When can your Franchise Agreement include a Release of the Franchisor?

2176693 Ontario Ltd. et al v. Cora Franchise Group Inc.

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The dispute in *2176693 Ontario Ltd. et al. v Cora Franchise Group Inc. et al.*[2] raises two distinct points of interest for franchising parties. First, if a franchisee wants to transfer its franchise to a third party, what can the franchisor require before approving the transfer? Second, and the main issue in *Cora*, can the franchisor obtain a general release from the outgoing franchisee as part of the transfer?

Although the Court did not deal squarely with all the conditions for approval of the transfer, it suggests that franchisors may impose conditions on a transfer of a franchise agreement to a third party provided those conditions do not violate the *Arthur Wishart Act*[3].

Further, *Cora* reaffirms that franchisors are not entitled to a release of the requirements of the *Act*, and when drafting franchise agreements they must abide by the *Act*; Courts will be vigilant in ensuring that the legislative rights of franchisees are protected and will decline to sever or read down provisions of a franchise agreement which violate the *Act*.

Background of the Dispute

The franchisees operated two Cora's Breakfast locations. In a related proceeding[4], the franchisees sued the franchisor for, among other things, failure to make proper disclosure under the *Act*, and recession of the franchise agreement. In order to mitigate their damages, the franchisees attempted to transfer their franchise agreement to a third party.

The franchise agreement contained two clauses relating to the transfer of the franchise agreement with conditions to the franchisor's approval of the transfer. The conditions included:

- provision of detailed information about the proposed assignee, so that the franchisor could decide whether the assignee was a suitable franchisee;
- the proposed assignee was to complete training programs and demonstrate its fitness as a franchisee; and
- the existing franchisee was to provide a general release of any claims against the franchisor, and specifically:

> 22.6.4 Franchisee and its directors, officers and shareholders signing and delivering in favour of Franchisor and its directors, officers, shareholders and employees, a general release in the form specified by Franchisor of any claims against Franchisor and its officers, directors, shareholders and employees.[5] [emphasis added by Application Judge]

The issue between the parties was regarding the validity and enforceability of the release clause which, based on its plain language, sought a full release of the franchisor. The franchisee's position was that such a release was contrary to section 11 of the *Act* which reads:

> Any purported waiver or release by a franchisee of a right given under this Act or of an obligation or requirement

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[2]2014 ONSC 600 ("Court" or "ONSC") and 2015 ONCA 152 ("Court of Appeal" or "OCA") (and collectively "*Cora*").
[3]*Arthur Wishart Act (Franchise Disclosure)*, S.O. 2000, c. 3, s. 11 ("*AWA*" or "*Act*").
[4]See *2176693 Ontario et al. v. The Cora Franchise Group Inc. et al., 2015 ONSC 1265.*
[5]*Cora*, ONSC at paragraph 6.

imposed on a franchisor or franchisor's associate by or under this Act is void.[6]

The franchisor initially insisted that the clause provided for a general release, however, after some negotiation the franchisor took the position that the release sought was not a release of all claims, but rather a release of any claims outside the *Act*.

Decision of the Superior Court

At first instance, Justice Matheson found that the clause of the franchise agreement requiring a general release of the franchisor was void and unenforceable as contrary to section 11 of the *Act*. In doing so, she rejected the franchisor's primary position – that the language of the clause that the release would be "in a form specified by the franchisor" excluded *AWA* claims and thus did not violate the *Act*. She also found the franchisor's proposal that the Court expressly narrow the release, as excluding any claims under the *Act*, was unacceptable as such a qualification was not in the existing language of the clause. Finding that approach only allowed for abuse by the franchisor:

> [14] I reject the Franchisor's submission that by offering to accept a narrower release after the issue was raised it has saved the requirement for a general release from the operation of s. 11 of the *AWA*. This approach serves only to allow for abuse. It allows a franchisor to "wait and see" if an objection is raised, and potentially secure the full general release if the franchisee does not assert its rights under the *AWA*. Thus, the door is open for the franchisor to take advantage of the franchisee, who may be unaware of s. 11 of the *AWA*.[7]

Matheson J. went on to discuss the goals and objectives of the *Act*, which are to protect the franchisee and "mitigate and alleviate the power imbalance that exists between franchisors and franchisees", and she stated that section 11 of the *Act* is to be interpreted in that light.[8]

The franchisor's alternative position was to "read down" the clause to exclude any claims falling under the *Act*, Matheson J. rejected that proposal and found that such an interpretation would fail to protect franchisees and was directly contrary to the *Act*.[9] She noted that certain provisions of the *Act* are codifications of common law rights and to allow the release clause to be read down to release only non-statutory rights would invite considerable debate and confusion about the status of overlapping claims.[10] In refusing to read down the offending sections of the clause, Justice Matheson also relied on the decision of the Ontario Court of Appeal in *Midas Canada*,[11] where the Court held "[i]f you include a term in your franchise agreement that purports to be a waiver or release of any rights a franchisee has under the Act, it will be void."

The Court noted that there may be other clauses that could be read down, as proposed by the franchisor, but concluded that the release provision was not such a clause:

> [38] There is no question about the purpose of and interpretative approach to be applied to the *AWA*. It must be interpreted in a manner that protects franchisees. While I do not rule out the possibility that there may be some clauses that can be read down in the manner invoked in *Seidel*, I find that s. 22.6.4 cannot be. It simply seeks a "general release". It is purported release of rights under the *AWA* and therefore caught by s. 11. A purposive interpretation of s.11 results in s.22.6.4 being void, not re-written to the benefit of the Franchisor. This is not unfair to the Franchisor, since it imposed the offensive term and ought not to benefit from doing so.[13]

Decision of the Ontario Court of Appeal

The franchisor appealed and the Court of Appeal upheld the decision of Matheson J. The Court of Appeal found that the provision was unenforceable because the franchisee's obligation under the wording of the release provision would be contrary to section 11 of the *Act*.

One point to note is that the Court of Appeal stated that if the clause had called for a release "...to the extent that the applicable law would permit...", or similar language, it would have provided flexibility to support the franchisor's interpretation that the clause excluded *AWA* claims.[14] However, in the absence of such language, the Court of Appeal rejected that interpretation.

The Court of Appeal then considered two possible approaches to severing the franchise agreement – one that would strike or sever only the offensive portions of clause in question and one that would merely read down the clause, to bring it into compliance with the *AWA*. Ultimately, the Court of Appeal rejected both options. The Court of Appeal reiterated the concerns of the Application Judge that reading down or notional severance of the release clause, to bring it into compliance with the *AWA*, would violate the purposes of the *Act* and would provide franchisors with no incentive to draft agreements which complied with the *Act* in the first place, because they would simply ask the Court to correct agreements that did not comply with the *Act*.[15]

The Court of Appeal also rejected the argument that this outcome effectively provided a windfall to the franchisee – who would obtain the transfer of the franchise agreement as requested, without having to provide any release to the franchisor. The Court of Appeal noted that the franchisor is still entitled to have all the other conditions of transfer met before approving the transfer.[16] Moreover, the Court of Appeal stated that the potential windfall to the franchisee did not outweigh the potential for abuse and subversion of the *Act*, if the offending clause was merely severed or read down.

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[6] *Act*, section 11.
[7] *Cora*, ONSC paragraph 14.
[8] *Cora*, ONSC at paragraphs 19 and 20.
[9] *Cora*, ONSC at paragraph 22.
[10] *Cora*, ONSC at paragraph 23.
[11] *405341 Ontario Ltd. v. Midas Canada Inc.*, 2010 ONCA 478.
[12] *Cora*, ONSC at paragraph 24.
[13] *Cora*, ONSC at paragraph 38.
[14] *Cora*, OCA at paragraph 25.
[15] *Cora*, OCA at paragraph 57.
[16] *Cora*, OCA at paragraph 61.

One interesting point to note is how the situation in *Cora* can be contrasted with the facts of *151828 Ontario Inc. et al v. Tutor Time Learning Centres, LLC et al.*, where the release signed by the franchisee was upheld – dispute a similar objection that it contravened section 11 of the *Act* – because it was signed by the franchisee with full knowledge of the franchisor's breach and with the benefit of independent legal advice.[17]

Lessons from *Cora*

What does the decision in *Cora* mean for parties to a franchise agreement?

- The Court in *Cora* did not take issue with the other conditions precedent for the transfer of the franchise agreement. Thus it would seem that, provided such conditions do not violate the *AWA*, the franchisor may have conditions on the transfer of the franchise agreement to third parties;
- The Court will approach a franchise dispute from the position that the *AWA* is intended to protect the franchisee and interpret a franchise agreement consistent with that purpose;
- Courts will not assist franchisors by interpreting franchise agreements that offend the *Act* in a manner that brings the agreement into compliance with the *Act*;
- More specifically, franchisees will not be expected to release or waive their rights under the *Act*, and clauses which seek such a release from a franchisee will be unenforceable;
- However, if the release has express language that *excludes* claims under the *AWA* or provides that the release sought is "...to the extent permitted by applicable law...", it may be enforceable; and
- Unlike *Cora*, in cases such as *Tutor Time*, the Court may enforce a release given by a franchisee when it is given with full knowledge of the franchisor's breach and with the benefit of independent legal advice.

ABOUT THE AUTHORS

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[17] *1518628 Ontario Inc. et al v. Tutor Time Learning Centres, LLC et al*, 2006 CanLII 25276 (ONSC) ("Tutor Time"), at paragraph 109.