Best practices: Including mediation and arbitration clauses in franchise agreements

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Whether to include a mediation clause and/or an arbitration clause in a franchise agreement requires careful consideration. While in certain circumstances mediation and arbitration offer significant advantages over in-court litigation of disputes, in other circumstances, mediation and arbitration may not be appropriate or may actually increase the complexity, time and cost of resolving disputes.

It is important to note that mediation and arbitration clauses generally will bind only parties to the franchise agreement. Franchise disputes often involve other interested parties who are not parties to the franchise agreement, such as alleged franchisor associates in cases involving disclosure under the Arthur Wishart Act (Franchise Disclosure) (AWA). These parties are not caught by mediation or arbitration clauses and may commence a court proceeding. In 2296423 Ontario Limited v. FOF Franchise Corp., the Ontario Superior Court of Justice declined to stay a civil action for rescission and damages because of an arbitration clause in the franchise agreement. The plaintiffs included the guarantor of a sublease, a sublandlord and a subtenant, none of whom were parties to the franchise agreement. The franchisor therefore had to defend the litigation in court, after having spent presumably significant time and expense litigating the enforceability of the arbitration clause.

MEDIATION CLAUSES

Mediation certainly offers many benefits, and can be very effective at early stages of franchise disputes to encourage early and cost-effective resolution. Mediation offers particular advantages for disputes between franchisors and existing franchisees where there is a mutual interest in preserving an ongoing franchise relationship.

However, mediation is most successful when it is agreed to and entered into voluntarily. In the absence of a mediation clause, parties to a franchise agreement may agree to mediate without having to comply with a specific term of the franchise agreement (which may impose certain limitations or requirements for mediation which may not be appropriate in the particular circumstances of a dispute). Additionally, a mediation clause can act as an obstacle to a franchisor who is not interested in mediating a particular dispute and wishes to proceed immediately to court. Importantly, in some Canadian jurisdictions (including in certain jurisdictions in Ontario), mediation is mandatory, and a franchisor considering including a mediation clause in its franchise agreement should assess the benefits of doing so where
mediation is already required by rules of court.

As with arbitration clauses, it is critical that careful consideration be given to drafting a mediation clause, including certain key aspects:

- timing of mediation (whether mediation is required as a condition-precedent to commencing an arbitration or litigation proceeding)
- types of disputes to be mediated (and carve-outs for disputes that may not be appropriate for mediation, for example, where injunctive relief is sought, such as where trademarks or other intellectual property is at issue)
- location of the mediation
- choice of mediator (specify that the mediator selected has recognized experience in mediating franchise disputes or at minimum a franchising background)
- responsibility for mediation fees

**ARBITRATION CLAUSES**

In certain cases, arbitration can provide advantages over in-court litigation proceedings. For example, a significant advantage offered by arbitration is the choice of arbitrator, and in particular the opportunity to specify that an arbitrator must be selected from a roster of arbitrators experienced in arbitrating franchise disputes. However, disputes over the arbitration clause or agreement, perhaps most commonly disputes over the enforceability of an arbitration provision and disputes over who should be the arbitrator, can prove costly and time-consuming, and often negate the expected advantages of arbitration which include obtaining a quick resolution of a dispute.

**ENFORCEABILITY OF ARBITRATION CLAUSES**

Franchisees may challenge the enforceability or interpretation of an arbitration clause because of the franchisee’s preference to litigate in court – which may, in certain cases, provide the franchisee with some bargaining power over the franchisor who wishes to avoid publicity, reputational risk or establishing a precedent which could be harmful to the franchisor’s business or brand. Additionally, an arbitration clause contained in a franchise agreement is generally favourable to the franchisor and drafted on the franchisor’s terms, and a franchisee may challenge the enforceability of an arbitration clause to deprive the franchisor of any perceived imbalance or advantages to the franchisor of proceeding by arbitration. Arbitrations are also costly – the arbitrator’s fees and arbitration must be paid for, while courts are free, which may be a consideration for a franchisee challenging an arbitration clause.

**COSTS OF ARBITRATION**

Additionally, although arbitrations are often perceived to provide opportunities to resolve disputes more quickly, that is frequently not the case. Arbitrations can become very drawn out, unless the parties have specifically turned their minds to an expedited procedure, and can proceed at a slower pace than litigation, especially if there is any dispute over the appointment of the arbitrator and/or how the arbitration should be conducted. Arbitrations therefore aren’t necessarily faster, and as stated above, can certainly be more expensive since in addition to paying lawyers, the arbitrator must be paid.

**DETERMINING WHETHER ARBITRATION IS THE APPROPRIATE PROCEDURE**
An arbitration may not be the appropriate procedure for certain types of franchise disputes, such as injunctions involving trademarks or other intellectual property. In such cases, a franchisor will generally be able to seek relief from a court on an urgent and expedited basis, and arbitration clauses typically have a carve-out allowing a franchisor to seek a court injunction. An arbitrator can generally grant specific performance, injunctions and other equitable remedies but it is advisable to have an option for the parties to go to court for any injunctive relief in the event that there is any delay in agreeing upon or appointing the arbitrator.

DISCLOSURE OF ARBITRAL AWARDS

An additional important consideration is the requirement under the regulations under the AWA to include in a franchisor’s disclosure document a description of the mediation or other alternative dispute resolution process contained in the franchise agreement, and the circumstances in which the process may be invoked. The disclosure document must also include a prescribed statement that mediation is voluntary. Also, to the extent a franchisor is thinking about arbitration as a way to avoid having to disclose the existence of litigation against the franchisor, it should be aware that some franchise lawyers take the position that an adverse arbitral award may indeed have to be disclosed in the disclosure document.

ARBITRATION CLAUSES MAY AVOID FRANCHISEE CLASS ACTIONS

One advantage of an arbitration clause, if drafted properly, is the ability to avoid class proceedings. In 1146845 Ontario Inc. v Pillar to Post Inc.\[1\], the Court stayed a proposed franchise class action in favour of enforcing the arbitration provision in the franchise agreement. The Court rejected the franchisees’ argument that the legislature, by way of s. 4 of the AWA (the statutory right to associate) intended to override the parties’ arbitration agreement to allow the franchisees to commence a class action. The Court considered the intersection of the AWA, the Class Proceedings Act, 1992 and the Arbitration Act, 1991. Under the Arbitration Act, courts must stay proceedings where the parties have agreed to arbitrate their disputes, unless the matter falls within a specific exception or the legislature has granted the court the exclusive jurisdiction to resolve the dispute. The franchisees argued that their right to associate in s. 4 of the AWA implicitly gave them the choice of either compelling arbitration or commencing a class proceeding against the franchisor. The Court disagreed, holding that where franchisors and franchisees mutually agree to arbitrate their disputes, effect will be given to their agreement.

CONCLUSION

Where a franchisor decides to include a mediation and/or arbitration clause in a franchise agreement, that mediation and/or arbitration clause must be carefully drafted to maximize the benefits and avoid potential pitfalls of resolving disputes by mediation or arbitration.

\[1\] 2000, S.O 2000, c. 3.

\[2\] 2014 ONSC 4038.
2014 ONSC 7400.
DETERMINING WHETHER ARBITRATION IS THE APPROPRIATE PROCEDURE

Arbitration and mediation are often considered as alternatives to litigation. However, they are not necessarily alternatives, nor are they always appropriate. While mediation and arbitration offer some advantages over litigation, they are not necessarily faster, and as stated above, arbitration and mediation can certainly be more expensive since in addition to paying lawyers, the arbitrator must be paid. An arbitrator can generally grant injunctive relief involving trademarks or other intellectual property. In such cases, a franchisor will generally be able to seek relief from a court on an urgent and expedited basis, and arbitration clauses typically provide that the arbitrator may issue final and binding awards much more quickly than a court. While arbitration and mediation can be faster, that is frequently not the case. Arbitration can become very drawn out, unless the parties have agreed to limit the time to hearing. In many jurisdictions, a mediation cannot last more than 21 days, whereas an arbitration generally lasts two to three days.

Franchisees may challenge the enforceability or interpretation of an arbitration clause because of the nature of the franchise relationship. Franchisees may argue that an arbitration clause is unconscionable and cannot be enforced. Arbitration clauses and agreements may be challenged for a number of reasons, including, but not limited to, the lack of an understanding of the clause, the failure to receive adequate notice, the failure to receive adequate information regarding the arbitrator, and the failure to receive a fair hearing. In determining whether an arbitration clause or agreement can be enforced, courts will consider whether the franchisor has disclosed the existence of legal action against the franchisor, whether the franchisee was aware of the franchisor's ability to compel arbitration, and whether the franchisee was aware of the franchisor's ability to seek relief from a court on an urgent and expedited basis.

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