A Primer on Franchising in Canada

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Over the last fifty years, Canada has increasingly become a chosen expansion destination for American franchise systems. Many American franchise systems have thrived in Canada, and it is often (according to stereotype) viewed as a natural extension of the American domestic marketplace. In 2017, franchising accounted for 5% of the Canadian economy, with the industry hitting CAD $96 billion in gross domestic product.[1] There are many reasons Canada is an attractive expansion destination for American franchisors. Canada is geographically proximate to the United States and has a highly skilled, educated workforce with consumer behaviors similar to those of Americans. Canada also presents unique opportunities given its size, natural resources, transportation infrastructure, and vacant land available for development. Generally, business practices and legislative developments in Canada tend to follow those in the United States, although Canadians have traditionally been less prone to litigation. The 2016 KPMG Competitive Alternatives Study, which compared business costs in 111 cities in ten countries, found that business costs in Canada are 14.6% lower than business costs in the United States.[2] This standing placed Canada second only to Mexico among the ten industrialized countries in the study. Further, Toronto, Montreal, and Vancouver, the three largest Canadian cities by population, were found to have lower business costs than every large American city.[3]

However, notwithstanding the similarities, there are substantial differences between the countries, and successful expansion to Canada should not

1. Canadian Franchise Ass'n, Annual Accomplishments Report 2018, at 40 (2018),

2. KPMG, Competitive Alternatives: KPMG's Guide to International Business Location (2016) (focus on Canada), https://assets.kpmg/content/dam/kpmg/pdf/2016/03/competitive-alternatives-2016-full-report.pdf.

3. *Id.* at 13.

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be taken for granted. It is important for franchisors hoping to expand into Canada to gain an understanding of the business and legal differences in the Canadian market, so as to better plan for a more effective and efficient entry. A significant number of American franchisors likely end up in Canada without any kind of proactive strategy. Often, they are initially attracted to Canada by interested local prospective single unit franchisees, area developers, or master franchisees who contact the franchisor. The franchisor, believing Canada is no different, may rush in only to find that the lack of planning and understanding the market can result in a problem or worse. As a result, most franchise professionals agree that a strategic and proactive entrance plan is necessary for success.

This article seeks to provide American franchisors with a better understanding of the Canadian franchise landscape, both from a legal and practical perspective, in order to enable and encourage a well-planned and executed expansion plan.

I. The Legal System in Canada

Like the United States, Canada has a system of federalism, with a federal government and federal Parliament based in Ottawa, ten provinces each with their own respective legislatures based in a provincial capital, and three semi-autonomous territories in the sparsely populated north. The Canadian legal system is based on federal and provincial legislation and, in nine of ten provinces, the common law. The common law is a body of jurisprudence built on the historical and continuing judgments of Canadian courts. The exception is the predominantly French speaking Province of Quebec. Quebec has been governed by a civil law system since French North America became subject to British rule in the eighteenth century. Civil law in Quebec has taken the form of a broad system of codified principles entitled the *Civil Code of Quebec*.[4] Doing business in Quebec requires a fulsome understanding of its Civil Code. American franchisors should consider this fact when targeting areas for growth in Canada.

A. *International Influences*

While a trend in Canada exists towards American-style legislation, it is still an open question whether U.S. common law decisions will be relevant in Canada. Canada's legal system is rooted in the legal system of the United Kingdom, from which independence began as an evolution (as opposed to an American-style revolution). This gradual process began in 1867, culminating in complete independence from the United Kingdom in the early twentieth century. English cases and cases from other former English colonies such as Australia are still influencing the development of Canadian jurisprudence, while American cases are rarely cited.

4. Civil Code of Quebec, R.S.Q. 1991, c. 64.2 (Can. Q.C.).

B. *Provincial Versus Federal Jurisdiction*

Canada divides its governmental powers between the one federal and ten provincial governments, pursuant to Sections 91 and 92 of the Constitution Act, 1867.[5] While the federal government has been granted exclusive jurisdiction to legislate over areas such as trade and commerce, bankruptcy and insolvency, and intellectual property, the provincial governments have exclusive jurisdiction over areas such as property and civil rights, and the administration of justice.[6] Although the federal government may have possibly exercised jurisdiction over franchising as an area involving the licensing of trademarks, the federal government has not expressed interest in exercising this jurisdiction. As a result, provincial governments have exercised jurisdiction to regulate franchising based upon their jurisdiction over property and civil rights, including contracts.[7] Now entrenched, the federal government will likely never attempt to legislate in the area, leaving it up to each province to determine if a franchise-specific law is appropriate in that province.

As of the date of this article, six of ten provinces have enacted franchise-specific legislation, namely Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island.[8] The remaining four provinces, namely Newfoundland, Nova Scotia, Quebec, and Saskatchewan, have no franchise-specific legislation. The provincial franchise legislation adopted in the six provinces is relatively similar; however, as discussed later, franchisors should recognize that some subtle but important differences exist among the laws.

C. *Taxation*

While taxes in Canada are levied by both levels of government, the federal government governs income tax under the Income Tax Act.[9] Corporations in Canada pay a combined income tax rate of 26.5–31%, depending on the province.[10] These corporate tax rates are comparable to the corporate rates in the United States, when factoring in the state corporate rates. The newly elected Ontario provincial government has promised to further reduce corporate tax rates in the province to encourage and attract foreign investment and businesses.[11]

5. Constitution Act, 1867, 30 & 31 Vict. c 3 (U.K.), *reprinted* in R.S.C. 1985, app II, no 5 (Can).

6. *Id.* § 92.

7. *Id.* § 91.

8. Franchises Act, R.S.A. 2000, c F-23 (Can. Alta.); Arthur Wishart Act (Franchise Disclosure), SO 2000, c 3 (Can. Ont.); Franchises Act, RSPEI 1988, c F-14.1 (Can. P.E.I.); Franchises Act, SNB 2007, c F-23.5 (Can. N.B.); Franchises Act, C.C.S.M. 2010, c F156 (Can. Man.); Franchises Act, SBC 2015, c 35 (Can. B.C.).

9. Income Tax Act, R.S.C. 1985, c 1 (5th Supp.) (Can.).

10. KPMG, Corporate Tax Rates: Substantively Enacted Income Tax Rates for Income Earned by a General Corporation for 2018 and Beyond – As of June 30, 2018 (2018).

11. Greg Davis, *Doug Ford pledges corporate tax cut to boost manufacturing jobs in Cobourg campaign stop* (Global News, Apr. 18, 2018), https://globalnews.ca/news/4152707/doug-ford-corporate-tax-cut-coburg-campaign-stop/.

One particular income tax issue that is unique to cross-border franchising and the licensing of trademarks is the nonresident withholding tax that is typically applied to payments from a resident Canadian franchisee to a nonresident (i.e., U.S. resident) franchisor. Specifically, Canadian tax law requires that resident Canadian franchisees withhold and pay a percentage of the U.S. resident franchisor's royalty payment and initial franchise fee to Canadian income tax authorities so as to ensure the nonresident franchisor's income in Canada has been appropriately taxed.[12] If properly structured, the amounts withheld and paid to the Canadian government should be a credit against any U.S. taxes to be paid by the U.S. franchisor, so as to avoid double taxation. It should be noted that this regime is not unique to payments from just Canada to the U.S. nonresident; withholding tax applies to such payments between residents and nonresidents of most countries, and the real question is whether a specific tax treaty exists between the two countries to avoid double taxation.

One method that some franchisors have used to minimize or avoid the negative cash flow consequences of nonresident withholding tax is to "gross up" the payments by the franchisee so that the amount to be paid is increased by an amount equal to the taxes withheld. In effect, the franchisee pays this portion twice, while the properly structured franchisor will still get the benefit of the tax credit in the home country. Perhaps for this reason, the use of a gross up is not very common in franchise contracts between Canadian franchisees and U.S. franchisors, and certainly not as common as when the franchisee is a resident in a non-Western country.

In addition, the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital (Canada-U.S. Convention) has reduced the withholding tax rate from twenty-five percent to ten percent.[13] Whereas previously no reduction in the withholding tax rate occurred if the franchisor was an American limited liability company (LLC), the Fifth Protocol to the Canada-U.S. Convention has very recently made it possible for LLCs to get reduced withholding tax rates, so long as they meet certain eligibility requirements.[14]

Canada also has a "value added tax" or multistage tax regime called the Goods and Services Tax (GST), administered by the federal government and levied on most sales of goods and services at every stage from producer to consumer. Each recipient remits to the federal government the difference between the amount of this tax that they pay versus the amounts that they collect, in the conduct of their business. However, the rate varies by province as the federal government has entered into agreements with various provinces

12. Income Tax Act, c 1 § 212(1)(d).

13. Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, Sept. 26, 1980, T.I.A.S. No. 11087, *as amended*, https://www.fin.gc.ca/treaties-conventions/usa_-eng.asp.

14. Fifth Protocol Amending the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, Sept. 21, 2007, http://www.fin.gc.ca/treaties-conventions/USA_1-eng.asp.

to levy and administer the GST along with a provincial retail sales tax; and these provincial rates vary by province. In provinces where there is such an agreement, a combined Harmonized Sales Tax (HST) is levied on all goods and services instead of the GST. For instance in the Province of Ontario, the combined HST tax rate is thirteen percent.[15] This tax applies to initial franchise fees, royalties, and other fees payable by franchisees to franchisors.

D. *Competition*

As a matter of federal jurisdiction, Canadian competition law is governed by the federal Competition Act.[16] This legislation was enacted to sustain and protect competition in Canada to ensure the Canadian economy remains efficient, adaptable, and conducive to competitive processes and product choices for consumers.[17] Franchisors should be mindful that the Competition Tribunal, a specialized administrative tribunal composed of judges and laypersons, has jurisdiction to make orders in regard to various reviewable activities such as price-fixing, mergers, abuse of dominant position, tied selling, refusal to deal, exclusive dealing, market restriction, delivered pricing, and certain misleading advertising practices.

Canadian and American law currently take a similar approach to price maintenance. For many years, price maintenance was a per se criminal offense in Canada. In 2009, amendments were made to the Canadian Competition Act, which decriminalized price maintenance, thereby making it possible for franchisors to dictate maximum *and* minimum pricing to their franchisees in most instances.[18] While Canada's position on price maintenance has been changed by statute, the U.S. position rests on case law, namely the U.S. Supreme Court's historic 2007 decision in *Leegin Creative Leather Products*., *Inc. v. PSKS*, *Inc.*, which overturned the per se rule against minimum price maintenance.[19] However, various state laws still provide that minimum price maintenance is per se illegal, so the situation in the United States appears to be less clear than in Canada.

E. *Intellectual Property*

The federal government in Canada has exclusive jurisdiction over intellectual property.[20] There are minor exceptions to this rule, such as the provincial control over assumed name and corporate name registrations as part of their jurisdiction over business corporations and other legal entities operating in the province. It is imperative for franchisors to be aware that trademarks are governed exclusively by the federal Trade-marks Act,[21] so that trademarks

15. Ontario Ministry of Finance, *Harmonized Sales Tax (HST)*, https://www.fin.gov.on.ca/en/tax/hst/index.html.
16. Competition Act, 1985, R.S.C. 1985, c C-34 (Can.).
17. *Id.* § 1.1.
18. *Id.* § 45.
19. Leegin Creative Leather Prods., Inc. v. PSKS Inc., 551 U.S. 877 (2007).
20. Constitution Act, 1867, 30 & 31 Vict, c 3 (Can.) at 91.
21. Trade-marks Act, R.S.C. 1985, c T-13 (Can.).

should be registered federally. If successful, a federal trademark registration provides protection across the entire country.[22] Copyright and patents are governed by the federal Copyright Act[23] and Patent Act,[24] respectively.

F. *Franchise Legislation in Canada*

Franchise legislation has evolved gradually in Canada. As mentioned earlier, six provinces have enacted franchise legislation.[25] Alberta paved the path for franchise legislation with Canada's first franchise statute, the Franchises Act, which came into force in 1971.[26] Ontario's franchise legislation, the Arthur Wishart Act (Franchise Disclosure)[27] (Wishart Act) followed in 2000, to be further followed by Prince Edward Island's Franchises Act[28] in 2006, New Brunswick's Franchises Act[29] in 2011, Manitoba's Franchises Act[30] in 2012, and, most recently, British Columbia's Franchises Act[31] in 2017. While Prince Edward Island, New Brunswick, Manitoba, and British Columbia made the effort to legislate consistently with Ontario, there are still differences between provincial franchise legislation that need to be taken into account when seeking to comply with these statutes.

In terms of their application, the Ontario, Manitoba, Prince Edward Island, New Brunswick, and British Columbia statutes are more wide-reaching in that they apply to any franchise to be operated in whole or in part in the province, regardless of where the prospective franchisee or franchisor is located.[32] In contrast, the Alberta statute will only apply if the franchise is to be operated in Alberta and if the prospective franchisee has some preexisting connection to Alberta, such as residency.[33]

Certain provinces define a "franchise" differently. Apart from Alberta, the other five franchise laws essentially define a "franchise" to include both the traditional "business format" franchise and the "product distribution" franchise.[34] Central elements of the business format franchise are the following: (1) the grant of a right to engage in a business; (2) the franchisee is required by contract or otherwise to make an upfront or ongoing payment

22. *Id.*
23. Copyright Act, R.S.C., 1985, c C-42 (Can).
24. Patent Act, R.S.C. 1985, c P-4 (Can.).
25. *See* statutes cited *supra* note 8.
26. Franchises Act, R.S.A. 2000, c F-23 (Can. Alta.).
27. Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3 (Can. Ont.).
28. Franchises Act, R.S.P.E.I 1988, c F-14.1 (Can. P.E.I.).
29. Franchises Act, S.N.B. 2007, c F-23.5 (Can. N.B.).
30. Franchises Act, C.C.S.M. 2010, c F156 (Can. Man.).
31. Franchises Act, S.B.C. 2015, c 35 (Can. B.C.).
32. *See* Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3 (Can. Ont.). at 2(1); Franchises Act, CCSM 2010, c F156 (Can. Man.).; Franchises Act, R.S.P.E.I. 1988, c F-14.1 (Can. P.E.I.).; Franchises Act, S.N.B. 2007, c F-23.5 (Can. N.B.).; Franchises Act, S.B.C. 2015, c 35 (Can. B.C.).
33. Franchises Act, R.S.A. 2000, c F-23 (Can. Alta.) at 3.
34. It is beyond the scope of this article, but each provincial franchise statute also defines and includes in the definition of franchise a separate "product distribution" or "business opportunity" and subjects these relationships to similar obligations as they do for "business format" franchises. *See* Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3 (Can. Ont.) at 1.

or payments, whether direct or indirect, to the franchisor or the franchisor's associate; (3) the franchisor grants the franchisee the right to sell, offer for sale, or distribute goods or services that are substantially associated with the franchisor's or the franchisor's associate's trademarks, logos, advertising, or other commercial symbol that is owned by or licensed to the franchisor or the franchisor's associate; and (4) the franchisor or the franchisor's associate has the right to exercise or exercises significant control over, or has the right to provide or provides significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques, or training.[35]

In general, arrangements involving the sale of goods or services at bona fide wholesale prices are excluded from being franchises. The application to a relationship with significant control or assistance is not entirely clear. But this exception does not apply in Ontario, where any payment by the franchisee to the franchisor may meet the payment element of the definition.

While similar to the definition in the United States, the business format franchise definition in the six provinces is very broad. Practitioners should be cautious in providing advice given the broad nature of the franchise definition, the relatively short life so far of the legislation, and the little case law to date. It is quite possible for relationships to exist among parties that, unbeknownst to them, qualify as a franchise.[36] The finding that a relationship is a "franchise" is, of course, significant in that it could place the franchisor in violation of their legal obligations, such as the mandatory presale disclosure obligations, if it fails to comply.

For relationships that satisfy the statutory definition of a franchise, franchisors must deliver a franchise disclosure document at least fourteen days before the prospective franchisee pays any consideration, or signs any agreement relating to the franchise (subject to specific exceptions that vary by province). While some notable differences exist, the disclosure obligations are sufficiently similar across the provinces; and, as a result, single form disclosure documents are now the norm, with these single disclosure documents meeting the minimum disclosure obligations in each province. This allows franchisors to avoid creating different disclosure documents for each province and also helps to satisfy the growing demand for disclosure documents by prospective franchisees in unregulated provinces.

Each of the provincial franchise laws mandates what needs to be in a fully compliant disclosure document, with the overriding obligation being to disclose "all material facts," a phrase that is uniformly defined in a very expansive and non-exhaustive way.[37] Suffice it to say, what constitutes a compliant franchise disclosure document in Canada differs substantially from

35. The Franchises Act, C.C.S.M. c F156 (Can. Man.).

36. For example, the recent Ontario case of *1706228 Ontario Ltd. v. Grill It Up Holdings Inc.*, [2011] O.N.S.C. 2735 (Can. Ont.), saw a court award damages to a prospective franchisee, even though negotiations had broken down and no franchise agreement was ever signed.

37. *See* Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3 (Can. Ont.) at 1.

what is required in the United States. While the Canadian statutes all have regulations that provide a mandatory minimum list of items that are to be addressed in the disclosure document, only an understanding of the case law in this area will provide a lawyer with a complete understanding of what is required in a compliant disclosure document and how the disclosure document has evolved since the laws were enacted. Further case law is contributing to the constant evolution of any franchisor's disclosure document. This is all in addition to the other unique and important requirements in a Canadian disclosure document, including that it must append the franchisor's proper financial statements and that it must include properly signed and dated certificates of compliance, usually by two directors and officers of the franchisor.[38]

G. *Considerations for Expanding into Quebec*

As mentioned earlier, while the rest of Canada uses a common law system, the province of Quebec follows a civil law system. As such, special consideration should be given to the laws of Quebec when expanding a franchise system into that province. For example, franchisors should be mindful of the special treatment that adhesion contracts are afforded under the Quebec Civil Code. In adhesion contracts, one of the contracting parties stipulates to the non-negotiable, essential terms of the agreement. In Quebec, courts may nullify or change these provisions if a reasonable person would find them incomprehensible or unreadable, or if they are considered to be abusive.[39]

The effects of a recent leading case, *Bertico Inc. et al v. Dunkin' Brands Canada Ltd.*, should also be considered.[40] In applying the Quebec Civil Code, the Court of Appeal held that implicit obligations flow from the nature of franchise agreements, including a positive obligation on the part of the franchisor to maintain brand strength by protecting, improving, and enhancing the brand.[41] The Supreme Court of Canada denied leave to appeal this case.[42] While *Bertico* is binding only in Quebec, franchisors should be aware of the potential for expansion of its principles to other provinces, and perhaps even other countries.

Another important practical consideration is the fact that Quebec's French language heritage is protected by its Charter of the French Language.[43] As a result, business affairs are largely conducted in French, and materials such as advertisements and menus must be provided in French. Franchisors that are hesitant about their own expertise in Quebec culture, language, and laws should consider using a master franchisee or area developer to cover Quebec operations and comply with the unique legal obligations.

38. *See id.* at 5(4).
39. Civil Code of Québec, C.Q.L.R. c CCQ-1991 (Can. Que.) at 1437.
40. Dunkin' Brands Canada Ltd. v. Bertico Inc., [2015] Q.C.C.A. 624 (Can. Que. C.A.).
41. *Id.* paras. 6–9.
42. Dunkin' Brands Canada Ltd. v. Bertico Inc., [2016] CarswellQue 1813 (Can. S.C.C.).
43. Charter of the French Language, C.Q.L.R., c C-11 (Can. Que.).

II. Entrance Strategies

There are several ways American franchisors can enter the Canadian market. Franchisors can directly franchise from the United States into Canada, or use a subsidiary or joint venture structure, using either an existing or new U.S. or Canadian entity. While these structures have their benefits and drawbacks, often the decision about which entity to use, and whether it is to be American or Canadian, are determined by tax considerations. Without a doubt every U.S. franchisor considering expansion to Canada needs to receive cross-border tax advice to determine the most tax efficient structure.

A. *Direct Franchising to Single-Unit Canadian Franchisees*

It used to be quite common for American franchisors to expand into Canada through a single-unit franchise model. While still common, and certainly more common than when a U.S. franchisor expands to other countries, many U.S. franchisors looking north are now frequently considering other multi-unit expansion models. This is most likely for two reasons: first, the trend generally in the U.S. favors multi-unit expansion strategies, and, second, the realistic costs of expansion, in part due to the cost of Canadian franchise law compliance.

B. *Joint Venture*

A franchisor could also enter Canada by setting up a joint venture franchise. Joint ventures are essentially contractual relationships whereby entities, which remain independent in their own business activities, make contributions for a single, identified common purpose.[44] In a joint venture between a U.S.-based franchisor and a local Canadian entity, the franchisor would grant certain rights to the joint venture Canadian entity. While this arrangement may alleviate some responsibilities from a physically distant franchisor, it also might result in the franchisor being too far removed to diligently oversee the business. And notwithstanding what many people hope for, this structure typically does not avoid the application of franchise laws, because a franchise-like license will still be granted from the U.S.-based franchisor to the Canadian joint venture entity that it partly owns.

C. *Canadian-Based Subsidiary or Affiliate*

Using a Canadian subsidiary or affiliate can be a desirable and tax-efficient expansion strategy, especially where the franchisor recognizes that an in-country presence or "boots on the ground" are what most likely will ensure success of the Canadian business. Typically, this subsidiary or affiliate executes master franchise, area development, or single-unit agreements within Canada. In some cases, the U.S. franchisor will not begin expansion in this way, but will later recognize the necessity of using a Canadian-based

44. Bruce McNeely, Carrying on Business in Canada—A Practical Guide for Non-Canadians 2.6 at 3.14 (Cassels Brock, 2003).

entity if and when the franchisor needs to expand in Canada. While this may not be the plan at the outset, success in the market may make it inevitable.

Incorporation of a subsidiary or affiliate may occur at the federal or provincial level. A number of different types of entities may be considered, including "regular" business corporations, or even a special purpose "flow through" entity called an unlimited liability corporation (ULC). ULCs can only be created in and under the laws of Alberta, British Columbia, and Nova Scotia, although any business corporation or ULC can carry on business throughout Canada. In either case, some provinces require 25% of a corporation's directors to be resident in Canada, while other provincial business corporation laws have no such residency requirements.[45] The decision on where to incorporate often turns on this issue alone.

Wherever a U.S. franchisor sets up a Canadian subsidiary or affiliate, it will also need to enter into a written license agreement with its Canadian entity and provide for a fair market value payment for use of the franchise system and trademarks. That is necessary to satisfy the transfer pricing requirements of the government tax authorities on both sides of the border.[46]

D. *Master Franchising, Area Development and Area Representatives*

With the increase in sophisticated expansion strategies, master franchising, area development, area representatives, and hybrid arrangements have become more common, if not the norm. Foreign franchisors can use master franchise agreements to select an arm's length "master franchisee" and provide them with a certain territory within which they may subfranchise to third-party franchisees who enter into agreements with the master franchisee instead of the foreign franchisor. Master franchising is useful in that it allows U.S.-based franchisors to delegate functions to an entity of their choice, with local expertise. Master franchisees typically assume many of the functions normally performed by the franchisor, such as recruitment, site selection, construction, and operational support. While these arrangements can be beneficial, franchisors should be mindful that they come at the cost of decreased control and fractioned royalties.

U.S. based franchisors also might use an area development agreement, whereby the franchisee is often granted an exclusive right to open franchises for its own account within a certain territory, over a determined period of time. Limits are typically placed on the franchisee's rights, such as a prohibition on subfranchising to a third party. Area development agreements also often allow franchisors to delegate functions to the area developer. However, the most crucial element is usually selecting the right area developer

45. Business Corporations Act, R.S.O., c B-16 1990 s. 118(3) (Can.); Corporations Act, C.C.S.M., c C225. 2017, § 100(3) (Can.); Business Corporations Act, R.S.S., c B-10 1978, §100(3) (Can.).

46. Income Tax Act, R.S.C. 1985, c 1, at 247(Can.).

candidate—one that is capable of becoming a multiple unit franchise owner and operator.

In addition, franchisors sometimes use the area representative model whereby local area representatives recruit and assist franchisees with local matters. Franchise agreements are still signed by the franchisor and each respective franchisee, but the area representative assumes designated tasks such as overseeing or administering many of the functions that a franchisor would otherwise ordinarily perform in the local market. This setup allows the franchisor to maintain full control over franchisees, while delegating tasks that are better accomplished locally by an area representative who, as the franchisor's agent, receives a commission, usually based on a percentage of the initial fees and royalties paid by franchisees.

III. Protecting a Franchisor's Intellectual Property in Canada

A. *Trademarks*

Trademarks are valuable to any franchise system to the extent that they demonstrate the unique nature of the goods and services of the owner of the trademark. Trademarks can include logos, wares, trade dress, and trade names. Canadian law recognizes the value in trademarks and allows franchisors to ensure that only licensed third parties, such as franchisees, make sanctioned use of the franchisor's trademarks. Specifically, Section 50 of the federal Trade-marks Act provides that if the trademark owner grants or authorizes the grant of a trademark license and has, under the license, direct or indirect control of the character or quality of the licensee's goods or services, the use of the trademark by the licensee is deemed to be use by the owner.[47]

In addition to statutory protection, the common law tort of passing off is also available to protect trademark-like rights. A plaintiff must show that the public identifies copied material with the plaintiff's goods or services and that the use of such copied material will likely cause confusion and harm to the plaintiff.[48] Passing off is useful in addition to other trademark claims, and it is especially useful when there are deficiencies in a trademark registration.

And with respect to the issue of registration, it is a critical component in protecting a franchisor's trademark. Much like in the United States, franchisors must file an application to register a trademark in Canada. A trademark application may be filed based on intent to use, in which case registration occurs only after actual use begins.[49] Alternatively, a trademark registration

47. Trade-marks Act, R.S.C., c T-13 1985, § 50 (Can.).
48. Ciba-Geigy Can. Ltd. v. Apotex Inc., [1992] 3 S.C.R. 120 (Can.).
49. Trade-marks Act, R.S.C., c T-13 1985 (Can.).

may be obtained in Canada if such trademark is registered in a country that is a treaty partner to Canada, such as the United States.[50]

Generally, registration should be done as soon as possible so as to minimize the risk that an individual who has observed the trademark or franchise's value abroad will seek to register first. Franchisors should not easily dismiss this risk, as the Canadian public is well versed in American brand names through wide cross-border media exposure. American brand names will likely be recognized in Canada, and it is certainly possible for an opportunistic Canadian to register and capture some value of a franchise's trademarks. Further, it is also possible that a franchisor will not be able to register a trademark in Canada that is already in use in the United States. This might transpire when a business in Canada uses a similar name or logo to an American franchisor looking to register later in Canada. By investigating such registrations as early as possible, the American franchisor will be better equipped to either avoid this situation or proactively plan to modify the intellectual property for use in Canada.

Additionally, franchisors entering the Canadian market should know that Canada is not yet a party to the Madrid Protocol. This protocol is a treaty that allows a franchisor to register its trademarks in one or more countries that are party to the treaty by filing an application to register the trademark in its home country and then designating additional countries through an international application.[51] Since Canada is not a party to the treaty, franchisors entering the Canadian market must file individual trademark applications in Canada. While this need may result in increased costs, franchisors are encouraged to consult Canadian counsel in filing such applications.

Both Canadian-based and U.S.-based franchisors might refrain from registration abroad because they are hesitant to allocate funds to foreign trademark applications. However, given the benefits of registration, and the relatively affordable cost of doing so, U.S. franchisors are encouraged to spend this money upfront, even before considering entry into Canada. The alternative is often more costly. Instead of paying a fee of registration, the hesitant franchisor might be forced to buy the third party's registration, or worse, to settle a dispute over the name. This undertaking is a very practical, yet important, piece of an effective entrance strategy and should be considered by franchisors, whether or not they have begun to seriously consider cross-border expansion.

B. *Trade Secrets*

Franchisors often attempt to keep certain elements of their business confidential to protect their competitive advantages. Confidential information and trade secrets can be found in certain techniques, recipes, processes, and compilations of technical information not released to the competition or the

50. *Id.*

51. Protocol Relating to Madrid Agreement Concerning International Registration of Marks, June 27, 1989, S. Treaty Doc. No. 106-41, Hein's No. KAV 6242.

public. A delicate balance must be found between providing the necessary amount of confidential information to franchisees, while simultaneously protecting that confidential information from disclosure.

Franchisors should pay specific regard to nondisclosure and confidentiality provisions in franchise agreements, as this information is only protected by contract, not by statute. If appropriately addressed in the contract, Canadian law will provide some recourse regarding misappropriation of a franchisor's confidential information in specific circumstances. For instance, confidential information is protected as long as the information has the necessary quality of confidence, was disclosed in a situation where the recipient of the information knew or ought to have known that the disclosure was for a limited purpose, and was used for a purpose other than that for which it was disclosed.[52]

C. *Copyright*

Under the Canadian Copyright Act, the owner of an original literary, dramatic, musical, or artistic work is given exclusive rights of production, reproduction, performance, and transmission, among others, of that work.[53] In the franchise context, copyright can and does subsist in works such as advertising materials, operating manuals, computer software, graphics, and design marks. Canadian law protects works once they are created, with no requirement for registration. Further, unregistered works created in the United States receive protection in Canada, even without registration.[54] Although registration is not required, it still might provide the owner with evidentiary benefits. This is an outcome of Canada's adherence to the Berne Convention for the Protection of Literary and Artistic Works.[55] For example, a Canadian copyright registration creates a legal presumption that the registered owner is the valid owner of the copyrighted work covered by the registration. In addition, the existence of a registration creates a presumption of the existence of copyright in the work, making it much more difficult for an infringer to claim that he or she did not know that the work in question was copyrighted and that their infringement was "innocent." Registration is likely more prevalent in the United States given the benefits for copyright holders, such as the right to enhanced damage awards.[56] Such additional benefits do not exist the same way in Canada, and, as such, registration in this capacity is often limited.

52. Lac Minerals Ltd. v. Int'l Corona Res. Ltd., [1989] 2 S.C.R. 574 (Can.).
53. Copyright Act, R.S.C., c C-42 1985, s 3. (Can.).
54. McNeely, *supra* note 44, at 5.3.
55. Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, *as amended*.
56. FindLaw, *Are Punitive Damages Available Under the Copyright Act* (2019), https://corporate.findlaw.com/intellectual-property/are-punitive-damages-available-under-the-copyright-act.html.

D. *Patents*

As of yet, patents are not a common issue in franchise arrangements in Canada. Unlike copyright, the Canadian Patent Act allows for a statutory monopoly over new Canadian inventions, so long as the original inventor registers such inventions.[57] But an invention that is patented or capable of being patented in one country may simply not be capable of protection in the other. Franchisors should consult with Canadian counsel if their franchise agreement implicates patent issues.

E. *Domain Names*

Aside from the well-known domain names, including ".com", the ".ca" top-level domain name is in widespread use across Canada. Franchisors can register a desired domain name with the Canadian Internet Registration Authority (CIRA), where registrations are handled on a first-come, first-served basis. In registering a ".ca" domain name, franchisors should ensure that they satisfy the eligibility requirements of applicants being Canadian.[58] The applicant is responsible to ensure that the registration or use of the name does not violate third-party intellectual property rights.[59]

Canadian law will provide recourse in cases of domain name infringement. Such infringement is held to occur when the complainant demonstrates on a balance of probabilities that the ".ca" domain name is confusingly similar to a trademark, official mark, or trade name in which the complainant has rights in Canada.[60] The complainant must also demonstrate that the registrant has no legitimate interest in the domain name and that the registration was made in bad faith.[61]

Overall, early registration of Canadian domain names is the most effective way to protect a franchisor's principal names.

IV. The Franchisor-Franchisee Relationship in Canada

A. *The Crux of the Relationship: The Franchise Agreement*

The basis of any franchisor-franchisee relationship in Canada is largely contractual. The typical franchise agreement provides a franchisee with a license to market a product or service through the use of a business method, including use of a trademark and business name, the methods of doing business, the overall look of the business, and access to certain benefits.

57. Patent Act, R.S.C., c P-4 1985, § 27 (Can.).

58. Canadian Internet Registration Authority (CIRA), Canadian Presence Requirements, https://cira.ca/canadian-presence-requirements-registrants.

59. Canadian Internet Registration Authority (CIRA), Website Terms of Use, https://cira.ca/website-terms-use.

60. Canadian Internet Registration Authority (CIRA), *CIRA Domain Name Dispute Resolution Policy*, https://cira.ca/cira-domain-name-dispute-resolution-policy.

61. Erin Hutchison, *Trademarks and Disputes: Considerations When Choosing a Domain Name* (Canadian Internet Registration Authority (CIRA) Aug. 16, 2017), https://cira.ca/blog/ca-domains/trademarks-and-disputes-considerations-when-choosing-domain-name.

The franchise legislation in the six provinces has specific application to aspects of franchise agreements in Canada. For instance, provincial franchise laws impose, to a greater or lesser degree, the governing law of the contract by applying that jurisdiction's laws on the terms of the franchise agreement. Those provisions of the franchise laws may not be waived and so affect any U.S. franchisor's franchise agreement in Canada. But, unlike relationship laws in the United States, Canadian franchise laws do not impose any "good cause" standard with regards to the franchisor's discretion to renew, transfer, or terminate the agreement. Instead, the Canadian franchise laws, and common law, impose on each party to the franchise agreement the statutory and common law duty of fair dealing, which will be discussed later in this article.

Overall, U.S. franchisors should consult Canadian counsel on how best to optimize Canadian opportunities within the drafting of their franchise agreements. At a minimum, an existing U.S. franchise agreement ought to be "Canadianized" before it is used as sometimes subtle but important differences exist in the laws and practices of franchising in Canada that should be reflected in any franchise agreement to be used. Candidly, only Canadian counsel well-versed in these subtle but important differences will be able to maximize the value in "Canadianizing" a U.S.-based franchisor's agreements.

B. *The Debate Between Employment Versus Independent Contractor Relationships*

An essential component of a franchise arrangement has been that franchisees are independent contractors of the franchisor. Several attempts have previously been made to characterize the relationship as one of employer-employee, with all the attendant complications that may entail. For example, if a franchisor is found to be an employer, the termination of a franchise agreement could lead to a wrongful dismissal counterclaim. The consequences may be greater in Canada than they have been elsewhere, as the law is more protective of employees in termination disputes. As an employer, a franchisor would also be obliged to comply with laws governing payroll taxes and source deductions. However, by and large, franchisors in Canada can be relatively confident that their relationships with franchisees will continue to be viewed as an independent contractor relationship so long as the control and other elements of the relationship created by the franchisor in their franchise contract and in the day-to-day operations of the business adhere to the common law tests that are used by the courts in Canada to differentiate between an employment versus independent contractor relationship. Those that deviate from the well-established tests should, however, have more to fear than ever before, as courts seem more willing than ever to penalize a "franchisor" who crosses the line.

For example, a recent decision of the Ontario Labour Relations Board (OLRB) is perhaps illustrative as it may indicate that courts are willing to

find increased liability for those who label their relationships as a "franchise," but retain too much control over their "franchisees." In *Milk and Bread Drivers, Dairy Employees, Caterers and Allied Employees, Local 647, affiliated with the International Brotherhood of Teamsters v. Canada Bread Company Limited* (*Canada Bread*), Canada Bread's drivers, who were principals of franchisee corporations that contracted with Canada Bread, were found to be dependent contractors and capable of being certified into unionized bargaining units.[62] The OLRB refused Canada Bread's request for reconsideration.[63] These Canada Bread drivers were called franchisees, as they owned a truck and purchased a bread delivery route, under contract with the bread manufacturer. A key factor in the decision, and in common employment cases in general, is the amount of control exerted over the business.[64] The finding here was based on the application of a number of criteria, particularly that the drivers had no control over pricing or over their customer lists, nor could they reject certain national or chain accounts, Canada Bread's control over the volume of products to be delivered, and methods of servicing clients such as Canada Bread collecting payment directly from customers and remitting drivers their share. This configuration led to the conclusion that the work performed by the drivers more closely resembled an employment arrangement than an independent contractor arrangement. To decrease the risk of a similar finding, franchisors should ensure that franchisees have control over their own businesses—especially in key areas such as pricing and the assignment of customers—as well as ensure that franchisees can independently solicit new customers. The implications of this decision for franchisors remain unclear but are potentially significant. The decision could signify a situation in which a franchisor has both the obligations of a franchisor under franchise law, while also the risk of having their franchisees deemed employee-like dependent contractors with the legal right to unionize. Franchisors with concerns about unionization or common employer issues should contact Canadian legal counsel.

In addition, and like the United States, recent developments in Canada give rise to a concern that franchisors are at risk of being found to be a joint employer of their franchisee's employees, along with their franchisees. These concerns arise mostly because of an initiative by the Ontario government that undertook a major review of the province's employment and labour laws by two appointed special advisors.[65] The special advisors produced a preliminary report for the Ontario government that suggested joint employer status for some franchisors was warranted.[66] Although their final report rejected the implementation of "joint employer" status for franchisors, it did support

62. Milk & Bread Drivers, Dairy Emps., Caterers & Allied Emps., Local 647 v. Can. Bread Co., [2017] CanLII 62172 (Can. Ont. LRB).

63. *Id.*

64. *Id.* para. 15.

65. Ontario Ministry of Labour, *The Changing Workplaces Review* (2018), https://www.labour.gov.on.ca/english/about/workplace.

66. Ontario Ministry of Labour, *The Changing Workplaces Review* Final Report, https://www.ontario.ca/document/changing-workplaces-review-final-report?_ga=2.27449532.1053868189

unionization and collective bargaining rights for employees of Ontario franchisees operating under the same brand.[67]

C. *Disclosure*

Provincial franchise legislation is designed to promote a balance of power between the franchisor and its franchisees.[68] Of critical importance to this objective is presale disclosure and transparency. As stated, every Canadian province with franchise legislation mandates a certain level of disclosure from franchisors to their prospective franchisees, based on the concept of disclosing "all material facts."

While no registration requirement exists in Canada, all existing franchise statutes provide (1) broad, but time-limited rights of rescission in the event that presale disclosure is not provided at all, or is provided improperly or out of time, and (2) statutory rights of action for misrepresentations contained in a disclosure document. For instance, in situations where disclosure is not provided at all, or is so deficient to the extent that it is deemed not to be disclosure, each provincial franchise law permits the franchisee to rescind the franchise agreement for up to two years after entering into it.[69] This possibility is in contrast to the sixty-day right of rescission where the disclosure document is deficient in some less material way, or where the franchisor does not comply with the mandatory fourteen-day waiting period from delivery of the disclosure document.[70]

D. *Materiality*

Disclosure requirements differ significantly between the United States and Canada. U.S. disclosure documents are not sufficient in Canada, where provincial franchise laws require that franchisors disclose "all material facts," including those mandated by regulation. Statutes, such as Ontario's Wishart Act, have provided broad definitions of materiality: "any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would reasonably be expected to have a significant impact on the value or price of the franchise to be granted or the decision to acquire the franchise."[71]

In *Raibex Canada Ltd. v. ASWR Franchising Corp.*, the Court of Appeal for Ontario provided further practical guidance on the determination of what is "material" and what needs to be disclosed.[72] Under the Wishart Act, an agreement may be rescinded where disclosure is so deficient that there has

.1537210481-1965439258.1537210481; Special Advisors Interim Report, https://www.labour.gov.on.ca/english/about/cwr_interim/index.php.

67. *Id.*

68. *See*, *e.g.*, 779975 Ontario Ltd. v. Mmmuffins Canada Corp., [2009] O.J. No. 2357 (Can. Ont. S.C.J.).

69. *See* Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3, at 6(2) (Can. Ont.).

70. *Id.* at 6(1).

71. Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3, § 1(1) (Can. Ont.).

72. Raibex Canada Ltd. v. ASWR Franchising Corp., [2018] O.N.C.A. 62 (Can. Ont. C.A.).

essentially been no disclosure at all.[73] On a summary judgment motion at the trial level, the judge suggested that all "material matters" needed to be known before proper disclosure could be given, including the specific location of the franchise.[74] However, this position is contrary to the common practice of entering into a franchise agreement before finding a location. Fortunately, the Court of Appeal for Ontario overturned the trial court's decision and took a more pragmatic business-oriented approach. Now, at least in claims for rescission, the materiality inquiry focuses on whether disclosure included enough information to allow the franchisee to "make a properly informed decision about whether or not to invest in a franchise."[75] This decision reflects the commercial reality that perfect disclosure is not always available and suggests that the threshold is whether an informed business decision can be made.

E. *Procedure and Form*

In provinces with franchise legislation, franchisors are required to deliver disclosure documents at least fourteen days before the earlier of (1) the party's entry into any agreement related to the franchise (with some very limited exceptions in certain provinces), or (2) the payment by the franchisee of any consideration.[76]

Many specific requirements should be considered prior to disclosure. For example, aside from Manitoba's legislation, Canadian franchise statutes require delivery of the disclosure document as one document at one time. Manitoba's statute allows for disclosure documents to be delivered in parts, subject to several requirements.[77]

F. *Exemptions*

All provincial franchise legislation exempts franchisors from the obligation to disclose in certain circumstances. However, because of the language used in some of these exemptions, and the case law interpreting the exemptions, many of them have been rendered useless in practice. For instance, in all provinces, the sale by a franchisor of an additional franchise to an existing franchisee—if the additional franchise is substantially the same as the existing franchise—is exempt from disclosure.[78] And the renewal or extension of a franchise agreement is an exempt transaction.[79] But in all provinces except Alberta, the statutes add a condition that these events are only exempt if no material change (as defined) has taken place since the last or prior franchise

73. *Id.* para. 40.
74. *Id.* para. 15.
75. *Id.* para. 49.
76. Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3, § 5(1) (Can. Ont.); Franchises Act, R.S.A. 2000, c F-23, § 4(2) (Can. Alta.).
77. The Franchises Act, C.C.S.M. 2010, c F156 (Can. Man.).
78. Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3, § 5(7)(c).
79. *Id.* § 5(7)(f).

agreement was executed.[80] With the courts generally interpreting these laws in a franchisee-friendly way, prudent counsel should not rely on any exemption with such a subjective element except at great risk. When in doubt, franchisors should provide a disclosure document. A similar caution applies to the supposed exemption on a resale by a franchisee. Perhaps the more safe exemptions to rely on are those without a subjective element, such as the sale by a trustee in bankruptcy, or sale to an insider, or in British Columbia and Ontario only, a sophisticated purchaser exemption where at least CAD $5,000,000 is being invested by the franchisee in the first year.[81]

G. *Wraparounds*

It may be tempting for a U.S. franchisor to want to supplement its existing U.S. disclosure document with a wraparound document that meets provincial requirements. However, the majority of Canadian franchise lawyers would advise against this practice in Ontario, as Ontario's franchise law does not explicitly permit a wraparound, and mandates a specific order for the issues in the disclosure document. Further, while Alberta, Manitoba, New Brunswick, and Prince Edward Island explicitly permit wraparound disclosure documents, the practical requirement to prepare a disclosure document that meets the Ontario standards in order to have one single compliant national disclosure document means that this option will likely never or rarely be used, as national disclosure documents are becoming the norm. So, it is likely as just as costly, yet far less risky, to create a new single cross-Canada-compliant disclosure document.

H. *The Fiduciary Relationship*

Canadian courts have consistently held that, absent a special circumstance, no fiduciary duties exist between parties to a franchise agreement. Generally, fiduciary relationships happen where one party owes special duties to the other, such as between trustees and beneficiaries. The concept of franchisors as fiduciaries was raised and decided in the seminal 1970 decision by the Supreme Court of Canada, *Jirna Ltd. v. Mr. Donut of Canada Ltd.*[82] The court found that, in imposing strict terms to protect its franchise system, a franchisor does not create a fiduciary relationship. Subsequent decisions by lower courts have recognized that while there may be a special relationship between parties in a franchise agreement, the relationship is not a fiduciary one.[83] The Ontario Court of Appeal's decision in *Shelanu Inc. v. Print*

80. *Id.* c 3; The Franchises Act, c F156; Franchises Act, R.S.P.E.I. 1988, c F-14.1 (Can. P.E.I.); Franchises Act, S.N.B. 2007, c F-23.5 (Can. N.B.); Franchises Act, S.B.C. 2015, c 35 (Can. B.C.).

81. Arthur Wishart Act (Franchise Disclosure), § 5(7)(h); Franchises Regulation, B.C. Reg. 238/2016 (Can. B.C.), at 6.

82. Jirna Ltd. v. Mr. Donut of Canada Ltd., [1972] 1 O.R. 251 (Ont. C.A.), *aff'd*, [1975] 1 S.C.R. 2 (Can. S.C.C.).

83. *See* Machias v. Mr. Submarine Ltd., [2002] O.J. No. 1261 (Can. Ont. S.C.J.); Country Style Food Servs. Inc. v. 1304271 Ontario Ltd., [2003] O.J. No. 362 (Can. Ont. S.C.J.).

Three Franchising Corp. (*Shelanu*) implies that it would have been an error of law for a trial judge to hold a franchisor to a fiduciary duty.[84] And, in one Ontario court decision, a judge stated that "it appears to be settled law that no fiduciary duty exists in law between a franchisor and a franchisee."[85]

However, franchisors must be aware that while a full fiduciary relationship will not generally exist, some duties or other obligations that are similar to those of a fiduciary may apply. For example, in *530888 Ontario Ltd. v. Sobey's Inc.*, the court noted that recent jurisprudence by the Supreme Court of Canada "demonstrates that the law of fiduciaries is an evolving one in which the categories of fiduciary relationships are not closed and in which fiduciary obligations can arise out of the relationship per se, and also out of the specific circumstances of a particular relationship."[86] The key takeaway is that while a franchisor is generally entitled to act in its own self-interest, such actions are limited by fiduciary-like obligations.

I. *The Obligation of Fair Dealing*

Franchisors' actions may also be limited by the requirement to act in good faith. The duty of fair dealing in the franchise context is enshrined in all provincial franchise laws. With the exception of Alberta, all of the provincial statutes stipulate that the statutory duty of fair dealing includes a duty to act in good faith and in accordance with reasonable commercial standards.[87] Canadian courts have reaffirmed that this statutory duty is essentially a codification of the common law position on good faith in franchising,[88] as first described by the Court of Appeal for Ontario in *Shelanu*.[89] It is important to note that the duty of good faith does not rise to the level of a fiduciary duty; good faith does not require that one party prioritize the other's interests, but it does require those interests given due regard. In *Fairview Donut Inc. v. TDL Group Corp.* (*Tim Hortons*),[90] the court reviewed the American case *National Franchise Association v. Burger King Corp.*[91] and noted that while the law differs slightly, the logic is compelling. In determining if conduct amounts to bad faith, "[r]egard must be had to the conduct of the franchisor taken as a whole and the benefits—or disadvantages—obtained by the franchisees as a whole."[92]

Ontario jurisprudence suggests that the duty of fair dealing cannot trump expressly worded contractual provisions. This is demonstrated in *Tim*

84. Shelanu Inc. v. Print Three Franchising Corp., [2003] O.J. No. 1919, para. 70 (Can. Ont. C.A.).
85. 1402066 Ontario Ltd. v. Cupps Int'l Inc., [2002] O.J. No. 1812 (Can. Ont. S.C.J.).
86. 530888 Ontario Ltd. v. Sobey's Inc., [2001] O.J. No. 318 (Ont. S.C.J.).
87. Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c 3 at 3(3) (Can. Ont.).
88. Landsbridge Auto. Corp. v. Midas Canada Inc., 73 C.P.C. (6th) 10, [2009] CarswellOnt 1655 (Can. Ont. S.C.J.).
89. *Shelanu Inc.*, [2003] O.J. No. 1919, paras. 63–66.
90. Fairview Donut Inc. v. TDL Group Corp., [2012] O.N.S.C. 1252 (Can. Ont. S.C.J.).
91. Nat'l Franchise Ass'n v. Burger King Corp., 2010 WL 4811912, (S.D. Fla. Nov. 10, 2010).
92. *Fairview Donut Inc.*, [2012] O.N.S.C. 1252, paras. 3–6.

Hortons, as well as *Spina v. Shoppers Drug Mart Inc.* (*Shoppers Drug Mart*)[93] and *1250264 Ontario Inc v. Pet Valu Inc.* (*Pet Valu*).[94] In *Shoppers Drug Mart*, the court rejected allegations of bad faith when Shoppers kept all benefits from supplier rebates because the agreement contained express provisions allowing Shoppers to do so. Interestingly, the court refused to strike other alleged instances of bad faith where it was not plain and obvious that the conduct was permitted by the agreement. In 2016 in *Pet Valu*, the Ontario Court of Appeal found that while deliberate non-disclosure breaches a franchisor's duty of fair dealing, the franchisor in that case had not breached its duty of fair dealing.[95] Although Pet Valu should have disclosed that it was keeping bulk discounts from suppliers before the appellants became franchisees, the contract did not contain an obligation to provide ongoing disclosure about the level of volume discounts.[96] There was, therefore, no indication that non-disclosure adversely affected the appellants as franchisees.[97]

The duty of fair dealing, and the obligation to act in accordance with reasonable commercial standards, can also complicate the way in which a franchisor can institute system-wide changes in Canada. While a typical franchise agreement will give a franchisor a wide discretion to dictate and implement system changes, every franchisor is also required to adhere to the fair dealing obligation in the performance of the contract, which would necessarily apply to the discretion and commercial reasonableness exercised in the decision regarding the system change. This obligation was the overriding issue in *Tim Hortons*, where the franchisor instituted system changes to drastically change the way in which baked goods were prepared and insisted on "loss leader" special offers. After a thorough analysis of the many steps taken by the franchisor to consult with franchisees and analyze the benefits and drawbacks, the court concluded that the franchisor had in fact discharged its obligations, so the court's decision provides a lesson that a franchisor needs to be cognizant of the fair dealing obligations when formulating and implementing a system change. The reality is that any system change of any significance should involve Canadian legal counsel's advice on how best to institute the change, how to abide by the fair dealing obligations, and how to properly document the change in order to later defend any claim that may arise as a result.

The Canadian common law on good faith has recently been reshaped by the seminal decision *Bhasin v. Hyrnew* (*Bhasin*) in which the Supreme Court of Canada found that the obligation of good faith applies to all parties to a contract as a principle of common law, rather than as a term courts could chose to imply.[98] Though it is not a franchise-specific decision, *Bhasin*'s

93. *Spina v. Shoppers Drug Mart Inc.*, [2012] O.N.S.C. 5563 (Can. Ont. S.C.J.).
94. 1250264 Ontario Inc. v. Pet Valu Canada Inc., [2016] O.N.C.A. 24 (Can. Ont. C.A.).
95. *Id.*
96. *Id.* para. 59.
97. *Id.*
98. Bhasin v. Hyrnew, [2014] S.C.C. 71 (Can. S.C.C.).

impact is significant—especially as the agreement in question was found to be "analogous to a franchise or employment contract."[99] The Supreme Court focused on the requirement of honest performance in holding that all parties to a contract should "not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract."[100] Previous cases should be read in light of this now-clear common law doctrine, and franchisors should be aware of the potential for new claims based on the honest performance requirement.

Finally, as in any other area of law, franchisors should be aware of Quebec's unique Civil Code. The Civil Code imposes a good faith obligation on parties to all contracts when an obligation is created, performed, or extinguished.[101] Interestingly, the decision in *Bhasin* brings the rest of Canada more in line with Quebec in applying good faith to all contracts. Indeed, one of the first judicial commentaries on good faith generally, as well as its relation to encroachment, came from the Quebec Court of Appeal's decision in *Provigo Distribution Inc. v. Supermarché A.R.G. Inc.*[102] In that case, the franchisee took issue with the franchisor's operation of a grocery store near the franchised grocery store, as well as the fact that the franchisor controlled all wholesale prices by virtue of its role as the franchisee's exclusive inventory distributor.[103] The court found that the franchisor was acting in bad faith, as it chose to compete with its franchisee without exercising a degree of restraint or good faith, and without fulfilling its franchise agreement obligations.[104] In light of *Bhasin* and the shifting nature of the law in this area, it might be wise to apply the additional caution used in Quebec across all Canadian franchises.

V. Other Practical Cross-Border Issues

A. *Leasing of Premises*

There are several ways that franchisors and franchisees can structure the leasing of premises. Canada and the United States have historically differed in their treatment of franchise premises. Common practice in the United States is for a franchisee to lease the premises. Conversely, common practice in Canada has been for the franchisor to first lease the premises and then sublease such premises to the franchisee so that all payments (both from the sublease and the franchise agreement) are deemed to be rent. Although this arrangement might attach contingent liability to franchisors, it also provides franchisors with landlord-like remedies such as the right to repossess the premises, or appoint a private receiver, without court sanction, to

99. *Id* para. 23.
100. *Id.* para. 73.
101. Civil Code of Quebec, R.S.Q. 1991, c 64.2 (Can. Q.C.).
102. Mercedes-Benz Crédit du Canada inc. c. Heger, [1995] R.J.Q. 464 (Can. Que. S.C.).
103. *Id.*
104. *Id.*

assume control and management of the franchisee's business in the event of nonpayment. In an effort to minimize contingent liability, the franchisor could arrange for a subsidiary or affiliate to lease the premises. However, this might be problematic if one or more problem leases are held by a company whose other assets are desirable leases.

Canadian practice is gradually becoming more similar to the United States, where franchisees directly lease the premises from the landlord. Some franchisors have maintained either the right to take possession of the leased premises through contractual terms or the right to assume the lease on termination of either the lease or the franchise agreement. While these provisions provide some safeguards for the franchisor, they still remain less powerful when compared to the remedies afforded by historical Canadian practice.

B. *Equipment and Supply Issues*

U.S. franchisors should be mindful of potential equipment and supply issues, especially across the U.S.-Canada border. For instance, equipment and supplies might be subject to tariffs, which is especially of concern with dairy, chicken, or other foodstuff products.[105] And items that the franchisor wishes to sell to a Canadian franchisee might require certification and/or testing before being permitted in Canada.

Careful drafting in the franchise agreement may save U.S. franchisors grief when it comes to selling equipment and supplies cross-border. For instance, franchisors should explicitly include a provision in the franchise agreement (and adequately disclose) that they wish to make a profit and/or retain benefits of volume purchases, rebates, and discounts. The recent case, *Quizno's Canada Restaurant Corp. v. 2038724 Ontario Ltd.*, is a potential warning that franchisors should be careful in how they structure their supply lines and pricing.[106] Although unresolved, the case has allowed the certification of a class of franchisees pursuing allegations that the franchisor's vertical pricing structure is unfair to franchisees.[107] In another case, a class action was certified against Midas Canada Inc. over a change to its product supply system that, allegedly, harmed franchisees.[108] Midas had terminated its own product supply system and implemented a supply agreement with a third party.[109] It was alleged that these changes improperly benefited the franchisor by eliminating a long-standing franchisee discount and placing

105. *Customs Tariff 2018 Chapter-by-Chapter*, Canada Border Services Agency (2018), https://www.cbsa-asfc.gc.ca/trade-commerce/tariff-tarif/2018/html/tblmod-eng.html. That being said, these specific tariffs are under reconsideration as of the date of this article.

106. Quizno's Canada Rest. Corp. v. 2038724 Ontario Ltd., [2010] O.N.C.A. 466, O.J. No. 2683 (Can. Ont. C.A.). Attorney Geoffrey B. Shaw and his firm were lead counsel for the appellant, Quizno's Canada Restaurant Corporation.

107. *Id.*

108. Landsbridge Auto. Corp. v. Midas Canada Inc., 73 C.P.C. (6th) 10, [2009] CarswellOnt 1655 (Can. Ont. S.C.J.).

109. *Id.*

franchisees at a competitive disadvantage.[110] This jurisprudence highlights the fact that franchisors must be aware of good faith and fair dealing obligations, in addition to any contractual duties, when contemplating changes to equipment and supply practices.

C. *Taking Security*

Canadian franchisors have historically asked their franchisees to grant to them a security interest in the franchised business assets in order to secure payment and performance of the franchisee's obligations. In Canada, security interests in personal property are under provincial jurisdiction. Provincial statutes provide that security interests must be perfected (usually by registration) once created, in order to maintain a certain level of priority against other claimants.[111] Even perfected security interests often do not provide priority above primary lenders or government claims for tax delinquencies, but a perfected security interest can still be useful to a franchisor in the event of default by a franchisee.

VI. Franchise Litigation

A. *Franchise Litigation in Canada*

Historically, the United States has been more a more litigious jurisdiction than Canada, which is likely a result of many factors. Canada has traditionally had fewer punitive damages awards, contingency fees, class actions, or jury trials. Moreover, in Canada, the losing party is also required to pay a certain amount of costs to the prevailing party.[112] While class actions and contingency fees are becoming more common, there are still notable differences between Canadian and U.S. litigation.[113]

B. *Class Actions Generally*

Class actions are generally less common in Canada than in the United States. After a period of about ten years with an increased frequency of class actions in franchise-related disputes, recent years have shown a return to fewer cases. Nonetheless, there are a variety of reasons why franchisees may be drawn to class actions. Generally, individual franchisees might have claims that they are unwilling to pursue alone because of the high costs associated with litigation.[114] Pursuing class actions allows franchisees to advance claims collectively and to pool their financial resources. Alternatively, enterprising franchisee counsel may be willing to pursue some of these claims on a contingency fee basis, in the hope of receiving a percentage of a significant settlement or judgment.

110. *Id.*
111. Personal Property Security Act, R.S.O. 1990, c P.10 (Can. Ont.).
112. Rules of Civil Procedure, R.R.O. 1990, Reg. 194 r. 57.01 (Can. Ont.).
113. Frank Zaid, Canadian Franchise Guide 2–39 (2004).
114. *Id*. paras. 2–326.

Franchise legislation in Canada has explicitly granted franchisees the right of association. For example, Ontario's franchise legislation stipulates that a franchisor may be liable for damages if it attempts to impede a franchisee's right of association.[115] The common law has reinforced the right to associate extends to the right to participate in class actions.[116]

C. *Class Action Procedure*

In Canada, certification of a class action does not require the certifying court to make an evaluation of the merits of the case; neither is there a numerosity test. As such, Canada may be a more fertile environment for franchisee-led class actions than the United States.

With the exception of Quebec, class actions are commenced in Canada by a complaint in the form of a statement of claim where the proposed representative plaintiff communicates the intention to proceed as a class action.[117] The court will make its decision on the basis of a certification motion where the plaintiff has the burden of satisfying the test for class action certification. To meet this test, the plaintiff must establish that (1) the pleadings disclose a cause of action; (2) there is an identifiable class of two or more people who would be represented by the representative plaintiff(s); (3) the claims of the class raise common issues; (4) a class proceeding would be the preferable method for resolution of the common issues; and (5) a representative plaintiff has been identified that fairly and adequately represents the class, has no conflict of interest with other class members on the common issues, and has produced a plan of proceeding that is workable.[118]

Plaintiff's counsel might request to schedule a hearing on the certification motion, and the timeline will be determined through a consultation process with the judge assigned to the action. Often times, the timeline for the motion will range from four to eight months but may extend well beyond that for purposes of exchanging affidavits, gathering expert opinions, conducting cross-examinations, and preparing final arguments.

Franchisors who attempt to bring preliminary motions before certification motions should be advised that Canadian courts will likely only permit preliminary motions that might narrow or dispose of the litigation entirely.[119] If such motions are filed, then the timeline for the certification motion will be determined once the motions have been resolved. This approach was evident in *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, where the court

115. Arthur Wishart Act (Franchise Disclosure), SO 2000, c 3 at 4(5) (Can. Ont.).

116. Landsbridge Auto. Corp. v. Midas Canada Inc., [2009] 64 B.L.R. (4th) 251, ¶ 17 (Ont. S.C.J.).

117. In Quebec, class actions are commenced by a motion seeking authorization of a class action, which precedes the actual pleadings in the action.

118. Class Proceedings Act, R.S.B.C., 1996, c 50 (Can. Que.). On the issue of commonality, arguably, the relationships between a franchisor and all of its franchisees are based on a standard franchise agreement and, therefore, are defined in large part by commonality. 1176560 Ontario Ltd. v. Great Atl. & Pac. Co. of Can., [2004] O.J. No, 865 (Ont. Div. Ct.) (holding that the commonality element was satisfied as a result of the franchise relationship).

119. Fairview Donut Inc. v. TDL Grp. Corp., [2010] O.N.S.C. 2845 (Can. Ont. S.C.J.).

refused to strike the franchisee's claim after several motions were brought by the franchisor.[120] The court ordered that the motions be heard at the certification hearing.[121] Nonetheless, franchisors should take note that it is possible to succeed on a summary judgment motion brought during the certification hearing.[122] Courts have also granted injunctions against the representative plaintiff of a class action.[123]

If a certification motion is dismissed in Ontario, Alberta, or Quebec, the judge may award costs to the defendants (i.e., the franchisor).[124] Alternatively, no such costs will be awarded in British Columbia, Manitoba, Saskatchewan, Newfoundland, or Labrador. Even in situations where costs are available, the amounts have historically been inconsistent, and the prevailing defendant's collection of such costs has proved challenging.

Conversely, if certification is successful, additional considerations arise. An opt-out process provides class members the opportunity to make an informed decision as to whether they want to remain a part of the action post-certification.[125] In the franchise decision *1250264 Ontario Inc. v Pet Valu Inc.*, the Ontario Court of Appeal reviewed the impact of an opt-out campaign in which it was alleged that aspects of the campaign were unfair or misleading.[126] The court held that class members have an "unassailable right to speak out in opposition to [a] class proceeding in an attempt to convince other class members to opt out" in the context of "acceptable intra-class debate."[127] This decision provides important guidance to what conduct is permissible by class members who oppose a class action. Absent the most extreme of circumstances of clear coercion, courts will not be willing to invalidate opt-out notices.

Costs are a key consideration for parties involved in franchise class actions. Recent jurisprudence maintains that individuals can be held liable for costs in class actions, even where the representative plaintiff is a corporation. In the *Pet Valu* case discussed earlier, Pet Valu was ultimately successful when the Court of Appeal dismissed the action in its entity and the Supreme Court of Canada denied leave to appeal. Pet Valu was awarded costs in the amount of CAD $1,703,896.94, and combined with older cost awards still

120. 2038724 Ontario Ltd. v. Quizno's Canada Rest. Corp., [2007] O.J. No. 1136 (Can. Ont. S.C.J.).

121. *Id.*

122. TA & K Enters. Inc. v. Suncor Energy Prods. Inc., [2011] ONCA 613 (Can. Ont. C.A.); *Fairview Donut Inc.*, [2010] O.N.S.C. 2845.

123. [2010] O.N.C.A. 466, O.J. No. 2683 (Ont. C.A.). In *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*, the court granted the franchisor's motion for an injunction against the three franchises operated by the principal of the representative plaintiff in a class action against the franchisor. The franchisor had terminated their franchise agreements due to continued non-compliance. Although the franchisee argued that the termination would fetter his role as the representative plaintiff, the court rejected this argument and instead upheld the termination and ordered the representative plaintiff to cease operating.

124. Class Proceedings Act, 1992, S.O. 1992, c 6 at 31(1).

125. Class Proceedings Act, c 6 at 9.

126. 1250264 Ontario Inc. v Pet Valu Inc., [2013] O.N.C.A. 279 (Can. Ont. C.A.).

127. *Id.* para. 73.

outstanding, was owed a total of CAD $1,736,675.54 by the representative plaintiff.[128] The representative plaintiff was a franchisee and effectively a shell company. By the time the matter was finally resolved, it had no assets. Pet Valu sought to recover its costs from the sole officer, director, and shareholder who had personally signed and guaranteed the franchise agreement. The court granted Pet Valu's motion for summary judgment against these individuals for the entire amount sought.

The continuing trend of dwindling class actions in Canada was recently demonstrated in the settlement of the *Zwaniga v. Johnvnice Foods Distribution L.P.* matter.[129] The matter settled for CAD $62,925.12. After deductions for legal fees and other amounts, this settlement meant each class member received about CAD $135. Similarly, in *2038724 Ontario Ltd v Quizno's Canada Restaurant Corp.*, the court commented on the settlement that the outcome for the class members was very poor, as they had gained nothing.[130] De minimus rewards and other factors have led to the decline in class action litigation in recent years.[131]

D. *Alternative Dispute Resolution*

Alternative dispute resolution (ADR) is designed to encourage parties to resolve disputes via compromise using methods such as arbitration. These arrangements can result in cost savings for both parties and can help alleviate strain on the court system. Still, while such provisions have been common in U.S. franchise agreements, they have only recently taken stride in Canada. Despite legislative efforts across Canadian provinces to encourage ADR in contractual relationships, the franchisor community has until recently been skeptical to endorse such provisions. Generally, franchisors believe that there are few advantages to being forced to compromise, especially when their primary concerns lie with protecting the value of the franchise system.

However, ADR may be a valuable tool for franchisors. Among other benefits, ADR often results in cost and time savings. It usually remains private and confidential, and it may also restrict the ability of franchisees to participate in class actions. Further, inclusion of ADR provisions is becoming a requirement in some jurisdictions like New Brunswick where mediation is mandatory, if invoked by either party to the franchise agreement. As a result, the use of ADR provisions has become more prevalent in Canadian franchise agreements. A natural consequence of this trend is that Canadian courts have now had the opportunity to comment on the validity of such provisions, and it is becoming clear that courts are generally willing to uphold them.

128. 1250264 Ontario Inc. v. Pet Valu Canada Inc., [2016] O.N.S.C. 5496.

129. Zwaniga v. Johnvince Foods Distrib. LP, 2017 O.N.S.C. 888 (Can. Ont. S.C.).

130. 2038724 Ontario Ltd. v. Quizno's Canada Rest. Corp., [2014] O.N.S.C. 5812 (Can. Ont. S.C.).

131. Another factor that will potentially decrease the number of franchise class actions in Canada is the growing trend towards upholding arbitration clauses in agreements, precluding the action.

For example, in *MDG Kingston Inc. v. MDG Computers Canada Inc.*, the Ontario Court of Appeal considered whether an arbitration clause contained in a franchise agreement remained effective in the face of a notice of rescission.[132] Ultimately, the Court of Appeal confirmed that the fairly drafted arbitration clause was valid and that the Wishart Act does not change the "normal rules regarding arbitration clauses, including the arbitrator's authority to decide its own jurisdiction as well as the severability of an arbitration clause. . . ."[133] This approach was subsequently followed in *Nazarina Holdings Inc. v. 2049080 Ontario Inc.*, where the Ontario Court of Appeal affirmed the validity of an arbitration clause contained within a franchise agreement.[134] It follows from this decision that an arbitration clause will be enforced where it "is very broad and provides a clear indication that the parties intended that their disputes, including disputes as to the validity of the franchise agreement itself, should be heard by an arbitrator and not by the courts."[135]

An evolving body of case law considers the circumstances under which a court will uphold the validity of the arbitration agreement in the face of a class action waiver. In the 2011 decision of *Seidel v. Telus Communications Inc.*, the Supreme Court of Canada held, in respect of one aspect of the claim, that a class proceeding could continue notwithstanding an arbitration agreement between the parties.[136] However, other aspects of the claim were stayed because of the arbitration clause.[137] This interpretation was consistent with applicable consumer protection legislation in British Columbia.[138]

More recently, the Ontario Superior Court of Justice clarified in *1146845 Ontario Inc. v Pillar to Post Inc.* that the right to associate granted under the Wishart Act does not mean a class action can be brought contrary to an arbitration provision.[139] The court considered *Sidel* and held that its proper application amounts to a question as to whether a legislative intention mandated court proceedings as the only appropriate jurisdiction for the dispute:

> After *Seidel v. TELUS Communications Inc.*, it is not a matter of weighing whether arbitration is a preferable procedure to resolve the issues raised in a proposed class action. In the immediate case (as was the case for all the class action claims in Seidel with the exception of one claim for which the court had exclusive jurisdiction), the franchisees should be held to their agreement to arbitrate.[140]

Essentially, it is now the law in Canada that arbitration and other similar clauses will be upheld unless the legislature clearly intended to grant the

132. MDG Kingston Inc. v. MDG Computers Canada Inc., [2008] O.N.C.A. 656 (Ont. C.A.). Attorney Geoffrey B. Shaw and his firm were lead counsel for the defendant, MDG Computers Canada Inc.,

133. *Id*., para. 32.

134. Nazarinia Holdings Inc. v. 2049080 Ontario Inc., [2010] O.N.C.A. 739. Cassels Brock and Blackwell LLP was lead counsel for the defendant, 2049080 Ontario Inc.

135. *Id*. para. 4.

136. Seidel v. TELUS Commc'ns Inc., [2011] SCC 15 (Can.).

137. *Id.* para. 7.

138. *Id.* paras. 1 & 5.

139. 1146845 Ontario Inc. v Pillar to Post Inc., [2015] O.N.S.C. 1115 (Can. Ont.).

140. *Id.*

courts exclusive jurisdiction to resolve the matter. The right to associate in Ontario does not meet this test, and, as such, arbitration clauses can serve to preclude a class action.

E. *Jury Trials in Franchise Disputes*

Although jury trials are significantly less common in Canada than in the United States, on rare occasions, a party may serve a jury notice in franchise cases. Once a moving party serves a jury notice, the other party has the option to bring a motion to strike the jury notice.[141] The moving party bears the onus of demonstrating that the case raises complicated issues of fact, law, or questions of mixed fact and law that render the case inappropriate for a jury to determine.[142] Bringing a motion to strike a jury notice may be advantageous in certain circumstances; however, whether such a motion will be granted depends on the circumstances of the case. Courts will strike a jury notice once convinced that the matter is so complex that a properly instructed jury would have problems understanding the issues of the case.[143]

Generally, the court will try to uphold the plaintiff's right to a jury trial. The Prince Edward Island Supreme Court has held that the decision to strike a jury notice should be based on a review of the true nature of the claim and relief sought, rather than technical considerations of pleadings and remedies sought.[144] Striking a jury notice could occur prior to trial by way of interlocutory motions, but sitting judges will likely choose to defer to the trial judge's discretion. In *Kawkaban Corp. v. Second Cup Ltd.*, the Ontario Superior Court of Justice found that issues such as termination of a franchise agreement, renewal of commercial lease, and negligent misrepresentation are not so complicated as to warrant striking a jury notice on an interlocutory motion.[145]

It remains to be seen whether we will see an increase in the prevalence of jury trials in Canada, particularly in franchise litigation, where franchisee-plaintiffs may see it as a strategic advantage.

VII. Remedies

A. *Injunctions*

Interlocutory or interim injunctions are available in Canada to assist in remedying improper conduct. Interlocutory injunctions involve court restraints on a party's act or behavior, but only while a court action or application is being resolved. Trials are a lengthy, time-consuming process, and

141. Rules of Civil Procedure, R.R.O. 1990, Reg. 194 at 47.02(1).

142. *Id.* at 47.02(2).

143. *See* Soldwisch v. Toronto W. Hosp.. [1983] 43 O.R. (2d) 449; Oliver v. Gothard, [1992] 10 O.R. (3d) 309; Stretch v. Wu, [1993] O.J. No. 607 (Ont. C.A.). Kawkaban Corp. v. Second Cup Ltd., [2003] CarswellOnt 5077 (Ont. S.C.J.). Attorney Geoffrey B. Shaw and his firm were lead counsel for the defendant, Second Cup Ltd.

144. Burns v. Thomson News. Co., [1997] 150 Nfld. & P.E.I.R. 358 (Can. P.E.I. S.C.T.D.).

145. *Kawkaban Corp.*, [2003] CarswellOnt 5077.

interlocutory injunctions allow the court to make a decision on whether to maintain the status quo throughout the litigation.[146] In many instances, this is in all practical terms where the dispute will likely be decided, as the party that loses the injunction will not pursue the matter further. Interlocutory injunctions have more recently been sought in several novel areas, especially with the advent of claims relating to the breach of the statutory duty of fair dealing. For example, in *Paul Sadlon Motors Inc. v. General Motors of Canada Ltd.* (*General Motors*), a franchisee was initially granted an interim interlocutory injunction enjoining a franchisor from revising the franchisee's market area and from appointing an additional franchisee to that area.[147] This injunction was later dissolved on a motion to continue the injunction. In making its decision, the court looked beyond the plaintiff-franchisee and considered the impact of the injunction on parties other than the franchisee; specifically, the franchisor and the new franchisee to be added to the disputed market area.[148] The court found that the new franchisee would suffer irreparable harm should the injunction be granted since an inability to establish a market presence is considered an unquantifiable loss of market share.[149] Further, the franchisor would suffer irreparable harm due to the disruption of its ability to establish its franchise network.[150] The court's balancing of the competing interests in this case is encouraging for franchisors seeking to oppose an injunction.

Similarly, in *1323257 Ontario Ltd. v. Hyundai Auto Canada Corp.* (*Hyundai*), the Ontario Superior Court of Justice granted an injunction against the franchisor, Hyundai Auto Canada Corp., preventing it from, among other things, terminating a certain Hyundai dealership and taking further steps to appoint a replacement dealership.[151] In that case, the court considered the franchisor's good faith obligations in deciding that a serious question remained for trial.[152]

Conversely, while the franchisees in *General Motors* and *Hyundai* were successful in obtaining interlocutory injunctions against the franchisor, in *Bark & Fitz Inc*. v. *2139138*, the franchisor obtained an injunction against certain of its franchisees.[153] In *Bark*, the franchisees ceased complying with the terms of their franchise agreements, over a dispute arising out of changes to the franchisor's core products.[154] The franchisor successfully argued that the franchisees should be prevented from terminating or breaching

146. Paul Sadlon Motors Inc. v. Gen. Motors of Canada Ltd., [2011] O.N.S.C. 4432 (Can. Ont. S.C.J.).
147. *Id.*
148. *Id.* para. 10.
149. *Id.* para. 78.
150. *Id.* para.136.
151. 1323257 Ontario Ltd. v. Hyundai Auto Canada Corp. (Hyundai), [2009] 55 B.L.R. (4th) 265 (Can. Ont.).
152. *Id*. paras. 85–86.
153. Bark & Fitz Inc. v. 2139138 Ontario Inc., [2010] O.N.S.C. 1793 (Can. Ont. S.C.J.).
154. *Id.* para. 3.

their franchise agreements; thus, requiring them to pay royalty fees.[155] The Ontario Superior Court of Justice recognized that the franchisees' refusal to pay royalty fees and stock core products could cause irreparable harm to the franchisor.[156] The court found that it is "an inescapable inference that this franchise system cannot survive pending trial . . . . In addition, the inability to maintain the advertising, marketing and quality control through core products creates a risk to the good will and reputation of this franchise."[157] This decision is significant in that the court recognized the importance of protecting the franchisor's ability to manage its franchise system and collect royalties pending a trial on the merits of the case.

Various situations exist in which the court will grant an injunction to enforce the terms of a franchise agreement. For instance, the court may grant an injunction when post-termination noncompetition covenants are breached by the franchisee. As a general note, Canadian courts take noncompetition covenants to be *prima facie* unenforceable, as they are viewed to restrict trade which is contrary to public policy goals. However, courts might be willing to enforce such provisions so long as the restrictive covenant or noncompetition clauses are seen as reasonable in terms of duration, geographic area, and activities restrained. In *Allegra of North America Inc. v. Wayne Zapje*, the Ontario Superior Court of Justice granted an injunction against a franchisee who decided to leave the system and compete with the franchisor.[158] The court granted an injunction in addition to damages in order to send the message that allowing such a breach of noncompetition terms would be akin to destroying the core of the franchise business, especially since it would open the doors for other franchisees to do the same.

Although a relatively high threshold is required, in some instances courts may grant a mandatory interlocutory injunction to compel a responding party to act in a certain way. In the franchise context, courts sometimes use mandatory interlocutory injunctions to enforce terms of the franchise agreement. The court will only do so if it is nearly certain that the moving party will be successful at trial, and that a mandatory injunction will most likely be granted at trial. In *1460904 Ontario Inc. v. MDG Computers Canada Inc.*, the court granted such an injunction for the transfer of a lease where the franchisee breached the terms of the franchise agreement in its failure to assign the lease to the franchisor at termination.[159]

155. *Id.* para. 41.
156. *Id.* paras. 30–34.
157. *Id.* para. 33.
158. Allegra of N. Am. Inc. v. Wayne Zapje, [2001] O.J. No. 5412 (Can. Ont. S.C.J.). Attorney Geoffrey B. Shaw and his firm were lead counsel for the plaintiff, Allegra of North America Inc.
159. 1460904 Ontario Inc. & Hamid Tabaee v. MDG Computs. Can. Inc. & Goran Varaklis, [2006] CarswellOnt 6744 (Ont. S.C.J.) (Cumming J.). Attorney Geoffrey B. Shaw and his firm were lead counsel for the defendant, MDG Computers Canada Inc.

B. *Claims for Future Royalties*

If a franchisee's breach causes termination and, therefore, a loss of an income source for the franchisor, Canadian law gives the franchisor the ability to claim lost future royalties. In *2 for 1 Subs Ltd. v. Ventresca*, the Ontario Superior Court of Justice granted a franchisor future royalties following the franchisee's infringement of the franchisor's right of first refusal to purchase a franchise at fair market value upon the franchisee's sale.[160] In an attempt to avoid payment of the transfer charge, the franchisee sold the assets of its 2 For 1 sandwich restaurant to a purchaser who changed the name to Rose's 241 Subs and Such.[161] Although three years were left in the franchisee's term at the termination of the agreement, the lack of mitigation by the franchisor led the court to grant two years of royalty payments.[162] Specifically, the court noted that the franchisor made no efforts to replace the franchisee, and existing jurisprudence suggests such a replacement would take approximately eighteen to twenty-four months.[163]

Ultimately, however, there is a dearth of jurisprudence in the area of lost royalty claims,[164] which could be a direct result of the emphasis on mitigation in Canadian courts.[165] Either way, U.S. franchisors should be aware that this remedy is available to them in certain limited circumstances.

C. *Liquidated Damages*

Liquidated damage clauses specify a predetermined amount of damages for failure to perform under a contract. The law in Canada on this point stems from law in the United Kingdom;[166] liquidated damages clauses will be upheld, but penalty clauses are not enforceable. The Supreme Court explains that "a sum will be held to be a penalty if extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from a breach."[167] Liquidated damage clauses will be permissible only where they are a genuine pre-estimate of the loss.

Recently, the case *Cavendish Square Holding BV v. Talal El Makdessi* changed UK law on liquidated damages to a test focusing on the parties'

160. 2 for 1 Subs Ltd. v. Ventresca, [2006] O.J. No. 1528 (Can. Ont. S.C.J.).

161. *Id.* para. 2.

162. *Id.* para. 41.

163. A&W Food Servs. of Can. Ltd. v. Leslie, [1989] 242 A.P.R. 111 (N.S.T.D.) (Can.); Pizza Delight Corp. v. White Rock Pizza Take-Out Ltd., [1985] 9 C.P.R. (3d) 282 (B.C.S.C.) (Can.); Damack Holdings Ltd. v. Saanich Peninsula Sav. Credit Union, [1982] 19 B.L.R. 46 (B.C.S.C.) (Can.).

164. Leonard H. Polsky, *Measure of Damages for Future Lost Royalties Case Comment:* 2 for 1 Subs Ltd. v. Ventresca, Franchise & Distrib. (2006), http://www.mondaq.com/canada/x/44774/Corporate+Commercial+Law/Franchise+Distribution+Gowlings+November+2006.

165. Jeffrey P. Hoffman & Geoffrey B. Shaw, Obstacles to Litigating the Franchise Case: Ten Procedural Issues of Interest (Nov. 2006) (unpublished paper presented to The Domino Effect: 6th Annual Franchising Conference); *see also* Mr. Submarine Ltd. v. Sowdaey, [2002] O.J. No. 4401, 118 A.C.W.S. (3d) 373 (Can. Ont. S.C.J.).

166. Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co., [1914] UKHL 1 (appeal taken from Eng.).

167. H.F. Clarke Ltd. v. Thermidaire Corp., [1976] 1 S.C.R. 319 (Can.).

interests.[168] The inquiry is whether the clause "imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation."[169] This holding means that clauses in excess of what the damages may actually have been can be upheld under UK law so long as there was equality of bargaining power and the clause is commercially justifiable. It is likely that this judgment will eventually affect the law in Canada. By virtue of this UK decision, Canadian common law may also change to permit more damages clauses.

VIII. Conclusion

As discussed throughout this article, several significant differences exist between franchising in Canada and the United States. While franchisors hoping to enter the Canadian market may be comforted by the numerous similarities, it is crucial for a successful entrance strategy to carefully consider the impact of differences across the business, law, and practice of franchising. A thorough entrance strategy must acknowledge the differences and exploit the similarities if a franchisor wants to achieve optimal success.

168. Cavendish Square Holding BV v. Talal El Makdessi (Rev 3) [2015] UKSC 67.
169. *Id.*