CITATION: 1318214 Ontario Limited et al v. Sobeys, 2010 ONSC 4141
COURT FILE NO.: 10-8668-00CL
DATE: 20100726

SUPERIOR COURT OF JUSTICE – ONTARIO

(COMMERCIAL LIST)

RE: 1318214 Ontario Limited, 1464167 Ontario Limited, 1469789 Ontario Limited, 1476182 Ontario Limited, 1478822 Ontario Limited, 2024036 Ontario Limited and 2144011 Ontario Limited, Plaintiffs

AND:

Sobeys Capital Incorporated, Defendant

BEFORE: Conway J.

COUNSEL: *David Sterns* and *Sam Hall*, for the Plaintiffs

W. Brad Hanna and *Geoff Moysa*, for the Defendant

HEARD: July 23, 2010

ENDORSEMENT

[1] The plaintiffs (the "**Franchisees**") operate or operated[1] "Price Chopper" grocery stores as franchisees under Sobeys' "Low Equity Program" (the "**LEP**"). They have started an action against Sobeys with respect to its operation and administration of the LEP, claiming breach of contract, breach of the duty of fair dealing under the *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 200, c. 3 (the "**Act**"), breach of fiduciary duty and negligence.

[2] The Franchisees withdrew funds from their franchise businesses to fund the litigation. Sobeys took the position that by doing so the Franchisees breached the clause of their franchise agreements which restricts the Franchisees from incurring legal and accounting expenses over $2,000 without Sobeys' consent. Sobeys issued notices of default requiring the Franchisees to return the funds, failing which their franchise agreements would be terminated.

[1] By the time of this motion, three of the plaintiffs were actually former franchisees, their franchise agreements having expired in May 2010. For purposes of this injunction motion, "Franchisees" refers to the four remaining Franchisees.

[3] The Franchisees seek an interlocutory injunction restraining Sobeys from terminating their franchise agreements pending resolution of their claims in the underlying litigation.[2]

[4] For the reasons that follow, I grant the interlocutory injunction on the terms set out below.

Brief Overview of the LEP

[5] Under the LEP, a franchisee purchases a franchise for a low equity investment of $25,000. Sobeys leases the store and equipment to the franchisee and finances the purchase of inventory. The franchisee agrees to repay the loan to Sobeys and signs numerous agreements with respect to the way in which the store is to be operated (collectively, the "**Franchise Agreements**"). The franchisee (and his spouse) must guarantee amounts owing to Sobeys and provide a collateral mortgage on the family home to support his obligations to Sobeys.

[6] Sobeys strictly controls the expenses of the store. It provides an annual pro forma for the store which sets out the projected sales and expenses for the upcoming year. Sobeys has subsidy arrangements for the franchisee to make a specified level of pre-tax earnings.

[7] The franchisee is required to deposit the gross sales of the store into a bank account. Sobeys withdraws a certain amount from this account each day to pay accounts payable owed to Sobeys for inventory purchases made by the franchisee.

[8] The operating agreement for the store (the "**Operating Agreement**") contains numerous clauses in which the franchisee agrees to adhere to Sobeys' financial and operational controls. The most relevant one, for purposes of this motion, is section 4.7 of the Operating Agreement which provides:

> The Retailer agrees not to retain or pay outside attorneys, or any accountants or auditors to prepare financial statements or to review those prepared through the RAS, without the prior written consent of Sobeys. No fees for any such legal, accounting, auditing or tax services may be incurred in excess of $2,000.00 per year. The Retailer may retain professional advisers to prepare tax returns.

[9] This $2,000 limit on legal and accounting expenses is set out in the pro forma delivered to the Sobeys franchisee each year.

Chronology of Events

[10] The dispute arose between the parties when Sobeys delivered the 2010 pro forma to the Franchisees in May 2009. The Franchisees retained counsel, Sotos LLP, and formed the

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[2] The Franchisees also seek relief from forfeiture in the underlying litigation but confirmed that they are not seeking that relief on this motion.

"Chopper Grocery Owners' Alliance" to voice their concerns about the new pro formas, seek accounting information from Sobeys and request a meeting with Sobeys.

[11] There were meetings and discussions between the parties over the summer and fall of 2009 but the issues remained unresolved. On December 4, 2009 Sotos wrote to Sobeys requesting additional information, failing which it was instructed to commence an action against Sobeys.

[12] Sobeys became aware that the Franchisees were withdrawing money for legal fees in June 2009. In one of its letters concerning accounting matters, Sobeys included a reminder that this withdrawal was contrary to the Operating Agreement. Sotos wrote back stating that this restriction was unreasonable. Later in December, at the end of another letter to Sotos on accounting issues, Sobeys reminded the Franchisees of this restriction when further amounts were withdrawn for legal and accounting fees. The total withdrawn by the each of the Franchisees prior to March 29, 2010 for legal and accounting fees was approximately $27,000.

[13] The critical events occurred in March and April 2010:

(a) **March 29, 2010:** Sobeys sent an email to each of the Franchisees stating that despite previous requests, Sobeys had still not yet received the signed 2010 pro forma and that if it did not receive it, Sobeys had the right to terminate the franchise agreement.

(b) **March 29, 2010:** The Franchisees each transferred $55,000, for a total of $385,000, out of their accounts to Sotos.

(c) **March 30, 2010:** Sotos sent a letter to Sobeys enclosing a draft statement of claim and advising that the Franchisees would be prepared to mediate the dispute before issuing the claim. Sotos advised that it would issue the claim on April 7, 2010 if Sobeys did not respond before that date. Sobeys did not respond to that letter.

(d) **April 8, 2010:** Sobeys sent notices of default (the "**Notices**") to the Franchisees with respect to the withdrawals for legal and accounting fees in the current fiscal year ($82,000, which included the previous withdrawals and the March 29 withdrawal) and said that failure to repay all monies in excess of $2,000 by April 12, 2010 would result in termination of the Franchise Agreement and Sobeys' repossessing the premises.

(e) **April 8, 2010:** The Franchisees issued the Statement of Claim and served it on April 9, 2010. The Statement of Claim was subsequently amended to include the claim for injunctive relief to prevent the termination of the Franchise Agreements.

(f) **April 15, 2010:** The parties consented to a without prejudice order that Sobeys would not terminate the Franchise Agreements pursuant to the Notices and that

the Franchisees would not withdraw further amounts for legal and accounting fees, pending the determination of the injunction motion.

Test for Interlocutory Injunction

[14] The test for an interlocutory injunction is well known and may be granted where the moving party establishes that: (a) there is a serious issue to be tried; (b) it will suffer irreparable harm if the injunction is not granted; and (c) the balance of convenience lies in its favour: *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311.

Serious Issue to be Tried

[15] The first stage of the test requires a preliminary examination of the merits of the moving party's claim. The court should not engage in an extensive review of the merits and should find this element of the test to be satisfied so long as it can be shown that the claim is not frivolous or vexatious: *RJR*, *supra*. It is a low threshold.

[16] The serious issue to be tried, for purposes of this motion, is not what is at issue in the underlying litigation. The serious issues, according to the Franchisees, relate to the validity of the Notices and Sobeys' right to terminate the Franchise Agreements.

[17] Specifically, the Franchisees submit that there are serious issues as to whether (a) the Franchisees were in default under the Operating Agreement by using funds, without Sobeys' consent, to fund the litigation against Sobeys; (b) Sobeys breached its duty of good faith at common law and under the Act in issuing the Notices; and (c) Sobeys is interfering with their right to associate under the Act.[3]

Did the Cash Withdrawals breach section 4.7?

[18] Section 4.7 restricts a franchisee from retaining outside attorneys and spending in excess of $2,000 on legal and accounting fees without Sobeys' consent.[4] Sobeys relies on the plain wording of that clause, as well as the knowledge of Ms. Muszak (one of the principals of the Franchisees who provided the Franchisees' evidence on the motion) that this restriction was imposed by Sobeys as one of the financial controls which are part of the LEP. It also submits that the March 29 withdrawal was made in the face of large accounts payable owed to Sobeys[5], the two previous warnings from Sobeys and without seeking Sobeys' consent to the withdrawal.

[19] The Franchisees argue that if the clause is interpreted as restricting them from retaining counsel and incurring legal fees over $2,000 to sue Sobeys it would effectively preclude

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[3] The Franchisees also submit that section 4.7 is unconscionable but concede that they have not pleaded this and that the statement of claim would have to be amended.

[4] The clause actually refers to spending any money on legal fees without consent but Sobeys appears to treat it as restricting legal fees over $2,000 without its consent.

[5] I note that Sobeys issued the notice of default with respect to the March 29 withdrawal, but not for any default in payments owed to Sobeys.

them from asserting or enforcing their rights against their franchisor. Since Sobeys would unlikely consent to a retainer of counsel or funds ever being used for that purpose, it effectively grants Sobeys immunity from its franchisees. Sobeys argues that the Franchisees would still be entitled to pursue their legal remedies against Sobeys with their personal funds, just not with corporate funds.

[20] I am satisfied that there is a serious issue to be tried as to whether the Franchisees are in default under section 4.7 for withdrawing their corporate funds to finance their litigation. There is an issue as to the proper interpretation of the clause and its scope, as well as its enforceability, before it can be concluded the Franchisees are in default under section 4.7 and risk losing their franchises as a result of that default.

[21] I do not have to decide whether the Franchisees will ultimately be successful on this issue or whether Sobeys' plain language interpretation will prevail. At this point, I only have to decide whether the issue, as framed by the Franchisees, is not frivolous and vexatious and meets the low threshold. I conclude that it does.

Did Sobeys breach its Duty of Good Faith?

[22] The Franchisees submit that there is a serious issue to be tried as to whether Sobeys breached its duty of good faith at common law and under section 3 of the Act in issuing the Notices and terminating the Franchisees for non-compliance with section 4.7. Section 3 of the Act provides a right of action in damages by a party to a franchise agreement against another party "who breaches the duty of fair dealing in the performance *or enforcement* of the franchise agreement" (my emphasis added). The duty of fair dealing "includes the duty to act in good faith and in accordance with reasonable commercial standards".

[23] Sobeys submits that its evidence (from Mr. Adams, General Manager of Price Chopper operations) does not in any way tie the Notices to the initiation of legal proceedings by the Franchisees and that it was a coincidence that they were issued around the same time as the Statement of Claim. Mr. Adams' evidence was that the Notices were issued solely because of the March 29 cash withdrawal. Sobeys argues that this is supported by the fact that Sobeys did not take any such action when the Franchisees previously threatened litigation.

[24] There is nonetheless a serious issue to be tried on this basis. Given the timing of events in March and April 2010 and the fact that Sobeys did not respond to Sotos' letter enclosing the Statement of Claim but rather issued the Notices, it raises the question whether there was indeed any connection between the litigation and the Notices.

[25] Further, there was evidence that Sobeys has in the past granted its consent to franchisees for legal fees well above the $2,000 limit where, for example, a franchisee had proceedings before the Labour Relations Board.

[26] In this case, was Sobeys acting in good faith when it issued the Notices? Did it have anything to do with the fact that the cash withdrawals were to finance litigation against

Sobeys? Was there any connection with the litigation? Even if there was a breach of section 4.7, was Sobeys' proposed termination of the agreements in good faith or could it have pursued some lesser remedy? These questions raise a serious issue to be tried.

Did Sobeys Interfere with the Franchisees' Right of Association?

[27] The Franchisees submit that by restricting their access to funds for legal fees and terminating the Franchisees for withdrawing the funds Sobeys is interfering with their right of association, contrary to section 4 of the Act.

[28] They rely on the very recent decision of *405341 Ontario Limited v. Midas Canada Inc.*, 2010 ONCA 478. The Court of Appeal upheld a decision of Cullity J. who determined that requiring a franchisee to sign a release as a condition of renewal (even though it was a term of the franchise agreement) was unenforceable for purposes of a class proceeding against the franchisor.

[29] Cullity J. found that the right of association in section 4 encompassed the right of franchisees to take collective action for the purpose of protecting their interests and enforcing their rights.[6]

[30] In upholding the decision not to impose the release as a term of renewal despite it being a term of the franchise agreement, the Court of Appeal stated, at paragraph 30, that "the purpose of the Act is to protect franchisees. The provisions of the Act are to be interpreted in that light".

[31] This is not a class proceeding, but 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 terminations under these circumstances amount to an interference with the Franchisees' ability to pursue collective action against the franchisor contrary to the Act.

Irreparable Harm

[32] The next question is whether the Franchisees will suffer irreparable harm if the injunction is not granted.

[33] "Irreparable" means harm that cannot be quantified in monetary terms. It is the nature of the harm and whether it can be quantified in monetary terms, not its magnitude, which must be assessed: *RJR, supra*.

[34] In the termination of a franchise, loss of business, profits, reputation and goodwill have been found to constitute irreparable harm.[7]

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[6] *405341 Ontario Inc. v. Midas Canada Inc*., 2009 CarswellOnt 6283 (S.C.J.) at para 17.

[35] Sobeys submits that there is no evidence from the Franchisees' accountant that the damages cannot be quantified in monetary terms. Also, because Sobeys will take over operation of the stores, actual operating results will be available. Sobeys will waive the non-competition clause in the Franchise Agreement if the injunction is denied, so the Franchisees will be free to seek work elsewhere. Sobeys is prepared to forego enforcement of its security on the Franchisees' homes.

[36] This does not adequately address the nature of the harm that may be suffered by the Franchisees if the injunction is not granted.

[37] The Franchisees have been Price Chopper franchisees for many years. Sobeys marketed the business as one which was ideal for the involvement of the store owners' families. Most of the owners have spouses or children who work with them at their stores. This family business was reinforced by Sobeys' requirement of spousal guarantees and collateral mortgages on the family homes.

[38] If the injunction is not granted, the remaining four Franchisees will lose their businesses. Regardless of whether Sobeys continues to operate the stores, those Franchisees will lose the business that they had purchased, that they were operating, that their families worked in and that they expected to develop over the term of the franchise. That opportunity cannot be restored to them with a payment of monetary damages.

[39] Even with the waiver of the non-competition agreements, the Franchisees will likely become employees of another store, rather than operating their own businesses. That change is not compensable in damages.

[40] I am satisfied that the Franchisees would suffer irreparable harm if this injunction is not granted.[8]

Balance of Convenience

[41] The balance of convenience clearly favours the Franchisees.

[42] Sobeys argues that it should not be forced to continue in business with the Franchisees now that the relationship of trust has broken down. It argues that it will be inconvenienced because other franchisees will no longer respect the terms of the franchise agreements. It submits that I can assess the strength of the Franchisees' case on the validity of the Notices in weighing the balance of convenience. Further, to the extent that funds have been withdrawn by the Franchisees to pay for legal fees, there is less money available to pay Sobeys' accounts payable for inventory purchases.

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[7] *TDL Group Ltd. v. 1060284 Ontario Ltd.*, [2000] O.J. No. 3868 (S.C.J.), aff'd at [2001] O.J. No. 3614 (Div Ct). See also *Erinwood Ford Sales Ltd. v. Ford Motor Co. of Canada Ltd.*, [2005] O.J. No. 1970 (S.C.J.) and *674843 Ontario Limited v. Culligan of Canada Ltd.* , 2006 CarswellOnt 1564 (S.C.J.)

[8] I distinguish the case of *C.M. Takacs Holdings Corporation et al v. 122164 Canada Limited o/a New York Fries*, 2010 ONSC 3817 cited by Sobeys. In denying the interlocutory relief to restrain termination of the franchise agreement, the court found that the franchisee has numerous uncured financial and other defaults.

[43] Sobeys does not dispute that the Franchisees are good operators. They are not in default under their Franchise Agreements (apart from the alleged default with respect to the withdrawn funds). There is no reason that they cannot continue to operate their stores within the system pending the outcome of their dispute with Sobeys. Mr. Adams acknowledged that in his cross-examination.

[44] The inconvenience to the Franchisees is that they will lose their family businesses, their employment and future prospects for their stores.

[45] The main inconvenience to Sobeys is that funds have been withdrawn for legal fees when, perhaps, they should not have been. However, I can restrict any future exposure to Sobeys by imposing restrictions on further withdrawals of funds until such time as the issue has been decided.

[46] On balance, the Franchisees will suffer far more if the injunction is not granted than Sobeys will suffer if the injunction is granted.

Decision

[47] I grant an interlocutory injunction pursuant to section 101 of the *Courts of Justice Act (Ontario)*, R.S.O. 1990, Chapter C.43, as amended, subject to the following terms:

(a) Sobeys or any person acting on its instructions shall not take any steps to terminate the Franchisees' Franchise Agreements or to take possession of the Franchisees' store premises pursuant to the Notices or the defaults alleged therein.

(b) The injunction shall remain in effect only until there is a judicial determination of whether the Notices were valid and Sobeys is entitled to terminate the Franchise Agreements pursuant to the Notices.

(c) The Franchisees shall comply in all respects with their Franchise Agreements while the injunction is in effect.

(d) While this injunction is in effect, the Franchisees shall not withdraw any further amounts from their "Price Chopper" businesses or bank accounts for legal and/or accounting expenses and fees without the prior order of this court.

[48] If the parties are unable to agree on the costs of this motion, I will receive written submissions (not exceeding three pages, double spaced, exclusive of bill of costs) from the Franchisees within 15 days and by Sobeys within 10 days thereafter.

Conway J.

Date: July 26, 2010