtain a release of common law claims from the transferring franchisees.

While technically only binding in Ontario, *Midas* and *Cora* would be considered highly persuasive to the courts in the other Statutory Provinces. Provisions in franchise agreements requiring a release as a condition of renewal or transfer should either expressly exclude franchise legislation from their ambit or, at a minimum, provide for a release of rights "to the extent that applicable law would permit."[79]

E. *Condition That Franchisee "Not Be in Default" of the Franchise Agreement*

Franchise agreements frequently require a renewing or transferring franchisee to not be in default of any covenants in the wider franchise agreement as a condition of renewal or transfer.[80] One frequently litigated issue that has usually arisen in the leasing context is whether the party seeking to renew or transfer the agreement is offside the "no default" condition. In these cases, the courts have gone out of their way to avoid allowing minor, historical breaches of the underlying agreement, which have long since been cured, to lead to a forfeiture of the renewal or transfer right.[81] In Ontario, the courts have applied a principle commonly referred to as "spent breach," under which a condition precedent requiring compliance with the covenants

78. *Id*. at para. 39 ("The blue pencil approach [to severance] does not apply in the circumstances, because there is no phrase in [the offending provision] that could be struck to enable the clause to require a release of only non-[statutory] claims.").

79. *Id*. at para. 25 (noting in passing that "[t]he [offending provision] does not call for a release of claims to the extent that applicable law would permit (which would import flexibility into the substance of the obligation to provide a release)"). I am grateful to Andraya Frith for bringing this passage of *Cora* to my attention.

80. See *generally* Bain, *supra* note 65, at 2; Truby & Beyer, *supra* note 3, at 38–39; Dick, *supra* note 2, at 3.

81. For a more detailed discussion of this case law, see Ship, *supra* note 1.

of the wider agreement will generally be interpreted as only requiring compliance at the time the renewal term begins or the transfer occurs.[82] For example, in one case, 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.[83] In *1290079 Ontario Inc. v Beltsos*, the renewing party 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 because, by the time of the renewal, the landlord continued to be a defendant in the personal injury litigation, which meant that the previous breach by the tenant "subsisted."[84] In the course of its reasoning, the court confirmed that 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."[85] Similar reasoning has been applied by appellate courts across Canada.[86] While we have not found a franchise case directly on point, it is likely that the principle of spent breach would apply equally to conditions precedent in franchise renewal and transfer clauses given its tenure in the common law and its endorsement by appellate courts.

However, the principle of spent breach is one of contractual interpretation, meaning that the principle should yield to clear contractual language in the renewal or transfer clause to the effect that any breach of the agreement voids the right to renew or transfer.[87] This suggests that clear drafting may assist a franchisor to overcome the principle, subject to the doctrines of unconscionability and relief from forfeiture. Further, as discussed in Part I.A

82. In two cases, *Fingold v Hunter*, [1944] O.J. No. 105, paras. 8 and 12 (Ont. C.A.), and *Re Spiegel and Modernage Furniture Ltd.* [1971] O.J. No. 1829, paras. 8–9 (Ont. C.A.), per Arnup J.A. (Jessup J.A. concurring), the courts held that the date on which to assess the party's compliance was the first day on which the other party refused to recognize the exercise of the option.

83. *Spiegel and Modernage Furniture Ltd.*, [1971] O.J. No. 1829, paras. 8–9 (Ont. C.A.).

84. *1290079 Ontario Inc. v Beltsos*, 2011 ONCA 334 at paras. 29–30.

85. *Id.*

86. *McLaughlin v Bodnarchuk* (1957), 8 D.L.R. (2d) 596, [1957] B.C.J. No. 131 at paras. 7–9 (B.C. C.A.); *SME Holdings v Cappeech Coffee Corp.*, 2000 BCCA 524 at para. 10, [2000] B.C.J. No. 1915 ("[T]he time when the tenant must not be in default is at the date of the expiry of the existing term."); *Burlock v Steeves*, [1990] N.B.J. No. 857 (N.B. C.A.); *Birchmont Furniture Ltd. v Loewen* (1978), 84 D.L.R. (3d) 599, [1978] M.J. No. 27 (Man. C.A.).

87. *Birchmont Furniture Ltd.*, *supra* note 86, at para. 5; *Sail Labrador*, *supra* note 38, at para. 50; *Re Pacella et al. and Giuliana et al.* (1977), 16 O.R. (2d) 6 at 8 (Ont. C.A.) (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]); *see also 1383421 Ontario Inc. v OLE Miss Place Inc.* (2003), 67 O.R. (3d) 161, 231 D.L.R. (4th) 193 at para. 65 (Ont. C.A.) (finding that the operative date to assess default was the date that notice of renewal was delivered because the rent payable during the renewal term was to be the subject of arbitration that could only take place months after the condition was satisfied).

above, the Supreme Court of Canada's decision in *Sail Labrador* may also apply in the context of a no-default condition in a renewal or transfer clause. As noted, *Sail Labrador* suggests that, absent very clear language to the contrary, a party in default may continue to exercise the right at issue so long as their previous default did not constitute substantial non-performance of the agreement.[88] In light of the doctrine of spent breach and the concept of substantial non-performance, it is risky for a franchisor to rely on minor, historical defaults that have long since been cured as a basis to deny a renewal or transfer.

F. *Damages for Breach of the Duty of Good Faith and Fair Dealing*

In two well-known franchise renewal cases in Ontario, the courts have awarded non-compensatory damages to franchisees in light of what the court held to be particularly egregious conduct by the franchisor during the time period prior to the renewal.[89] These cases establish that franchisors must conduct themselves fairly throughout the renewal process and cannot withhold vital information from their franchisees regarding the status of the renewal. These decisions may also apply to appropriate cases in the transfer context.

In *Salah v Timothy's Coffees of the World Inc.*, the franchisee operated in a shopping center and was a sub-lessee to the franchisor. The franchise agreement and sublease provided that they would be renewed in the event that the franchisor entered into a new head-lease with the landlord at the shopping center. The franchisor decided that it preferred to work with a different franchisee at this location and entered into negotiations with the landlord to sign a new head-lease, except that the premises would be moved to a different floor of the shopping center. Importantly, the franchisor took active steps to ensure that the franchisee was not made aware of its intentions, including by intentionally failing to return phone calls from the franchisee and instructing the landlord to refrain from passing on any information to the franchisee about the existing or new head-lease. The franchisor ultimately refused to renew the franchisee. The Ontario Court of Appeal, in addition to finding that the franchisor breached the renewal clause, held that the franchisor breached the duty of good faith by actively withholding critical information from the franchisee and awarded $50,000 over and above compensatory damages.[90] The court recognized that damages for breach of the statutory duty of good faith under the *Ontario Act* were separate and in addition to compensatory damages owing for breach of contract.[91] This analysis would likely apply in the other Statutory Provinces.

88. *Sail Labrador*, *supra* note 38, at para. 50.

89. *Salah v Timothy's Coffees of the World Inc.*, [2009] O.J. No. 4444 (Ont. Sup. Ct.), aff'd 2010 ONCA 673 (Can.); *1159607 Ontario Inc. v Country Style Food Services Inc.*, 2012 ONSC 881 (Can.).

90. *Salah*, *supra* note 89, at para. 22.

91. *Id.* at paras. 26, 29.

Similarly, in *1159607 Ontario Inc. v Country Style Food Services Inc.*, the franchisor also withheld critical information from the franchisee concerning its discussions with the landlord regarding the head-lease. After the franchisor and the landlord agreed to an early termination of the head-lease, the franchisor took active steps to keep this information from the franchisee. In later meetings with the franchisee, moreover, the franchisor made no mention of the head-lease termination and instead implied to the franchisee that negotiations with the landlord were in their final stages.[92] This active deceit led the court to award $25,000 in non-compensatory damages against the franchisor.[93]

III. Statutory Disclosure Issues on Renewal or Transfer

In the Statutory Provinces, franchise renewals and transfers raise a key practical issue. Given the wording of the franchise legislation and a number of Ontario decisions interpreting that wording, renewals and transfers often require the franchisor to deliver a disclosure document to renewing and transferee franchisees that is partially customized to the specific circumstances of the transaction. In the sections below, we discuss the limited statutory exemptions to disclosure that are available in the context of renewals and transfers. We then briefly discuss the process for customizing disclosure documents for these transactions in the (likely) event that an exemption is unavailable. Before addressing these points, however, we first provide a brief overview of the franchise disclosure regime applicable in the Statutory Provinces to the extent necessary to provide context for the specific issues that arise on renewal or transfer.

In the Statutory Provinces, franchise legislation requires the franchisor to deliver a disclosure document to the franchisee at least fourteen days before the franchise agreement is executed or consideration is paid. Given that there is no registration regime for franchise disclosure in Canada, disclosure documents must be current and up-to-date[94] at the time they are provided to individual franchisees. This is always the case unless a specific statutory exemption to disclosure is available. In addition to disclosing under each of the subject matter areas prescribed in the regulations passed under the applicable franchise statutes, the Canadian legislation contains basket-clause language requiring the disclosure of all other "material facts." The standard of materiality is statutorily prescribed to include that which can reasonably be expected to have a significant effect on the value of a franchise or the decision to acquire the franchise.[95] As discussed below, unless one of the exemptions

92. *Country Style Food Services Inc.*, *supra* note 89, at paras. 54–55, 63.

93. *Id.* at para. 129.

94. *Tutor Time*, *supra* note 57, at para. 56 (". . . an Ontario disclosure document is "evergreen" and must be updated to reflect all material facts as they exist on the date that it is delivered to the prospective franchisee").

95. *See* legislation cited in *infra* note 116 and accompanying text.

is available under the franchise legislation, the disclosure document must be customized to address the material circumstances of the renewal or transfer at issue.

A. *Potential Disclosure Exemptions on Renewal and Transfer of the Franchise Agreement*

1. Exemption for Renewals and Extensions

The *Alberta Act* fully exempts renewals and extensions from the disclosure requirement.[96] However, the corresponding exemption in Ontario, Manitoba, New Brunswick and Prince Edward Island is significantly more restricted. In these provinces, the exemption is available only "where there has been no interruption in the operation [of the franchise] . . . and there has been no material change since the franchise agreement or latest renewal or extension of the franchise agreement was entered into."[97] The definition of "material change" is substantively similar under these statutes and focuses on whether the information "would reasonably be expected to have a significant adverse effect on the value or price of the franchise . . . or on the decision to acquire the franchise."[98] The requirements of this exemption are triggered whenever a franchisor and an existing franchisee enter into a new form of franchise agreement to replace an existing agreement, or when they extend the term of an existing agreement.[99]

As a matter of practice, Canadian franchise lawyers are generally wary of relying on this exemption, given the broad statutory definition of "material change" and a concern that courts will rarely agree that no material change has occurred during the preceding term.[100] This concern is in part informed by the fact that the onus of proving the applicability of an exemption rests with the party seeking to rely on it and the courts have held that exemptions are to

96. *Alberta Act*, *supra* note 6, at s. 5(1)(d).

97. *Ontario Act*, *supra* note 6, s. 5(7)(f); *Manitoba Act*, *supra* note 6, s. 5(11)(f); *New Brunswick Act*, *supra* note 6, s. 5(8)(f) ; *Prince Edward Island Act*, *supra* note 6, s. 5(7)(f).

98. *Ontario Act*, *supra* note 6, s. 1(1); *Manitoba Act*, *supra* note 6, s. 1(1); *New Brunswick Act*, *supra* note 6, s. 1(1); *Prince Edward Island Act*, *supra* note 6, s. 1(1)(k); *see also* Joseph Adler & Michael Laidhold, *Assessing Materiality in Franchise Disclosure Documents: A Canada–U.S. Analysis*, 30:4 FRANCHISE L.J. 245, 246 (2011) (stating that because the definitions of material change in the Manitoba, New Brunswick, and PEI statutes "include a change in the 'franchise' in addition to a change in the business, operations, capital, or control of the franchisor . . . and a change in the franchise system," they are "significantly broader than the applicable definitions" set out by the Alberta and Ontario provisions).

99. *Suncor Energy Products Inc.*, 2010 ONSC 7022, para. 50, aff'd on other grounds 2011 ONCA 613 (Can.).

100. For a similar observation, see Yiokaris, *supra* note 15, at 20 ("In practice, the exemption . . . is virtually useless, because rarely will there have been no material changes."); Dick, *supra* note 2, at 5 ("In practice, most franchise systems undergo "material changes" during the initial term of a franchise agreement as defined by the legislation. The exemption is therefore rarely resorted to."); *see generally* Frank Zaid, Jennifer Dolman & Andraya Frith, *Ontario's Franchise Legislation: Lessons Learned in the First Decade and What's Ahead for the Future*, 29:2 FRANCHISE L.J. 63 (2009) (noting that the breadth of the exemption is uncertain).

be narrowly interpreted in favor of disclosure.[101] This exemption has received very little judicial consideration. In *1159607 Ontario Inc. v Country Style Food Services Inc.*, the Ontario Superior Court held that a material change had occurred when the renewal lease had a term of twenty-one months, as opposed to the previous term of five years.[102] There was therefore a requirement for disclosure. Similarly, in *MDG Kingston Inc. v MDG Computers Canada Inc.*,[103] the court held that changes to key provisions of the original franchise agreement in the renewal agreement—dealing "costs of services, allocation of expenses . . . punitive penalty provisions, purchase price of goods, and warranty service provisions"—constituted material changes, thus requiring a disclosure document to be delivered. In the course of its reasoning, the court noted in obiter that "it would be exceptionally rare that no material changes occur with respect to the franchise business within a period of five years."[104]

2. Exemption for Certain Types of Transfers

A narrow exemption is available in the context of franchise transfers and resales that appears to have similar substantive content to parallel exemptions found in a number of U.S. state disclosure regimes.[105] The key requirement of this exemption is that the "the grant of the franchise is not effected by or through the franchisor."[106] The legislation clarifies that the transaction will not be effected by or through the franchisor simply because "the franchisor has a right, exercisable on reasonable grounds, to approve or disapprove the grant" or because a transfer fee is charged.[107] Nevertheless, the courts have heavily circumscribed the scope of this exemption, requiring that the

101. *See Ontario Act*, *supra* note 6, s. 12; *Alberta Act*, *supra* note 6, s. 19; *Manitoba Act*, *supra* note 6, s. 12; *New Brunswick Act*, *supra* note 6, s. 13; *Prince Edward Island Act*, *supra* note 6, s. 13, all of which make clear that the onus to prove an exemption rests with the party asserting it; *see also 2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*, 2011 ONCA 467 at para. 32 ("Given the purpose and context of the Act, the exemptions to disclosure set out in ss. 5(7)(a)(iv) and 5(8) must be narrowly construed.").

102. *Country Style*, *supra* note 89, at para. 104.

103. *MDG Kingston Inc. v MDG Computers Canada Inc.*, [2007] O.J. No. 5561 (Ont. Sup. Ct.), rev'd on other unrelated grounds 2008 ONCA 656 (Can.).

104. *MDG Kingston*, *supra* note 103, at para. 6. The decision was reversed on appeal, but on a different issue concerning the applicability of an arbitration clause.

105. Truby & Beyer, *supra* note 3, at 2, 5 (noting that the FTC regime exempts resale transactions in which the franchisor is not significantly involved and that a number of state statutes exempt transactions not effected by or through the franchisor).

106. *Ontario Act*, *supra* note 6, s. 5(8) (". . . [A] grant is not effected by or through a franchisor merely because (a) the franchisor has a right, exercisable on reasonable grounds, to approve or disapprove the grant; or (b) a transfer fee must be paid to the franchisor in an amount set out in the franchise agreement or in an amount that does not exceed the reasonable actual costs incurred by the franchisor to process the grant."); *Alberta Act*, *supra* note 6, s. 5(2); *Manitoba Act*, *supra* note 6, s. 5(16); *New Brunswick Act*, *supra* note 6, s. 5(10); *Prince Edward Island Act*, *supra* note 6, s. 5(7).

107. *Ontario Act*, *supra* note 6, s. 5(7)(a) (no disclosure document required where there is "the grant of a franchise by a franchisee if (i) the franchisee is not the franchisor, an associate of the franchisor or a director, officer or employee of the franchisor or of the franchisor's associate; (ii) the grant of the franchise is for the franchisee's own account; (iii) in the case of a master franchise, the entire franchise is granted; and (iv) the grant of the franchise is not effected by or through

franchisor play only a passive role in the resale transaction in order to be eligible. In the leading case on point, the Ontario Court of Appeal held that the exemption applies "only when the franchisor is not an active participant in bringing about the grant and does nothing more than 'merely' exercise its rights to consent to the transfer."[108] Given the narrow ambit of the exemption as interpreted by the courts, franchise counsel in Canada are typically wary of relying on the exemption and typically advise franchisors to disclose to transferees directly in order to reduce the risk of rescission.[109]

In order to rely safely on this exemption, franchisors must limit their involvement in the resale transaction so that they are merely exercising their existing contractual rights to consent, impose a transfer fee, or both. Therefore, franchisors cannot safely rely on the exemption where they require transferees to sign new documents that are not expressly and clearly contemplated in the franchise agreement as being a condition of the transfer.[110] A clear example of being offside the exemption is to require a spouse of the transferee to sign a personal guarantee, or the transferee itself to sign a general security agreement, where no such requirements existed prior to the transfer.[111] Other cases have suggested caution before requiring the transferee to sign any additional documents that the original franchisee did not have to sign.[112]

The franchisor should also limit the extent to which it is involved in direct discussions with the transferee, as the courts have relied upon franchisors' direct involvement in negotiations between transferors and transferees as supporting a finding that the franchisor played an active role.[113] Since fran-

the franchisor"); *Alberta Act*, *supra* note 6, s. 5(1)(a); *Manitoba Act*, *supra* note 6, s. 5(11)(a); *New Brunswick Act*, *supra* note 6, s. 5(8)(a); *Prince Edward Island Act*, *supra* note 6, s. 7(a).

108. *2189205 Ontario Inc. v Springdale Pizza Depot Ltd.*, 2011 ONCA 467, para. 33 (Can.).

109. For a similar observation, see Levitt & Robinson, *supra* note 15, at 19 (". . . the common wisdom is to provide prospective purchasers of existing franchises with disclosure in order to avoid any possible risk . . .").

110. *2189205 Ontario*, *supra* note 108, at 46–48 ("The franchisor . . . required the [transferees] to execute documents which were not specified in the Franchise Agreements"); *Tutor Time*, *supra* note 57, at para. 49.

111. *Tutor Time*, *supra* note 57, at para. 49 (". . . [A] franchisor who exercises the power, albeit on reasonable grounds and pursuant to its usual practice, to require a non-officer, non-shareholder spouse . . . to in effect become a co-franchisee is not merely engaging in the relatively passive act of approval of the transfer of the franchise. . . . Rather, the grant is being effected by or through the franchisor."); *Brister v 2145128 Ontario Inc.*, 2014 ONSC 6714 (Can.) ("though there is no evidence of [the transferor] being required to provide security . . . [the franchisor] required [the transferee] to enter a General Security Agreement . . .").

112. *2189205 Ontario*, *supra* note 108, at 47 ("[T]he franchisor required execution of documents that the vendor had not been required to sign, the undertaking for car wrapping and the specific acknowledgement that there was no reliance . . . on any financial representations by the franchisors."); *2147191 Ontario Inc. v Springdale Pizza Depot Ltd.*, 2015 ONCA 116 (Can.) ("The [franchisor] required the [transferees] to execute an acknowledgement. Among other things that document provided certain additional protection to the [franchisor].").

113. *2189205 Ontario*, *supra* note 108, at 47 ("[T]he franchisor negotiated together with the vendor and the respondents to bring about the sale of the business and the assignment of the franchise."); *2147191 Ontario*, *supra* note 112 ("The appellants were involved in three meetings with the respondents in respect of the respondents' acquisition of the franchise.").

chisors are expressly permitted by the statute to provide their consent to the transaction without providing disclosure, the franchisor is likely permitted to take steps to evaluate the transferee's financial and operational fitness[114] including through at least some contact with the transferee. However, the contact should be minimal and focused purely on obtaining the information necessary for the franchisor to determine whether to provide consent.

B. *Customization of Franchise Disclosure Documents for Renewal or Transfer*

As noted above, Canadian franchise legislation includes basket-clause language requiring the disclosure of all other "material facts" in addition to the other prescribed subject matter areas. Under Ontario case law, which would likely be persuasive in the other Statutory Provinces, the basket-clause language requires disclosure of all material facts relevant to the grant of the franchise.[115] The standard of materiality is statutorily defined as that which "would reasonably be expected to have a significant effect on the value or price of the franchise . . . or the decision to acquire the franchise."[116] Given such wording of the franchise legislation, and a number of Ontario decisions interpreting that wording, it is common practice in Canada for franchise counsel to actively consider the basket clause when drafting or advising on disclosure documents.[117] In a recent case, the Ontario Court of Appeal suggested that whether a fact falls within the basket clause as a "material fact" must be considered on a case-by-case basis, using a "highly fact specific analysis."[118] In this section of the article, we briefly discuss customizing disclosure documents for these transactions. We first provide a

114. *2147191 Ontario Inc. v Springdale Pizza Depot Ltd*., 2014 ONSC 6714 (Can.), para. 16; *Tutor Time*, *supra* note 57, at para. 25 ("It would not serve the best interests of [the franchise] or that of its network of franchisees to allow a franchise to be transferred without an assessment of the proposed transferee's character, experience and credit worthiness.").

115. *See*, *e.g.*, *6792341 Canada Inc. v Dollar It Limited*, 2009 ONCA 385, paras. 36–39 (Can.) (using the basket clause to find that a disclosure document was materially deficient because it failed to disclose the terms of the head-lease whose covenants the franchisee agreed to satisfy); *Caffé Demetre Franchising Corp. v 2249027 Ontario Inc.*, 2015 ONCA 258, paras. 53, 59 (Can.) ("Since there is nothing in the Act or in the regulations that expressly specifies that this type of information must be contained in the disclosure document, the question is whether . . . [it] falls within the [general] definition of a 'material fact.'")

116. *See Ontario Act*, *supra* note 6, s. 1(1) (definition of "material fact"); *Alberta Act*, *supra* note 6, s. 1(1)(o); *Manitoba Act*, *supra* note 6, s. 1(1); *New Brunswick Act*, *supra* note 6, s. 1(1); *Prince Edward Island Act*, *supra* note 6, s. 1(1)(l).

117. *See*, *e.g.*, Dominic Mochrie & Peter Viitre, *Best Practices for the Preparation and Use of a Franchise Disclosure Document*, O.B.A., 7 (2010) (presented at Ontario Bar Association's Annual Franchise Law Conference, November 2010) (". . . the list of required information contained in the . . . regulation may, in some cases, be only the beginning of the discussion [with the client and the franchisor]"); Adler & Laidhold, *supra* note 98, at 245–46 ("This catch-all disclosure obligation requires franchisors issuing disclosure documents . . . to consider the disclosure of not only the prescribed disclosures set out by regulation but also any other material fact. . . ."); George Eydt & Edward (Ned) Levitt, *The Devil Is in the Details: How Canadian and U.S. Franchise Legislation Differs*, 32:4 FRANCHISE L.J. 237, 239 (2013) (noting "the requirement to include all material facts, in addition to all prescribed items"); Weinberg & Frith, *supra* note 18, at 22.

118. *Caffé Demetre Franchising Corp*., *supra* note 115, at para. 59.

brief overview of the disclosure regime applicable in the Statutory Provinces to the extent necessary to provide the necessary context.

Canadian franchise legislation leaves the matter of enforcement completely to private litigation. In addition to a cause of action for misrepresentation and/or failure to disclose, Canadian franchise legislation provides a rescission remedy that is the most significant cause of action available to franchisees for disclosure deficiencies. If successful in a rescission claim, a franchisee is able to rescind the franchise agreement without penalty or obligation and obtain significant financial compensation from the franchisor. The financial compensation includes the refund of all monies received by the franchisor, the purchase by the franchisor of any inventory, supplies, or equipment that the franchisee had purchased pursuant to the arrangement, and the payment of compensation to the franchisee for any losses incurred in "acquiring, setting up and operating" the franchise.[119] Under the *Alberta Act*, however, compensation is limited to the franchisee's net losses.[120]

The rescission remedy is subject to two potential limitations periods. Where the disclosure document fails to meet the content requirements of the legislation, or where it is delivered late, the right of rescission must be exercised by the franchisee "no later than 60 days after receiving the disclosure document."[121] By contrast, "if the franchisor never provided the disclosure document," the franchisee has "two years after entering into the franchise agreement" to exercise the right of rescission.[122] The key issue in many rescission cases is whether the two-year limitation period is applicable where the content of the disclosure document is deficient in some non-trivial way. A full treatment of this issue falls outside the scope of this article. However, we note a tension in the existing case law regarding the applicable test as to whether a disclosure document is fatally deficient, thus amounting to no disclosure. This tension may inform franchisors when considering the risks of failing to customize their disclosure documents for renewals and transfers. In its leading decision in *6792341 Canada Inc. v Dollar*

119. *Ontario Act*, *supra* note 6, s. 6(6); *Manitoba Act*, *supra* note 6, s. 6(5); *New Brunswick Act*, *supra* note 6, s. 6(6); *Prince Edward Island Act*, *supra* note 6, s. 6(6). For a more comprehensive discussion as to how rescission damages are quantified, see Ephraim Stulberg & Jonathan Mesiano-Crookston, *Rescission Under the Ontario Arthur Wishart Act: Quantifying the Remedy*, 33:2 FRANCHISE L.J. 235 (2013).

120. Under the *Alberta Act*, the financial remedy is narrower in that it is restricted to the "net losses" suffered by the franchisee. *Alberta Act*, *supra* note 6, s. 14(2).

121. *Ontario Act*, *supra* note 6, s. 6(1); *Alberta Act*, *supra* note 6, s. 13(a); *Manitoba Act*, *supra* note 6, s. 6(1); *New Brunswick Act*, *supra* note 6, s. 6(1); *Prince Edward Island Act*, *supra* note 6, s. 6(1). Under the Alberta Franchisees Regulation, Alta Reg 240/1995, s. 2(4), a disclosure document will be deemed to have been properly provided to the franchisee "if the document is substantially complete." This means that the two-year limitations period is only available where the disclosure document is not substantially complete.

122. *Ontario Act*, *supra* note 6, s. 6(2); *Alberta Act*, *supra* note 6, s. 13(b); *Manitoba Act*, *supra* note 6, s. 6(2); *New Brunswick Act*, *supra* note 6, s. 6(2); *Prince Edward Island Act*, *supra* note 6, s. 6(2).

It Limited,[123] the Ontario Court of Appeal endorsed the reasoning of a lower court decision in which it was held that any "material" omission in a disclosure statement was fatal and constituted absent disclosure.[124] This test suggests a wide scope for the two-year limitations period and has been followed by a number of lower courts.[125] However, *Dollar It* is less than clear in its endorsement of this test, noting that "each case will fall to be considered on its own particular facts."[126] By contrast, in a more recent decision of the Ontario Court of Appeal, the court cited a different passage from *Dollar It* to suggest that the operative test was whether the deficiency "effectively deprived the franchisees of the opportunity to make a properly informed decision to invest in the . . . franchise."[127] While this passage may suggest a higher, more fact-sensitive standard for a finding of absent disclosure, we suggest waiting for a more definitive statement from the Court of Appeal on this issue before assuming that this is the governing test.[128]

For present purposes, the important issue is whether the failure to customize a disclosure document to the unique circumstances of a particular renewal or transfer gives rise to the risk of a rescission claim. Some Ontario decisions are worth highlighting in this regard. First, *Dollar It* was the first appellate decision to address the issue of site-specific disclosure requirements. In that case, the disclosure document failed to include a copy of the applicable head-lease, the covenants of which the franchisee agreed to observe as a condition of its sublease. The Ontario Court of Appeal held that the head-lease was material and should have been included as part of the disclosure document. This omission, combined with several other deficiencies, led the court to conclude that the disclosure document was fatally deficient, thereby attracting the two-year limitations period for rescission.[129] Second, in *1518628 Ontario Inc. v Tutor Time Learning Centres, LLC*, the Ontario Superior Court considered the adequacy of a disclosure document delivered to a proposed transferee in a franchisee assignment transaction. Prior to the transfer, the franchisor sent representatives to inspect the franchise location while it was still under the control of the original transferor. The representative reported to the franchisor that there were "serious problems with the accounts, billings, financial arrangements with family users and

123. *Dollar It*, *supra* note 115. This can be contrasted with *4287975 Canada Inc. v Imvescor Restaurants*, 2009 ONCA 308 (Can.), where the court held that the applicable limitations period was sixty days from the date of disclosure where the disclosure document was delivered late (but was not otherwise deficient).

124. *Dollar It*, *supra* note 115, at para. 78, citing *6862829 Canada Limited et al. v Dollar It Limited et al.*, [2008] O.J. No. 4687 at paras. 64–65.

125. *See*, *e.g.*, *Sovereignty Investment Holdings, Inc. v 9127-6907 Quebec Inc.*, [2008] O.J. No. 4450 (Ont. Sup. Ct.).

126. *Dollar It*, *supra* note 115, at para. 78.

127. *Caffé Demetre Franchising Corp.*, *supra* note 115, at para. 63.

128. In another recent decision, the Ontario Court of Appeal referred again (in passing) to the lower materiality test. *2240802 Ontario Inc. v Springdale Pizza Depot Ltd.*, 2015 ONCA 236, para. 51 (Can.).

129. *See also 4287975 Canada Inc. v Imvescor Restaurants*, 2009 ONCA 308 (Can.).

the overall management" of the business. However, this site-specific information was omitted from the disclosure document provided to the transferee.[130] The court held that this information should have been included in the disclosure document because it "would materially impact upon the decision of any reasonable person to proceed with a transfer of the interest in the franchise within a few months after the reports."[131] The court concluded that disclosure document, which contained other deficiencies as well, was fatally deficient and thus subject to the two-year rescission remedy. The court's reasoning on the rescission issue was cited with approval some years later by the Ontario Court of Appeal in *Dollar It*.[132]

Dollar It and *Tutor Time* strongly suggest that any material facts that deal with issues that are specific to the particular franchise location and the renewal or transfer at issue should be included within the disclosure document. Failure to disclose such material facts will likely give rise to a risk of statutory rescission. As matters currently stand, the practice of counsel in the Statutory Provinces is to partially customize disclosure documents to address the material facts of the individual renewal or transfer transaction. Generic disclosure documents in Canada tend to be initially drafted to accommodate renewals and transfers by containing subsections and detailed notes to provide specific information to renewing franchisees or transferees and which qualify the information applicable to new franchisees.[133] For example, when disclosing the costs necessary to establish the franchise, generic disclosure documents frequently contain a separate section disclosing the costs applicable to renewing, as opposed to new, franchisees.[134] By contrast, the establishment costs for transferees are invariably unique and based on the circumstances of the transaction, so the better practice is to revise the applicable section of the disclosure document to address the circumstances of the individual transferee.[135] If the renewing franchisee or transferee is required to sign a new form of franchise agreement, the disclosure document will obviously need to reflect the updated terms and conditions as well exhibit any

130. The franchisee was provided with the franchisor's U.S. disclosure document.

131. *Tutor Time*, *supra* note 57, at paras. 62–63.

132. *Dollar It*, *supra* note 115, at paras. 73–74.

133. For similar observations, see Weinberg & Frith, *supra* note 18, at 27 (generic disclosure documents can "employ the use of detailed notes to renewing and resale franchisees throughout the body of the . . . document in order to highlight where additional or different information applies to them . . . [and] use . . . schedules and exhibits . . . to provide information that is uniquely relevant to the particular candidate"); Christine Jackson, *Preparing Disclosure Documents for Renewal*, OSLER.COM (last visited July 14, 2015) (generic disclosure documents can ". . . build in a certain amount of flexibility through the use of notes to renewing franchisees . . . and schedules specific to renewing franchisees").

134. *See*, *e.g.*, Zaid, Dolman & Frith, *supra* note 100, at 64.

135. *See* Zaid, Dolman & Frith, *supra* note 100, at 64; Edward (Ned) Levitt, *Everything You Wanted to Know About Franchise Legislative Compliance (But Were Afraid to Ask)*, C.F.A., 10 (2013) (presented at the Canadian Franchise Association's Annual Franchise Law Day, January, 2013).

other agreement that relates to the franchise, such as key ancillary documents and any applicable leases.[136]

Customization can be cumbersome in the context of transfer.[137] Depending on the circumstances, material facts may include information that belongs to the transferor, requiring the franchisor to obtain the transferor's consent before including such information in the disclosure document. One example is information concerning the historical financial performance of the transferring franchisee, which may well be considered a material fact to the transferee that is purchasing the business.[138] Such information may be disclosable if in the possession of the franchisor. In *Tutor Time*, the court held that a contractual confidentiality obligation owed by the franchisor to the transferring franchisee did not relieve the franchisor from its obligation to include material facts in the disclosure document.[139] Therefore, as a condition of consenting to a transfer, franchisors should require a transferring franchisee to consent to inclusion of requisite information regarding its operations in any disclosure document, or require franchisees to agree in advance through a provision in the franchise agreement.[140] Where information is obtained from the franchisee, the disclosure document should make clear that the franchisor has not independently vetted the information.

IV. Conclusion

Renewal and transfers frequently give rise to legal and business challenges for franchisors and franchisees. In this article, we have attempted to distil the key legal issues and authorities that govern franchisee renewals and transfers in Canada's common law provinces. Courts in Canada have frequently been called upon to interpret and enforce renewal and transfer provisions, both in the franchise context as well as in the broader context of commercial disputes. In the end, the analysis of most renewal and transfer issues turns on the wording of the franchise agreement and any applicable franchise legislation.

136. *See generally* Levitt & Robinson, *supra* note 15, at 21–23.

137. Adler & Laidhold, *supra* note 98, at 246 ("Particularizing disclosure documents for each and every franchise sale situation is a time-consuming and costly endeavor.").

138. Peter Viitre & Daniel Zalmanowitz, *Difficult Disclosure Issues*, O.B.A., 5 (2009) (presented at Ontario Bar Association's Annual Franchise Law Conference, October 2009) (". . . [if] the franchisor has actual performance numbers . . . it must disclose them"); Levitt & Robinson, *supra* note 15, at 21 (". . . it has been suggested that the sales history of a franchise and other performance metrics, if known by the franchisor at the time of a transfer, are . . . material facts"); Weinberg & Frith, *supra* note 18, at 27 ("The historical financial performance of the existing franchisee will be known and will be particularly relevant to the resale franchisee.").

139. *Tutor Time*, *supra* note 57, at paras. 64–66.

140. Levitt & Robinson, *supra* note 15, at 21.