



All That Glitters: The *Midas* Touch on Franchise Agreements

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A recent Court of Appeal decision has challenged the validity of historically standard franchise practices. Before this decision was released, a standard franchise agreement renewal provision would require that the franchisee release the franchisor from any and all potential lawsuits based on past events; likewise, a comparative release clause would apply where a franchisee would want to assign its franchise to a third party. In *405341 Ontario Limited v. Midas Canada Inc.*, the Ontario Court of Appeal was of the view that inclusion of such a release clause in a franchise agreement is contrary to the spirit and intent of Ontario's franchise law.

This article will briefly summarize the history and context of the decision, and provide information and commentary that will be of importance to both franchisors and franchisees.

The Way It Was

Ontario's franchise law act is formally known as the *Arthur Wishart Act* (2000) ("the Act"). The three main principles of the Act are: (i) franchisors and franchisees owe each other a duty of good faith; (ii) potential franchisees are entitled to certain disclosure by the franchisor prior to signing a franchise agreement; and (iii) franchisees have the right to associate with each other. Moreover, section 11 of the Act clearly states that no party to a franchise agreement can contract out of the provisions in the act. In other words, no franchise agreement can include provisions that the Act prohibits, even with the consent of both parties.

For years, standard franchise agreements provided that the agreement could not be renewed unless the franchisor was released from any potential liability arising from events that occurred under the franchise agreement to the date of the renewal. If a franchisee felt that the franchisor was treating it unfairly, it nonetheless had to give up its right to sue in order to extend the term of the franchise agreement. Franchisees agreed to these provisions because, in return, they received the right to continue operating their franchised business.

The Ontario Superior Court of Justice in the 2006 case *1518628 Ontario Inc v. Tutor Time Learning Centres* determined that the franchisee could not recant the release it had given to the franchisor, whereby the franchisor was released from the failure to provide disclosure in exchange for what was effectively the franchisor's consent to an assignment of the business by the franchisee. In that case, the purchaser of shares of a franchisee was not provided with the disclosure required by the Act. The franchisee's business failed and was sold to a third party who then operated the business outside of the franchise system. At the time of the sale, the franchisee indicated that it had the right to rescind the franchise agreement because of the failure of the franchisor to provide disclosure. At that time the franchisee owed money to the franchisor. Ultimately, a settlement was reached between the franchisee and the franchisor, which included a release in favour of the franchisor. The settlement was reached with the advice of counsel, and with the franchisee being fully aware that it was renouncing any claims it had arising from the failure to receive proper disclosure. Once the sale to

the third party was completed, the franchisee attempted to rescind the settlement on the basis that the release was contrary to the Act. Justice Cummings did not accept the franchisee's argument and concluded that section 11 of the Act does not apply to releases given by franchisees to franchisors in the settlement of disputes for "existing, known breaches of the act in respect of its disclosure obligations." Justice Cummings reached this conclusion in part because, in his view, "[t]he settlement of a claim arising from and consequential to an existing statutory right of rescission is not in itself "a waiver or a release" of that statutory right to rescission. It is a release of the claim arising from having exercised the right of rescission or being in the position to exercise the right of rescission."

Arguably, the *Tutor Time* case stands for the proposition that releases in franchise agreements stand up to the Act where the franchisee is aware of the breach and obtains legal advice, and it accordingly supports the practice of obtaining releases as a precondition to renewals or assignments. In *Midas*, the Court of Appeal clarified that this is not the case.

The Way It Is

In *Midas*, the franchisee alleged that the release was contrary to the part of the Act dealing with the right of association. Section 4 of the Act states that franchisees have the right to associate with each other, and any provision in a franchise agreement prohibiting that right is considered void. In this case, the franchisor attempted to use the general release provision to prevent the franchisee from joining a class action suit against it. The class action dealt with a change to the franchise system's supply chain system and not with disclosure. The franchisee argued that in upholding the right to associate, section 4 "encompassed the right of franchisees to join in class proceedings with other franchisees for the purpose of enforcing their rights against the franchisor."

The court agreed and looked beyond the mere facts of the case. It attacked the very idea of contractual releases in franchise agreements, stating that "requiring franchisees to give up any claims they might have against a franchisor for purported breaches of the Act in order to renew their franchise agreements unequivocally runs afoul of the Act" (at para 30). The purpose of the Act, the court noted, is to protect franchisees. Section 11 embodies that sentiment.

The court distinguished its decision from *Tutor Time* because the franchise agreement in *Midas* was signed before the breach arose and so the obligation to give the release was signed without any knowledge of the breach. Not only was *Tutor Time* distinguished, but the instances where *Tutor Time* might apply were narrowed. *Tutor Time* might otherwise have continued to govern in those instances where a franchisee right had crystallized into a claim. But the *Midas* decision went beyond merely distinguishing *Tutor Time*, by declaring that "the distinction between rights and claims is artificial. The claims in the class action are derived from rights that the class members are seeking to assert" (at para 27). Ultimately, the court held that release provisions in franchise agreements are void.

The Way It Appears To Be Heading

Midas holds a number of implications for future franchise agreements. Most obviously, if a franchisee is faced with a contract renewal, and has multiple grievances against the franchisor, the franchisee can renew the contract and retain the right to sue. Likewise, if a franchisee wants to assign its franchise to a third party, and has made allegations against the franchisor, the franchisee can sell and also retain all of its rights to sue.

From a franchisee's perspective, *Midas* means a newly acquired freedom to pursue its rights while maintaining its livelihood. From a franchisor's perspective, this decision may open up the possibility of scenarios where, for example, "trouble-making" franchisees cannot be forced out of the system at renewal time.

From a practical point of view, the decision in *Midas* suggests that solicitors must re-think how they draft franchise agreements. In the future, franchise agreements may be drafted to bring the "release" desired by the franchisor closer to the *Tutor Time* facts than the *Midas* facts. It might be possible accomplish this goal by forcing a true settlement as opposed to imposing a condition that benefits

the franchisor to the detriment of the franchisee. In other words, solicitors may think of trying to achieve a win-win situation instead of a zero sum game with the franchisor holding all of the cards.

Franchisors and franchisees operating under current franchise agreements should continue to act in good faith towards one another, and approach each other on all issues, whether in preparation of contract renewal or otherwise, openly and honestly.

Conclusion

Midas has not changed the basic principals of franchising. Before *Midas* every franchise agreement imposed on each party a duty of fair dealing in its performance and enforcement, and that still remains the governing principle of the franchise relationship. What *Midas* has done is clarify the extent to which the Courts may apply that principle. Franchisors may now have to exercise more caution in how they seek to interpret and enforce their agreements, and franchisors working with their solicitors may need to be more creative in structuring their affairs to achieve results close to their expectations but making the duty of fair dealing paramount. ■