

Franchising - Canada

Assignment of franchise agreement by a trustee in bankruptcy

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Introduction

The recent decision in *Ford Credit Canada Ltd v Welcome Ford Sales Ltd*⁽¹⁾ may have significant implications for franchisors whose franchisees become insolvent, as the Alberta Court of Appeal ruled that pursuant to the Bankruptcy and Insolvency Act of Canada, a franchise agreement may be assigned by a trustee in bankruptcy.

Section 84.1 of the act allows a trustee to apply to court for an order assigning the rights and obligations of a bankrupt under an agreement. In deciding whether to make the order, the court must consider, among other things, whether the person to whom the agreement is to be assigned can perform the obligations incumbent on it pursuant to the agreement, and whether it is appropriate to assign the agreement to that person. Such an order may be made even in the presence of a contractual consent requirement.

Facts

The franchisor, Ford Motor Company, appealed a decision allowing the trustee of the franchisee, Welcome Ford Sales Ltd, to assign the auto dealership pursuant to Section 84.1 of the act.

The dealership had ceased operations after Ford Credit Canada discovered that a senior employee of the franchisee was misappropriating funds. An order appointing a receiver was then made, whereby any agreements of the franchisee then in place could not be terminated without the court's consent. The franchisor immediately advised the court that it would not consent to an assignment of the franchise agreement, even to one of its existing franchisees. However, the chambers judge issued an order authorising the trustee to market the dealership. The franchisee then became bankrupt and the chambers judge approved an application by the trustee to assign the franchise agreement to a third-party purchaser, which also operated another Ford dealership.

Proceedings

The franchisor argued that the franchisee had breached the franchise agreement prior to the appointment of the receiver and, as a result, the agreement had terminated. The franchisor asserted that a failure by the franchisee to supervise its employees properly and the closure of the dealership amounted to a breach. The court found that the dealership had not operated since the appointment of the receiver due to the franchisor's own lack of cooperation in providing new products and manufacturer's support following discovery of the breach. Furthermore, the default clause of the franchise agreement applicable in the event that the dealership closed for seven days required that the franchisor send notice of termination within a certain period. The franchisor's notice of termination was sent after such period had lapsed and weeks after the receiver had been appointed. The court also found that the purchaser stood ready to operate the dealership upon court approval, and that any deficiencies in the franchisee's supervision of the employees would cease to be a concern upon such assignment. The court ultimately found reasonable the chambers judge's decision that no fundamental breach of the franchise agreement had occurred.

The franchisor argued that whether the rights and obligations under the agreement could be assigned (Section 84.1(3) of the act) must be decided before the court's assessment of whether the proposed assignee was able to perform the obligations

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and whether it was appropriate to assign the agreement to that proposed assignee (Section 84.1(4) of the act). However, the court found that the franchisor's argument was unsupported by both a literal reading of the provisions of the act and legislative intent.

The franchisor also argued that Section 84.1(3) of the act precluded assignment by the court by reason of the personal nature of such rights and obligations. The franchise agreement expressly stated, among other things, that:

- it was personal in nature;
- consent was required for transfers of the franchisee's assets or shares; and
- the franchisor was required to ensure that dealerships were operated by qualified individuals.

Therefore, the franchisor argued that the franchise agreement was personal to the parties that entered into it and could not be assigned. Nevertheless, the court determined that the franchise agreement was a standard commercial franchise agreement, regardless of the fact that it was expressly identified as a contract for personal service, which could be performed by virtually any businessperson with capital and experience in automotive retailing. Furthermore, the evidence put forth by the franchisor did not support the contention that it was important to the franchisor that the current franchisee, and no other party, operate the franchise. In reaching this conclusion, the court considered that the franchisor had made no inquiry regarding the franchisee prior to execution of the franchise agreement; nor did the parties remain in contact thereafter, with all of the franchisor's contacts with the franchisee being with the general manager and employees of the franchised business rather than its owner. There was no evidence of any service, talent or quality which could be provided only by the franchisee owner.

The franchisor maintained that the ultimate purchaser was not fit to run the business and, as such, the franchise agreement could not validly be assigned to it. However, the court, relying on affidavit evidence from other Ford dealers and the purchaser's success in operating its own Ford dealership, dismissed this argument.

Decision

The appeal was dismissed by the Alberta Court of Appeal, which held that the franchise agreement could validly be assigned to a third party.

The court of appeal agreed in all respects with the chambers judge's conclusions that the franchise agreement was assignable by its nature due to evidence that:

- the purchaser would be able to meet the obligations of the franchise agreement;
- the franchisor had unreasonably withheld its consent;
- any breaches of the franchise agreement would be cured by its assignment; and
- the franchisor's rights under the agreement would remain unchanged.

Comment

As reflected in this decision, Section 84.1 of the Bankruptcy and Insolvency Act can have significant consequences for franchisors where a franchisee becomes bankrupt, as a franchisor may be saddled with a new franchisee selected by a trustee which it has not approved. Of particular concern is the notion that the same template franchise agreement could be held to be 'assignable by its nature' in one case, but not in another, based in large part on who the prospective purchaser may be. In this case the court did appear prepared to accept evidence of the unsuitability of the prospective purchaser as grounds for precluding an assignment; however, the prospective purchaser had an excellent record and operated a successful dealership with the same franchisor; and - perhaps equally as importantly - the court was not convinced of the personal nature of the agreement, in large part because of the franchisor's longstanding tolerance of an absentee franchise owner. One wonders whether the ruling would have been different had the business been a more traditional franchise in which the franchisor had a higher degree of day-to-day involvement with its franchise owner.

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Endnotes

(1) 2011 ABCA 158.

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