

Franchising - Canada

Restrictions of Use Covenants Are Valid Personal Obligations of Franchisee

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A recent decision rendered by the Quebec Superior Court held that the restriction of use covenants contained in several servitudes or easements were personal obligations of the franchisee. Therefore, the court upheld their validity, despite invalidating the actual easements themselves. The decision is interesting in light of the particularities of Quebec civil law, which differs from the common law applicable elsewhere in Canada.

Facts

In *Haddad and 159363 Canada Inc v Le Groupe Jean Coutu (PJC) Inc* (2008 QCCS 3081) the plaintiff pharmacist and franchisee operated several pharmacies under the franchisor's banner from 1975 to 2002. The franchise agreement contained a right of first refusal in favour of the franchisor in circumstances where the franchisee received an offer to operate under a third-party banner or otherwise dispose of his or her rights in and to the pharmacy. However, in 2002, given the strained relationship between the parties, the franchisee notified the franchisor of its intention not to renew its franchise agreement with the franchisor without disclosing what he intended to do with the building and pharmacy after the expiry of the term of the franchise agreement. The franchisor began constructing its own pharmacy within 500 metres of the franchisee's location. The franchisee then surreptitiously started to shop around for another banner with which to operate his pharmacy immediately following the expiry of the franchise agreement, and concluded and signed an agreement with a third party prior to expiry, to take effect upon expiry of the franchise agreement.

However, shortly after the franchisee signed this agreement, the third party discovered the existence of the right of first refusal in favour of the franchisor. Given the franchisee's non-disclosure of the franchisor's right of first refusal, the third party wanted to withdraw from the deal. Nevertheless, the franchisor exercised its right of first refusal and the franchisee ultimately accepted the franchisor's counter-offer for the purchase of his pharmacy.

The franchisee also owned the building in which the pharmacy was located, as well as several other buildings in the downtown area of the same city. The franchisor negotiated a 10-year lease with the franchisee for the lease of the building where the purchased pharmacy was located. Given the franchisee's previous conduct, the franchisor also negotiated a right of first refusal in its favour in respect of any third-party offer to purchase the building and a restrictive covenant prohibiting the use of the leased building, as well as the franchisee's other buildings in the same sector, as a pharmacy-type business for the duration of the 10-year lease agreement. Furthermore, the franchisor negotiated a non-compete covenant from its franchisee prohibiting him from working as a pharmacist or operating a pharmacy for a period of five years. Finally,

several easements were also registered on the title of all the buildings owned by the franchisee, prohibiting their use as a pharmacy-type business. A breach of the restrictive covenants in the easements entitled the franchisor to a payment by the franchisee of C\$5 million in liquidated damages.

In 2006 the franchisee solicited and received a third-party offer for the purchase of the building leased by the franchisor. As a result, the franchisor exercised its right of first refusal to purchase the building and the parties subsequently concluded the transaction. Shortly afterwards, the franchisee instituted proceedings before the Superior Court of Quebec requesting that the non-compete provisions contained in the lease, as well as the restrictive covenants contained in the easements, be declared invalid. The franchisee essentially claimed that as a result of the sale of the building to the franchisor, the civil law concept of confusion resulted in the extinguishing of the lease and all its obligations (including the non-compete covenants) due to the fact that the franchisor had now become both the lessor and the lessee of the building.

Decision

The Superior Court of Quebec ultimately concluded that the non-compete covenants contained in the lease and the restrictive covenants contained in the easements could survive both the termination of the lease as well as the cancellation of the easements, given the personal nature of such obligations. Furthermore, the court blamed the franchisee for his consistent and reprehensible bad faith in his dealings with the franchisor. Despite the survival of the restrictive covenants contained in the easements as personal obligations of the franchisee, the court nonetheless invalidated the actual easements and ordered that they be cancelled, noting that if the franchisee sold his other buildings to a third party acting in good faith, use of the buildings in any manner by such third party could not be restricted.

Comment

Most commentators have found that the Superior Court of Quebec's position in this decision as regards restriction of use covenants contained in easements is quite particular and it will be interesting to see whether the Court of Appeal will uphold the Superior Court of Quebec's decision. Despite the favourable outcome to the franchisor, it seems clear that the court's disapproval of the franchisee's conduct influenced its decision to consider the restriction of use covenants to be personal obligations of the franchisee that survived such termination and cancellation. It may be prudent for the franchisor to require that otherwise valid restrictive covenants be included in a separate and distinct agreement and to state expressly that they will survive the expiration or termination of any other agreement between the parties, including any lease or franchise agreement.

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