UNIQUE CIRCUMSTANCES IN LITIGATING FRANCHISE CLASS ACTIONS[1]

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A. Introduction

In recent years Ontario courts have seen a number of certifications of franchise class proceedings. The trend appears to be accelerating, with several certifications occurring within the past three years and more decisions currently on reserve. The evolution of franchise litigation in Canada to its current state has been a lengthy process and numerous issues peculiar to the franchise business model have been argued and decided along the way.

This paper explores the emergence of franchise class actions in Ontario, and evaluates them from both the franchisor and franchisee perspective. The main recurring themes from the jurisprudence will be examined, and various litigation strategies will also be discussed. Although Ontario courts have, by and large, embraced class proceedings as a vehicle for resolving system-wide franchise disputes, they have by no means been a magic bullet in the hands of franchisees and their true practical effectiveness at obtaining equitable results for both sides remains to be proven.

B. The Current State of Franchise Class Proceedings

The advent of the *Arthur Wishart Act (Franchise Disclosure),2000*[2] marked a fundamental change in franchise litigation in Ontario, and particularly in franchise class action litigation. The *Arthur Wishart Act* is remedial legislation that was introduced to address the "inequality of bargaining power" between franchisees and franchisors.[3] Among other things, it imposes on franchisors and franchisees a duty to deal fairly with each other, protects franchisees' rights of association, and requires franchisors to disclose all material facts to prospective franchisees before a franchise agreement is executed.[4] As Justice Strathy described in *779975 Ontario Ltd. v. Mmmuffins Canada Corp.*, the *Arthur Wishart Act*:

> was designed to level the playing field occupied by franchisors and franchisees. One of the purposes of the statute in general, and of s. 5 in particular, is to adjust the informational imbalance between the parties and to ensure that franchisees are able to make informed decisions about their investments. Sections 6 and 7 give teeth to the franchisee's rights and impose dramatic financial consequences on franchisors, and their associates, who fail to comply with their statutory duties of disclosure. These sanctions are a strong incentive to franchisors to ensure that they comply with the letter, as well as the spirit of the law.[5]

Though the *Arthur Wishart Act* was introduced in 2000, there was little immediate class action activity in the franchise context. The 2002 decision of Justice Winkler (as he then was) to certify a class of A&P franchisees against their franchisor in *1176560 Ontario Ltd. v. Great*

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2 S.O. 2000, c. 3.

3 *779975 Ontario Ltd. v. Mmmuffins Canada Corp.*, [2009] O.J. No. 2357 at para. 10 (S.C.J.) ("*Mmmuffins*")

4 *Arthur Wishart Act, 2002*, SO 2000, c 3, ss. 3, 4 and 5, respectively ("*Arthur Wishart Act*").

5 *Mmmuffins*, above at para. 30.

Atlantic & Pacific Company of Canada Ltd. marked the first certification of a franchise class action in the *Arthur Wishart Act* era.[6] For the following five years, there were no franchise class actions brought in Ontario, and only two certification decisions were released immediately after that period of inactivity:

- *405341 Ontario Limited v. Midas Canada Inc.*,[7] in which a class of Midas franchisees successfully certified a class proceeding against Midas Canada Inc. The plaintiffs alleged that Midas, which had raised royalty rates owed by each franchisee on its retails sales in exchange for a substantial discount to each franchisee on prices paid for products purchased from Midas, had breached the *Arthur Wishart Act* when it stopped supplying products to its franchisees, who thereby lost the benefit of the significant discount.

- *2038724 Ontario Ltd. v. Quiznos Canada Restaurant Corp*,[8] in which the plaintiffs alleged that Quiznos, the franchisor of a large sandwich shop chain, conspired with its designated supplier, Gordon Food Services, to artificially inflate the price at which franchisees purchase certain required supplies. The plaintiffs claimed that Quiznos and Gordon Food Services breached the price maintenance sections of the *Competition Act*[9] and that Quiznos breached its contract with the franchisees. The action was certified as a class proceeding.

However, since *Midas* and *Quiznos*, there have been a number of franchise certification decisions, and it would appear that the trend will continue.[10] Within the past three years, three additional certification decisions have been released:

- *578115 Ontario Inc. v. Sears Canada Inc.*[11], in which a class of Sears franchisees successfully certified an action against Sears for various heads of liability, including breach of implied terms of the franchise agreements, and breach of statutory duties of good faith and fair dealing under the *Arthur Wishart Act*. Though the franchise agreement stated that Sears would pay each franchisee a rebate of 4% of the total annual net purchases made by the franchisee from approved suppliers, the plaintiffs alleged that Sears failed to disclose the fact and quantum of rebates it had been receiving, and that

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6 *1176560 Ontario Ltd. v. Great Atlantic & Pacific Company of Canada Ltd.* (2002), 62 O.R. (3d) 535 (S.C.J.) at para. 5, aff'd (2004) 70 O.R. (3d) 182 (Div. Ct.), leave to appeal denied (C.A.) *("A&P"*). (Osler, Hoskin & Harcourt LLP acted for A&P. Sotos LLP acted for 1176560 Ontario Ltd.)

7 *Landsbridge Auto Corp. v. Midas Canada Inc.* (2009), 73 C.P.C. (6th) 10 (Ont. S.C.J.) ("*Midas #1*") (Sotos LLP acted for Landsbridge Auto Corp).

8 *2038724 Ontario Ltd. v. Quiznos Canada Restaurant Corp.* (2009), 96 O.R. (3d) 252 aff'd 2010 ONCA 466; leave to appeal to the S.C.C. dismissed by [2011] S.C.C.A. No. 348 ("*Quiznos Div. Ct.*") (Sotos LLP acted for 2038724 Ontario Ltd.).

9 R.S., 1985, c. C-34.

10 Note that although the Government of Ontario is exempt from the application of the *Arthur Wishart Act*, its network of private drivers license issuers have had their claims against Ontario certified as a class proceeding over the compensation paid to them under their forms of agreement in *Mayotte v. Ontario*, 2010 ONSC 3765 leave to appeal denied 2010 ONSC 5275 (September 24, 2010) per Sachs J [*Mayotte*]. (Sotos LLP acted for Mayotte).

11 2010 ONSC 4571 ("*Sears*").

Sears did not make the plaintiffs aware that they were only receiving part of the rebate paid by suppliers to Sears.

- *Trillium Motor World Ltd. v. General Motors of Canada Ltd.*,[12] where a class of former automobile dealers were successful in certifying a class proceeding against GMCL. In the face of the global economic crisis and government bailouts, GMCL reduced the size of its dealer network, and offered "wind-down agreements" to 240 dealers. The 207 dealers who entered into the wind-down agreements brought this class action alleging that GMCL breached its duty of fair dealing under the *Arthur Wishart Act* because of the way it handled the wind-down process, including the time provided for the dealers to consider whether to accept the wind-down agreements.

- *1250264 Ontario Inc. v. Pet Valu Canada Inc.*,[13] where the franchisees in a pet supply chain alleged, among other things, that the franchisor breached its obligations to pass on to the franchisees volume-based rebates, allowances and discounts given by suppliers and manufacturers to Pet Valu or its affiliates. The franchisees argued that the passing on of such benefits is a fundamental component of the Pet Valu system, and in failing to do so they breached both the franchise agreement and the statutory fair dealing requirement under the *Arthur Wishart Act*. The class action was certified on these issues.

This trend has continued, with the recent intended certification and subsequent summary dismissal in *TA&K Enterprises Inc. v. Suncor Energy Products Inc.*[14], the recent summary

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[12] 2011 ONSC 1300 aff'd 2012 ONSC 463, (Ont. Div. Ct.), and 2012 ONSC 1443 (Ont. Div. Ct.) ("*Trillium*"). (Osler, Hoskin & Harcourt LLP acted for General Motors of Canada Limited ("GMCL") and Sotos LLP acted for Trillium Motor World Ltd.). As discussed further below, GMCL obtained leave to appeal Justice Strathy's certification decisions with respect to certain issues on June 22, 2011: 2011 ONSC 3939 (Div. Ct.). In particular, the Ontario Divisional Court found that it was "open to serious debate" that the following issues were certifiable as common issues: 1) whether GMCL had a duty to disclose material facts concerning its restructuring to franchisees at the times of soliciting the Wind-Down Agreement; and 2) whether GMCL interfered with the class members' right to associate under s. 4 of the *Arthur Wishart Act*. Moreover, Justice Low granted leave on the issue of whether a class proceeding was the preferable procedure under s. 5(1)(d) of the *Class Proceedings Act*, SO 1992, c 6 ("CPA"). The defendants CBB and General Motors appealed the certification decision to the Divisional Court, but were unsuccessful on all counts. CBB sought further leave to appeal the decision at the Ontario Court of Appeal, but in August 2012 the Court of Appeal refused to allow the appeal.

[13] 2011 ONSC 287 ("*Pet Valu*") (Sotos LLP acted for 1250264 Ontario Inc.). The judge overseeing the class action released further reasons for decision on March 28, 2011 setting out the common issues for trial. On June 21, 2011, the Court dismissed a motion to declare all future "releases" entered into by franchisees to be enforceable. Further, on July 27, 2012, the court overturned the completed opt-out process based on prejudice it found had occurred during the opt-out period. A court-approved notice to the class will follow, and summary judgment motions have been scheduled for January 2013.

[14] 2010 ONSC 7022 (S.C.J.) aff'd 2011 ONCA 613. The plaintiff and defendant both brought an initial application for summary judgment, which was appealed to the Ontario Court of Appeal on June 13, 2011. The Court of Appeal decision, released on September 27, 2011, affirmed the lower courts finding. Justice Goudge of the Court of Appeal rejected the arguments put forward by TAK to treat the Retail Franchise Agreement (RFA) as valid for more than one year, and held that the RFA met the requirements of s. 5(7)(g)(ii) of the Act, and it therefore fit within the exemption provided by that section. Note that Osler, Hoskin & Harcourt LLP acted for Suncor and Sotos LLP acted for TA&K Enterprises Inc.

judgment in *Tim Hortons* that would have granted certification in the alternative,[15] and certification decisions in *Shoppers Drug Mart,*[16] *Panzerotto*[17] *and Zwaniga*[18] expected in the coming months. Given that the Ontario Court of Appeal has recently declared that class actions involving hundreds of franchisees suing their franchisor over a common franchise agreement are "exactly the kind of case for a class proceeding,"[19] we must expect to see a growing number of franchise class proceedings over the coming years.

C. The Unique Relationship Between Franchisor and Franchisee

Franchisors and franchisees operate in a state of tension with one another. Although the two are in many senses partners and share many common business interests, they are, in another sense, adversaries at the negotiating table. So, while the franchise business model relies on both sides being profitable in order for a system to succeed, franchisors and franchisees occasionally come to view the situation as a zero-sum game wherein one party's profitability can only come at the expense of the other's. In the worst of cases this dynamic can lead one party to engage in behaviour that renders the other's business unprofitable. Though short-sighted, it is not

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[15] *Fairview Donut Inc. and Brule Foods Ltd. v. The TDL Group Corp. and Tim Horton's Inc.* 2012 ONSC 1252 (*"Tim Hortons"*). A certification motion and a motion by the defendants for summary judgment were heard between August and October 2011. On February 24, 2012, Justice Strathy released his decision which dismissed the certification motion and granted the defendants summary judgment. Justice Strathy did, however, indicate that had he not dismissed the plaintiffs' claim in summary judgment he would have certified the class proceeding subject to further minor submissions. The plaintiffs have appealed to the Ontario Court of Appeal on some aspects of Justice Strathy's decision and the hearing is scheduled for October 30, 2012.

[16] Osler, Hoskin & Harcourt LLP is acting for Shoppers Drug Mart in *Spina et al. v. Shoppers Drug Mart et al.* The Plaintiffs filed and served their Statement of Claim on December 20, 2010. A Rule 21 motion brought by the defendants and the plaintiffs' certification motion were heard in August 2012. The certification motion was adjourned (with the exception of argument on s. 5(1)(a) of the CPA), and reasons on the Rule 21 motion and s. 5(1)(a) of the CPA are pending.

[17] *6323588 Canada Ltd. v. 709528 Ontario Ltd.*, 2012 ONSC 2985 (Sup Ct) ("*Panzerotto*"). In *Panzerotto*, the plaintiff franchisee brought a motion to certify a class proceeding relating to three aspects of the franchise business. The plaintiff claims that the franchisor is required to account to franchisees for and to pay them "Excess Advertising Contributions". The second claim relates to "Excess Order Processing Contributions". The third claim relates to "Product Rebates" – payments in the form of rebates, bonuses, discounts and other allowances that the franchisor received from suppliers on account of supplies sold to the franchisees. On May 23, 2012, Justice Strathy adjourned the motion, with leave to bring a motion to substitute a new representative plaintiff within 90 days failing which the motion for certification would be dismissed. As no motion was brought within the 90 day window, it appears that the case will likely be dismissed.

[18] *Zwaniga v. Revolution Food Technologies Inc. And Johnvince Foods Distribution L.P.*, 2012 ONSC 3848 ("*Zwaniga*"). On March 24, 2011, Thomson Rogers issued a national class action lawsuit on behalf of investors who allege to have been misled by food distributors. Claiming over $20 million in damages, the plaintiffs allege misrepresentations were made to investors including statements related to the income they could expect to receive from purchasing Revolution 650 vending machines. The claim also includes allegations that the defendants failed to comply with disclosure obligations pursuant to the *Arthur Wishart Act*. On September 28, 2011, Thomson Rogers issued a companion $20 million class action lawsuit against the directors of Revolution Food Technologies Inc. (suppliers of the vending machines) for their alleged legal responsibility as "franchisor's associates". The defendants' summary judgment motion is scheduled to be heard on September 10 and 11, 2012.

[19] *Quiznos Canada Restaurant Corporation v. 2038724 Ontario Ltd.* 2010 ONCA 466 at para. 62, leave to appeal to the S.C.C. dismissed by [2011] S.C.C.A. No. 348 ("*Quiznos C.A.*").

uncommon for parties to franchise agreements to go for the "quick buck" at the expense of the long-term viability of the franchise system.

Franchisee-franchisor relationships are characterized by a power imbalance in favour of the franchisor. Much of this imbalance can be attributed to the superior bargaining power of franchisors. Franchisors are typically large corporations with a comparatively vast amount of resources at their disposal and are experienced at opening franchised businesses. In contrast, franchisees are typically small business-people with limited resources who may be unsophisticated in terms of the issues surrounding the opening of a franchise.

Franchises are governed by franchise agreements which stipulate the terms of all aspects of the franchise relationship. These standard form contracts, also known as contracts of adhesion, are typically offered on a take-it-or-leave-it basis with little or no room for the franchisee to negotiate.[20] Due to the fact that franchise agreements are long-term agreements, they must necessarily confer a certain level of discretion on the parties to allocate future risks in order to adapt to changing conditions over time. Invariably it is the franchisor who reserves the right to exercise this discretion. For example, franchise agreements typically grant the franchisor broad discretion over whether to renew the agreement at the end of the term. A franchisor can effectively terminate a franchisee simply by waiting the contract out, even in the absence of a good business reason. Furthermore, franchise agreements typically confer upon the franchisor the discretion to control many of the franchisees' costs and methods of operation, e.g. setting the price for essential supplies.

While franchisor discretion is not inherently poisonous to the franchise relationship, it places the franchisee in a vulnerable position. Franchisees rely on the franchisor not to exercise its broad discretion in an unfair manner. The franchisees' business depends to a great extent on the fair and reasonable exercise of franchisor discretion.

Equally important are the practical realities inherent in franchise relationships which contribute to the power imbalance in favour of the franchisor. Franchisees simply have much more to lose in franchise agreements than franchisors do. For a franchisee, the loss of a franchise is devastating and can represent the loss of not only a significant investment but their family's sole source of income. For franchisors, while they clearly rely heavily on franchisees as a group for the continued success of their business, the loss of a single franchisee is a comparatively minor setback. In fact, in the event that a franchisee defaults, franchisors will often have an opportunity to buy back the franchisee's business, thereby significantly mitigating their losses.

Franchisees must maintain an ongoing relationship with their franchisors, which can make individual litigation problematic. Due to the high level of franchisor discretion and the power imbalance between the parties, it is difficult for franchisees to continue to operate a franchise in the spectre of ongoing litigation. This tension extends to the relationships between the franchisor and other franchisees, who may be hesitant to throw their support behind a plaintiff franchisee for fears of franchisor retaliation.

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[20] *Shelanu Inc. v. Print Three Franchising Corporation* (2003), 64 O.R. (3d) 533 (C.A.) ("*Shelanu*") at para. 58; *405341 Ontario Limited v. Midas Canada Inc.*, 2010 ONCA 478 at paras. 32-39, aff'g (2009), 64 B.L.R. (4th) 251 (S.C.J.) ("*Midas #2*") at para. 38.

Franchisors, for their part, are often understandably reluctant to maintain a business relationship with a franchisee who has openly expressed his or her deep dissatisfaction with the system. Other franchisees may similarly be upset over a fellow franchisee airing their grievances in open court, viewing it as an unwanted advertisement of the system's problems which hurts the value of their investments.

By proceeding as a class action, prospective class members may shelter under the representative plaintiff or a former franchisee who is no longer under the yoke of the franchisor. Since class proceedings require minimal involvement on the part of class members, it is possible for them to advance their claims while still maintaining an ongoing relationship with the franchisor.

D. The Nature of Typical Franchise Disputes that Give Rise to Class Proceedings

(i) Overcharging on the supply of goods or withholding of supplier rebates

The central issue in many franchise cases involves the alleged overcharging on the supply of goods or withholding of supplier rebates. Supply agreements often require franchisees to purchase most or all of their supplies from the franchisor or its designated suppliers at prices determined solely by the franchisor. This is an area of maximum vulnerability on the part of the franchisee and maximum discretion on the part of the franchisor. Perhaps unsurprisingly, this area of franchisor discretion lends itself to actual or perceived franchisor abuse and has been fertile ground for franchise class actions.

Cases where these types of claims were brought include:

- ***909787 Ontario Ltd. v. Bulk Barn Foods Ltd.***[21] The plaintiff alleged that the defendant franchisor was overcharging them for supplies. Although certified at first instance, the Divisional Court de-certified the case on appeal for the reason that the franchise agreements tied the price of supplies purchased by franchisees to the prevailing prices in the franchisee's region and therefore the allegedly overcharged prices were not common. For this reason, the court found, the individual issues in calculating damages would overwhelm the common ones.

- ***A&P***. The plaintiffs alleged that A&P withheld rebates owing to the franchisees contrary to its obligations under the franchise agreement.

- ***Sears.*** The plaintiffs alleged that Sears received secret rebates from its suppliers and did not pass them on to the franchisees under their franchise agreement.

- ***Quiznos.*** The plaintiffs alleged that Quiznos conspired to artificially inflate the price at which franchisees purchase certain required supplies.

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[21] *909787 Ontario Limited v. Bulk Barn Foods Ltd.* (2000), 2 C.P.C. (5th) 61 (Ont. Div. Ct.), rev'g (1999), 90 A.C.W.S. (3d) 352 (Ont. S.C.J.) [*Bulk Barn*] (Osler, Hoskin & Harcourt LLP acted for Bulk Barn Food Ltd., and Sotos LLP acted for 909787 Ontario Limited).

- ***Pet Valu.*** The plaintiffs alleged that Pet Valu breached its obligations to pass on to the franchisees volume-based rebates, allowances and discounts given by suppliers and manufacturers to Pet Valu or its affiliates.

- ***Panzerotto***. The plaintiffs alleged that *Panzerotto* breached its obligation to share with its franchisees "Product Rebates", that is, payments in the form of rebates, bonuses, discounts and other allowances that the franchisor received from suppliers on account of supplies sold to franchisees**.**

- ***Shoppers***. The plaintiffs alleged that *Shoppers* breached its obligation to share various rebates owing to the franchisees contrary to its obligations under the franchise agreement.

Different approaches have been taken to the question of overcharging on supplies over the years. In *Bulk Barn,* a pre-*Arthur Wishart Act* case, the plaintiffs framed their case as a straight breach of contract. In *Quiznos*, the plaintiffs pleaded breach of contract, breach of the price maintenance provisions under the *Competition Act* and breach of the statutory duty of fair dealing under the *Arthur Wishart Act*. The franchisees in *A&P* pleaded breach of contract and breach of the duty of fair dealing under the *Arthur Wishart Act*. In *Sears*, the plaintiff alleged that the defendant misrepresented rebates in the pre-contractual disclosure document and relied on the *Arthur Wishart Act* in support of its claim for breach of contract, breach of duty of good faith and unjust enrichment. At their core, however, each of these cases centred around pricing of supplies in tied selling arrangements.

(ii) Disclosure provisions of the Arthur Wishart Act

One of the principal obligations created by the *Arthur Wishart Act* is that franchisors must provide prospective franchisees with detailed disclosure documents setting out all material facts about the franchise system before the franchisees sign up or pay any money to the franchisor.[22] These disclosure documents must strictly adhere to the requirements of the *Arthur Wishart Act* and its associated regulation,[23] and must be sent to prospective franchisees at specific times.[24]

Trillium deals with the requirement to deliver a disclosure document to franchisees upon entering into a new agreement relating to the franchise. As discussed above, the representative plaintiff, Trillium Auto World, was one of 207 General Motors dealers terminated in connection with the 2009 auto-bailout. In agreeing to provide General Motors Canada Ltd. (GMCL) with bailout money, the Government required that GMCL undergo a significant downsizing of its dealership network. GMCL implemented this requirement by informing 240 of its dealers that their franchise agreements would not be renewed and offering each of the dealers a wind-down agreement (WDA) to carry them through the remainder of their term. GMCL presented the WDAs on the basis that if the dealers did not sign them then it would likely go bankrupt. GMCL

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22 *Arthur Wishart Act*, ss. 5-7.

23 O. Reg 581/00.

24 *Arthur Wishart Act*, s. 5(1).

gave the dealers six days or less to decide whether or not to sign the WDA. 207 of the dealers including Trillium signed the WDAs.

Trillium argued that the WDA was in fact a franchise agreement under the *Arthur Wishart Act*, and that GMCL failed to provide the franchisees with disclosure documents as required by the *Arthur Wishart Act*. Accordingly, Trillium sought a declaration that class members could rescind or cancel the WDA, and claimed damages for GMCL's failure to comply with the disclosure obligations under the *Arthur Wishart Act* in addition to claims based on breach of the duty of fair dealing and the right of association. In certifying the class action and finding that the allegations satisfied the reasonable cause of action test under s. 5(1)(a) of the CPA, Justice Strathy held: "[i]t does not strike me as unreasonable, or inconsistent with the statutory purpose, to suggest that GMCL had an obligation to make full and fair disclosure of all material facts known to it that might reasonably affect the franchisees' decision."[25] The decision was appealed to the Divisional Court, where the defendants CBB and General Motors were unsuccessful on all counts. The Court unanimously upheld the decision of the motion judge in certifying the class proceeding, and CBB's further appeal to the Ontario Court of Appeal was dismissed in August 2012.[26]

(iii) System Changes

Significant changes to a franchise system to the detriment of the franchisees can form the basis of a class action claim.

Midas #1 dealt with a system change claim. For many years, Midas supplied its franchisees with discounted house-brand automobile parts. Prior to 1981, the royalty charged by Midas was 5%. This royalty was increased in 1981 to 10% with a *quid pro quo* (though not contained in the franchise agreement) being a 14.5% discount to all Midas dealers on all products purchased from Midas. However, in 2003 Midas exited the manufacturing and distribution businesses altogether, instead establishing an arrangement whereby its franchisees could purchase product from a third party supplier. Although Midas changed its system in 2003, it continued to charge its franchisees a 10% royalty.

Midas' franchisees have asserted that these changes to the "Midas System" breached Midas' duties of good faith including its statutory duty of fair dealing contained in the *Arthur Wishart Act* and other similar provincial statutes regulating franchising in Canada.[27] They allege that at the time of the system change the dealers lost the benefit of the 14.5% discount and a consolidated purchasing network. The remedy claimed by the class members is the reduction of royalties to reflect the loss of a central component of the franchise system.

System change concerns are also at the heart of *Tim Hortons*. The plaintiff claims that the Tim Hortons franchisees have paid increased costs as a result of the conversion in 2002 from

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25 *Trillium* at para. 73.

26 *Trillium*, above at note 12. See also *Zwaniga*, above at note 18, where the plaintiffs amended their original statement of claim to add allegations that the defendants failed to comply with their disclosure obligations pursuant to the *Arthur Wishart Act*. The summary judgment motion for this case is scheduled to be heard on September 10 and 11, 2012.

27 *Franchises Act*, R.S.A. 2000, c. F-23; *Franchises Act*, R.S.P.E.I. 1988, c. F-14.1.

traditional baking to a flash frozen model, which requires the franchisees to purchase frozen products and finish them in special ovens (artfully coined the "Always Fresh" concept). The franchisees also allege that the franchisor imposed a lunch menu on them that was in breach of their licence agreements and that they lose money on the lunch menu because of unreasonably low margins. The franchisees claim breach of contract, unjust enrichment, breach of the *Arthur Wishart Act* and misrepresentation. The plaintiffs' motion to certify the proceeding as a class action on behalf of franchisees was dismissed and the defendants' motion for summary judgment granted. Justice Strathy stated that had he not dismissed the plaintiffs' claim in summary judgment, their claims would have met the test for certification subject to minor further submissions. An appeal has been brought to the Ontario Court of Appeal on some aspects of Justice Strathy's summary judgment decision and is being heard on October 30, 2012.[28]

(iv) Breach of contract and encroachment

In *Mont-Bleu Ford Inc. et al. v. Ford Motor Company of Canada, Limited*,[29] the plaintiff franchisees were certified as a class in a claim over breach of contract. The claim related to a change by Ford Motor Company of Canada ("Ford") in how it marketed vehicles in Canada. Ford started allowing dealers operating under its Mercury and Lincoln lines to offer Ford-brand vehicles as well. The result was that there were many more dealerships offering Ford vehicles than there were previously. This created increased intra-brand competition. The plaintiff franchisees argued that under their franchise agreements the Mercury and Lincoln dealers were "additional dealers" and Ford had breached an obligation to perform a market analysis to determine whether their geographic area could sustain the additional dealers. Ford admitted that it had performed no such market analysis. Although there was some dispute over whether a class proceeding was the preferable procedure for resolving the claim, the Divisional Court certified it and the case subsequently settled.[30]

(v) Misrepresentation cases

Common law misrepresentation has also formed the basis for a franchise class action. In *Rosedale Motors Inc. v. Petro-Canada Inc.*,[31] a pre-*Arthur Wishart Act* case, the plaintiff was a franchisee in the Certigard franchise system. The plaintiff alleged that the franchisor, Petro-Canada, had misrepresented the profitability of the proposed franchise. They argued that Petro-Canada's market research was performed inadequately and that incorrect conclusions were drawn from it. The motion judge declined to certify the lawsuit as a class action, holding that there was not a single representation made to the entire class but rather a number of individual representations made to each class member. From the motions judge's perspective, the issue of whether or not there was common law misrepresentation would have to be made on a case-by-

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[28] *Tim Hortons*, above at para 365.

[29] [2000] 95 A.C.W.S. (3d) 230 (S.J.C.), rev'd [2000] 48 O.R. (3d) 753 (Div. Ct.) ("*Mont-Bleu*").

[30] [2004] O.T.C. 279.

[31] [1998] O.J. No. 5461 (QL) (Gen. Div.), rev'd. [2001] O.J. No. 5368 (QL) (Div. Ct.) ("*Rosedale Motors*"). See also *Zwaniga*, above at note 18, where the plaintiffs brought a class action seeking damages relating to alleged misrepresentations to investors including regarding the incomes they could expect to receive from purchasing vending machines. The summary judgment motion for this case is scheduled to be heard on September 10 and 11, 2012.

case basis and therefore a class action was not the preferable vehicle. This decision was reversed on appeal to the Divisional Court. The Divisional Court held that there were enough significant common issues to certify the class, specifically: 1) whether Petro-Canada had a duty of care in relation to its research into the profitability of a franchise, and whether it had breached the standard of care; and 2) whether its representations were false and misleading. The Court held that resolution of those common issues would significantly advance the action. However, the Court noted that there were still some substantial issues regarding the misrepresentation that would need to be resolved on an individual basis.

It is worth noting that the facts that gave rise to *Rosedale Motors* took place before the introduction of the *Arthur Wishart Act* and relied on common law misrepresentation. Section 7 of the *Arthur Wishart Act* allows franchisees to claim damages for misrepresentations contained within the statutorily required pre-contractual disclosure document. Statutory misrepresentation cases under the *Arthur Wishart Act* more readily lend themselves to certification since they are all based on common disclosure or lack of disclosure, and reliance on faulty disclosure is deemed to exist under s. 7.[32]

E. The Test for Certification of Class Proceedings in the Franchise Context

Franchisees seeking certification of class proceedings face the same test set out in s. 5(1) of the CPA as all other plaintiffs in class actions. In particular, a representative franchisee plaintiff must show that:

> (a) the pleadings or the notice of application discloses a cause of action;
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> (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;
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> (c) the claims or defences of the class members raise common issues;
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> (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
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> (e) there is a representative plaintiff or defendant who,
>
> (i) would fairly and adequately represent the interests of the class,
>
> (ii) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and
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> (iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members. [33]

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[32] *Arthur Wishart Act*, s. 7(2).

[33] CPA, above, s. 5(1).

For the most part, courts have taken a favourable view to the compatibility of class proceedings and the issues typically raised in franchise disputes. Indeed, as indicated above, our courts have certified franchise class actions more often than not. However, though courts have frequently acknowledged that franchise disputes are well suited to class proceedings, Justice Strathy recently held that a thorough inquiry is needed in each case to determine whether a class proceeding is the appropriate avenue for resolving a claim, and that it is "wrong to simply say that because this is a franchise claim it is appropriate for class action."[34] Further, in *Tim Hortons*, Justice Strathy, when considering the preferable procedure part of the test for certification under the CPA and after identifying the number of franchise disputes that have been found suitable for certification, stated:

> This is not to say that a class action will be the preferable procedure for the resolution of every franchise case.[35]

In applying the test for certification in the franchise context, courts have necessarily taken into account considerations that arise in light of the unique relationship between franchisee and franchisor. The franchise certification cases referred to above have considered the special circumstances of franchise disputes in light of each one of the prongs of the test in the CPA. The two elements of the certification analysis that have received the greatest degree of attention in the franchise certification decisions are "common issues" (s. 5(1)(c)) and "preferable procedure" (s. 5(1)(d)) requirements. Each of these stages of the test is discussed in turn.

Common Issues

(i) Factors to consider in the "common issues" analysis

In franchise litigation, typically all class members are or were parties to a franchise agreement that is identical in many or all respects that are material to the litigation. This is an obvious and important factor in considering whether the issues raised by the action are common. As the Divisional Court found in *Quiznos*, while each franchisee may have suffered different damages, the conduct giving rise to liability was "systemic." According to the Court, "every franchisee is subject to the same contract, pricing structure and distribution."[36] In *A&P*, the court found the franchisor's argument that there were numerous individual issues unpersuasive, holding that "although there are 70 Franchise Agreements at issue, each is a standard form contract, identical in all material respects to each other agreement."[37] Similarly, in *Trillium*, Justice Strathy stated:

> A typical franchise relationship involves a common contract, a common "system" and common treatment of franchisees by the franchisor. These attributes may give rise to common issues that can be decided without reference to the individual circumstances

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[34] *Pet Valu*, above at para. 104.

[35] *Tim Hortons*, above at para. 352

[36] *Quiznos Div. Ct.*, above at para. 49.

[37] *A&P*, above at para. 37.

> of the franchisee, thereby making the proceeding particularly suitable as a class action.[38]

Justice Strathy referred to these comments in *Tim Hortons* and stated:

> The intersection of the *C.P.A* and the *Arthur Wishart Act* has provided a fertile ground for the growth of franchise class actions. . . . The existence of a group of franchisees, operating under a standard contract, can give rise to common issues of fact or law that are capable of resolution on a class-wide basis. The *C.P.A.* has proven to be an effective procedural tool to address concerns that individual franchisees are powerless, vulnerable and lack an effective voice. [39]

Moreover, franchise contracts typically adopt the law of a single jurisdiction. Where, for instance, parties to a franchise agreement adopt the law of Ontario, they are subject to the relationship provisions of the *Arthur Wishart Act*, including the duty of fair dealing under Section 3 and the right of association under Section 4, regardless of where the franchisee carries on business.

Each of the following common issues involves questions of fact and law that would have to be proven by any individual member of the class asserting a claim. Each has been found to be suitable for certification in previous franchise certification motions:

(a) breach of a common franchise agreement in relation to the supply of products to franchisees;[40]

(b) failure of a franchisor to pass on supplier rebates and allowances;[41]

(c) breach of the common law contractual duty of good faith in relation to the supply of products by a franchisor;[42]

(d) breach of the statutory duty of fair dealing under the *Arthur Wishart Act* in relation to the prices charged on supplies;[43]

(e) breach of the statutory duty of fair dealing under the *Arthur Wishart Act* in relation to the failure of the franchisor to disclose or pass-on rebates from suppliers;[44]

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38 *Trillium*, above at para. 57.

39 *Tim Hortons*, above at para. 205

40 *A&P*, *Quiznos C.A.* and *Tim Hortons*, above.

41 *A&P* and *Pet Valu*, above.

42 *A&P*, *Quiznos C.A.*, and *Tim Hortons*, above.

43 *A&P* and *Pet Valu*, above.

(f) breach of the statutory duty of fair dealing under the *Arthur Wishart Act* in relation to the amount of time provided to the plaintiffs' to accept a reject a "wind down" offer from the defendant;[45]

(g) whether a Franchise Agreement imposes a common law duty on a franchisor to charge commercially reasonable prices and whether such duty has been breached;[46]

(h) whether conduct by a franchisor in relation to the distribution of products to franchisees can give rise to unjust enrichment;[47]

(i) whether damages relating to overcharging on supplies and improper withholding of supplier monies can be determined in the aggregate;[48] and

(j) whether a duty was owed to a network of dealers to adjust the compensation paid to the dealers;[49]

(k) whether a corporation breached the plaintiffs' right of association under s. 4 of the *Arthur Wishart Act*.[50]

Cases in which the determination of the common issues will leave few, if any, individual inquiries to be undertaken are ideally suited for class treatment.[51] For example, in circumstances where the proposed representative plaintiff seeks an interlocutory and permanent mandatory order requiring compliance by the franchisor with its obligations under the franchise agreement and where that relief would be common to all franchisees, that would be a factor in favour of certification.[52]

Not all proceedings in the franchise context raise common issues, however, even if the claims involve standard form agreements. The analysis is necessarily fact driven. In *Bulk Barn*, the high level of individuality among franchise claims proved a bar to certification. Although the case was certified at first instance, certification was overturned on appeal. The plaintiff alleged that the franchisor, Bulk Barn, had breached its standard form franchise agreement, which contained a provision stating that supplies to franchisees would be priced at a level "generally

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44 *Sears*, above and *Pet Valu*, above.

45 *Trillium*, above.

46 *Quiznos CA.*, above.

47 *Midas #1*, above.

48 *A&P* and *Quiznos C.A.*, above.

49 *Mayotte*, above.

50 *Trillium*, above.

51 *Cassano*, above.

52 *Quiznos Div. Ct.*, above.

charged or realized by other competitive suppliers in the general market area."[53] The appellate court had particular difficulty in seeing commonality amongst franchisees, all of whom were from different general market areas:

> The network of stores as has been noted is spread out over a substantially large geographical area in Canada. The wording of the contract ties the whole question of comparable price to those "generally charged or realized by other competitive suppliers in the general market area or region in which the franchise business is located." There was no evidence before the court and certainly no reason to expect that local prices would be the same in St. John, New Brunswick as they would in Sarnia, Ontario or for that matter within a large heavily populated area such as the Greater Toronto area or the Hamilton/Burlington area. The possible differences in each locale raise the very distinct possibility that there are no common issues which can be manageably tried together and which will advance the litigation. [54]

It is important to note, however, that the force of the ruling in *Bulk Barn* has likely been diminished by the Supreme Court of Canada's decision in *Hollick* which emphasized the "low bar" for certification.[55] Further, the record in *Bulk Barn* was of a very different nature than what has been commonly found in the cases that have followed *Hollick*. Finally, leave to appeal the Divisional Court's decision to the Ontario Court of Appeal was granted, but the action settled prior to the hearing.

The fact that damages cannot be determined without individual inquiries is not a bar to certification. For example, in certifying common issues relating to the assessment of damages in the *Sears* decision, Justice Strathy held that "while individual assessments may be required, the determination of a common method of assessment will advance the claim of every class member."[56] Justice Strathy took a similar position in *Trillium*, where he held that even if "damages have to be dealt with individually, the task will not be insurmountable."[57] Further, in *A&P*, Justice Winkler (as he then was) held on the certification motion:

> Although *A&P* argues that there are substantial individual inquiries necessary to determine individual entitlement, if the plaintiffs are successful in proving their allegation that Rebates have been wrongfully withheld, the distribution process is but a matter of accounting.[58]

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53 *Bulk Barn.*, at para. 5.

54 *Id.*, at para. 25.

55 *Hollick v. Toronto (City)*, [2001] 3 S.C.R. 158.

56 *Sears*, above at para. 50.

57 *Trillium*, above at para. 120.

58 *A&P*, above at paras. 37 and 52.

(ii) The determination of damages as a common issue

Generally speaking, in franchise litigation involving systemic or system-wide issues, common issues relating to damages are likely more readily determined in the aggregate and therefore more likely to be certified. This is particularly true where damages can be calculated on a straightforward basis or are capable of proof with resort to the records of the franchisor.[59] By contrast, determinations of damages arising from misrepresentations and breaches of contract are less likely to be certified as common issues.[60]

It is also important to note that a franchisee's individual profitability is irrelevant to the common issues analysis. In deciding a refusals motion in the context of the *A&P* litigation, the court specifically found that the franchisees' profit was not relevant to a claim against their franchisor where it withheld supplier rebates and allowances:

> I do not regard the level of profit made by the plaintiffs to be relevant to the common issues. In the counterclaim, A&P claims it has overpaid members of the class and claims the plaintiffs have benefited from largesse by A&P. The finances of the plaintiffs are relevant to the counterclaim but I do not agree there is relevance to the profits made by each franchisee in the common issues phase of the trial.[61]

Preferable Procedure

The CPA is remedial legislation. It is to be construed generously to give full effect to the benefits foreseen by its drafters, particularly at the certification stage. Its three procedural goals of judicial economy, access to justice and behaviour modification are intended to ensure the just and expeditious resolution of large, complex cases.[62] In light of this, the Supreme Court of Canada has emphasized that "preferable" is to be construed broadly and is meant to capture two ideas: first, whether or not a class proceeding would be a fair, efficient and manageable method of advancing the claim; and second, whether a class proceeding would be preferable in the sense of preferable to other procedures such as joinder, test cases, consolidation, etc.[63] The question in

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59 *Quiznos Div. Ct.*, above.

60 In *Caponi v. Canada Life Assurance Co.* (2009), 72 C.P.C. (6th) 331 at para. 41 (Ont. S.C.J.), the Ontario Superior Court of Justice refused to allow the application of section 24(1) of the CPA. The plaintiff alleged that the defendant's wind-up of a supplemental pension plan was a breach of contract. In holding that damages could not be calculated in the aggregate, M.C. Cullity J. stated: "I am not satisfied from the evidence that a determination of the aggregate liability to the Class members could be effected without calculating the loss suffered by each member. In consequence, it appears that the precondition to an aggregate assessment in section 24(1)(c) would not be satisfied."

61 *1176560 Ontario Ltd. v. Great Atlantic & Pacific Co. of Canada*, [2003] O.J. No. 5703 at paras. 27-32 (S.C.J. Master).

62 *Hollick*, above at paras. 14-16.

63 *Id.*, at para. 28.

the preferability analysis is not whether there should be any litigation at all, but whether or not a class proceeding is the preferable procedure for resolving the dispute.[64]

Class actions relating to allegations of system-wide breaches by a franchisor have been found to be ideally suited to the overriding objectives of the CPA.[65] As stated above, the Ontario Court of Appeal has recently found that such cases are "exactly the kind of case for a class proceeding."[66] Further, in the *Sears* decision, Justice Strathy highlighted the inequality between the franchisor and the franchisees as a key consideration in determining that a class proceeding was the preferable procedure:

> In view of the power imbalance between the franchisor and the franchisees, the very concern that the [*Arthur Wishart Act*] was designed to address, there is a significant impediment to access to justice by way of individual action, particularly where some of the franchisees remain a part of the Sears system.[67]

Indeed, courts have repeatedly referred to the apparent "vulnerability" of franchisees in their consideration of the preferable procedure requirement. In particular, courts have held that this power imbalance makes class actions – as opposed to individual court proceedings brought by franchisees on their own – the preferred vehicle for franchisees to advance claims against franchisors.[68] For example, in the *A&P* case, Justice Winkler (as he then was) stated that franchisees "are exactly the type of plaintiffs that may be required to prosecute a class action lawsuit in the context of a franchise relationship, with the inherent vulnerability in the dependent ongoing nature of the relationship between franchisor and franchisee."[69] Similarly, in *Trillium*, Justice Strathy wrote:

> It is not realistic to think that an individual franchisee, who has experienced the loss of their business, is financially or psychologically equipped to engage in protracted, complicated and very expensive litigation with one of the largest corporations in North America and a major Canadian law firm.[70]

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64 *A&P*, above at para. 45.

65 *A&P*, above at paras. 51-58; *Midas #1*, above at paras. 80-82; *Mont-Bleu* at para. 16; *Quiznos Div. Ct.*, above at paras. 141-144; *Quiznos C.A.*, above at para. 62.

66 *Quiznos C.A.*, above at para. 62.

67 *Sears*, above at para. 68.

68 See, however, *Tim Hortons*, above at para. 352, where Justice Strathy noted the fact that a number of franchise disputes have been found to be suitable for certification does not mean that a class action will be the preferable procedure for the resolution of every franchise case.

69 *A&P*, above at para. 41.

70 *Trillium*, above at para. 161. The defendants appealed the certification decision to the Divisional Court, but were unsuccessful on all counts. The Court unanimously upheld the decision of the motion judge in certifying the class proceeding. CBB's further appeal to the Ontario Court of Appeal was dismissed in August 2012.

The so-called "behaviour modification" objective arises frequently in the context of the preferability inquiry in franchise class action litigation. In *Quiznos*, for example, the Divisional Court noted that the motion judge characterized the relationship between the franchisees and franchisor as acrimonious, and that the efforts of franchisees to bring their concerns to Quiznos' attention were "thwarted with threats and intimidation."[71] Similarly, the court in *A&P* found evidence that A&P had "consistently failed to produce proper records to the franchisees despite repeated requests and A&P's obligations to do so in accordance with its duty of utmost good faith as franchisor." In the *A&P* decision, Justice Winkler (as he then was) went on to comment on various tactics deployed by the franchisor to prevent a class action, both in the context of the behaviour modification consideration under the *CPA* and the duty of utmost good faith owed by a franchisor to its franchisees:

> Here there are allegations of misconduct of A&P that if proven, would entitle the class members to a recovery. Moreover, there is evidence that A&P has consistently failed to produce proper records to the franchisees despite repeated requests and A&P's obligations to do so in accordance with its duty of utmost good faith as franchisor. The litigation plan proposed by the plaintiffs coupled with the availability, and suitability, of an aggregate assessment should they be successful in their claims, augur in favour of a conclusion that a class proceeding could achieve behavioural correction.[72]

F. Benefits of Class Proceedings from the Franchisee Perspective

Class proceedings are beneficial for franchisees for many of the typical reasons that class actions are beneficial. For instance, claims which cannot be viably litigated on the individual level (due to the fact that the costs of litigation grossly outweigh the amounts at issue) can become viable when litigated on a class-wide basis. This allows the representative plaintiff to pursue their claim more effectively, since they will enjoy much greater leverage with a class behind them and they will have an easier time finding a law firm to represent them on a contingency basis.

In the franchising context specifically, class proceedings are particularly beneficial for franchisees other than the representative plaintiff, who might otherwise not get the opportunity to raise their claims at all. Unlike typical consumer product or mass tort class actions, class members in franchise class actions must maintain an ongoing relationship with the defendant throughout the course of litigation. Class proceedings help to maintain these relationships. Litigation is a divisive process and can sometimes result in the loss of the franchise by the representative plaintiff. The rest of the class, however, can often shelter under the representative plaintiff and avoid adverse consequences. Class members do not need to do anything to take part

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[71] *Quiznos Div. Ct.*, above at para. 72.

[72] *A&P*, above at para. 58.

in a class proceeding, but can potentially reap the benefits if the common issues are decided in their favour.[73]

The supervisory powers of the court under s. 12 of the CPA can further deter a franchisor from taking matters into its own hands during the course of the lawsuit, as was seen in *A&P* (discussed below). Section 12 grants courts the power to impose such terms on the parties as it considers appropriate to ensure the fair and expeditious determination of the class proceeding. This section can be added assurance for class members that they will not be the subject of franchisor retribution, and therefore serves as a further benefit of class proceedings from the franchisee perspective.

G. Nipping Class Proceedings in the Bud – The Availability of Summary Judgment

While the common features of a franchise agreement may work to a franchisor's detriment in resisting class action certification, amendments made to Ontario's summary judgment rule, which came into effect in January 2010, provide more options to franchisors. Among the most notable changes to the Ontario summary judgment regime from the point of view of a franchisor is the provision that a judge may weigh evidence, evaluate the credibility of a deponent or draw any reasonable inference from the evidence when determining whether a genuine issue requiring a trial exists. Under the new rule, a motions judge may direct a "mini-trial" on a discrete issue where the interests of justice require oral evidence in order to dispose of the motion. This amendment overrules jurisprudence that prevented motions judges from making evidentiary determinations on a motion for summary judgment, and allows franchisors the ability to contest factual issues arising from the plaintiffs' claims at a preliminary hearing.[74]

Suncor was the first franchisor to avail itself of the new summary judgment rules – with great success – before the Ontario Superior Court of Justice.[75] In the *Suncor* case, the plaintiff commenced a proposed class proceeding on behalf of 241 Sunoco gas station franchisees, who alleged that the defendant Suncor had failed to deliver a disclosure document in breach of its obligations under the *Arthur Wishart Act*. Both the plaintiff franchisee and Suncor agreed to proceed by way of summary judgment. The plaintiff argued that Suncor was required to deliver a disclosure document, while Suncor relied on s. 5(7)(g)(ii) of the *Arthur Wishart Act* and argued that a disclosure statement was not required because "the franchise agreement is not valid for longer than one year" and the franchise agreement "does not involve the payment of a non-refundable franchise fee."[76] Justice Perell ruled in favour of Suncor, holding that Suncor was not required to pay claimed damages of $200 million due to an alleged failure to deliver a disclosure document to franchisees.[77]

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[73] While franchisees will be included in a class proceeding by default, they may opt out of the proceeding under s. 9 of the CPA.

[74] Note that five appellate decisions were concurrently released from the Ontario Court of Appeal which provided guidance to clarify the scope and application of the new summary judgment rule. See *Combined Air v. Flesch*, 2011 ONCA 764.

[75] *Suncor*, above at note 14.

[76] *Suncor*, above at para. 2.

[77] *Suncor*, above at note 14.

A more recent example of a franchisor using the new summary judgment rules with great success is the *Tim Hortons* case. Justice Strathy dismissed a $2 billion dollar franchise and competition class action against Tim Hortons which alleged Tim Hortons had made system changes which cut into the profits of their franchisees. The plaintiffs alleged breaches of express and implied terms of the franchise agreement, a breach of the duty of faith and fair dealing both at common law and under Ontario's *Arthur Wishart Act*, unjust enrichment, and a breach of the *Competition Act* price maintenance and conspiracy provisions. Dismissing these claims, Justice Strathy rejected arguments that the franchisor had breached any of the above, and characterized the franchisees claim as one not for any profit they were owed under the franchise agreement, but for a bigger piece of the pie. Aspects of this summary judgment decision are being appealed by the plaintiffs to the Court of Appeal on October 30, 2012.

Though the obvious benefit of summary judgment is that the plaintiffs' claim is stopped in its tracks at an early stage, there are other appealing aspects to pursuing the summary judgment avenue from both franchisors' and franchisees' perspectives. In particular, a judgment or dismissal arising from summary judgment can be obtained much more quickly than the usual amount of time required to litigate typical class proceedings through to settlement or disposition by the courts. In *Suncor*, it took less than one year from the launch of the claim to obtain summary judgment. This timeline stands in stark contrast to the snail's pace established in most franchise class actions.[78]

In *Tim Hortons*, Justice Strathy heard the certification motion and the motion for summary judgment at the same time. Whether other franchisors will be able to have a motion for summary judgment heard before or at the same time as certification is uncertain given Justice Strathy's comments on this procedure and the resulting substantial record.[79]

H. Avenues for Avoiding Class Proceedings Altogether

As discussed above, class proceedings are often viewed as the most effective means of empowering franchisees and levelling the playing field against more sophisticated and well-funded franchisors. However, litigation – whether in the form of class actions or otherwise – ought to be viewed by both franchisors and franchisees as a last resort for resolving disputes. Given the extraordinary costs of complex litigation, and the tremendous toll exacted on the relationship between franchisees and the franchisor that arises from litigation, it makes sense for both franchisors and franchisees to turn their minds to preventing issues from escalating to litigation.

One important preventative measure is to ensure that the lines of communication between franchisor and franchisee remain open. An effective way to achieve this is to establish and encourage franchisees to communicate among themselves and with franchisors through franchisee associations. A second and more controversial approach to avoiding class litigation is to include in the franchise agreement a specific provision requiring disputes to be resolved

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[78] In the *Quiznos* case, above, the claim was commenced in May of 2006 and did not proceed to certification until March of 2008. By contrast, note the relative expediency with which the parties and court dealt with certification in *Pet Valu*, above, where the claim was commenced in December of 2009 and the certification hearing took place in October, 2010.

[79] *Tim Hortons*, above at paras. 367-369.

through private arbitration rather than through class proceedings. Both of these preventative measures are discussed below.

Franchise Associations

Franchisor management constantly debate among themselves and with their legal counsel the extent to which franchisees should be involved in what is typically seen to be the business of the franchisor. It is the franchisor who typically reserves for itself the right to establish and make changes to its franchise system. Yet it is often recognized that franchisee input regarding the franchise system can have various degrees of value. Whether that value should be crystallized into a right of the franchisee to participate in decision making affecting the franchise system is a matter that each franchisor must consider in the establishment and development of its franchise system.

The choices a franchisor makes in designing this aspect of its franchise system have a significant impact on how issues are ultimately addressed when those issues might affect more than one franchisee. Franchise systems are inherently well positioned to prevent franchise litigation, given that franchising represents a form of relationship that usually involves constant communication between a franchisor and its franchisees, individually and collectively. This is particularly true if litigation is properly viewed as a last resort for resolving issues between a franchisor and its franchisees. All parties have the ability to determine the effectiveness of their relationship in this regard, and within a context where the law imposes an overriding duty on those parties to carry out their contractual obligations in good faith.

Franchise systems usually include mechanisms for the distribution of information as between a franchisor and its franchisees, both individually and collectively. The ability to inform one another can provide a valuable tool in the prevention or resolution of misunderstandings or disputes outside of any legal process.

Arbitration Clauses in Franchise Agreements

A common feature of many franchise agreements is the so-called "arbitration clause", which effectively provides that any disputes arising in respect of alleged breaches of the franchise agreement are to be resolved through arbitration, rather than through court proceedings (including class proceedings). While these provisions offer many theoretical benefits to franchisors, arbitration may not always be the preferred avenue for dispute resolution. In any event, recent case law suggests that arbitration clauses may be ineffective in preventing franchisees from banding together and initiating class proceedings against franchisors.

The theoretical advantages of arbitration clauses are numerous, particularly from the perspective of the franchisor. First, arbitrations are private proceedings, and documents produced, arguments advanced and decisions rendered through arbitration are typically confidential. Keeping the prying eyes of the public at bay – particularly in high profile disputes – is clearly appealing to franchisors. Second, arbitration offers the parties increased flexibility and greater speed in resolving disputes. Rather than having to navigate the complex procedural rules that apply to court actions, parties to arbitration can efficiently appoint an arbitrator to oversee proceedings, and can tailor the rules governing the arbitration as required. Finally, arbitration clauses have been seen as a means for franchisors to bar franchisees from banding together and commencing class actions.

However, the practical reality is that the utility of arbitration clauses is limited from the franchisor's point of view. While there is no doubt that arbitrations do provide a greater level of privacy to franchisors, they may not allow for complete confidentiality. Franchisors have an obligation to publicize the fact and nature of litigation in disclosure documents required under the *Arthur Wishart Act*, though it is not entirely clear whether disclosure of a pending arbitration – as opposed to a pending civil action before the courts – is required.[80] In any event, depending on the issue(s) in dispute, the existence of arbitration and any arbitration award would likely be considered to be a "material fact" that must be disclosed to prospective franchisees in accordance with s. 5 of the *Arthur Wishart Act*. Similarly, an arbitration is no less expensive than litigation before the courts, and a franchisor may not always view the relative speed of arbitration as beneficial, particularly if it has a weak defence to the franchisee's claim.

Moreover, it increasingly appears as though the courts will allow franchisees to bring class proceedings even in the face of arbitration clauses, potentially eliminating one of the provision's principal benefits to franchisors. In particular, franchisors must be wary of the potential impact of the Supreme Court of Canada's recent decision in *Seidel v. Telus Communications Inc.*, in which the Court considered whether a mandatory arbitration clause in the appellant's consumer contract with Telus meant that the appellant could not proceed with a class action against Telus.[81] Despite the existence of the arbitration clause, Seidel commenced a class action against Telus on behalf of a proposed class of customers, alleging that Telus unlawfully charged her for time that her phone was not actually connected to its cellular network. Seidel argued that Telus engaged in deceptive business practices in violation of various provisions of the *Business Practices and Consumer Protection Act* (the "BPCPA").[82] In particular, the BPCPA provided that an affected party may bring a proceeding before the B.C. Supreme Court,[83]and that any agreement between the parties that would waive or release "rights, benefits or protections" conferred by the BPCPA was "void".[84] In ruling that the arbitration provision in the consumer contract could not prevent the plaintiff from commencing a class action, the Court held that arbitration clauses are generally enforceable, though they cannot override "legislative language to the contrary".[85] Such language clearly existed in the BPCPA.

This decision is particularly significant when viewed in the light of certain provisions of the *Arthur Wishart Act* and other recent Ontario jurisprudence in the franchise context. It is worth noting that while the BPCPA specifically provides that an affected party may bring his or her complaint before the B.C. Supreme Court, the *Arthur Wishart Act* contains no comparable

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[80] See s. 5 of O. Reg. 581/00 to the *Arthur Wishart Act*, which requires the franchisor to include in its disclosure document "[a] statement, including a description of details, indicating whether the franchisor, the franchisor's associate or a director, general partner or officer of the franchisor has been found liable in a civil action of misrepresentation, unfair or deceptive business practices or violating a law that regulates franchises or businesses, including a failure to provide proper disclosure to a franchisee, or if a civil action involving such allegations is pending against the person."

[81] 2011 SCC 15 ("*Telus*").

[82] S.B.C. 2004, c. 2.

[83] *Id.*, s. 172.

[84] *Id.*, s. 3.

[85] *Id.*, at para. 42.

language in respect of the Ontario Superior Court of Justice. Nevertheless, there may be another source of "legislative language to the contrary" in the *Arthur Wishart Act*. In particular, subsection 4(1) of the *Arthur Wishart Act* affords franchisees in Ontario the right to associate. Further, subsection 4(2) of that Act provides that this right cannot be interfered with, prohibited or restricted by contract or otherwise. Indeed, under subsection 4(4) of the *Arthur Wishart Act*, any provision in a franchise agreement or any other agreement relating to a franchise which purports to interfere with, prohibit or restrict a franchisee from exercising the right to associate is void. A franchisee may attempt to rely on *Telus* for the proposition that a provision in its franchise agreement requiring the franchisee to arbitrate any disputes interferes with its right to associate, and is therefore void.

This argument may be particularly compelling given the Ontario Court of Appeal's decision in *Midas #2*. In that decision, the Court of Appeal considered whether a provision in Midas' franchise agreement requiring franchisees to release Midas from liability as a condition for the renewal or transfer of their rights under the Agreement was void, partly on the basis that it contravened the franchisees' right of association under s. 4 of the *Arthur Wishart Act*. The Court of Appeal agreed with the motion judge that the right of association in s. 4 of the *Arthur Wishart Act* encompasses the right of franchisees to participate in a class action.[86] In reaching its decision, the Court held that Midas was "relying on a term of the franchise agreement - a standard form contract of adhesion - to defeat the rights its franchisees would otherwise have under the [*Arthur Wishart Act*]."[87]

It is possible that a creative franchisor could craft an arbitration clause in its franchise agreement that would provide for group or class arbitration. Though the concept of class arbitration has not been considered by our courts, such a provision would theoretically address concerns relating to the franchisor's interference with the franchisees' right to associate under the *Arthur Wishart Act*. As outlined above, unlike the BPCPA, the *Arthur Wishart Act* does not specifically grant the right for affected parties to bring their disputes before the court. Nevertheless, such a provision raises a host of complex legal issues – including the ability of a private arbitrator to preside over a complicated class proceeding in which the rights of non-parties are affected – and is outside the scope of this paper.

From the franchisee perspective, arbitration clauses have some clear disadvantages. Individual arbitration proceedings lack the leverage and power-balancing tendencies of collective litigation. As with individual litigation, the relatively small amounts of money in play can serve as a disincentive for franchisors to give any ground. Furthermore, although arbitration is arguably cheaper and less procedurally demanding than court proceedings, it is by no means cheap or easy. In most cases the parties will still need to hire lawyers, and there may be fewer procedural safeguards in place to ensure fairness throughout the process. Generally it will be the franchisor who selects the arbitrator, possibly even necessitating travel to foreign jurisdictions.[88] When parties operate at a significant power imbalance (as in the franchisor-franchisee situation), it is rarely advantageous for the weaker party to proceed through arbitration.

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86 *Midas #2*.

87 *Id.*, at para. 38.

88 Although such a provision would be void under s. 10 of the *Arthur Wishart Act*, which requires Arthur Wishart Act claims to be heard in Ontario.

I. Settlement of Class Proceedings

A common strategy for franchisors facing a motion for certification is to approach franchisees and bargain with them individually in an attempt to whittle down the class.

A&P[89] offers a cautionary tale on the pitfalls of such a strategy. The proposed class representatives were franchisees in a grocery store chain operated by defendants, A&P. They alleged that A&P violated the franchisees' rights under their franchise agreements by withholding certain rebates which were owed to the franchisees. In response to the lawsuit, A&P threatened to counterclaim against each individual class member if the certification was granted, on the basis that it was actually *over*paying on the rebates.

Concurrent with the motion for certification, the plaintiffs moved for extraordinary relief under ss. 12 and 19 of the CPA. They alleged that A&P had attempted to undermine the class action by intimidating the proposed class members. Evidence was adduced that A&P had:

- monitored the franchisees' payments to their lawyers in respect of the proceedings, thereby misusing the information that they had obtained in their role as the stores' accountant;
- forced prospective class members to either sign releases with respect to the proceeding or face rent increases;
- sent each class member their statement of defence and counterclaim without including the plaintiff's corresponding reply and defence to the counterclaim; and
- asked all franchisees to execute new franchise agreements which included a release in favour of A&P from the claims asserted in the lawsuit.

The court found that A&P had intended to defeat the certification motion by improperly interfering with the certification motion. Winkler J. ordered that A&P be limited in its communications with the franchisees during the opt-out period to only essential business as contemplated in the franchise agreements.

The *A&P* decision indicates that courts will not stand idly by while defendant franchisors pressure individual class members into executing releases or opting out of class actions in order to undermine the certification process.[90] As the court stated,

> The conduct evident in the action to date underscores the need for the court to maintain close supervision over class proceedings,

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89 *A&P*, above.

90 See also a recent decision of the Ontario Superior Court in *1250264 Ontario Inc. v. Pet Valu Canada Inc.*, 2012 ONSC 4317, which indicates that not only will courts not stand idly by while defendant *franchisor*s pressure individual class members into executing releases, a court will also exercise its discretion to over-turn an opt-out process where prejudice comes from an independent franchisee association. In *Pet Valu*, Justice Strathy overturned a completed opt-out process due to the actions of an independent franchisee association actively working to influence Pet Valu franchisees to opt-out of the class proceeding. While there was some indication that this franchisee association had ties to the franchisor, the franchisor itself had not interfered with the opt-out process and was on the record as telling its franchisees their participation in the class proceeding would not affect the ongoing business relationship.

> even in the pre-certification stages. More importantly the court is, and must remain, the proper arena for disputes between litigants in a class proceeding. Certification motions are not decided by polls among the class. The battle cannot be taken to the individual class members. Conduct aimed at pitting one member of the class against another cannot be condoned. While legitimate defence tactics are acceptable in class proceedings, this court will not permit defendants to undermine the process in the pre-certification period in an effort to bring an end to the class proceeding.[91]

The issue of whether defendant franchisors can enter into settlement agreements with individual class members was recently considered by the Ontario Superior Court of Justice in a motion within the *Pet Valu* proceeding, after it had been certified as a class action.[92] The motion arose as a result of transactions between the franchisor and certain franchisees, in which Pet Valu "bought back" the franchisees' franchises in exchange for a sum of money and, among other things, a release of all claims, including those claims in the class action. The representative plaintiff argued that such release ought to be unenforceable. The Court agreed for a number of reasons, including that none of the franchisees who had signed the releases were before the court and that those franchisees would have the option of opting out of the class proceeding in the future.

In making its ruling, the Court distinguished the recent decision in *Berry v. Pulley*,[93] which was not a franchise case, but rather concerned a labour dispute between two groups of pilots from Air Canada and Air Ontario. The lawsuit was certified as a class proceeding in 2001, but with an interesting twist: there were multiple subclasses of defendants. The fight in *Berry* erupted when the plaintiff submitted an offer to settle to only two of the seven subclasses of Air Canada pilots. The question before the Court was: could the plaintiff make an offer to settle with only *some* of the defendants in an apparent attempt to whittle the class of defendants down to a smaller size? Justice Perell held that they could not. Offers to settle must be made to an entire class or not at all.

In distinguishing the decision in *Berry*, the *Pet Valu* court stated that,

> In [*Berry*], the offer was made directly to all members of two subclasses, excluding the class representatives. Moreover, the offer was to settle the claims made in the action. In this case, the offer is being made, at least at the present time, to a fraction of the class, it is an offer to settle all commercial issues between the franchisor and the particular franchisee, including the franchisee's entitlement to recovery in the class action. As I have said, on the present state of the record, there is no evidence that the offer is being made for the purposes of undermining the class action. On the contrary, it is

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91 *A&P*, above at para. 93.

92 2011 ONSC 3871 (Sotos LLP acted for 1250264 Ontario Inc.).

93 2011 ONSC 1378 ("*Berry*").

> being made for legitimate business reasons that benefit both parties.[94]

Indeed, the Court left open the possibility that releases executed by individual class members could be appropriate if they were given in the right circumstances:

> In *Berry v. Pulley*, Perell J. was not addressing the situation of a single class member who, for compelling personal or financial reasons that were unrelated to the class action, wanted to settle with the defendant and to waive his or her entitlement to participate in the class action. [...] A case might be made, in such circumstances, that an individual class member should be permitted to settle individually with the opposing party, if the court is satisfied that there is no unfairness to the individual or to the class at large and no threat to the integrity of the class proceeding.[95]

J. Practical Considerations for Franchisor and Franchisee Counsel

From the point of view of franchisors facing class proceedings, a typical approach is to individualize as many of the issues in dispute as possible with a view to avoiding certification or severing the group claim. It is common for franchisor counsel to employ a "divide and conquer" campaign in the hopes of destroying or at least weakening the group dynamic. However, now that the Court of Appeal in *Midas* has recognized that section 4 of the *Arthur Wishart Act* extends to the right to commence a class action, attempts by a franchisor to interfere with a class or group proceeding could very well expose a franchisor to a claim for damages under subsection 4(5) of the *Arthur Wishart Act*. Of course, as mentioned earlier, just because franchisees have the statutory right to associate that extends to the right to bring a class action does not mean that every franchise class action should be certified. Again, the test for certification under the *CPA* must be satisfied, and any group action by franchisees must be properly joined within the requirements of provincial rules of civil procedure.

Similarly, in light of the Court of Appeal's statement in *Quiznos* regarding the suitability of class proceedings for the resolution of franchise disputes, franchisors would do well to narrow their resistance to certification to those issues for which they feel their positions are strongest. Though every case is different, a franchisor should carefully evaluate its strengths and weaknesses for the certification hearing and define its approach accordingly, rather than expend tremendous resources in an attempt to defeat certification across the board.

For franchisees, counsel will be wise to narrow their claims to encompass only a few strong issues. Franchise relationships are complex and prospective plaintiffs often have "laundry lists" of perceived grievances against their franchisor. Effective class actions narrow the issues to one or two of the most serious breaches which are both provable and common across the entire class. The *Quiznos* case in particular illustrates that so long as the determination of the common

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94 *Pet Valu*, above at para. 35.

95 *Id.*, at paras. 36-37.

issues will significantly advance litigation, the fact that there may be individual issues remaining will not be a bar to certification.

Having a strong class representative is essential in franchising cases. Human factors in franchise litigation should not be underestimated. The class representative's reputation and, in some cases, life's work will be subjected to intense scrutiny, and they may even face criticism from their former peers. It takes a particularly strong-willed individual to take these allegations in stride and calmly pursue the claim. The ideal representative plaintiff will often be one who is respected by his or her peers, but has the fortitude and drive to take the claim to completion.

Given the recent string of certifications of franchise class actions, it may be that fewer cases will drag on at the certification stage in the future. Courts may be less and less willing to revisit issues which have been litigated several times in recent years (such as releases, and individual damage calculations overwhelming common issues). However, the true test for franchise class actions will arrive in the coming months as several of the cases discussed above make it to trial. While class proceedings have, for the most part, been embraced by franchisees and Ontario courts as an effective mechanism for resolving true system-wide franchising disputes, the critical final steps still remain.