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Actions Speak Louder Than Words: The Enforceability of Oral Agreements Collateral to a Franchise Agreement

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In *Meadow Enterprises Inc. v. Quizno's Canada Restaurant Corporation*,[1] the franchisee, Meadow Enterprises Inc., commenced a claim for damages for breach of its franchise agreement with the franchisor, Quizno's Canada Restaurant Corporation.

In 2003, the franchisee acquired the right to operate a Quizno's franchise located in a remote location. The franchise agreement provided: (a) a 15-year term; (b) a 15-year renewal option; (c) that the franchisee pay weekly royalties of 7% of its gross sales; and (d) that the franchisee pay weekly marketing fees of up to 5% of its gross sales. The franchisee alleged that there was an oral collateral agreement entered into at the time of the execution of the franchise agreement, providing that:

a) The franchisor would subsidize the franchisee's purchase of products and supplies (known as the Ocean Freight Subsidy) because the franchise was in a remote location;

b) Part of the consideration for the payment of royalties was the appointment of an area director, who would provide services and assistance to the franchisee; and

c) The franchisor would deal honestly and reasonably with the franchisee and would treat all its franchisees fairly and equally in accordance with its obligations of good faith.

An area director was appointed to liaise between franchisees and the franchisor, and to provide operational and administrative support. In 2008, the area director position was eliminated, and the functions were then performed by the franchisor. The Ocean Freight Subsidy was eliminated in July 2015, at which time the franchisor implemented a new distribution model. In 2016, the franchisor implemented a program reducing royalty and advertising fees for any franchisees who purchased a new type of oven — this program was known as the "New Deal". When the franchise agreement expired in February 2018, the franchisee did not exercise its renewal option.

The franchisee claimed for damages against the franchisor for the following breaches of the franchise agreement: (1) the elimination of the Ocean Freight Subsidy, (2) the elimination of the area director; (3) misuse of the marketing fund; (4) impaired profitability and diminished value of the franchise arising from the misuse of the marketing fund; and (5) failure to reduce royalty and advertising fees.

[1] 2018 BCSC 1967.

1) Elimination of the Ocean Freight Subsidy

The franchisor argued that the Ocean Freight Subsidy was gratuitous and that it had no obligation under the franchise agreement to provide the subsidy to the franchisee. (Note: the authors do not know whether the franchisor argued that the entire agreement clause [assuming the franchise agreement contained such a clause] negated any alleged oral agreement.) The franchisee submitted that the subsidy was part of the business model, and that the franchisor had previously acknowledged the obligation to provide the subsidy. The Court, accepting the franchisee's evidence, found that the subsidy was a fundamental component of the franchise agreement and that therefore the franchisor had breached the agreement by wrongfully eliminating the subsidy.

2) Elimination of the Area Director

The franchisee argued that: (a) the elimination of the area director deprived it of a number of support services; (b) it itself had to assume the area director's functions, post-elimination; and (c) part of the 7% royalty it paid was used to cover the costs of the area director. The franchisee claimed a 2% overpayment from the date of the elimination of the area director, on the basis that franchisees in a competitor business only paid a 5% royalty.

The Court was unconvinced by the franchisee's argument stating that, under the franchise agreement, the franchisor did not have an obligation to retain an area director, but rather the right to do so. The Court was also unable to substantiate franchisee's claim that the 7% royalty was linked to the existence of the area director, as the franchise agreement provided no such breakdown. Thus, this aspect of the franchisee's claim was dismissed.

3) Misuse of the Marketing Fund

Section 12.3 of the franchise agreement provided for the payment of marketing fees to the franchisor to be used for marketing initiatives to the benefit of the franchise system. The franchisee argued that, in respect of the sum of $212,534 paid to the franchisor as a contribution to the marketing fund, it had received little-to-no benefit, and despite numerous requests, and being so entitled, never received financial statements for the marketing fund.

The Court was persuaded by the franchisee's evidence on this point, finding that the value of marketing services supplied by the franchisor was likely even lower than estimated by the franchisee in its breakdown. As a result, the Court awarded the franchisee the full value of its claim regarding the marketing fund, citing the franchisor's failure to provide the benefit for which the franchisee had contracted under the franchise agreement as a serious breach. (Note: there is no analysis in the decision as to how this value was determined.)

4) Impaired Profitability and Diminished Value of the Franchise

The franchisee alleged that its profitability was diminished as a consequence of the franchisor's failure to use the marketing fund to promote the franchise business. The franchisee alleged both loss of revenues and depreciation of the value of the franchise business as well.

For the loss of revenue allegation, the franchisee prepared a calculation, based on marketing investment return figures obtained from the Nielsen Company, which resulted in approximately $347,700 in losses over the franchise agreement's 15-year term. The Court determined that this allegation was not only speculative, but could not be substantiated by expert evidence or factual proof. Therefore, the Court dismissed this aspect of the claim. Turning to the depreciation of the value of the franchised business, the Court held that any such alleged loss in value was never crystallized, since, upon expiration of the franchise agreement, the franchisee did not sell the franchise but merely closed the doors. Consequently, this allegation of breach was dismissed too.

5) Failure to Reduce Royalty and Advertising Fees

The franchisee alleged that despite meeting all the criteria for the "New Deal" program, the franchisor refused to make the fee reduction. The franchisee asserted that the franchisor's refusal was because the franchisee had commenced litigation at the time the program was offered, and that the franchisor required the franchisee to release the franchisor from all claims. The franchisor's position was that the program was only available to franchisees who were in "good standing", being no operational or financial defaults at the time, and that a franchisee engaged in litigation is not considered in "good standing". The Court found that the franchisee's litigation did not put it in operational or financial default. Further, given that the franchisee had no other defaults, it should have been provided the fee reduction, and therefore was entitled to recover its overpayment.

Takeaways

This case demonstrates a court's willingness to recognize the existence of a collateral oral agreement, even as supplementary to an existing written franchise agreement (and perhaps in the face of an entire agreement clause, if any), where the existence of such an oral agreement can be established on the basis of the parties' conduct. In particular, this case represents the principle that actions can speak louder than words, especially where those actions substantiate unwritten elements of a business model and make them enforceable at law. Further, this case also reminds franchisors that, generally speaking, marketing fees collected from franchisees must be used for the purpose for which they were intended, and franchisors must be able to provide evidence of use.

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Internet Defamation: Observations on *Magno v. Balita*

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On May 23, 2018, Justice Ferguson of the Ontario Superior Court of Justice released a decision involving a claim for internet defamation or "cyberlibel". The decision raises several interesting issues in Internet defamation law. This article addresses two of them: (1) the significance of failing to plead justification in the statement of defence; and (2) the risk that the conduct of defendants and counsel may aggravate damages. As set out below, these points show that Internet defamation cases are different from other types of civil actions and are governed by different legal principles.

Background

In *Magno v. Balita*,[1] the plaintiff, Oswald Magno, brought a motion for summary judgment against the defendants, Balita Media Inc. ("Balita"), Teresita Cusipag, and Romeo Marquez (collectively, the "defendants") in respect of 35 articles that the defendants published from December 7, 2012 to January 24, 2014, in print and online, which Mr. Magno alleged to be defamatory.

Justice Ferguson determined that this was an appropriate case for summary judgment. She also determined that the defendants defamed Mr. Magno and could not avail themselves of any defences to his claim. The Court awarded general/aggravated damages in the amount of $300,000 and punitive damages in the amount of $110,000 jointly and severally against the defendants.

Magno involved what has been called a "campaign of vilification and defamation", which are becoming more common in the United Kingdom and Canada.[2] These campaigns encompass attacks against a wide range of persons and occupations, including public officials, civil servants, politicians, prominent businessmen, lawyers and business competitors. Some of the perpetrators of the campaigns of vilification and defamation do not view themselves as bound by the normal rules of civility that govern the legal profession. They often treat lawyers and the legal system with derision and contempt.[3]

Requirement to Plead Particulars of Justification in the Statement of Defence

Magno addresses the requirement to plead particulars of justification in the statement of defence and the consequences of failing to comply with that requirement. Before examining

1 *Magno v. Balita*, 2018 ONSC 3230 [*Magno*].
2 *Thompson v. James & Anor* [2013] EWHC 515 (QB); *Rutman v. Rabinowitz*, 2016 ONSC 5864, paras. 11-30.
3 *Busseri v. Doe*, 2014 ONSC 819; *Manson v. John Doe*, 2013 ONSC 628; *Trout Point Lodge v. Handshoe*, 2014 NSSC 62.

the decision of Justice Ferguson, some basic principles of the defence of justification are stated as follows:

- The defense of justification is a complete defence to a libel action.[4]
- However, this defence should not be raised lightly. The defence should only be raised and pleaded where the defendant has evidence to support such a plea. If the defense is pleaded and is unsuccessful, this will often constitute grounds for aggravation of damages.[5]
- If no particulars are given, the defendant is not entitled to discovery on the truth of the statements.[6]
- There is no need for a plaintiff to demand particulars.[7]

Justice Ferguson summarized further aspects of the applicable law in this respect:

> [20] A defendant is required to plead particulars of justification/truth in their statement of defence. The basis for this rule is that a plaintiff should be fully informed of a defendant's case. The evidence that may be introduced at trial is therefore limited to the pleaded particulars of justification/truth. In the absence of particulars, the defendant cannot introduce evidence in support of the defence at trial: Raymond E. Brown, *Brown on Defamation*, loose-leaf, 2nd ed. (Toronto: Thomson Reuters, 2017), at 10-121 ("*Brown*"); *Yorkshire Provident Life Ins.* v. *Gilbert*, [1895] 2 Q.B. 148, *Govenlock* v. *London Free Press Co.* (1915), 1915 CanLII 555 (ON CA), 35 O.L.R. 79 (C.A.) at 83, and *Parkland Chapel* v. *Edmonton Broadcasting* (1964), 1964 CanLII 480 (AB QB), 45 D.L.R. (2d) 752.

As Justice Ferguson found in *Magno*, the defendants "provided absolutely no particulars or facts with respect to this defence in their pleadings".[8] Applying the principles above, she held as follows:

> [23] I do not agree with the defendants' submission that they have provided sufficient particulars in their statement of defence. They do not state any facts, such as specific acts or statements by Magno, that would justify their imputations of dishonourable and unlawful conduct and other defamatory statements made against him. They rely on a bald, flawed pleading.
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> [24] Objectively, the particulars in the statement of defence were neither sufficient nor specific enough for Magno to know whether the defendants had

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4 Roger McConchie and David Potts, *Canadian Libel and Slander Actions* (Irwin Law: 2004), pp. 498-99.
5 McConchie & Potts, pp. 501-502.
6 McConchie & Potts, pp. 717-718.
7 McConchie & Potts, p. 719.
8 *Magno*, para. 21.

> sufficient and sustainable grounds to support the truth of the statements complained of.
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> [25] There are approximately 35 articles containing alleged defamatory statements. Each article gives rise to a separate cause of action. Each have potential defences. Nothing is particularized for each article. The defendants have not indicated which of their alleged particulars contained in their defence apply to which alleged libel. Despite being alerted to this issue the defendants took no steps to request leave to amend their defence and they did not request an adjournment. They tried to repair their problems in their original supplementary factum in which they simply allege that Magno was aware of the case he had to meet and provided no facts or particulars that would actually make Magno aware of the case to meet for each of the 35 articles complained of in the action.
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> [26] The court is faced with a bald plea of justification/truth without particulars. In the absence of particulars pleaded no particular evidence can be adduced. There is no admissible evidence to support the defendants' justification/truth defence. The defendants attempted unsuccessfully to explain the defendants' actions/defences in unhelpful, non-responsive submissions.

Conduct of the Defendant and Defence Counsel May Aggravate Damages

It is well established that the defendant's conduct, including the conduct of their counsel can aggravate damages in defamation cases. For example, in *Leenen v. Canadian Broadcasting Corp.*,[9] Justice Cunningham held that one of the factors that court will take into account when determining an appropriate damages award is "the conduct of the defendant and defendant's counsel through to the end of trial".[10] Justice Ferguson applied this principle to the evidence and observed as follows:

> The defendants' motive and conduct, assisted by their counsel, have aggravated the damages. Pleading the defence of justification/truth without clear and sufficient evidence of the truth of the imputation has consequences. An unsuccessful plea of justification/truth may be taken into account in aggravating Magno's damages. The defendants in this case exhibited malicious, high-handed and oppressive conduct which provides the foundation to award aggravated damages.[11]

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9 2000 CanLII 22380 (ON SC).

10 *Ibid.*, para. 205. See also *Rutman v. Rabinowitz*, 2018 ONCA 80, *Trout Point Lodge Ltd. v. Handshoe*, 2012 NSSC 245, *Kent v. Martin*, 2016 ABQB 314, H*ome Equity Development Inc. et al v. Crow et al*, 2004 BCSC 124; *Nazerali v. Mitchell*, 2016 BCSC 810, paras. 182-83 (criticism of the cross examination of the plaintiff).

11 *Magno*, para. 70.

Justice Ferguson went on to give specifics of the conduct of the defendants, who "did everything in their power to inflict pain on Magno".[12] Certain of the factors that she considered included:

(a) "they refused to retract the defamatory statements and to apologize";

(b) "they pursued a defence of truth/justification when no particulars were pleaded";

(c) "they attempted to introduce the affidavit of Marquez on the day of the hearing, which was not only materially late (they had at least 5 months to submit it), but also replete with hearsay, improper opinion evidence and further malicious slurs;"

(d) "they incorporated further information from Marquez (which was not admitted) in their factum and in their other written submissions;" and

(e) "with regard to the responsible communication defence, they claim that Magno's own conduct absolved them of their obligation to obtain and present his side of the story".[13]

Justice Ferguson also took into account submissions made by the defendants, including that "the impugned words about Magno were reported in response to his conduct", and that Mr. Magno was the "author of his own misfortune".[14] As Justice Ferguson held, the defendants were "essentially claiming that Magno somehow deserved to be publicly and widely denigrated for forwarding a news article about Marquez; for writing to then-PM Harper to thank him for appointing a Filipino-Canadian to the Senate; and for joining other members in his community for petitioning the PCPO to examine disturbing articles published by Balita."[15]

Conclusions

The growing number of cases involving "campaigns of vilification and defamation" reflects the proliferation of different forms of social media and the increasing malevolence of persons using the Internet to inflict damage another person other individuals or companies. The issues from *Magno* addressed in this article reflect two deeply entrenched principles that apply to the conduct of defamation proceedings, and distinguish them from other types of civil litigation:

- The pleadings in libel actions are very important,[16] and
- The conduct of the defendant and their counsel can mitigate or aggravate the damages.

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12 *Magno*, para. 71.
13 *Magno*, para. 71.
14 *Magno*, para. 71.
15 *Magno*, para. 71.
16 McConchie & Potts, pp. 531-534.

In these respects, the conduct of defamation actions, especially Internet defamation actions, is different from other civil actions. They are governed by different principles of substantive, procedural, and evidentiary law. In *Whitehead v. Sarachman*, Justice Corbett summarized some of the reasons for the complexity of the conduct of defamation proceedings, including that the law has "developed, not over decades, but over centuries, to try to balance these competing interests, in the context of the 'rough trade' of public debate".[17]

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[17] *Whitehead v. Sarachman*, 2012 ONSC 6641, para. 71.

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Moore v Sweet: Unjust Enrichment at the Supreme Court of Canada

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In November of last year, the Supreme Court of Canada released its decision in Moore v Sweet,[1] which provided necessary clarification of the "juristic reason" component of the test for unjust enrichment. The Supreme Court has also confirmed the circumstances in which a constructive trust remedy is appropriate within the context of unjust enrichment. As a result, the appellant was successful, and the majority of the Supreme Court reversed the split decision of the Ontario Court of Appeal.

The facts of the case were relatively straightforward: The appellant had previously been married to the deceased. Around the time of their separation, the appellant and the deceased entered into an oral agreement whereby the appellant would remain the designated beneficiary for the life insurance policy on the deceased's life on the basis that she would continue to pay the related premiums. The appellant paid the premiums on the life insurance policy until the deceased's death approximately 13 years later, while, unbeknownst to the appellant, the deceased named his new common law spouse (the respondent), as irrevocable beneficiary of the policy soon after the oral agreement was made. At the time of his death, the deceased's estate was insolvent.

At the application hearing, Justice Wilton-Siegel awarded the appellant the proceeds of the life insurance policy on the basis of unjust enrichment. The respondent was successful in arguing before the Ontario Court of Appeal that the designation of an irrevocable beneficiary under the Insurance Act was a "juristic reason" that permitted what was otherwise considered the unjust enrichment of the respondent at the appellant's expense. The appellant was subsequently granted leave to appeal to the Supreme Court of Canada.

Justice Coté, writing for the Majority, agreed that the test for unjust enrichment was flexible and permits courts to use it in the promotion of justice and fairness where required by good conscience. The Court clarified that the juristic reason permitting an unjust enrichment needs to justify not only the enrichment of one party but also the corresponding deprivation of the other party. While the irrevocable beneficiary designation may have required the payment of proceeds for the policy to the respondent, it could not be considered as also requiring the appellant's deprivation of the proceeds to which she was entitled under the oral agreement. The Court found that a designation of an irrevocable beneficiary under the Insurance Act precludes claims by creditors of an estate, but it does not state "with irresistible clearness" that it also precludes a claim in unjust enrichment by a party who has a contractual or equitable interest in the proceeds.

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[1] *Moore v. Sweet*, 2018 SCC 52 Our firm argued the case before the Supreme Court of Canada on behalf of the appellant.

While reaching the opposite result, the dissent acknowledged that this was a difficult appeal, in which both parties were innocent and had strong moral claims to the proceeds of the life insurance policy.

We look forward to following the role of this decision in further developments in the Canadian law of unjust enrichment.