

JANUARY 2012

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The Quebec Court of Appeal Just Rendered an Important Judgment Regarding Franchisees' Rights and Recourses in Case of Territorial Encroachment

Important note: Fraser Milner Casgrain (*Me Luc Giroux*) represented Canadian Tire Corporation Ltd. in this case.

Last December 1st, the Quebec Court of Appeal rendered, in the case of *Martineau v. Canadian Tire Corporation Ltd.*¹, an important judgment dealing with several aspects of the relationship between a company and the merchants doing business under its banner, particularly with respect to fraud by concealment, contract of adhesion and territorial encroachment.

Facts

Real Martineau, a long-time merchant operating a Canadian Tire store, instituted an action for damages claiming the sum of \$ 6,167,000 from Canadian Tire Corporation on the basis that Canadian Tire Corporation had, according to this merchant, committed fraud by concealment when his merchant contract was extended in October 1999.

Mr. Martineau alleged in its procedures that, prior to the signature of his new merchant contract, Canadian Tire Corporation had permitted the establishment of two new Canadian Tire stores within the commercial area of his store, one in Blainville and the other in Fabreville, without previously informing Mr. Martineau of this situation.

¹ *Martineau v. Canadian Tire Corporation Ltd*, Quebec Court of Appeal, December 1st 2011, court file number 500-09-019165-083; 2011 QCCA 2198.

The contract between Mr. Martineau and Canadian Tire Corporation included a territorial protection policy (the "Encroachment Policy") aiming to protect, under certain conditions, the merchant's goodwill in case of the establishment of new Canadian Tire stores within his commercial area. This policy, external to the main contract, however provided that the merchant had no right to be compensated if it had previously accepted the arrival of a new Canadian Tire merchant within his commercial area. Also, even when the merchant's consent has not been given, the Encroachment Policy provided that the merchant had to bear the first 5% of decrease in his annual sales caused by the establishment of a new store before being entitled to compensation, for a period of 2 years, based on a formula set out in Encroachment Policy.

Mr. Martineau claimed that the merchant contract and the Encroachment Policy were both contracts of adhesion since their essential stipulations were imposed by Canadian Tire Corporation. The latter claimed that, on the contrary, both had been negotiated and agreed upon by mutual agreement.

Analysis

Negotiations and the qualification of the agreement as a contract of adhesion

According to the Court of Appeal, and contrary to a commonly held belief in the franchise community, a merchant agreement which has not been negotiated directly between a company and a merchant operating under its banner is not necessarily a contract of adhesion.

For instance, when a merchant's association has negotiated the company's standard agreement, a certain equality of strength between the negotiating parties may, in the view of the Court of Appeal, be inferred and, consequently, prevent the qualification of the agreement as being a contract of adhesion and the application of all constraints resulting from such qualification.

In this case, the Court of Appeal held that Mr. Martineau's merchant contract had been negotiated Canadian Tire Dealers' Association and should therefore be qualified as a contract by mutual agreement and not as a contract of adhesion.

Free and informed consent and the absence of prejudice

Considering the evidence, the Court of Appeal also concluded that Mr. Martineau knew, before extending his merchant contract on October 7, 1999, that Canadian Tire Corporation would establish a new store in Blainville. Therefore, he could not later claim fraud since his consent was free and informed at the time the extension contract was signed.

Regarding the establishment of another Canadian Tire store in Fabreville, the Court found that Mr. Martineau was only informed after the signing of the extension contract on October 7, 1999. However, the Court also found that no loss subject to compensation had been incurred by Mr. Martineau. The evidence showed that, in the two years following the establishment of the Fabreville store, the sales of the store of Mr. Martineau had only dropped by 3.5% per year, which was below the 5% threshold per year that would have entitled Martineau to an indemnity under the Encroachment Policy.

As the Court of Appeal found that all merchants, through their association, had negotiated their merchant contract and the Encroachment Policy, it also found that all merchants had given their informed consent to the 5% threshold before being entitled to any compensation.

Furthermore, the Court added that, although the merchant claimed otherwise, a 5% threshold before having the right to be compensated in case of territorial encroachment was reasonable.

Obligation to inquire

In this case, Mr. Martineau had received two pro forma statements from Canadian Tire Corporation. The merchant did examine the

figures shown in the first pro forma statement he received, but did not review the second one which revised the first one downward.

The Court of Appeal pointed out, in this regard, that the merchant had a duty to inquire.

The merchant is therefore required to make its own due diligence on data received from the company and cannot satisfied himself with the figures received from the latter or refrain from inquiring an ambiguous situation arising from the receipt of two different pro forma statements, as in this case. The merchant must therefore act with prudence, especially since these pro forma statements did not constitute a guarantee under any circumstances whatsoever.

Implied waiver

The Court of Appeal said that a waiver to the exercise of a right or recourse may also be inferred from the merchant's conduct.

When a merchant feels aggrieved by the conduct of the company, it must act within a reasonable time and not act in a way that could reasonably be construed as a waiver of its recourses.

In this case, Mr. Martineau had waited more than two years before bringing his action. Moreover, he agreed, during this period, to an expansion of his store, while alleging in his proceedings that, had he known the true situation, he would never have agreed to sign his extension contract in October 1999.

Also, he did not take advantage of with the Canadian Tire Corporation's policies to attempt to minimize his damages.

The Court of Appeal concluded that, in addition to the other grounds for dismissal of its action, the behaviour of Mr. Martineau was, in any case, equivalent to a waiver of his rights.

Conclusions

According to this important ruling, the indemnity provisions stipulated in the Canadian Tire Corporation's merchant contracts, in the case of

territorial encroachment, are valid and enforceable.

Also, according to the Court of Appeal, stipulating that a merchant must bear the first 5% of losses in sales caused by the establishment of a new store within a specific commercial area before being entitled to any indemnity does not constitute an abusive clause.

On another level, the intervention of a merchant's association in the negotiation of the standard agreement can prevent the qualification of such agreement as a contract of adhesion.

Regarding the financial projections provided by a company, this decision reiterates the principle that a merchant should not blindly accept without question the projections submitted by the company and that it should act prudently by making his own financial analysis.

Finally, the fact that a merchant does not promptly complain about the establishment of a new store within its commercial area may amount to a tacit acceptance of such encroachment.

Obviously, the quality of the agreement and the relevance of its provisions, particularly in regard to territorial encroachment, were key factors in obtaining this favourable decision for Canadian Tire Corporation.

Complaints of territorial encroachment often constitute a hot topic between a company and its merchants and the best way to avoid problems in this respect is to stipulate clear and reasonable provisions in the franchise agreement.

Launching of a New Book on the Management of the Franchisors-Franchisees Relationship

On January 18th 2012, Jean H. Gagnon, counsel and strategic advisor in the FMC's Franchise and Distribution Law Group, launched his 19th book titled "*LE PARTENARIAT STRATÉGIQUE: Comment profiter pleinement des forces du franchisage*"

(“STRATEGIC PARTNERSHIP: How to fully take advantage of the strengths of franchising”).

In this new book, Jean describes an innovative model for the management of the relations between a franchisor and his franchisees in order to more fully take advantage of the strengths and resources of franchising as a business model.

For more information, here is the link to the Éditions Yvon Blais’ website page describing *(unfortunately in French only at this time)* the content of this [book](#).

An English version this book should be available later this year.

Contact Us

Please contact a member of the [National Franchise and Distribution Group](#) for more information on doing business in Quebec or protecting your company’s brand name and business name.