Cassels

Arbitration Frustration: Narrowly Drafted ADR Clause Prevents Franchisor from Arbitrating Against Individual Franchisee Operators

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The use of arbitration clauses in Canadian franchise agreements is increasingly common and, when carefully drafted, these agreements can provide many benefits to franchisors.

However, a recent decision of the Ontario Superior Court of Justice shows the unintended consequences of a poorly drafted arbitration clause. In *Kanda Franchising Inc. and Kanda Franchising Leaseholds Inc. v. 1795517 Ontario Inc.*, the Court ordered that a franchisor's claims against its corporate franchisee must be arbitrated pursuant to an arbitration provision in the franchise agreement, but declined to compel the individual operators of the franchise agreement to arbitrate along with the franchisee due to the strict, narrow language of the arbitration provision.[1]

In this case, following the breakdown of the relationship between Kanda, a franchisor of optical retail stores, and its franchisee in Richmond Hill, Ontario, the franchisor delivered a Notice to Arbitrate seeking damages for breach of contract and breach of the duty of good faith and fair dealing under section 3 of the *Arthur Wishart Act* (Franchise Disclosure), *2000* (the Wishart Act). The claim was brought against the corporate franchisee as well as the two individual owner-operators of the franchise agreement. In response, counsel for the franchisee parties agreed that the claims against the corporate franchisee were subject to the arbitration clause, but refused to consent to the arbitration of the claims against the individuals on the basis that they were not parties to the arbitration agreement. The franchisee parties also disagreed with the franchisor's choice of arbitrator. The franchisor then brought an application to the Court seeking to appoint their preferred arbitrator and compel all of the franchisee parties to arbitration of the dispute.

After reviewing the relevant contractual language and the *contra proferentem* principle, which requires that contractual language be interpreted in favour of the non-authoring party of the contract, the Court sided with the franchisee parties, finding that the individual defendants were not parties to the franchise agreement and its arbitration provision and, therefore, could not be compelled to submit to arbitration. The only signing party to the franchise agreement on the franchisee side was the corporate defendant, and although the franchise agreement imposed express obligations on the individuals, this did not rise to the level of making them parties to the agreement. The Court also noted that the arbitration provision was not drafted to expressly include claims by and against shareholders, directors, and employees of the franchisee (as some arbitration clauses are). As such, the Court inferred that the franchisor had either chosen not to do so or was aware

that the franchisee would not have accepted such a term. As a result, the Court ordered that only the dispute between the franchisor and corporate franchisee be submitted to arbitration, with the franchisor's preferred arbitrator being appointed.

In *Kanda*, imprecise drafting led to the peculiar outcome that the franchisor's claims against one defendant (the corporate franchisee) could be arbitrated, while its claims against the other defendants (the individuals) would have to proceed before the courts, if at all. Such a result could likely have been avoided through more careful drafting of the franchise agreement and its arbitration clause. Had the individuals been made guarantors to the franchise agreement and expressly subject to the arbitration provision, it seems likely that the Court would have allowed all of the franchisor's claims to proceed by way of arbitration.

However, Kanda raises other questions with respect to the arbitrability of claims which are frequently made by franchisees against non-party "franchisor's associates," "agents" or "brokers" which courts have previously compelled to arbitration where the relevant franchise agreement contained an arbitration clause.[2] Franchisors seeking to avail themselves of the benefits of arbitration clauses should be careful to draft them expansively, given the narrow and franchisee-friendly approach courts are likely to apply in resolving a dispute over the scope of the arbitration agreement.

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[1] *Kanda Franchising Inc. and Kanda Franchising Leaseholds Inc. v. 1795517 Ontario Inc.*, 2017 ONSC 7064 (CanLII), <http://canlii.ca/t/hp0lc> (*Kanda*)

[2] See for example: *Nazarinia Holdings Inc. v 2049080 Ontario Inc.*, 2010 ONCA 739, <http://canlii.ca/t/2d614>; *MDG Kingston Inc. v MDG Computers Canada Inc.*, 2008 ONCA 656, <http://canlii.ca/t/20xf4>