Pulling the Reins in on Franchisees' Fair Dealing and Right to Associate Claims

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Sections 3 and 4 of the Arthur Wishart Act (the "*AWA*"), are at the forefront of recent developments in franchise law and are powerful tools in the hands of court and counsel. Both provisions confer broad equitable discretion on the court. Section 3 deals with the duty of good faith and reasonable commercial standards (codifying the common law) and section 4 guarantees franchisees the right to associate and prohibits franchisors from directly or indirectly restricting, interfering, penalizing or prohibiting the exercise of this right. If breached, both of these sections include a right of action in damages.

Both of these provisions have struck the fancy of the court and there have been a number of important developments. Each will be discussed in turn.

<u>The Right to Associate</u>

One of the big stories of 2010 is collective action, now enshrined as an organizing principle of franchise litigation and a core element of the This development is an expression of the Court's concern for proportionality, behaviour modification and access to justice.

On July 6, 2010, the Court of Appeal released its reasons in *405341 Ontario Limited and Midas Canada Inc.* Justice Cullity, within the context of a class proceeding, ordered that a provision in the Midas franchise agreement which required a release as a condition of the agreement's renewal or assignment violated the *AWA* right to associate, and to that extent was void and of no force and effect.

The issue of requiring franchisees to provide a release within the context of a class action has previously been litigated. In *1176560 Ontario Ltd v The Great Atlantic and Pacific Company of Canada Ltd.*, 2002 CanLII 6199 (Ont.S.C), while certification was pending, the franchisor offered much needed renovations and rent subsidies in exchange for a release from the action. The Court took a very negative view of the demands for a release from a pending class action as a condition of the receipt of ordinary course commercial benefits. But unlike *Midas*, in *A&P*, the demands for a release were made within the context of a larger campaign the Court found was intended to intimidate the putative class.

In *Midas* the franchise agreement expressly called for the provision of a release in the event of an extension. The release was not imposed as a litigation tactic. The Agreement said:

> "…franchisee and each of its shareholders, directors and officers shall, as a condition for the extension of the franchise relationship, execute and deliver to Midas a general release of any and all claims and causes of action against Midas, its affiliated corporations and their respective officers, agents and employees."

There was a similar provision regarding assignments. One of the class members had, under protest, provided a release at the time of an assignment.

The franchisee argued that the release requirement violated its right to associate under section 4 of the *AWA.* It asked the Court to enjoin Midas from requiring it to execute a release from the claims certified as a condition of the renewal or transfer of its rights.

Justice Cullity noted that section 4 of the *AWA* is not concerned "with the right to associate socially or recreationally":

> "…it is unquestionable that the provisions and the intentions reflected in such agreements are subject to the overriding provisions of the *Arthur Wishart Act*. …that Midas is seeking compliance with the agreements is beside the point. If the agreements interfere with the right of association conferred by s. 4.1, they will be void to that extent. If they require releases of rights under the statute, the releases would be void and the relevant provisions of the agreement would be unenforceable. I see no difference in principle between this case and any other in which a franchise agreement contains offers of benefits to franchisees conditional on the execution of releases of their rights to fair dealing under the *AWA* or their rights to damages for a breach of the franchisor's obligations under the statute. It would defeat the purpose of the statute if the obligation of fair dealing could be bargained away by such provisions of standard form franchise agreements – whether or not an inquiry would be permitted into the fairness of the bargain…
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> In my judgment, if the exercise of a franchisee's rights under a franchise agreement requires a release of rights given by the *AWA*, the release will, at least *prima facie*, be void by virtue of section 11. I say *prima facie* to leave open the possibility of cases such as *Tutor Time* or other circumstances in which it would be inequitable to permit a franchisee to rely on the provision of section 11. In this case, the fact that the franchisee is under no obligation to exercise the rights under the agreement appears to me to be of no relevance. The case is one where the franchisor is attempting to require the execution of a release that would deprive the franchisees of their rights under the Act. In the absence of any circumstances that should exclude an application of section 11, I am satisfied that such a release would be void and that, in consequence to the agreement to provide it, is unenforceable. In my opinion, the agreement is void pursuant to section 4(4) of the *AWA*."

The Court of Appeal endorsed the Reasons and approach of Justice Cullity:

> "The purpose of the Act is to protect franchisees. The provisions of the Act ought to be interpreted in that light. Requiring franchisees to give up any claims that they might have against a franchisor for purported breaches of the Act in order to renew their franchise agreement, unequivocally runs afoul of the Act. To suggest that by accepting the terms of the agreement the respondents have in effect 'settled' their claims within the meaning of *Tutor Time*, in my view, misapprehends and misstates the ratio of that case. Here there has been no settlement of the respondent's rights. The respondent is merely trying to assert its right through its claims. The assertion that it has waived or released those rights contravenes section 11 of the *Act*."
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> "The language of section 11 could not be clearer. If you include a term in your franchise agreement that purports to be a waiver or release of any rights a franchisee has under the Act it will be void."

The Court of Appeal distinguished a "voluntarily negotiated settlement of existing claims as was the case in *Tutor Time*" from permitting a franchisor to rely on "a standard form contract of adhesion — to defeat the rights its franchisees would otherwise have under the Act." To permit a franchise agreement to operate in this way, the Court concluded, is "to ignore reality and emasculate the very provisions that are in place in the Act to protect franchisees from this very sort of thing."

The Court of Appeal agreed with the manner in which Justice Cullity distinguished *1518628 Ontario Inc. v. Tutor Time Learning Centres LLC*1***[1]***.:

> "the settlement of a claim arising from and consequential to an existing statutory right of rescission is not in itself 'a waiver or release' of that statutory right to rescission. It is a release of the claim arising from having exercised the right of rescission or being in the position to exercise the right of rescission. In my view, if a franchisee, as in the instant situation, with full knowledge of a breach of the franchisor's obligations to disclose as required by the Act and regulations and with the benefit of independent legal advice chooses to affirm the franchise agreement as a term of settlement of the claims that arise from the franchisor's breach, then the franchisee can no longer rescind and make a claim to the remedies afforded by section 66 of the Act.

As put by the Court of Appeal, *Tutor Time* "simply has no application to the facts of the case …the [Midas] agreement was signed prior to the claims arising and therefore without full knowledge of the breaches."

Midas is an important case. Its reach is potentially very broad. The language of the decision is expansive. It is not restricted to class proceedings. It is grounded in the Court's perception of the nature of the franchise relationship and the remedial purpose of the *AWA.*

The Court's declaration that the *AWA* is intended to enable franchisees to "protect their interests and enforce their rights through collective action" and its invocation of Charter principles is reminiscent of some of the jurisprudence on the OBCA and CBCA oppression remedy provisions in which the Court of Appeal describes the oppression remedy as the "Charter of Rights and Freedoms of the corporate world".2[2]

Very quickly, after the Court of Appeal's decision in *Midas*, the principle was picked up in the trial courts.

On July 26, 2010 in *1318214 Ontario Limited et al v Sobeys*, 2010 ONSC 4141 (CanLII), the Superior Court prohibited Sobeys from terminating the franchise agreements of a group of Price Chopper operators who had withdrawn funds from the business to support litigation against Sobeys.

Their franchise agreement had a provision which capped the withdrawal of funds at $2,000 for legal fees without the consent of Sobeys. When Sobeys gave notice of its intention to terminate the franchise agreements, a group of franchisees moved for an injunction.

The franchisees argued that termination of their franchise agreements on this basis interfered with their right to associate under section 4 of the *AWA.*

1[1] 2006 CanLii 25276 (ON S.C.); affirmed (12 April 2007) 598/06 (Div. Ct.).
2[2] *Budd v Gentra*, 1998 CanLII 5811 (On C.A), citing Peterson "Shareholder Remedies in Canada".

Justice Conway applied *Midas*, noting that "the purpose of the Act is to protect franchisees. The provisions of the Act ought to be interpreted in that light." The court went on to note that although "this is not a class proceeding … it is a collective effort of the franchisees to enforce their rights. I find that there is a serious issue to be tried as to whether the issuance of the notices and proposed termination under these circumstances amount to an interference with the franchisees' ability to pursue collective action against the franchisor contrary to the Act."

The second decision of 2010 relevant to the issue of collective action is the April 21 decision of the Ontario Superior Court of Justice in *Stoneleigh Motors et al v. General Motors of Canada Limited,* 2010 ONSC 1965 (CanLII). In this case, 21 General Motors dealers from across the country brought a multiparty action against General Motors on the Commercial List in Toronto for specific performance of their dealer agreements.

The dealers had been given notice in May 2009 that their agreements would not be renewed at the expiry of the current term, October 31, 2010. The dealers relied on a provision of the dealer agreement which 'assured' them of the opportunity to enter into a new agreement' at the expiry of the current five-year term provided they were not in default of any provisions of their existing agreement. GM's position was that it had the right under another provision of the dealer agreement to control its dealer network

Most of the plaintiffs had signed agreements agreeing to resolve any disputes including non-renewal or termination of their dealer agreements in private one-on-one industry arbitration under the National Automotive Dealer Arbitration Program Rules for Dispute Resolution (the "NADAP Rules"). GMCL brought a motion to stay the plaintiffs' action on the basis of the arbitration agreement. Alternatively, GM took the position that the dealers' claims had been improperly joined under the *Rules of Civil Procedure* and should be severed. Importantly, the NADAP Rules did state that class, multi-party or representative claims were non-arbitrable, and ultimately the court held that the claim, framed as a multi-party action, was, within the plain language of the arbitration agreement, not subject to arbitration. The court found in fact that the NADAP Rules' preservation of the dealers' right to advance a class action, multi-party or representative action against GM reflected the dealers' right to associate under section 4 of the *AWA.* The court stated (at para. 62):

> "In light of Rule 20(c) of the NADAP Rules, it cannot be said that there is any denial of a right to associate. . . . Rule 20(c) of the NADAP Rules is consistent with the philosophy underlying Cullity's decision [*Midas*] and to like effect by Winkler J. as he then was in *1176560 Ontario Limited v. The Great Atlantic and Pacific Company of Canada Limited*. As such, the *Midas* decision is not engaged by this case. The plaintiffs did not advance the argument that section 4 of the *AWA* ousted or trumped statutory procedural safeguards such as those found in Rule 5(5) [the joinder section] of the Rules of Civil Procedure. In the absence of any specific statutory language in the *AWA* or elsewhere, I question whether such a conclusion is appropriate."

Accordingly, the Court did not have to deal with the interesting question of whether, in the absence of such language, it would have applied *Midas* to permit the dealers to associate in a multi-party action, particularly in light of the evidence they put before the court that they lacked the institutional human and economic resources to prosecute their claims individually against GMCL. The NADAP Rules did provide that an arbitrator has the power to join one arbitral proceeding with another arbitral proceeding but only after each dealer had commenced the arbitration process separately by filing its own request for mediation.

Stoneleigh is a powerful illustration of the Court's concern for proportionality and access to justice as drivers of collective action. The Court was heavily influenced by the 'litigation realities' of small businesses across the country litigating against a large and powerful franchisor. The Court was persuaded by the dealers' evidence (which was not opposed) that they lacked the informational, economic and human resources to litigate individually against GMCL. Although the Court denied GM its stay, the Court did recognize that one action with so many plaintiffs would be somewhat cumbersome and that effective trial management by the Commercial List would be required. In the Court's opinion, the alternative of so many separate actions is a significantly greater ill and would not promote the convenient administration of justice

Although not a class action, a tactical decision that was made at an early stage, the case was in many respects presented as such by the plaintiffs. The court emphasized the existence of core questions of fact and law common to all of the plaintiffs' claims. Of particular significance was the fact that both the claim and the defence were premised on single uniform provisions of the dealer agreement which were identical to all plaintiffs. In deciding that the plaintiffs' claims should not be severed, however, the Court made the point of indicating that it should not be taken as accepting the plaintiffs' proposed procedure set out in their trial requirement memorandum nor their proposal to treat the evidence of some of the plaintiffs as evidence of all. The Court stated that procedural issues would be properly addressed at a case conference.

The *Stoneleigh* case is an instructive example of the proportionality imperative. The case was deliberately pleaded on a very narrow basis – specific performance of a single provision of the dealer agreement. Damages claims beyond very specific liquidated claims ones were not pursued. A detailed trial plan was filed shortly after the pleading was delivered, issues for trial were identified and described, affidavits of documents were delivered early and the applicable law briefed. In short, the judge was presented, early on the proceeding, with a formula for the resolution of the dispute by way of a directed commercial court trial.

Similar themes are reflected in the January 2010 decision of the Ontario Court of Appeal in *Griffen v. Dell*3***[3]***. In that case, the court considered an arbitration provision in a consumer agreement for the purchase of a computer. The case was a class action. The *Consumer Protection Act* applied to some but not all of the class members' arbitration provisions. The court refused Dell's request for a partial stay.

> "Dell offered no evidence to indicate that the arbitration of these claims would be anything other than cost prohibitive … there is a lack of reality to Dell's argument that the claim should proceed by way of arbitration. There will be no arbitration. The real choice is between clothing Dell with immunity from liability … and giving those purchasers [a] day in court."

On August 23, 2010, Justice Strathy certified a class action by Sears franchisees in *578115 Ontario Inc. v. Sears Canada Inc.,* 2010 ONSC 4571 (CanLii) noting that "no procedures, other

3[3] *Griffen v. Dell Canada Inc.*, 2010 ONCA 29 (CanLii) than individual actions or single actions joining multiple plaintiffs, had been proposed as preferable to a class action. In view of the power imbalance between the franchisor and franchisees, the very concern that the *AWA* was designed to redress, there was a significant impediment to access to justice by way of individual action, particularly where some of the franchisees remain a part of the Sears system (para. 68)". **[any reference to section 4/preferable procedure in Pet Valu?]**

Damages for Bad Faith

The scope of the duty of good faith has been extensively discussed and its minimum content is well settled. The duty approximates but is not quite a fiduciary standard. Whatever else it means, the duty of good faith requires a franchisor to take the legitimate interests of the franchisee into account when exercising its powers under the franchise agreement. Counsel will do well to remember the cautionary note in *Shelanu* that it is possible to find an absence of good faith even where the provisions of the agreement have been strictly complied with. In this respect the duty of good faith is similar to the broad equitable discretion of the oppression remedy which looks beyond the strict letter of a contract to the parties' legitimate expectations and the fairness of commercial outcomes.

The lower court decision in *Salah v. Timothy's Coffees*, was released October 26, 2009, and dealt with a franchisee's right of renewal.

Timothy's was operating a corporate store on the third floor of the Bay Shore Shopping Centre in Ottawa. It had a head lease with the shopping centre for a 4 year term ending on September 30, 2005. The plaintiffs, Mr. Salah, and his company, 147, became a franchisee and entered into a Franchise Agreement and sub-lease for the store. The Franchise Agreement described the premises as situated at "Bay Shore Shopping Centre." The sub-lease said that Timothy's had entered into a head lease as tenant for premises located at "Bay Shore Shopping Centre."

The franchisee was concerned that the agreement only conferred a four year term with no right to renew. Timothy's Franchise Development Manager wrote a letter stating: "Should we be able to renew our lease in the future, we would extend the option to renew providing you are in good standing under the Franchise Agreement at the time of the renewal." She explained a renewal fee in the amount of 50% of the franchise fee (i.e. $12,500 was normally charged on all of their franchise renewals). Because the term the franchisee would be entering into was a four year term, she said "we are willing to decrease the usual fee to half of the 50% of the franchise fee (i.e $6,250)."

There was a schedule to the Franchise Agreement showing a valuation of the equipment that he was purchasing for the store which indicated a 10% depreciation. The franchisee testified that he understood that the furniture, fixtures and signs were to be depreciated by 10% per year over a ten year period which he understood to mean that Timothy's had agreed that the Franchise Agreement would be extended for 10 years.

In fact, that was the length of the new lease into which Timothy's entered into in the spring of 2005.

On September 30, 2005, Timothy's treated the agreements as being at an end and entered into a new Franchise Agreement with a different franchisee at a different location on the second floor of the shopping centre.

The plaintiffs claimed that they had a right to a new lease term that was not restricted to the location on the third floor, but extended to and included the entire shopping centre. The franchisor asserted that the plaintiffs had no right of renewal and that the Franchise Agreement was intended to be co-terminus with the lease.

Timothy's argued that the new premises were not even in existence at the time the Franchise Agreement was negotiated and it could not, therefore, have been the intention of the parties that the agreement would continue by way of renewal at that location. It also argued that the parties had not negotiated important issues such as who would be obligated to pay for the cost associated with the construction of the new location and what would the terms be that governed the parties' relationship during the period between the expiry of the Franchise Agreement in its original location and the construction of the new location two months later.

The Court disagreed with the franchisor. It noted the "extremely knowledgeable vice-president of a large successful company" negotiating with "a man searching for a business opportunity who has some background in commerce and accounting but who has been involved in endeavors which were not successful. The *Wishart Act* was specifically enacted so as to correct the imbalance which existed in a situation like this one." The Court noted that none of the franchise documents, including the lease, particularized the franchise location within the shopping centre. They all referred only to the Bay Shore Shopping Centre.

The plaintiff relied on a very general Schedule to his Agreement as creating an enforceable right to renew the lease and Franchise Agreement. The franchisor argued and the Court noted that many of the essential terms of the lease renewal were absent.

The Court brushed aside the characterization that the alleged right of renewal was fatally and absurdly incomplete:

> "The defendant states that it would be absurd to give credence to the plaintiff's Schedule A interpretation since many exact terms were not agreed upon. **While I accept that the terms of the renewal were not known**, on the evidence there was a willing franchisee with the financial ability to pay. **Whether there would have been an agreement on all terms is unknown**, but Mr. Salah was prevented from having the option to even consider these, due to unanswered questions, a deliberate withholding of information and, finally, a gross falsehood as to the price he would have to pay." [Emphasis added]

This treatment of the so-called renewal document is one of the more aggressive applications of the obligation to negotiate and perform a contractual obligation in good faith.

The court was motivated by evidence that throughout 2004 and 2005 the franchisee left repeated messages for and tried to engage the franchisor's representative in the renegotiation of the lease. All of the franchisee's efforts were ignored. During this period, the franchisor, however, was negotiating with its landlord. Eventually the franchisor's representative did engage in discussions with the franchisee, but sent an internal email stating "I have informed Abdul. He has problems listening or doesn't understand". The court noted that "he made no effort to ensure Mr. Salah understood".

In the meantime, a prospective location which had been offered to the franchisee and which he declined substantially improved with the addition of a Winners store. Pedestrian traffic and sales were very strong in the area. Timothy's asked Bay Shore Shopping Centre not to pass on any information about the second floor location to the franchisee and solicited an application from another potential franchisee.

When the franchisee persisted, he was told that the cost for the new location was $350,000, an amount that the trial judge found was false and calculated to discourage the franchisee. When he said he could not pay $350,000 he was given a letter of termination. The letter invited the franchisee to call for explanation, but the individual who "received the calls ignored the franchisee's efforts."

The trial judge found that Timothy's breached its Franchise Agreement because of its failure to offer Mr. Salah the opportunity to enter into a new lease in the new location as provided in Schedule A. The only option to put to Mr. Salah was to move to a new location as if Schedule A did not exist, for a price that was dishonest and apparently intended only to dissuade him.

The judge also found that Timothy's "actively sought to keep the franchisee from finding out what was going on with the lease that he expected to be renewed and that was in fact renewed." The court found that the franchisor actively mislead him until June 2005, some four months before the end of the term.

In these circumstances, the Court had no difficulty finding a breach of contract awarding damages as well as an additional $50,000 damages for the breach of the statutory duty of good faith and for inflicting mental distress. In so doing, the Court noted that "since the corporation is a sophisticated one and the plaintiff was a vulnerable franchisee, it is important to assess damages at a level which will prevent the franchisor from failing in this duty in the future." The court used an employment law analogy relying on the Wallace Factors. The Court noted that:

> "the franchisor is aware that Mr. Salah was the full time operator of the store with his wife assisting. It was reasonable to assume that if the franchisor's conduct left him without the business, he would be unable to support his family. Further he would be restrained, according to the terms of the Franchise Agreement, from employment with any competitor for a period of 2 years. Given his documented 'passion' for the product as noted by Ms Parent and given the restraint clause, it is evident that he would be seriously impacted by being unable to amend the agreement as provided in Schedule A.
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> It is one thing to require a party to offer its contractual counterpart the opportunity to negotiate a renewal in good faith if that opportunity has been expressly agreed to. Indeed, the Court of Appeal did just this in a decision released last month, *Laurel Oak Marketing Ltd v Royal Canadian Golf Association*4[2]
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> The provision in that case said:

> This agreement shall commence on the date executed beginning with the April 1996 issue and shall continue until the publication of the Fall issue of the year 2000. On January 1, 2000, the RCGA and Laurel Oak shall initiate good faith negotiations concerning the extension of this agreement for the publication of Golf Canada for a further 5 year period. *If Laurel Oak has discharged its obligations under this Agreement in a reasonably satisfactory Manner throughout the term hereof, and if at the end of such term RCGA has not decided to discontinue the endorsement of the Publication, Laurel Oak shall have preferred status over any other potential publishing group to publish the publication for the said five year extension. (emphasis added)*

At the conclusion of the term, the defendant did not have any negotiations at all. It put the contract out to tender. The Court held this was a breach of its duty to perform its contract in good faith to negotiate an 'extension of this agreement'.

This case has many instructive lessons. Courts will take a highly activist approach on behalf of franchisees where it perceives an exploitation of the inherently unequal balance of power. Franchisors and franchisees should therefore be careful regarding what they write in internal communications such as e-mails to each other and in internal corporate records. Abusive communications or ones which convey an intent to ignore the requirements of the contract or system will also weigh heavily against the franchisee. This is seen in the Court's careful note of the plaintiff's polite and professional behaviour as contrasted with the conduct of the defendant's representatives.

The franchisor's internal e-mails, perhaps not intended to be callous, were viewed by the Coourt that way and provided fuel for the fire which could have been avoided. Similarly, the supportive observations recorded by the district manager provided strong foundation for the judge's findings.

Although the need to maintain morale and motivate the franchisee is recognized, franchisors would do well to adopt standardized comments and avoid evangelical remarks. Clearly the Court was moved, as it often is in the employment and franchise context, by the franchisee's efforts to communicate with sophisticated executives. Although the franchisor's executive may have had good reason to not return calls at a particular time, he did so at his peril, particularly when his letter of termination invited the franchisee to contact him.

On October, 14 2010, the Court of Appeal dismissed Timothy's appeal. In strongly worded Reasons, Chief Justice Winkler upheld the trial judge's decision including her interpretation of the franchise agreement *contra preferentum* and her treatment of Mr. Salah and his franchise corporation as a single entity.

The Chief Justice gave special consideration to section 3 of the *AWA*. Consistent with the principles discussed above, he considered 'the conduct of the appellant…the evidence showed that the franchisor deliberately kept Mr. Salah in the dark about its intentions…actively sought to keep the franchisee from finding out what was going on with the lease…deliberately withheld critical information and did not return telephone calls'.

Winkler CJO then went on to consider the trial judge's award of damages under the *AWA*. He rejected Timothy's argument that it was an error for the trial judge to award damages other than on a compensatory, exemplary or punitive basis.

In upholding the award of damages for breach of section 3 of the *AWA*, he said:

> "the AWA is remedial legislation. It deserves a broad and generous interpretation. The purpose of the statute is clear: it is intended to redress the imbalance of power as between franchisor and franchisee; it is also intended to provide a remedy for abuses stemming from this imbalance. An interpretation of the statute which restricts damages to compensatory damages related solely to proven pecuniary losses would fly in the face of this policy initiative".

The Chief Justice concluded by noting that the AWA reflects a legislative intent to give special consideration to the franchise relationship both in terms of the duties owed and the remedies that flow from a breach of those duties. The legislative intent to confer damages at large for breach, and not only on a compensatory basis, is 'evident in the wording of subsection 3(2) of the *AWA which focuses on the conduct of the breaching party and not injury to the other side*. The trial judge's award of damages was informed by these considerations'. (emphasis added)

The *Salah* decision is an important illustration of the potency of behaviour modification in the Court's approach to franchise litigation.

On January 6, 2010, the Ontario Superior Court released *Agribrands Purina v. Kasaneks*5***[3]*** in which it allowed a Purina dealer's conspiracy and breach of contract claim.

Although not technically a franchise case, the decision is certain to reverberate at the franchise bar.

In Ontario, Purina operates its business through a network of dealerships operating in defined geographic territories. The plaintiff entered into a Dealership Agreement with Purina. It paid a $40,000 fee and borrowed $60,000 from Purina. Less than a year after entering into the agreement, the business failed.

Purina sued for enforcement of security for a $60,000 advance it made to the dealer for inventory. The dealer counterclaimed alleging that Purina had breached its duty of good faith and conspired against it by operating a competing sub-dealership which it supplied with Purina product.

Although there were some problematic facts for Purina, it no doubt took comfort in the fact that the Dealer Agreement had been in place less than a year, was for a two year term and could be terminated on 60 days notice. The dealer had also made a minimal investment in the business.

In these circumstances, how much could a damages award be? One can understand this view in light of the Supreme Court's ruling in *Hamilton v. Open Window Bakery*6***[4]*** that a defendant is

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6[4] [2004] 1 S.C.R. 303.

entitled to the most advantageous interpretation of a contract for the purpose of the calculation of damages.

Why else would it have started an action for enforcement of its security after it put the dealer out of business?

The relationship began with the kind of cheery letter which often accompanies the first term of a distributorship or Franchise Agreement:

> "… we are pleased to recognize you as an authorized Purina Dealer with all the rights and obligations of a Purina Dealer. It is with *good faith* that we enter into this interim period and [sic] *looking forward to a long prosperous relationship with your new business"* [Court's emphasis]

Once the relationship got underway, things proved difficult. Purina did not want to relinquish an established relationship it had in the plaintiff's market area. The trial judge found that Purina was improperly competing against its dealer through an unauthorized sub-dealer arrangement in its dealer's assigned territory.

Purina's "ultimate and overriding objective" in supplying the sub-dealer was "to maximize" distribution of Purina's feed products. Although "Purina did have some hope that [the plaintiff] would succeed it was only to the extent that its success would preserve Purina's market share in that region".

Because the Dealership Agreement had a fixed term of two years and could be terminated on 60 days notice, Purina not surprisingly argued that damages should be limited to two years. There is ample authority for this proposition both in the Ontario Court of Appeal7[5] and in the Supreme Court of Canada8[6].

But, the trial judge, incensed by what he viewed as Purina's underhanded conduct, brushed this argument aside as "factually incorrect in the context of the evidence respecting Purina Dealership Arrangements in atypical longevity". He said he found that "whatever words may be contained in the Dealership Agreement relative to notice, the preponderant weight over the evidence leads to the conclusion that Purina Dealerships were typically business relationships of long duration" and that it "would have continued indefinitely".

The Court noted that the contract, as many such contracts and franchise agreements do, automatically renewed from year to year once the initial two year term was reached, unless specific notice was given by Purina or the Dealer. As such, it was not a contract which came to an end unless renewed. The court also seized on the letter which accompanied the Dealer Agreement as evidence of an intention to have a perpetual contract.

The Court then turned to the *Open Window Bakery* principle which holds that the assessment of damages under contract is not a "tort like inquiry" as to what would have happened if the defendant had not breached its contractual obligation. The assessment of damages requires only a determination of the minimum performance the plaintiff was entitled to under the contract i.e. "the performance that was least burdensome for the defendant".

7[5] *Aldo Ipploito and Company Limited v. Canada Packers Inc.* (1986), 57 OR 2nd 65 (C.A.).
8[6] *Hamilton v. Open Window Bakery Limited.*

Again, motivated in no small part by what he perceived as Purina's determined efforts to dodge its contractual obligation, the trial judge read an important qualification into *Open Window Bakery*. He said "I do not question this proposition, but its foundation is that the parties are presumed to be acting honestly and in good faith. Although the defendant in *Open Window* breached its contract the trial judge specifically found that the defendant had acted in good faith at all material times … the factual principle that underlies *Hamilton v Open Window Bakery*'s application is totally absent in the circumstances of this case."

Thereafter the Court undertook an analysis of the doctrine of good faith and the now well established principle that where a party exercises its rights pursuant to a discretionary power in a contract, it must act honestly and in good faith and with a view to securing the performance not denial of the contract's objectives.

Notably, the trial judge relied on *Shelanu* and drew a direct analogy between the franchise relationship and the relationship created by the Dealership Agreement. 9[7]

The evidentiary findings of the trial judge are worth emphasizing. He found that:

> "the evidence makes plain that the original and clear anticipation of the parties was that the commercial relationship would most likely have continued indefinitely in the normal course. Against this background, rather than being a reasonable enforcement of the basic bargain between the parties in accordance with the dictum in *Hamilton v Open Window Bakery*…I accept the plaintiff's submission that reliance by Purina on Article 4 to limit liability would necessarily presume that the provision can be invoked in bad faith so as to limit its own liability for its own contractual breach."

In so doing, the Court found that the *Open Window Bakery* principle:

> "has no application here because the foundation of good faith that was present in that case is evidently absent in this case. I reject Purina's argument that it can rely on this provision to limit its liability or the quantum of damages that it ought to pay. I find such a result would be unconscionable. I acknowledge that the doctrine of unconscionability traditionally been restricted to the consideration of circumstances existing at the time the contract was made, but on the authority of *Morrison v Coast Finance Limited and Shelanu*, it appears to be open to the Court to consider unconscionability looking at the bargain in light of subsequent events and the balance of equities regarding its enforcement."

Like so many of the cases, bad facts made bad law – bad at least from the point of view of franchisors.

9[7] *Nareerux Import Company Limited v CIBC* - The Court considered good faith dealings between the parties in a letter of credit transaction and noted the Court of Appeal statement that although Canadian law is not yet recognized a stand-alone duty of good faith in the performance of a contract that is independent from the terms of the contract, as the United States has done, the jurisprudence establishes that there is an implied contractual duty of good faith not to act in a way that defeats or eviscerates the very purpose an object of the agreement.

Thereafter, the Court went on to award damages. Although the plaintiffs had been in business for less than a year when it failed, had paid $40,000 and borrowed $60,000, the Court found that the business would have continued for 28 years from the date of inception to the date of the principles retirement.

After embarking on an extensive damages inquiry beyond the scope of this paper, the Court dismissed Purina's debt enforcement claims and allowed the dealer's counterclaim in the amount of $2,096,406.00.

The decision is currently under appeal to the Ontario Court of Appeal. It is one which franchisors and franchisees alike should pay careful attention to.