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FRANCHISE LAW

The Role of Equity in Franchising Law

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THE ROLE OF EQUITY IN FRANCHISE LAW

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This paper will provide an overview of equitable remedies and their function in the context of franchise law. With this objective in mind, the paper will address the following equitable remedies: (i) injunctions; (ii) specific performance; (iii) equitable rescission; (iv) relief from forfeiture; and (v) equitable set-off. As a whole, this paper is intended to serve as a primer on these equitable remedies, and to help guide franchise lawyers seeking to afford their clients with the best remedy at the courts' disposal.

EQUITY AND THE EQUITABLE JURISDICTION OF THE COURTS[1]

In the 19th century the law of England was separated into law and equity, with law having strict rules and equity, at least in theory, being more flexible. Equity was within the purview of the Court of Chancery, while other courts, such as the Court of the Exchequer, were the courts charged with the administration of the common law. This dichotomy between the two bodies of law was not perceived by some as being responsive to modern needs. As Lord Denning, the great proponent of equity, put it in his book, *The Discipline of Law*:

> During the 19th century the Courts of Common Law had laid down strict rules of law expressed in archaic terms such as "consideration" and "estoppel". Those strict rules had survived the *Judicature Act 1873* and were capable of causing injustice in many cases. There was a gap between those strict rules and the social necessities of the 20th century.[2]

[1] The authors acknowledge with thanks the significant contributions and assistance of Evan Barz, Student at Law at Osler, Hoskin & Harcourt LLP, Mackenzie Clark, Student at Law at DLA Piper (Canada) LLP and Jacqueline Rotondi, Summer Law Student at DLA Piper (Canada) LLP.

[2] Lord Denning, *the Discipline of Law*, (London: Butterworths, 1979) at 197.

In Ontario (Upper Canada), there was no court of equity at all until 1837, at which time the Court of Chancery of Upper Canada was created.[3] Common law and equity were then merged in Ontario in 1881, as were the courts that administered them, pursuant to the Ontario *Judicature Act.*[4]

The flexibility of equitable principles has permitted Canadian jurists to tailor remedies in keeping with what they perceive to be societal expectations prevailing at the time that a particular decision is made. In *Pro Swing Inc v ELTA Golf Inc,* the Supreme Court of Canada explained that equitable maxims exist to guide the discretion of judges in awarding equitable remedies.[5] Equity's maxims reflect a moral and ethical approach to the exercise of equity's jurisdiction. They are not definitive rules but serve as a guide to act ethically and conscionably.

The following are thirteen generally accepted equitable maxims:[6]

1. **Equity Will Not Suffer a Wrong to Be Done Without a Remedy:**

   Equity is ancillary and supplemental to the common law. Equity only intervenes when applying the common law would lead to an inadequate result.[7]

2. **Equity Follows the Law:**

   This maxim avoids the possibility that inconsistent approaches could result from the application of the rules of equity and common law. If there is a conflict, common law prevails.[8]

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[3] Ontario Ministry of the Attorney General, First Report, Ontario Civil Justice Review (March 1995), Part I, Chapter 3, "History of the Ontario Courts" <www.attorneygeneral.jus.gov.on.ca/english/about/pubs/cjr/firstreport/history.php>

[4] Elizabeth Brown, "Equitable Jurisdiction and the Court of Chancery in Upper Canada" (1983), 21.2 Osgoode Hall Law Journal 275 <http://digitalcommons.osgoode.yorku.ca/cgi/viewcontent.cgi>

[5] *Pro Swing Inc v ELTA Golf Inc,* 2006 SCC 52 at para 22 [*Pro Swing*].

[6] Jeffrey Berryman, *the Law of Equitable Remedies*, 2nd ed, (Toronto: Irwin Law Inc, 2013), at 15 - 20 [*J Berryman*].

[7] *Ibid* at 16.

3. **Where There is Equal Equity, the Law Shall Prevail:**

Equity operates on a party's conscience in relationship to the other party in dispute. Therefore, where both parties are equally affected, equity is of no assistance and whatever the common law says will prevail.[9]

4. **Where Equities are Equal, the First in Time Shall Prevail:**

Where two parties base their claims on the assertion of an equitable interest, the party who acquired an interest first shall have priority.[10]

5. **Delay Defeats Equities, or, Equity Aids the Vigilant and Not the Indolent:**

Expresses the general sentiment that equity will not be granted to a party who waited to exercise his right.[11]

6. **A Person Who Seeks Equity Must Do Equity:**

If a person seeks to enforce an equitable right, they need to act fairly and justly towards the defendant. This maxim looks at current not prior conduct of the claimant.[12]

7. **A Person Who Comes into Equity Must Come with Clean Hands:**

This maxim looks at the prior conduct of the claimant to determine whether to grant equitable relief. However, the claimant's wrongdoing and depravity must have a necessary relation to the equity sued for, i.e. the conduct has to connect to the dispute in question. This maxim applies only to the grant of equitable relief.[13] An interesting example of the application of the maxim arose in *Diversey Inc v Virox Holdings Inc.*[14] The defendants, which had terminated a licencing agreement, applied for an injunction to restrain the plaintiff from offering the defendants' products for sale. Evidence was led that suggested to the court that the majority shareholder of one of the defendants had a collateral purpose in terminating the licencing agreement, that related to the impact the

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[8] *Ibid.*

[9] *Ibid.*

[10] *Ibid* at 17.

[11] *Ibid.*

[12] *Ibid.*

[13] *Ibid* at 18.

[14] 2012 ONSC 6822.

agreement had on his ability to sell his shares. This collateral purpose meant that the defendants did not come before the court with clean hands and so the injunction was denied.[15]

8. **Equality is Equity:**

In the absence of any other rule or law, this maxim states that equity favours equal division of gains or losses.[16]

9. **Equity Looks to the Intent Rather than to the Form:**

Equity acts on the person's conscience and is more concerned with the person's substantive intent over the form used to express that intention. Therefore, if by insisting upon some formality a party will defeat the substance of a transaction, equity will act to provide relief.[17]

10. **Equity Looks On as Done That which Ought to Have Been Done:**

Expresses the ability of equity to focus on a transaction and not the form.[18]

11. **Equity Imputes an Intention to Fulfil an Obligation:**

This maxim underpins equity's doctrine of performance and satisfaction and is quite specific in its reach. Where a party is bound in equity to do something for a claimant, but has yet to perform that undertaking, equity will in appropriate circumstances regard a subsequent, although unrelated act by the party, as performance of the undertaking owed the claimant.[19]

12. **Equity Acts in Personam:**

The maxim suggests that equity acts to bind only the person and not his or her property. However, equity does have the capacity to create interests in property which are also binding on third parties unless they can rely on the defence of *bona fide* purchaser for value without notice.[20]

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[15] *Ibid* at paras 60 - 61.

[16] J Berryman, *supra* note 6 at 18.

[17] *Ibid* at 19.

[18] *Ibid*.

[19] *Ibid*.

[20] *Ibid* at 20.

13. **Equity Will Not Assist a Volunteer:**

> Generally, a claimant who has not provided consideration for the obligation owed to him cannot seek the assistance of equity to enforce the obligation. This maxim applies to prevent an intended recipient of a gift from enforcing a gift, or a promisee from gaining specific performance where he has not provided consideration.[21]

In the franchise law context, Section 9 of the *Arthur Wishart Act (Franchise Disclosure), 2000,* (the "AWA")[22] provides that the rights conferred under the AWA are in addition to, and do not derogate from, any other right or remedy that a franchisee or franchisor may have at law. The statute thereby expressly preserves a role for equitable remedies. Additionally, pursuant to section 96(2) of the *Courts of Justice Act,* where a rule of common law and a rule of equity conflict, the rule of equity prevails.[23] But what role do equitable remedies actually play in franchise law, particularly in light of the statutory requirement of good faith and fair dealing?

EQUITABLE REMEDIES IN FRANCHISING

INJUNCTIONS

The Courts of Justice Act

In Ontario, the Superior Court of Justice has exclusive jurisdiction to grant injunctions. Section 101 of the *Courts of Justice Act* provides that a judge may grant an injunction where it appears to be "just or convenient to do so," and on such terms that are considered just. Section 99 adds that damages may be awarded in addition to, or in substitution for an injunction:

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[21] *Ibid.*

[22] *Arthur Wishart Act (Franchise Disclosure), 2000*, SO 2000, c3, section 9 [*AWA*].

[23] *Courts of Justice Act*, RSO 1990, c C43, section 96(2).

> 101.(1) In the Superior Court of Justice, an interlocutory injunction or mandatory order may be granted or a receiver or receiver and manager may be appointed by an interlocutory order, where it appears to a judge of the court to be just or convenient to do so.
>
> Terms
>
> (2) An order under subsection (1) may include such terms as are considered just.
>
> Damages in substitution for injunction or specific performance
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> 99. A court that has jurisdiction to grant an injunction or order specific performance may award damages in addition to, or in substitution for, the injunction or specific performance.

The Three Part Test for Grant of an Injunction

Determining whether it is "just and convenient" to grant an injunction requires application of the well-known, three part test set out by the Supreme Court of Canada in *RJR-MacDonald v Canada (Attorney General)* ("*RJR-MacDonald*").[24] The test examines: (a) on a preliminary basis, the merits of the case, (b) whether the applicant is likely to suffer irreparable harm if the injunction is not granted, and (c) whether the balance of convenience favours granting an injunction.[25]

The First Limb of the RJR-MacDonald Test

It remains somewhat uncertain whether, in a particular case, the court will require the applicant to demonstrate only that its claim raises a serious issue to be tried, a relatively low threshold, or whether it must convince the court that it has a strong *prima facie* case, meaning that the there is a high level of assurance that the applicant will succeed at trial.[26] The more

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[24] *RJR-MacDonald Inc v Canada (Attorney General)*, [1994] 1 SCR 311 [*RJR-MacDonald*].

[25] *Ibid* at paras 83 – 85; and *CM Takacs Holdings Corporation v 122164 Canada Limited o/a New York Fries*, 2010 ONSC 3817 at para 27 [*CM Takacs*].

[26] *Quizno's Canda Restaurant Corporation et al v 1450987 Ontario Corp et al*, [2009] OJ No 1743 at para 39 [*Quizno's*].

stringent test is likely to be applied, for instance, where the circumstances of the case are such that the grant of an interlocutory injunction would be tantamount to a final determination of the claim.[27] An example is where the applicant seeks to enforce a post-termination restrictive covenant in the franchise agreement that is in restraint of trade, such as a covenant not to compete with the franchisor's business for a specified period of time and within a stipulated geographic area;[28] and where the applicant seeks a mandatory injunction as opposed to a prohibition.[29] It is, of course, not always easy to distinguish between a mandatory and a prohibitive injunction, given that a clever drafter can choose to formulate the prayer for relief in negative rather than positive terms. In general, where the order being sought is restorative in nature, i.e. where the applicant seeks to restore a broken relationship, the order is likely to be viewed by the court as a mandatory injunction.[30]

Although some decisions in the franchising context have taken the position that where there is a clear breach of a negative covenant, the elements of irreparable harm and balance of convenience are not required,[31] in the recent decision in *MTY Tiki Ming Enterprises v Boundris,*

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[27] *MTY Tiki Ming Enterprises v Boundris*, 2016 ONSC 3290 at para 26 [*MTY*]; and *Second Cup Ltd v Niranjan*, [2007] OJ No 3409 at paras 23-24 [*Second Cup Limited*] [Osler was counsel for Second Cup].

[28] *Second Cup Limited*, *ibid* at para 25.

[29] *CM Takacs*, *supra* note 25 at para 28.

[30] *Bark & Fitz Inc v 2139138 Ontario Inc,* 2010 ONSC 1793, at para 9 [*Bark & Fitz*]; and *TDL Group Ltd v 1060284 Ontario Limited*, 2001 OJ No 3614 at para 9.

[31] *Ontario Duct Cleaning v Wiles*, [2001] OJ No 5150 at para 3 [Osler was counsel for Ontario Duct Cleaning]; also, see *Pet Valu Canada Inc v 1381114 Ontario Limited*, et al, 2013 ONSC 5361, at para 10 where Justice Blackhouse stated "a fundamental aspect of any franchise system is the protection of its method of operation, goodwill, products and services. Where there is a clear breach of a non-competition provision which is a negative covenant, the elements of irreparable harm and balance of convenience are not required."

Justice Boswell opted to apply a contextual approach, considering all three limbs of the test and varying the weight to be given to each depending on the context of the particular case.[32]

The Duty of Good Faith and Fair Dealing and the First Limb of the RJR-MacDonald Test

Pursuant to subsection 3(2) of the AWA, a party to a franchise agreement has a right of action for damages against another party to the agreement who breaches the duty of fair dealing in the performance or enforcement of the franchise agreement. Pursuant to subsection 3(3), the duty of fair dealing includes the duty to act in good faith and in accordance with commercially reasonable standards. Accordingly, in its analysis of the first limb of the *RJR-MacDonald* test, the strength of the merits, the court will engage in an examination of the respondent's conduct to see how strong the case is that the respondent has breached its duty of good faith and fair dealing.[33] This is a separate and distinct inquiry from an examination of both parties' conduct as part of the analysis of whether equity dictates that an injunction should be granted or refused. It is suggested, therefore, that while the duty of good faith and fair dealing is central to the analysis of the first limb of the *RJR-MacDonald* case where there is a claim for breach of section 3 of the AWA, equitable considerations *per se* do not come into play at this stage of the analysis. In short, the principles attaching to the duty of good faith and fair dealing and the long established principles of equity are functionally different.

The Second Limb of the RJR-MacDonald Test

At the second stage of the test, the court must use its discretion to determine whether a refusal to grant the injunction will cause the applicant irreparable harm. Irreparable harm is harm incapable of being adequately or appropriately remedied by any other means at the time of

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[32] *MTY*, *supra* note 27 at paras 54 - 56.

[33] *1318214 Ontario Limited v Sobeys Capital Incorporated,* 2010 ONSC 4141 at paras 22 - 26 [*Sobeys Capital*].

trial.[34] In *RJR-MacDonald*, the Supreme Court of Canada elaborated on the approach to irreparable harm, explaining that it is the nature of the harm suffered that is important, not the magnitude: "it is harm which either cannot be quantified in monetary terms or which cannot be cured, usually because one party cannot collect damages from the other."[35] R.J. Sharpe lists typical examples of irreparable harm as including those where the act complained of would put the party out of business, cause irreversible damage to business reputation, or prevent the gaining of livelihood.[36]

Equity and the Third Limb of the RJR-MacDonald Test

When turning to the third limb of the *RJR-MacDonald* test, being an assessment of the balance of convenience, the court must consider what the Honourable Justice Sharpe has referred to as the "indefinable array of elements",[37] and assess the impact on each of the two parties, as well as on third parties, of the grant or refusal of the injunction being sought. At this stage of the analysis, equitable considerations can be relevant, particularly with respect to the formation of an appropriate remedy.

In *Bark & Fitz,*[38] Justice Karakatsanis, as she then was, concluded that the franchisor had met the onus of demonstrating a strong *prima facie* case for an injunction prohibiting its

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[34] J Berryman *supra* note 6 at 30.

[35] *RJR-MacDonald supra* note 24 at para 64.

[36] Robert J Sharpe, *Injunctions and Specific Performance*, Looseleaf (Canada Law Book, Release No 24, November 2015), at 2-33, para 2.410 [*RJ Sharpe*].

[37] *Ibid.*

[38] *Bark & Fitz, supra* note 30.

franchisees from breaching their restrictive covenants.[39] Moreover, it was clear to Her Honour that the franchisor would suffer irreparable harm if the injunction were not granted, since the vast majority of the franchisees in the system had ceased paying royalties or contributing to the advertising fund, were no longer carrying core products, and were considering de-identifying their stores.[40] Her Honour was not impressed, however, with the franchisor's behaviour. There was evidence that the franchisor has breached its duty of good faith and fair dealing by replacing popular products with other branded products on which it charged a mark-up, requiring the franchisees to accept unordered and unneeded product, and failing to disclose or share rebates with franchisees, although the disclosure document said that it would do so. While the franchisor's conduct did not amount to fundamental breach of the franchise agreement, it raised an issue to be tried in respect of a possible breach of section 3 of the AWA.[41] Moreover, while Her Honour was not prepared to go so far as to find that the franchisor had manipulated financial evidence to support its application, she was clearly unimpressed by the fact that the franchisor had refused to provide information regarding the rebates and discounts it had received or the underlying price lists, financial statements or tax returns.[42] Her Honour also noted that the franchisor's principals had taken substantial consulting and management fees while the franchisees' principals were unable to draw a salary or other form of income.[43] In considering the balance of convenience, therefore, Her Honour stated that she had

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[39] *Ibid* at para 21.

[40] *Ibid* at para 33.

[41] *Ibid* at paras 17 - 20.

[42] *Ibid* at paras 18 and 32.

[43] *Ibid* at para 37.

broad discretion to fashion a remedy that would be fair and equitable in the circumstances,[44] and proceeded to craft a made-to-measure order balancing the interests of the two sides.

Equity in Action in Franchising Injunction Applications

It is not surprising that the equitable "clean hands" maxim often arises in franchise cases, given the frequent focus on the parties' conduct towards each other in the context of their obligations of good faith and fair dealing. The doctrine that a person who seeks equity must come with clean hands prevents a party who has itself acted in a manner that the court deems to be unfair from obtaining equitable relief. Justice Sharpe has pointed out that while this sounds like an overarching maxim whereby the court will scrutinize all aspects of the plaintiff's behaviour and deny relief if they find it offensive, such is not the case.[45] For example, in *Polai v City of Toronto*, which was not a franchising case, the plaintiff was first denied relief because the court found him to have unclean hands.[46] On appeal, the decision was reversed, as the misconduct must relate to the very transaction concerning the complaint, not the general morality or conduct of the plaintiff.[47]

In last year's decision, *244674 Ontario Inc v Home Instead Inc,* an injunction was granted to stop two franchisees from operating an unrelated business out of their franchise premises, thereby violating the express terms of their franchise agreement and actively

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[44] *Ibid* at para 38.

[45] RJ Sharpe, *supra* note 36 at 1-50, para 1.1030.

[46] *Polai v City of Toronto*, [1969] 1 OR 655 at para 22.

[47] *Polai v City of Toronto*, [1969] OJ No 1624 at para 46.

misleading the franchisor.[48] In the context of the litigation, the franchisees refused to disclose their minute books or produce their banking records.[49] Justice Myers of the Ontario Superior Court of Justice held that where there is a strong *prima facie* case that a franchisee has deliberately breached contractual prohibitions and has refused to produce relevant documents, the court should be more willing to hold the franchisees to their bargain, and be "less swayed by pleas to equity made by those who appear unwilling to do equity".[50]

In *Peleshok Motors Ltd v General Motors of Canada*, the plaintiff, a franchised dealer of the defendant for sale and service of automobiles, had made fraudulent warranty claims.[51] The defendant wished to terminate the franchise agreement based on the fraudulent warranty claims and there were grounds to do so in the franchise agreement. The plaintiff applied for an interlocutory injunction to restrain the defendant from treating the agreement as terminated and requiring the defendant to abide by its terms until the trial. The application was dismissed because the plaintiff had failed to make out a strong *prima facie* case for an injunction.[52] In addition to applying the *RJR-MacDonald* test, the Court looked at the conduct and dealings of the parties. The court stated that because the relief sought was equitable, the principle "he who comes in equity must come with clean hands" was applicable.[53] The court commented that even

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48 *244674 Ontario Inc v Home Instead Inc,* 2015 ONSC 8004, leave to appeal refused, 2016 ONSC 4562.

49 *Ibid* at para 5.

50 *Ibid* at para 4.

51 [1977] OJ No 810.

52 *Ibid* at para 26.

53 *Ibid.*

if the plaintiff had made out a strong *prima facie* case, the application for the injunction would have been denied based on this maxim.[54] The court emphasised that it is not necessary for the plaintiff to have led a blameless life, but that his past record in the transaction must be clean. In the case at hand, the president of the plaintiff company had acted culpably and had therefore disentitled the company to the equitable relief requested.[55]

Cash Converters Canada Inc v 1167430 Ontario Inc. involved a franchisor who sought an injunction to enjoin a franchisee from continuing with a royalty strike.[56] The franchisee argued that the franchisor had not come to court with clean hands and therefore was not entitled to equitable relief in the form of an injunction.[57] The Court considered the reprehensible behaviour of the franchisees, and found the opposite was true. The franchisees had not provided any compelling evidence that the franchisors had fundamentally breached the franchise agreement. In addition, in assessing the manner in which the franchisees presented their case, the court stated:

> The respondents are prepared to allege and say anything that they feel would tarnish the name and goodwill and reputation of the Applicant. It is impossible to accept as *bona fide* the crocodile tears from the respondents about deficits on the bottom lines of their financial statements when the contradicted evidence is that they are making money as franchisees as they scheme to take over and abolish the franchisor.[58]

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[54] *Ibid.*

[55] *Ibid* at para 27.

[56] [2001] OJ No 5860.

[57] *Ibid* at para 34.

[58] *Ibid* at para 32.

The respondent's self-help remedy of cutting off royalty payments meant that it had not come to court with clean hands.[59] The injunction was awarded to the franchisor.

Parties must take care not to misstate or overstate their case, or otherwise mislead the tribunal, or risk losing the relief to which they are otherwise entitled. In *Royal Bank v Boussoulas*[60], which was not a franchising case, the bank argued that because it had made out the elements for a Mareva injunction, the Court had no discretion to deny the injunction on equitable grounds. The Court held that this proposition was "just wrong":

> An injunction is not a common law remedy like damages, which is a non-discretionary remedy; an injunction is an equitable remedy and it is discretionary and can be refused on equitable grounds, including the clean hands doctrine.[61]

The Bank had overstated its case, making unsupportable allegations in its notices of motion, factums and affidavits.[62] Its behaviour was such as to disentitle it to equitable relief.[63] The judgment cited I.C.F. Spry, stating: "an applicant who culpably misleads the court in making his application may be refused equitable relief on this ground,"[64] and this approach was upheld on appeal. Despite the strong substantive argument of the bank, the motions judge had

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[59] *Ibid* at para 34.

[60] *Royal Bank v Boussoulas*, 2012 ONSC 2070.

[61] *Ibid* at para 54.

[62] *Ibid* at para 29.

[63] *Ibid*.

[64] *Ibid*, citing ICF Spry, *the Principles of Equitable Remedies*, (London: Sweet & Maxwell, 2010) at 414.

discretion to make the equitable award and was not circumscribed to making only a costs award.[65]

The Importance of Evidence

It is difficult to imagine any type of litigation in which presenting sufficient, compelling evidence is not critical to getting the desired result. That being said, there have been recent developments respecting the level of evidence which the courts are requiring to grant injunctions, particularly in the context of the irreparable harm test.

In *Injunctions and Specific Performance,* it is noted that the while some courts have required evidence of irreparable harm to be "clear and not speculative", others continue to take a more lenient approach.[66]

For example, in *Molson Canada 2005 v Miller Brewing Company,* while accepting the proposition that evidence of irreparable harm "must be clear, not merely speculative, and supported by the evidence", Justice Wilton-Siegel noted that the evidence could take many forms. He was prepared to consider market studies and reports in considering the market's reaction to the grant or refusal of an injunction, and to draw inferences of irreparable harm from them if the inferences reflected commercially reasonable conclusions based on those facts.[67]

Nonetheless, there has been some suggestion that merely citing a potential loss of business, reputation or goodwill will not be enough to satisfy the irreparable harm test.[68] Recent

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[65] *Ibid* at para 55.

[66] RJ Sharpe, *supra* note 36 at 2-46, para 2.420.

[67] *Molson Canada 2005 v Miller Brewing Company,* 2013 ONSC 2758 at para 132.

[68] *Sobeys Capital, supra* note 33 at para 34.

cases have required plaintiffs to meet the higher evidentiary burden of demonstrating specific examples of irreparable harm. For example, in *Allegra of North America and Allegra Corporation of Canada v Russell Sugimura,* the Court rejected the franchisor's argument that irreparable harm would be suffered in consequence of a franchisee's breach of non-competition agreement because it would provide other franchisees with a basis for disregarding their non-competition agreements.[69] The Court found this evidence to be too speculative as it was not based on any irreparable harm that flowed from the breach of the agreement.

The aforementioned case of *MTY*[70] also provides interesting comment on the irreparable harm test. Along with raising requirements in the first branch of the test, the decision also applied an elevated standard of the evidentiary requirements to prove irreparable harm. The plaintiff sought to rely on the decision in *Quizno's Canada Restaurant Corp v 1450987* (*"Quiznos"*), arguing that without an injunction, the goodwill, reputation and integrity of its franchise system would be irreparably harmed.[71] In denying the plaintiff's application, the Court distinguished the circumstances from those in *Quiznos*. While in *Quiznos*, there was clear evidence that the franchisees were not abiding by the terms of the agreement and were compromising the brand, no such evidence existed in *MTY*.[72] The Court acknowledged that failure to abide by a restrictive covenant could be a source of irreparable harm for a franchisor's credibility and ability to manage and control the franchise. Ultimately however, the evidentiary

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[69] *Allegra of North America and Allegra Corporation of Canada v Russell Sugimura et al*, (August 26, 2008), Milton, CV-08-21790-00 Ont SC, (unreported).

[70] *MTY*, *supra* note 27

[71] *Quizno's*, *supra* note 26 at paras 93 - 95.

[72] *MTY*, *supra* note 27 at para 65.

record before the court in *MTY* showed only a "modest level of irreparable harm".[73] Consequently, it was held that the franchisor had not suffered irreparable harm. Franchisees and franchisors seeking an injunction should observe the recent decision in *MTY* and note the Court's preference for stronger, more particularized and less speculative evidence of irreparable harm.

SPECIFIC PERFORMANCE

An order for specific performance compels the defaulting party to uphold its end of a contract with the prospect of a contempt of court order in the event of non-compliance.[74] Such orders are consistent with the objective of contractual remedies: to put the plaintiff in the position he or she would have been had the contract been performed.[75] In the context of franchise law, specific performance makes it more difficult for parties to a franchise agreement to go their separate ways. For example, an award of specific performance may require a franchisor to renew a franchise agreement, or compel a franchisee or franchisor to perform particular terms of a franchise agreement. Specific performance may be preferable to an award for damages where it is difficult for the court to assess damages, or where the nature of the harm suffered is such that there is a risk that damages will inadequately or inappropriately address the wrong.[76]

[73] *Ibid* at para 66.

[74] J Berryman, *supra* note 6 at 269.

[75] RJ Sharpe, *supra* note 36 at 7-4, para 7.50.

[76] J Berryman, *supra* note 6 at 277.

That said, there are a number of obstacles to obtaining an order for specific performance, which is a discretionary, equitable award. In *Bell Canada v Manitoba Telecom Services Inc,* the Court affirmed the general reluctance towards enforcing positive covenants, "on the basis of, collectively, the burden of ongoing judicial supervision of the relationship, the burden to the defendant of performing the covenant potentially outweighing the benefit to the plaintiff, and the unattractive prospect of yoking the parties together in a hostile relationship".[77] Further, as Justice Neufeld of the Alberta Court of Queen's Bench recently put it, "An order compelling the parties to cooperate and be agreeable is no more efficacious than an agreement promising to do so."[78] His Honour noted that regardless of whether the order sought in the particular case was labelled prohibitory or mandatory, if granted it would require the Court's intervention and dictation of a timeline and process.

Common law courts, therefore, only infrequently order specific performance of the defaulting party's obligations. There are a number of reasons for this, as discussed below, which are often rooted in equitable considerations or considerations of fairness or balance.

Reasons for Reluctance to Grant Specific Performance

1. **The court's reluctance to engage in supervision**

In the past courts would almost certainly decline to grant an order of specific performance if it would require ongoing supervision of the parties and their venture.[79] Courts viewed active supervision as imposing a significant burden on judicial resources and imposing a

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[77] *Bell Canada v Manitoba Telecom Services Inc*, [2004] OJ No 2319 at para 105.

[78] *Alan Arsenault Holdings Ltd v TDL Group Corp,* 2016 ABQB 97 at para 51.

[79] J Berryman, *supra* note 6 at 289.

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higher public cost than an order for damages.[80] This approach is no longer applied consistently, and courts will order ongoing supervision when it is necessary and in the interests of justice.[81] The rule against supervision was discussed by the Supreme Court of Canada in the case of *Pro Swing Inc v ELTA Golf Inc* ("*Pro Swing*").[82] The decision held that, "the courts do not usually watch over or supervise performance…[as] supervision by the courts often means re-litigation and the expenditure of judicial resources".[83] The Court went on to cite Justice Sharpe, explaining that in deciding whether to grant specific performance, the Court will weigh the relative advantage of doing justice by granting the order, against the general cost to society of having justice administered.[84] An order for damages was noted as being preferred because of its finality, and because enforcement is left to administrative rather than to judicial machinery.[85] Conversely, specific performance requires more judicial resources.

2. **The requirement of uniqueness**

Specific performance is typically refused where damages are an acceptable remedy. Therefore if specific performance is requested in relation to a contract, the subject matter of that contract must be unique in the sense that damages would be an inadequate remedy.

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[80] *Ibid* at 290 - 291.

[81] RJ Sharpe, *supra* note 36 at 1-13, para 1.290.

[82] *Pro Swing supra* note 5.

[83] *Ibid* at para 24.

[84] *Ibid* at para 24, citing RJ Sharpe, in *Injunctions and Specific Performance* (2nd ed (loose-leaf)), para 7.480.

[85] *Ibid.*

In franchise cases, courts have shown that the consideration of uniqueness will not be limited to the object of the contract in question. In *Wallace v Allen,* the Court stated that it would not simply look at whether the object of the contract was unique, but would consider whether the interest in that contract was unique to the parties.[86] In this case, the Court acknowledged that, to some extent, every business is unique.[87] The same approach was applied in *Chuang v Toyota Canada Inc.,* where the Court held that although the profitability of the dealership concerned was unique, this form of uniqueness could nevertheless be compensated by way of monetary damages.[88] Although the company at the centre of the case was unique, the appellant's acquisition of that company was not because he was in the business of acquiring companies.[89] Franchisors and franchisees should be aware that, in asking for specific performance relating to a particular franchise, for example, it might not be sufficient to show that the franchise itself is a unique one.

3. Specific performance will not be available to enforce franchise agreements if there is clear evidence that it will result in a breakdown of the parties' relationship

While courts are reluctant to enforce a positive obligation for personal service, because it could result in involuntary servitude; in general, franchise agreements are not considered personal service agreements. For example, in *Yule Inc v Atlantic Pizza Delight Franchise (1968) Ltd.,* the Court held that a franchise agreement was a commercial agreement between corporate entities and not a contract of personal service that would give rise to a bar against

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[86] *Wallace v Allen*, 2009 ONCA 36 at paras 39 - 40.

[87] *Ibid* at para 40.

[88] *Chuang v Toyota Canada Inc,* [2007] OJ No 2069 at para 26 [*Chuang*].

[89] *Ibid.*

specific performance.[90] The same conclusion has also been reached in Manitoba[91] and Alberta.[92] The courts will now look to see if the relationship between the parties requires mutual trust and if it does, specific performance is likely to be refused.[93] To determine this question, the courts require evidence of the actual relationship of the parties and how that has affected the business.[94]

Courts will look closely at the quality of the relationship between the parties, and the likelihood of them being able to successfully continue commercial dealings. In the absence of actual evidence of a breakdown in relationship, courts will presume that the parties are able to continue business operations. In *Erinwood Ford Sales Ltd v Ford Motor Co of Canada Ltd*, the Ontario Superior Court dismissed concerns of a deteriorated relationship because there was no evidence that the breakdown in relations had caused a financial impact on the franchise or had any other impact on performance of the parties' obligations under the agreement.[95] Similarly, in *1323257 Ontario Ltd v Hyundai Auto Canada Corp,* the Court found the loss of confidence between the parties did not amount to a breakdown of relationship that would prevent them from continuing business together.[96]

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[90] *Yule Inc v Atlantic Pizza Delight Franchise (1968) Ltd,* [1993] OJ No 682.

[91] *North West Beverages v Pepsi-Cola Canada Ltd* (1971), 20 DLR (3d) 341.

[92] *Ford Motor Co of Canada, Ltd v Welcome Ford Sales Ltd,* 2011 ABCA 158.

[93] *1193430 Ontario Inc v Boa-Franc (1983) Ltee* [2005] OJ No 4671.

[94] *Healthy Body Services Inc v Muscletech Research and Development Inc,* [2001] OJ No 3257.

[95] *Erinwood Ford Sales Ltd v Ford Motor Co of Canada Ltd*, [2005] OJ No 1970 at para 94.

[96] *1323257 Ontario Ltd v Hyundai Auto Canada Corp*, [2009] OJ 95 at para 122.

Additional Factors Relating to Specific Performance

In *The Law of Equitable Remedies*, J. Berryman outlines additional factors the court requires the plaintiff to show in seeking an order for specific performance:[97]

(a) The plaintiff is ready, willing and able to perform:

The case of *Chuang v Toyota Canada Inc* reiterated this requirement, stating that in order to obtain specific performance, the plaintiffs must demonstrate readiness and willingness to perform the obligations under their agreement.[98] If the plaintiff is unable to perform an essential term of the contract, the court cannot enforce specific performance, as the order must "foster rather than frustrate the reasonable expectations of the parties".[99]

(b) The plaintiff has not breached any of his contractual obligations:

This requirement is connected to the maxim: "[h]e who seeks equity must do equity." In other words, a plaintiff should not be able to rely on his own wrongdoing to recover specific performance. The role of equitable maxims is discussed in more detail below.

(c) The plaintiff must not delay in bringing the action:

In addition to complying with the *Limitations Act*,[100] the plaintiff must also be wary of the use of the doctrine of delay as a defence to an action for specific performance.[101] If the plaintiff's

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[97] J Berryman, *supra* note 6 at 327.

[98] *Chuang*, *supra* note 88 at para 19.

[99] *Ibid.*

[100] *Limitations Act,* SO 2002, c24.

delay is unreasonable and has caused prejudice to the defendant, the court will not grant specific performance.

(d) The plaintiff comes to court with clean hands:

As previously discussed, this equitable maxim appears frequently in franchise cases. It is typically invoked where a plaintiff is attempting to take advantage of his own wrongdoing or is pursuing an illegal purpose.[102]

EQUITABLE RESCISSION

Definition

Rescission is an equitable remedy which enables an innocent party—whose consent to the formation of an agreement has been vitiated in one way or another—to rescind the agreement.[103] The remedy entitles the parties to treat the agreement as though it were void *ab initio*: the contract is terminated, and the parties are returned to the positions they were in before the agreement was established.[104]

Although they share many commonalities, it is important to recognize the distinction between common law rescission and equitable rescission. Both remedies developed before the Judicature reforms and, as a result, the common law courts' approach to rescission developed

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[101] J Berryman*, supra* note 6 at 332.

[102] *Ibid* at 334.

[103] *Halsbury's Laws of Canada*, vol 76, *Equitable Remedies – Estoppel* (Markham, Ont: LexisNexis Canada, 2012) at HER-27 "Nature of Rescission" [*Halsbury's*].

[104] *Ibid* at note 100.

differently than that of the equitable remedy in the courts of Chancery. Though the courts ultimately merged, today the remedies continue to retain distinctive elements.[105]

In Canada, the distinction between common law and equitable rescission remains in relation to both the scope and manner of the remedies' application. In terms of scope, common law rescission arises in a narrow set of circumstances, including fraudulent representation, bribery, duress and non-disclosure. In contrast, the limits of when rescission can be ordered are not fixed in equity, and the decision to order rescission ultimately rests in the court's discretion.[106] As a result, the situations in which rescission can be granted in equity extend beyond the circumstances in which the remedy is available at common law. For example, whereas rescission is only available to a party at common law in circumstances of fraudulent misrepresentation, rescission may be ordered in equity when a representation was negligently or innocently made.[107]

As for its application, common law rescission can be exercised by a party to an agreement simply announcing its election to rescind by incontrovertible words or conduct. Common law rescission takes effect immediately and the role of the court is to assess whether the rescission was properly effected. In contrast, in equity, an agreement may only be rescinded in accordance with the terms of a court order. As such, the innocent party may not rescind on its

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[105] John McGhee (QC), *Snell's Equity*, 33rd ed (London; Thomson Reuters, 2015) at 409 [*Snell's Equity*].

[106] *McEachern v Webster*, 2000 PEDCTD 82, 195 NFLD & PEIR 256 at para 65 [*McEachern*] and *Ormond v Richmond Square Development Corp*, [2001] OJ No 4165, 109 ACWS (3d) 169 (Sup Ct) at paras 29 – 31 [*Ormond*].

[107] *Keen v Altera Developments Ltd*, [1993] OJ No 2623, 43 ACWS (3d) 866 (Gen Div) at para 31.

own volition, but must apply to court for the equitable remedy. Importantly, until the court order takes effect, the agreement remains in force.[108]

A further distinction between common law and equitable rescission is the application of the legal doctrine, *restitutio in integrum*.[109] This doctrine directs that if the parties to an agreement can no longer be restored to their original condition, rescission cannot be ordered. At common law, this maxim is applied strictly such that if the position of the parties cannot be restored to their original condition, then rescission should not be elected.

By contrast, in equity, since courts have greater flexibility and enjoy discretion in determining when an agreement should be rescinded, the positions of the parties may be altered to achieve "substantial" restoration."[110] Substantial restoration will typically result in the court crafting its order to place the parties most approximately to their original position.

Distinction Between Statutory & Equitable Rescission in the Franchise Law Context

Before discussing the treatment of equitable rescission in Canadian franchise jurisprudence, it is important to distinguish between equitable rescission and statutory rescission pursuant to, for example, section 6 of the *AWA*.[111]

In brief, the *AWA* provides franchisees with the right to rescind a franchise agreement—without penalty or obligation—if there are deficiencies in the disclosure, or if no disclosure

[108] *McEachern supra* note 106 at paras 62 – 64.

[109] *The Western Bank of Scotland v Addie* (1867) LR 1 SC App 145 at 164 - 165.

[110] *Ormond supra* note 106 at paras 30 – 31.

[111] This paper will focus on the rescission remedy afforded by section 6 of the *AWA*. Rescission is also available under franchise statutes in Alberta, New Brunswick, PEI, Manitoba and BC.

document has been provided. Pursuant to section 6(1) of the *AWA*, a franchisee may rescind (or unravel) the franchise agreement no later than sixty days after receiving the disclosure document, if the franchisor fails to provide the disclosure document or statement of material change within the time requirements of the *AWA*, or if the contents do not meet the requirements of the *Act*.[112] Moreover, pursuant to section 6(2) of the *AWA*, if the franchisor never provided a disclosure document, the franchisee may—within two years after entering into the agreement—rescind the agreement.[113]

Importantly, when a franchise agreement is rescinded pursuant to section 6 of the *AWA*, section 6(6) provides that if the rescission is effective, the franchisor or the franchisor's associate must within 60 days of the effective date do the following:

(a) refund to the franchisee any money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment;

(b) purchase from the franchisee any inventory that the franchisee had purchased pursuant to the franchise agreement and remaining at the effective date of rescission, at a price equal to the purchase price paid by the franchisee;

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[112] *Ibid* at section 6(1).

[113] *Ibid* at section 6(2). The harsh nature of the statutory remedy has been further magnified by the courts' interpretation of section 6 of the *AWA*. Failure to comply with the disclosure requirements will often result in a court concluding not that the disclosure was incomplete, but that, in fact, no disclosure occurred. Consequently, this liberal interpretation of section 6(2) affords the aggrieved franchisee a two-year period within which it may exercise the remedy, as compared with the shorter 60-day period under section 6(1) of the *AWA*. For example, the failure to provide disclosure as one document at one time prescribed in section 5(3) of the *AWA*, is not viewed by the courts as an incomplete disclosure under section 6(1) of the *AWA,* but will be deemed to be a complete failure to disclose under section 6(2) of the AWA, affording the franchisee a full two-years from the date the franchise agreement was entered into to rescind the franchise agreement (See *Ontario Ltd v Dig This Garden Retailers Ltd*, [2005] OJ No 3040, 256 DLR (4th) 451 (CA) at paras 18 – 19 [*Dig This Garden*].

(c) purchase from the franchisee any supplies and equipment that the franchisee had purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee; and

(d) compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts set out in clauses (a) to (c).

The intent of subsection 6(6) of the *AWA* is, as the court observed in *Payne Environmental*, [114] "to put the franchisee (the focus is not on the franchisor) in the position it was in prior to entering into the franchise agreement" (in effect, restitution).

Notwithstanding the availability to franchisees of a statutory right of rescission under section 6 of the *AWA*, equitable rescission remains a remedy the courts may grant in the appropriate case, such as where a franchisee is out of time for seeking statutory rescission under section 6 of the *AWA*.[115] The ongoing availability of equitable rescission is provided for in section 9 of the *AWA*, which broadly states that remedies contained within the *AWA*, "are in addition to and do not derogate from any other right or remedy a franchisee or franchisor may

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[114] *Payne Environmental Inc v Lord and Partners Ltd* [2006] OJ No 273, 14 BLR (4th) 117 (Sup Ct).

[115] Under section 6(1) of the *AWA*, a franchisee has 60 days from the date it received a disclosure document to rescind the franchise agreement. Under section 6(2) of the *AWA*, a franchisee has two years from the signing of the franchise agreement to rescind the franchise agreement. If the franchisee does not deliver a notice of rescission on time, it cannot proceed with a claim for statutory rescission against the franchisor. Provided the franchisee delivers a notice of rescission on time, the general two-year limitation period set out in the *Limitations Act, 2002*, will only be triggered once the franchisee "discovers" that the franchisor does not intend to comply with its financial obligations set out in section 6(6) of the *AWA*. This is either at the expiry of the 60 day period prescribed by section 6(6) for the franchisor to pay the franchisee, or at such earlier time as the franchisor advises that it will not be paying any monies to the franchisee under section 6(6) of the *AWA*. As was held in *20130489 Ontario Inc v Philthy McNasty's (Enterprises) Inc,* 2011 ONSC 6852, 219 ACWS (3d) 321, aff'd 2012 ONCA 381, [2012] OJ No 2521, prior to either of these two events, the franchisee has no cause of action against the franchisor for rescission. Equitable rescission is different; it does not require a notice of rescission before a proceeding may be commenced . As for the applicable limitation period, a franchisee has two years from the date it discovered or ought reasonably to have discovered that it has such a claim to commence a proceeding.

have at law."[116] As a remedy established by the courts of Chancery, it is evident that equitable rescission is still available to franchisees and franchisors, should the circumstances avail themselves to such a claim.[117] This point has been confirmed by Ontario courts, which have held that equitable rescission is "independent and unaffected by the *AWA*."[118]

Equitable Rescission in Canadian Franchise Jurisprudence

Given the existence of the statutory remedy of rescission under Canadian franchise legislation like the *AWA*, it is not surprising that equitable rescission has been largely unaddressed in Canadian franchise jurisprudence. That being said, the decisions in *TDL Group Ltd. v Zabco Holdings Inc.* ("*Zabco*")[119] and *Choi v Paik* ("*Choi*")[120] provide a reasoned and thorough discussion of the remedy and its application. Significantly, both *Zabco* and *Choi* arose in jurisdictions where franchise legislation did not exist at the time the cases were heard and as such, do not address the differences between equitable rescission and the statutory remedy of rescission under the *AWA* or other provincial franchise statutes.

The paragraphs below examine the decisions in *Zabco* and *Choi*, with a view to exploring the general application of equitable rescission in franchise cases. This is followed by

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[116] *AWA supra* note 22 at section 9.

[117] Note that, unlike equitable rescission, statutory rescission under section 6 of the *AWA* is only available to franchisees. This is made clear by section 6 of the *AWA*, which provides that "[a] franchisee may rescind the franchise agreement, without penalty or obligation…" [emphasis added] This limitation is logical, given that the *AWA* is remedial legislation that is intended to ensure franchisees are sufficiently informed through comprehensive disclosure prior to making what is typically a large and long-term investment.

[118] See *778875 Ontario Ltd v Mmmuffins Canada Corp*, [2009] OJ No 2357, 177 ACWS (3d) 961 (Sup Ct) at para 47 and *Dig This Garden supra* note 113 at para 28.

[119] *TDL Group Ltd v Zabco Holdings Inc*, 2008 MBQB 239, 232 Man R (2d) 225 [*Zabco*].

[120] *Choi v Paik*, 2008 BCSC 1122 [*Choi*].

an analysis of other case law that has commented on the remedy, including the interplay between equitable rescission and the more commonly pleaded statutory right of rescission.

TDL Group Ltd. v Zabco Holdings Inc.[121]

Zabco is a 2008 decision of the Manitoba Court of Queen's Bench, in which the plaintiff franchisor sued the defendant franchisees for arrears owed in connection with two Tim Hortons locations.[122] The franchisees counterclaimed, asserting that the franchisors had failed to warn the franchisees that "no Tim Hortons store in Winnipeg could be profitable without concessions."[123] The franchisees claimed that this omission amounted to negligent misrepresentation, for which the franchisees requested rescission of the franchise agreement.

After rejecting the defendants' claim of negligent misrepresentation, Justice Joyal discussed the scope of the equitable remedy. Specifically, the Court emphasized that rescission is only available in respect of *pre-contractual conduct* that "induced a party to enter into an agreement in the first place."[124] Justice Joyal held that if post-contractual conduct was the subject of the claim, the proper remedy was in "damages, not rescission."[125] The Court explained that limiting rescission to claims of pre-contractual misconduct was logical, since the basis for the underlying agreement was vitiated by that misconduct; conversely, post-contractual

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[121] *Zabco supra* note 119.

[122] *Ibid* at para 23.

[123] *Ibid* at para 45.

[124] *Ibid* at para 262.

[125] *Ibid* at para 264.

conduct would not undermine the basis on which the agreement was founded.[126] Joyal J.'s reasoning aligns with courts that have considered the remedy under other branches of law.[127]

Justice Joyal also commented at length on various bars to equitable rescission.[128] The Court noted that affirmation of a contract, which can be explicit or inferred from conduct, would result in a party entitled to rescission, losing the remedy.[129] The Court provided the example of a franchisee continuing to operate a business—with full knowledge of a misrepresentation—as tacit affirmation of a contract.[130] By continuing to take a benefit under the agreement, the party entitled to equitable rescission is deemed to have waived the remedy.[131] Another potential bar identified by Joyal J. is "delay." Although delay and affirmation are related, Justice Joyal noted that the two bars need not occur simultaneously; a substantial period of delay may be spent without an act of affirmation by a party to the franchise agreement. Significantly, Justice Joyal noted that delay will have occurred after "the passage of a reasonable amount of time" and suggested that "[r]easonable time is not necessarily a matter of years or months, but can be a

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[126] *Ibid* at para 266.

[127] See, for example, the judgment of Justice McIntyre in *Bauer v Bank of Montreal*, [1980] SCJ No 46, 110 DLR (3d) 424 at 7.

[128] It is important that there are no comparable bars to statutory rescission under section 6 of the *AWA*.

[129] In *Dig This Garden* supra note 113, the Ontario Court of Appeal recognized the franchisee's right to continue operating the business for a reasonable period in order to mitigate its damages to its landlord and suppliers. The continued operation of the business by the franchisee did not deprive it of the right to rescind the franchise agreement under section 6(2) of the *AWA*. However, as confirmed in *Beer v Personal Service Coffee Corp*, [2005] OJ No 3043, 141 ACWS (3d) [*Beer*], the franchisee, in spite of having rescinded the franchise agreement, might be exposed to a separate claim by the franchisor pursuant to section 9 of the *AWA*. The franchisor cannot use such a claim to avoid liability to the franchisee under section 6 of the *AWA*.

[130] *Zabco supra* note 119 at para 321.

[131] This point is expressed most clearly in *Panzer v Zeifman*, [1978] OJ No 3456, 20 OR (2d) 502 (CA) at para 24.

matter of days."[132] Finally, the court explained that a claimant seeking an equitable remedy must come to court with "clean hands".[133] As such, in order to effectively establish a right to equitable rescission, a party must demonstrate that their past record in the transaction is free from improper conduct.[134]

Choi v Paik

Choi v Paik[135] (*"Choi"*) is a British Columbia Supreme Court decision involving a Papa John's pizza outlet, operated under a joint venture agreement. The plaintiff claimed that the agreement was founded on misrepresentations since the defendants had never disclosed applicable franchise and goodwill fees.[136] The plaintiffs asserted that, had they been informed of

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[132] *Zabco supra* note 119 at para 322.

[133] Contrast this with the statutory remedy of rescission under section 6 of the *AWA*. No equitable defences are available to a statutory claim of rescission once it is established that a franchisor either did not deliver a disclosure document at all or made improper disclosure. Simply stated, if disclosure is insufficient or non-existent, then the franchisee is entitled to statutory rescission. Section 6 establishes a strict-liability offence. As the Ontario Court of Appeal stated at paragraph 32 of *Beer* (*supra* note 129)," There is nothing in the language of s. 6(2) suggesting that a franchisee's right to rescind is in any way conditional. Where there is non-disclosure, the statutory right to rescind appears to be absolute. . . .".

[134] *Zabco supra* note 119 at para 318. This should be contrasted with statutory rescission under section 6 of the *AWA*. In *Beer* at paragraph 32, the Ontario Court of Appeal held that "…there is nothing in the language of [section 6(6)] that suggests such payments are conditional in any way on the conduct of the franchisee and therefore the right to payment also appears to be absolute." In *Beer*, after rescinding the franchisee had immediately set up a competing business that serviced the same customers as the franchisor. The Court of Appeal found that although Mr. Beer had an absolute right to statutory rescission under section 6(2) of the *AWA*, the franchisor had a separate right to pursue an action against him under section 9 of the *AWA* for the alleged appropriation of business, unlawful use of customer lists and equipment, misappropriation of know-how and systems and related complaints regarding the franchisee's conduct following rescission.

[135] *Choi* supra note 120.

[136] *Ibid* at para 2.

these fees, they never would have entered into the agreement, and sought rescission as a remedy.[137]

After determining that the defendant had in fact misrepresented the nature of the fee structure, Justice Walker set out eight requirements for an aggrieved party to avail themselves of the remedy of equitable rescission. These requirements include:

1. A positive representation must have been made by the defendant;
2. The representation must have been an existing fact;
3. The representation must have been made with the intention that the plaintiff should act upon it;
4. The representation must have induced the plaintiff to enter into the contract;
5. The plaintiff must have acted promptly after learning of the misrepresentation to disaffirm the contract;
6. No innocent third parties must have acquired rights for value with respect to the contract property;
7. It must be possible to restore the parties substantially to their pre-contract position; and
8. An executed contract for the sale of land will not be rescinded unless fraud is shown.[138]

Upon the facts before Justice Walker, equitable rescission was available to the plaintiffs and the remedy was granted.[139] Significantly, the test incorporates all of the preconditions for equitable rescission, namely that: (i) the misrepresentation caused the party to enter into the agreement; (ii) the party entitled to rescission didn't affirm or delay rescission; and (iii) the parties can be returned to their original position. In addition, the test provides important

137 *Ibid* at paras 17 – 19.

138 *Ibid* at para 81, citing favourably to *Kingu v Walmar Venture Ltd* (1986), [1986] BCJ No 597, 10 BCLR (2d) 15 (CA), at 20-21. For similar analysis, see also *Riding Mountain Excavating Ltd v K&D Farm Corp*, [1999] BCJ No 1134, 68 BCLR (3d) 63 (CA).

139 *Ibid* at para 83.

protections for third parties who were not the cause of the conduct vitiating the contract and should not be unfairly prejudiced as a result of the contract being rescinded.

After evaluating the plaintiffs' claims, Justice Walker also discussed other circumstances when equitable rescission may be available to an aggrieved party. The Court held that unconscionable conduct of such a nature so as to render a bargain questionable on equitable grounds, could provide an opportunity to rescind a contract.[140] In the case at hand, Justice Walker noted that the defendant's behaviour—including taking advantage of the plaintiffs' limited English language skills—amounted to unconscionable conduct that could entitle the plaintiff to rescission.[141]

Interestingly, Justice Walker also found that rescission could be available in respect of post-contractual conduct where one party has "so failed to perform its contractual obligations that the failure is seen as 'substantial'."[142] The Court's conclusion on this point appears to be antithetical to the proposition that equitable rescission is only available in respect of behaviour that undermined the foundation of an agreement. It could be that Justice Walker was commenting on the common law rescission and *not* the equitable remedy available to the courts.

Other Jurisprudential Commentary on Equitable Rescission

In addition to *Zabco* and *Choi*, other franchise decisions have made reference to equitable rescission, though often in a summary fashion. Because these other decisions, unlike

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[140] *Ibid* at para 86.

[141] *Ibid* at paras 88 – 89.

[142] *Ibid* at para 84.

Zabco and *Choi*, are Ontario cases, the courts make a point of addressing the differences between equitable and statutory rescission.

In *1490664 Ontario Ltd v Dig This Garden Retailers Ltd*, for example, Justice MacFarland of the Ontario Court of Appeal held that "statutory rescission is different from equitable rescission and the principles of the latter do not apply to the former."[143] In making this statement, MacFarland J. clarified that the requirement that "both parties…be restored to their original situations" in equitable rescission, was not applicable to claims under the *AWA*.[144] Further, the Court recognized that because Section 6 of the *AWA* provides a complete code for statutory rescission, as long as the requirements encapsulated by that provision are met, rescission will be granted according to the statute.

Interestingly, in *Essa v Mediterranean Franchise Inc*, Justice Renke of the Alberta Court of Queen's Bench noted, in *obiter*, that equitable rescission, as a remedy in-and-of-itself, does not entitle a party to compensatory damages.[145] However, he went on to explain that in certain circumstances of rescission based on misrepresentation, compensatory damages in addition to a rescission order may be merited. This would be in circumstances where rescission alone "does not do justice between the parties."[146] With statutory rescission under section 6 of the *AWA*, not only is the franchise agreement rescinded (unravelled) but the franchisee is entitled to

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[143] *Dig This Garden supra* note 113 at para 28.

[144] *Choi supra* note 120 at para 27.

[145] 2016 ABQB 178, 266 ACWS (3d) 597 at para 182.

[146] *Ibid* at para 183 citing favourably to *Bank of Montreal v Murphy*, [1986] BCJ No 973, 6 BCLR (2d) 169 (CA). Also, see *Dig This Garden supra* note 113 at paras 38-39, where the Ontario Court of Appeal noted that, in addition to the remedies prescribed in section 6(6) of the *AWA*, a party would be entitled to compensatory damages "for losses incurred in acquiring, setting up, and operating the franchise." As a result, under the statutory remedy of rescission, franchisees appear to be entitled to a form of "double-recovery"—rescission and damages.

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certain payments under section 6(6) of the *AWA* which may include any losses acquiring, setting up and operating the franchise under section 6(6)(d). The losses under section 6(6)(d) are compensatory in nature.

The Future of Equitable Rescission

Given the relative ease of proving statutory rescission in provinces where there is franchise legislation, it is likely that this remedy has circumscribed the number of claims for equitable rescission in franchise jurisprudence. Since a plaintiff merely has to establish insufficient or no disclosure within the prescribed time limits, availing themselves of the statutory right is relatively straightforward. Conversely, under equitable rescission, the plaintiff has to provide considerable evidence and detailed pleadings in order to substantiate its claim, and its claim is subject to various equitable defences. The onerous nature of establishing a right to equitable rescission is particularly clear when making claims of misrepresentation, because courts and procedural statutes require thorough support to prove such allegations.[147]

In addition to the relative ease of bringing a rescission claim under section 6 of the *AWA*, the statutory remedy has likely also precluded claims for equitable rescission for other reasons. Specifically, if a party chose to bring a claim for equitable rescission for non-disclosure after the two-year mark prescribed by section 6(2) of the *AWA*, a court could very well deny the claim on the basis of delay or, depending on the circumstances, due to an express or implied affirmation of the contract. That being said, where a misrepresentation attaches to circumstances

[147] See, for example, *Hughes v Sunbeam Corp (Canada)*, [2000] OJ No 4595, 101 ACWS (3d) 471 (Sup Ct) at paras 22 – 23, where the following particulars were set out for a statement of claim in negligent misrepresentation: (i) the representation; (ii) when, where, how, by whom and to whom it was made; (iii) the existence of a duty of care based on a "special relationship" between the representor and representee; (iv) the falsity of the representation; (v) that the representor acted negligently in making the representation; (vi) reasonable reliance by the representee on the representation; and (vii) the resulting loss or damage. R.25.06(8) of the Ontario *Rules of Civil Procedure*, RSO 1990, c C 43, also requires that: "Where fraud, misrepresentation, breach of trust, malice or intent is alleged, the pleading shall contain full particulars, but knowledge may be alleged as a fact without pleading the circumstances from which it is to be inferred."

surrounding the formation of the agreement and the party only became aware of that misrepresentation beyond the two-year mark, a successful claim for equitable rescission is conceivable.

Equitable rescission may also be available in one circumstance where statutory rescission appears to be precluded: instances of misrepresentation in the franchise disclosure document that do not amount to non-disclosure. Pursuant to section 7 of the *AWA*, "[i]f a franchisee suffers loss because of a misrepresentation" the franchisee is entitled to seek compensatory damages.[148] This point was also acknowledged in *2219338 Ontario Ltd v Grill It Up! Restaurants Inc*, where Justice Quigley held that misrepresentation gives rise to a "slightly less severe" remedy of "a right to obtain damages", as opposed to a right of rescission.[149] In these instances, a savvy franchisee may be able to seek rescission through equity, since the discretion to order the remedy ultimately rests with the court that hears the matter and courts have held that equitable rescission is available in instances of innocent or negligent misrepresentation.

As discussed in *Choi*, there could also be an opportunity for a claim in equitable rescission if a party is subject to "unconscionable conduct of such a nature so as to render a bargain questionable on equitable grounds." Such a claim would inherently be fact driven, but it may provide a fruitful and, seemingly novel, claim for rescission of a franchise agreement. Moreover, based on the amorphous nature of the phrase "unconscionable conduct of such a nature as to render a bargain question on equitable grounds", one can envision a host of claims grounded in this proposition.

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[148] *AWA supra* note 22 at section 7(1).

[149] 2012 ONSC 6621, 222 ACWS (3d) 627 at para 27.

RELIEF FROM FORFEITURE

Definition

Relief from forfeiture is a purely discretionary equitable remedy which allows a party to maintain legal rights that would otherwise be forfeited due to default.[150] The remedy is most often evoked in situations of breach of contract, where the breach in question is minor and allowing a party to terminate the agreement would be a harsh result vis-à-vis the severity of the actual breach. If compensation could satisfy the non-breaching party's loss, then the courts may use relief from forfeiture to shield a breaching party from an unconscionable outcome.[151]

All Canadian jurisdictions have statutes which expressly provide for relief against forfeiture. In Ontario, the statutory basis for the remedy is contained in section 98 of the *Courts of Justice Act*, which states:

> A court may grant relief against penalties and forfeitures, on such terms as to compensation or otherwise as are considered just.[152]

The power is broad, enabling the courts to prevent the forfeiture of a proprietary right under any *private* contract.[153] However, in circumstances where the forfeiture in question is the

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[150] *Halsbury's supra* note 103 at HER-22 "Nature of Relief Against Forfeiture".

[151] *Snell's Equity supra* note 105 at 385-386.

[152] RSO 1990, c C43 at section 98.

[153] *Comtab Ventures Ltd v Canada*, [1984] FCJ No 922 (QL) (TD), 28 ACWS (2d) 430 at paras 26 – 28.

result of a statutory rule, the outcome is different; the courts must give effect to the statute's provisions.[154]

Test for Relief From Forfeiture

The test for relief from forfeiture was confirmed in the leading case, *Saskatchewan River Bungalows Ltd. v Maritime Life Assurance Co.*("*Saskatchewan River Bungalows*")[155] The Court set out three factors to be considered before granting relief from forfeiture:

1. The reasonableness of the breaching party's conduct;
2. The gravity of the breach; and
3. The disparity between the value of the property forfeited and the damage caused by the breach.[156]

On the facts before the Court, relief from forfeiture was denied as a result of the conduct of the party in breach. The breaching party had defaulted on payments under an insurance contract, was made aware of the default, but failed to remedy the situation.[157] As such, Justice Major was unwilling to grant relief from forfeiture on the basis that the reasonable conduct requirement had not been met. Justice Major did not consider the second and third branches of the test.[158]

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[154] *Canadian National Railway Co v R* (1922), 64 SCR 264, [1923] 2 DLR 693 at para 35.

[155] [1994] 2 SCR 490, [1994] SCJ No 59.

[156] *Ibid* at para 32. This test has been affirmed in numerous Ontario Court of Appeal judgments, including: *PDM Entertainment Inc v Three Pines Creations Inc*, 2015 ONCA 488, [2015] OJ No 3420; *Kozel v Personal Insurance Company*, 2014 ONCA 130, 119 OR (3d) 55 [*Kozel*]; and *Ontario (AG) v McDougall*, 2011 ONCA 363, [2011] OJ No 2122.

[157] *Ibid* at para 34.

[158] *Ibid* at para 35.

In *Kozel v The Personal Insurance Company* ("*Kozel*"), however, the Ontario Court of Appeal elaborated on the test for relief for forfeiture.[159] The Court explained that the first factor focuses on the breaching party's conduct "as it relates to all facets of the contractual relationship, including the breach in issue and the aftermath of the breach."[160] The second factor examines "both the nature of the breach itself and the impact of that breach on the contractual rights of the other party."[161] Finally, the third factor involves an analysis of the proportionality between the forfeiture and the damage caused by the breach.[162]

Relief From Forfeiture in Franchise Jurisprudence

In the franchise context, relief from forfeiture is typically sought by a franchisee when faced by termination pursuant to the terms of a franchise agreement. Commonly, agreements will expressly state that the franchisor has a right to terminate the contract upon the occurrence of specific events. Defaults that typically give rise to a right of termination include, *inter alia*: (i) non-payment of fees or royalties, (ii) failure to provide timely financial reporting, and (iii) failure to meet performance targets.[163] In the event of a default that either has not been cured or that gives rise to an immediate right of termination, the franchisor will serve notice of termination and the franchisee will resist with an application for relief for forfeiture.

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[159] *Kozel supra* note 156.

[160] *Ibid* at para 61.

[161] *Ibid* at para 67.

[162] *Ibid* at para 69.

[163] Daniel F So, *Canadian Franchise Law: A Practical Guide* 2nd ed (Markham, Ont; LexisNexis, 2010) at 157.

To date, efforts to resist termination in franchise matters have met with little success. Judges are loathe to prevent a party from enforcing a valid contractual provision in a commercially reasonable way. Commensurate with general commercial law principles, courts will enforce the terms of a freely entered into agreement. Simply put, the jurisprudence is replete with examples of relief from forfeiture being denied.[164]

For example, in *Love v Turf Management Systems Inc*,[165] the plaintiff franchisee breached the terms of a franchise agreement by virtue of a shareholder selling his 49% interest to the majority shareholder. The franchisee was obliged to provide the franchisor with a right of first refusal and obtain the franchisor's consent to the sale, but did neither. The defendant franchisor then terminated the agreement and the franchisee sought relief from forfeiture.[166] In rejecting the plaintiff's claim to the remedy, Justice MacKinnon held that:

> This is a commercial contract entered into between two parties *of at least average sophistication* after both having independent legal advice. The court should construe the agreement fairly and broadly to ensure that the basic intention and object of the contract is carried out. A court must not deviate from the literal force of a particular article of an agreement where the intention of the parties is clearly and unequivocally expressed, unless such clear intention is plainly controlled or contradicted by other parts of the agreement. That exception is not applicable to the case at bar [emphasis added].[167]

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[164] In jurisdictions outside of Ontario, claims for relief from forfeiture have also failed, including, for example: *Leader Window Fashions Ltd v Home Products Inc*, [1993] BCWLD 854, 38 ACWS (3d) 1147 and *C Corp (Ontario) Inc v E & S Kramps Holdings*, [1989] CLD 1138, 16 ACWS (3d) 391 (QB).

[165] [1997] OJ No 5054, 38 BLR (2d) 70 (Gen Div).

[166] *Ibid* at para 3.

[167] *Ibid* at para 9.

Mackinnon J.'s cogent analysis is a common judicial refrain—courts will favour enforcement of commercial contracts where they are clear and the parties to the agreement are of at least "average sophistication". Franchisors and franchisees need not have a high degree of business acumen for the courts to uphold a termination pursuant to the express terms on an agreement.

CM Takacs Holdings Corp. v 122164 Ontario Ltd[168] is another example of a court refusing to evoke its equitable jurisdiction to block a termination. The defendant franchisor terminated the plaintiffs' franchise agreements with respect to four New York Fries locations,[169] as a result of the franchisee making consistently late payments and "showing all the hallmarks of bankruptcy."[170] The franchisee sought relief from forfeiture. While upholding the validity of the termination, Justice Leitch stated:

> The defendant is exercising its right under a commercial contract. I have found that its conduct has been commercially reasonable. They have complied with the duty of fair dealing and have acted in good faith.[171]

The Court's mention of fair dealing and good faith helps explain the reluctance of Canadian courts' to grant relief from forfeiture. Courts have consistently found that the relationship between franchisor and franchisee is one of ordinary good faith and does not

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[168] 2010 ONSC 3817, 190 ACWS (3d) 755.

[169] *Ibid* at para 1.

[170] *Ibid* at para 41.

[171] *Ibid* at para 40.

amount to a higher duty of *uberrima fides*, or utmost good faith.[172] As long as the franchisor, in the course of terminating the franchise agreement, acts honestly and reasonably with due regard for the franchisee's interest, the franchisor is not required to accede to a breaching party's request for relief in the face of a termination, and is entitled to act self-interestedly in relying on the terms of the agreement, strictly construed.[173]

Future of Relief From Forfeiture—When Might Relief From Forfeiture Succeed?

Given that the courts have consistently upheld the right of franchisors to terminate a relationship with a franchisee, is there a possibility that a claim for relief from forfeiture could ever succeed in franchise litigation?

Although the jurisprudence to date has made it difficult to envision, the decision of Justice Pitfield in *677815 B.C. Ltd. v Mega Wraps B.C. Restaurants Inc.* ("*Mega Wraps*")[174] sheds some light on when the equitable remedy might be granted. The plaintiff franchisee had acquired the rights to two turn-key wrap style restaurants in Victoria, B.C.[175] Due to construction deficiencies with the franchise locations, the franchisor authorized the franchisees to withhold certain monies owing until the deficiencies were repaired.[176] Shortly thereafter, the franchisor

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[172] See, for example*, Pizza Ltd v 805837 Ontario Inc*, 1997 CarswellOnt 5494 at para 131, where Epstein J (as she then was) held: "While within a franchise relationship, as in every relationship governed by contract, there is a duty to act toward each other in good faith, the nature of the relationship does not give rise to the level of confidence or authority that arises in contacts *uberrimae fides*. In a business relationship where both sides freely enter into the contract with an opportunity to be fully informed…then other than an implied duty to act fairly and in good faith, the duties are governed by the terms of the contract."

[173] *1177304 Ontario Inc (cob Harvey's Restaurant) v Cara Operations Ltd*, [2008] OJ No 4370, 54 BLR (4th) 244 (Sup Ct) at para 68.

[174] 2005 BCSC 503, [2005] BCWLD 2568 [*Mega Wraps*].

[175] *Ibid* at para 2.

[176] *Ibid* at para 10 – 11.

claimed that the deficiencies had been rectified and demanded payment; the plaintiffs refused, asserting that the deficiencies remained.[177] The franchisor then served notice of termination for breach and the franchisee responded by challenging the lawfulness of the termination.[178]

Justice Pitfield determined that the termination was unlawful and that relying on the equitable remedy was unnecessary. However, in *obiter*, Pitfield J. explained that, had termination not otherwise been unlawful, he would have exercised his equitable jurisdiction to provide relief from forfeiture.[179] In accordance with the test espoused in *Saskatchewan River Bungalows*, Justice Pitfield noted that the subject matter of the dispute was "purely monetary" and that the amount of arrears owing under the agreement was relatively small vis-à-vis the money paid to acquire the franchise. Moreover, there was no "impropriety" on the part of the plaintiff, such that termination of the contract for such an insignificant amount would result in an "unreasonable and unacceptable result."[180]

Justice Pitfield's reasoning is instructive and provides guidance for franchisees resisting termination through a claim of relief from forfeiture. First, the Court's emphasis of the "solely economic" nature of the dispute suggests that courts may be willing to order the remedy if a

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[177] *Ibid* at para 13.

[178] *Ibid* at para 16 – 17. *Anc Business Solutions Inc v Virtulink Canada Ltd*, 2014 ONSC 1619, 238 ACWS (3d) 623, is another case where the Court found an unlawful termination, but explained that had the termination not been unlawful, the Court would have granted relief from forfeiture on an equitable basis. In reaching this conclusion, the Court found that the franchisee met all three elements of the *Saskatchewan River Bungalows* test (paras 66 – 67). With respect to the third branch of the test—the disparity between the value that would be forfeited and the damage caused by the misconduct—the Court emphasized that the franchisee had invested over $1 million into the business and the alleged breach of operating without an approved voicemail system was comparably minor. As a result, the Court held that permitting the termination of the agreement for a relatively minor breach would result in a particularly inequitable outcome (para 68).

[179] *Ibid* at para 33.

[180] *Ibid* at para 34.

termination right is being exercised strictly in relation to a monetary breach. In particular, in circumstances where the breach is minor vis-à-vis the breaching party's overall economic obligations, the remedy is more likely to be awarded. Secondly, if the party seeking relief is able to demonstrate that it came to court with "clean hands", the courts will be more inclined to award the remedy. In *Mega Wraps*, the franchisees had relied on the representation of the franchisor to withhold monies owed and, as such, their conduct was clearly not blameworthy. The requirement that a party seeking equitable relief come to court with clean hands speaks to the "reasonableness of the breaching party's conduct" in the *Saskatchewan River Bungalows* test, and has been affirmed as a requirement for obtaining relief from forfeiture in other franchise jurisprudence.[181]

Ultimately, successful claims for relief from forfeiture will be inherently fact driven. Franchisees that hope to resist termination must be mindful of the factors outlined in *Saskatchewan River Bungalows* and, in particular, the requirement that their own behaviour in the circumstances be reasonable. If a franchisee can demonstrate that it acted without impropriety and the circumstances are such that monetary compensation is sufficient to satisfy the franchisor's loss, a successful claim for relief from forfeiture may be attainable.

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[181] See, for example, *Sebe v TDL Group Ltd*, [1997] OJ No 407, 69 ACWS (3d) 110 aff'd 72 ACWS (3d) 1217, 1997 CarswellOnt 2724 (CA) at paras 24 – 26, where Justice Macdonald refused to grant relief from forfeiture since the franchisee had defaulted on several payments and had breached the terms of a settlement agreement. Also see, *Kochar v Ruffage Food (EC) Corp*, 23 RPR (2d) 200, 32 ACWS (3d) 982 (Ont Gen Div) at para 9, where the Court would not evoke its equitable jurisdiction since the franchisee was hiding revenue which defeated a large portion of royalties owed under the franchise agreement.

EQUITABLE SET-OFF

Definition

Equitable set-off is a remedy that allows a defendant to reduce a damages award on the basis of a related claim it has against a plaintiff. At its simplest, equitable set-off enables a party to reduce its liability to another party by an amount that party owes to it:

> [Set-off] arises if 'A' has a claim against 'B', and 'B' has a claim against 'A'. In this case, an evaluation of the elements of the cross-claims between 'A' and 'B' may be taken to determine the extent, if any, of the ultimate sum payable between 'A' and 'B'.[182]

The remedy is available in respect of claims for a liquidated or unliquidated money sum. In order to effectively plead equitable set-off, the defendant's claim must have been "so closely connected with [the plaintiff's] demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim." [183] The relationship between the parties and their underlying obligations has been simply stated as one of a "close connection" or "interconnectedness."[184]

Equitable set-off is often contrasted with two other forms of set-off recognized in law: (i) contractual set-off, and (ii) legal set-off. Contractual set-off—like equitable set-off—involves the discharge of debts. However, contractual set-off differs in that the right arises as a result of mutual agreement between the parties and is governed by the law of contract. Consequently, parties who have a contractual right of set-off are free to establish whichever arrangement they

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[182] Kelly R Palmer, *The Law of Set-Off in Canada* (Aurora: Canada Law Book Inc, 1993) at 1.

[183] *Algoma Steel Inc v Union Gas Ltd*, [2003] OJ No 71, 63 OR (3d) 78 (CA) at para 29, citing favourably to Justice Wilson in *Telford v Holt*, [1987] 2 SCR 193, 41 DLR (4th) 385.

[184] *Coba Industries Ltd v Millie's Holdings (Can) Ltd*, 65 BCLR 31, [1985] BCWLD 2768 (CA) at para 20.

wish.[185] In contrast, equitable set-off, like all equitable remedies, is a purely discretionary remedy at the disposal of the courts.

Legal set-off also shares many similarities with equitable set-off, but differs in its scope of application. Specifically, legal set-off is limited to debts between two parties, which are *mutual* cross-obligations. Assessing mutuality requires an analysis between the parties and the nature of the obligations themselves; the debts must be between the same parties and in the same right. The mutuality requirement in legal set-off results in the remedy being unavailable if the debt is assigned, unless the rights of set-off have accrued before the assignment takes place.[186] In contrast, under equitable set-off the courts do not limit the application of the remedy to mutual cross-obligations; rather, as long as the debts are sufficiently interconnected, the court may exercise its discretion to grant the remedy. Moreover, since mutuality is not a requirement for equitable set-off, assignment of an obligation does not result in the defeat of the remedy.[187]

Test for Equitable Set-Off

The test for equitable set-off was endorsed by the Supreme Court of Canada in *Telford v Holt* ("*Telford*")[188] and consists of five elements:

> 1. The party relying on set-off must show some equitable ground for being protected against his adversary's demands;

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[185] *Halsbury's Laws of Canada*, vol 57, *Debtor and Creditor* (Markham, Ont: LexisNexis Canada, 2012) at HDC-14 "When set-off is available".

[186] *Ibid*.

[187] A Robert Anderson et al, "Recent Developments in the Law of Set-Off", *The Annual Review of Insolvency Law*, Ed Dr Janis P Sarra (Thomson Reuters, 2009) at 11.

[188] [1987] 2 SCR 193, 41 DLR (4th) 385.

> 2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed;
> 3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross claim;
> 4. The plaintiff's claim and the cross-claim need not arise out of the same contract; and
> 5. Unliquidated claims are on the same footing as liquidated claims. [189]

The elements required to establish a claim to equitable set-off are not hotly contested, with the exception of the third requirement: interconnectedness between the plaintiff and defendant's claims. In *Telford*, for example, the focus of the Court's analysis was whether the plaintiffs could establish that the respective debts arose "of the same contract or closely interrelated contracts."[190] Ultimately, Justice Wilson found that the debts were sufficiently connected, since they arose out of the same land exchange deal.[191]

Equitable Set-Off in Franchise Jurisprudence

In Canadian franchise jurisprudence, only a handful of cases address equitable set-off and it is posited as a helpful tool to be used for a defendant franchisor who has been sued by a plaintiff franchisee that itself is in default of its obligations.

The decision in *2189205 Ontario Inc. v Springdale Pizza Depot Ltd.* ("*Springdale*") is instructive.[192] The plaintiff franchisee had already obtained a final judgment enabling it to

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[189] *Ibid* at para 35.

[190] *Ibid* at 39.

[191] *Ibid*.

[192] 2013 ONSC 1251, 226 ACWS (3d) 8. Note that the *Springdale* litigation has resulted in eleven separate decisions, thereby providing considerable guidance to a franchisor attempting to avail themselves of the remedy.

rescind a franchise agreement pursuant to section 6(2) of the *AWA*.[193] Yet to be adjudicated by the Court, however, were the franchisee's additional claims for compensatory damages, under section 7 of the *AWA*. Prior to adjudication, the franchisor sought leave to amend its pleadings to add an additional claim of equitable set-off for debts owed by the franchisee at the time of rescission and in respect of franchisee's damages claim under section 7 of the *AWA*.[194]

In upholding the franchisor's right to set-off against the franchisee's s damages claim, Justice Morgan held that the *AWA*, "does not cloak the franchisee with a form of immunity" and that remedies under the *Act* were, in fact, subject "to the defences and counterclaims raised by a franchisor."[195] The Court reasoned, "it would be unthinkable to allow a franchisee to claim return of money spent on equipment without allowing a franchisor to seek a corresponding order that the equipment be returned."[196] Justice Morgan's analysis accords with section 9 of the *AWA,* which provides that remedies available under the *AWA* are in addition to those a party to a franchise agreement may otherwise have at law. In short, restricting the franchisor's right to equitable set-off would be inconsistent with the overall statutory scheme of the *AWA*.

Significantly, however, Justice Morgan restricted the availability of the equitable set-off claim to the section 7 damages claim and refused to allow the claim with respect to section 6 rescission claims.[197] This limitation was later endorsed by Justice Lederman of the Superior

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[193] *Ibid* at para 4. Significantly, pursuant to section 6(6), a successful claim for rescission under section 6(1) & (2) of the *AWA*, obliges the franchisor to refund to the franchisee money paid in the establishment and operation of the franchise, purchase all inventory and equipment at the purchase price paid by the franchisee, and compensate the franchisee for any losses that the franchisee may have incurred in acquiring, setting up and operating the franchise.

[194] *Ibid* at para 7.

[195] *Ibid* at paras 12 – 13.

[196] *Ibid* at para 14.

[197] *Ibid* at para 16.

Court of Justice[198] and, ultimately, by a panel of the Court of Appeal.[199] For his part, Justice Lederman made clear that the "amounts under ss. 6(6) (a) – (c) [of the *AWA*] are payable to the rescinding franchisee regardless of revenue earned."[200] Were it otherwise, then subsections 6(6) (a) through (c) [of the *AWA*] would "not be necessary" since a "single section providing compensation for [the franchisee's] net losses would suffice if the intention of the *Act* was simply to put the franchisee back in its former position."[201]

Outside the *Springdale* saga, equitable set-off has also been addressed—with mixed results—in a few summary judgment motions. In *241 Pizza (2006) Ltd v Loza*,[202] the plaintiff franchisor sued the franchisee for monies owing in respect of royalty fees, advertising fees, and rental arrears. The franchisee, in response, counter-claimed for alleged fundamental breaches of the franchise agreement and breaches of the duty of fair dealing. The franchisees claimed equitable set-off against the monies owing to the franchisor.[203]

In granting the plaintiff's motion for summary judgment and rejecting the defendant's claim for equitable set-off, the Court explained in detail that the defendant failed to establish both an equitable ground for the remedy and a close connection between the relief sought and

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[198] *2189205 Ontario Inc v Springdale Pizza Depot Ltd*, 2013 ONSC 1232, 227 ACWS (3d) 87 [*Springdale*].

[199] *2189205 Ontario Inc v Springdale Pizza Depot Ltd*, 2013 ONCA 626, 233 ACWS (3d) 64.

[200] *Springdale supra* note 198 at para 29.

[201] *Ibid* at para 30.

[202] 2016 ONSC 6623

[203] *Ibid* at para 3 – 7.

the demands of the plaintiff.[204] Most poignantly, however, the Court emphasized the importance of substantiating one's claims to equitable set-off. In this case, the defendant failed to put forward any evidence in respect of the amounts sought by way of equitable set-off and the Court admonished the franchisee for this obvious deficiency.[205]

Hino Truck Centre (Toronto) Ltd v Hino Motors of Canada Ltd,[206] provides an example where the claim to equitable set-off was successful. In *Hino* the franchisee owed the franchisor a considerable amount of money for a fleet of trucks. The franchisee in turn claimed a debt owed by the franchisor for breach of its obligations.[207] The Court applied equitable set-off to give the franchisor the balance of the debts respecting the sale of trucks.[208]

By contrast, in *Tupperware Canada Inc v 1196815 Ontario Ltd,* the Court rejected the defendant's claim to equitable set-off.[209] The Court held that—in keeping with other areas of the law—equitable set-off does not apply to promissory notes or other bills of exchange.[210] Interestingly, the Court also briefly considered the issue raised in the *Springdale* litigation: namely, whether set-off could be available in the context of statutory rescission under section 6

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[204] *Ibid* at para 19 & 36.

[205] *Ibid* at para 39.

[206] 181 ACWS (3d) 936, 2009 CarswellOnt 6584 (Sup Ct).

[207] *Ibid* at 23.

[208] *Ibid* at 30 – 31.

[209] [2008] OJ No 532, 164 ACWS (3d) 614 (Sup Ct).

[210] *Ibid* at para 33 – 34, citing favourably to *Iraco Ltd v Staiman Steel Ltd*, 54 OR (2d) 488, [1986] OJ No 242 (Sup Ct).

of the *AWA*. Ultimately, however, the Court determined that this was a triable issue, which should not be addressed on a summary judgment motion.[211] The franchisee's argument that section 6(6) of the *AWA* exclusively governs the determination of amounts owing upon rescission—thereby superseding the law of set-off—was left to be reconsidered on another day.[212]

Outside of these cases, there are few reported decisions that address the issue of equitable set-off in the franchise context. Nevertheless, given the "close connection" that inheres between parties to a franchise agreement, one can imagine that claims for equitable set-off will proliferate should franchisors and franchisees have debts owed to one another. Given the helpful direction from the Court in the *Springdale* litigation, when it comes to claims for incomplete or non-disclosure, a franchisor would be wise to restrict claims to equitable set-off to claims for damages under section 7 of the *AWA*.

CONCLUSION

Franchise lawyers must be equipped with a wide range of competencies and an understanding of an array of different legal areas including, *inter alia*: commercial, real estate, intellectual property, consumer protection, tax, labour and employment, and, increasingly, litigation. As franchisees and franchisors continue to bring their disputes to the courts in order to enforce their legal rights, jurists will no doubt increasingly rely upon equitable principles to devise a remedy that most appropriately suits the circumstances before them. In an effort to achieve the best result for their clients, lawyers, whether acting for franchisors or franchisees, will increasingly be called upon to be fully apprised not only of the applicable legal doctrines but

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[211] *Ibid* at paras 49 – 50.

[212] *Ibid* at para 39.

also the available equitable maxims and remedies that in the appropriate case, may have the greatest impact on its outcome.