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SPECIFIC PERFORMANCE OF FRANCHISE AND DISTRIBUTION AGREEMENTS IN CANADA

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1. Introduction

Specific performance is a powerful remedy that can fundamentally affect the complexion of commercial litigation when sought as the primary relief by the plaintiff. The spectre of an order for specific performance can significantly influence the conduct of the parties after the commencement of the litigation, for example by making it increasingly difficult for the parties to go their separate ways. Specific performance as the primary remedy in litigation has the potential to lead to compressed litigation timetables, including orders for expedited trial dates and interlocutory injunction motions.

In the context of a dispute arising under a franchise or distribution agreement, the spectre of a judgment for specific performance has huge implications. Franchise and distribution agreements create complex relationships requiring ongoing performance obligations for both parties, necessitate close working relationships requiring mutual trust over long periods of time, and often entail the sharing of confidential information, including trade-marks and trade secrets. While specific performance would appear to be a common remedy sought by plaintiffs in Canada in disputes concerning franchise and distribution agreements,[1] few reported decision have yet considered

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1. See, *e.g.*, *Unitech Energy Corp. v. International Datashare Corp.* (2003), 121 A.C.W.S. (3d) 457, 2003 ABQB 203, [2003] A.J. No. 333; *Stoneleigh Motors Ltd. v. General Motors of Canada Ltd.* (2010), 71 B.L.R. (4th) 271, 187 A.C.W.S. (3d) 995, 2010 ONSC 1965, at para. 2; *Sultani v. Blenz The Canadian Coffee Co.* (2005), 3 B.L.R. (4th) 93, 138 A.C.W.S. (3d) 653, 2005 BCSC 571, affd 359 W.A.C. 288, 10 B.L.R. (4th) 191, 2005 BCCA 578, at para. 2 (S.C.); *Chuang v. Toyota Canada Inc.* (2007), 157 A.C.W.S. (3d) 1029, 2007 CarswellOnt 3262, [2007] O.J. No. 2069 (S.C.J.), at para. 11; *Firoozi v.*

the application of the traditional barriers to specific performance to the unique circumstances of franchises and distributorships.

The purpose of this article is to provide an analysis and application of the fundamental principles of specific performance to the franchise and distribution business models. In this regard, emphasis will be placed on three doctrines that have the most significant import in the franchise and distribution context. After the governing principles are set out and their modern application explained, hypothetical examples will be employed to illustrate the application of the doctrines to franchise and distribution disputes.

The first doctrine, discussed in Section 2, is the rule against supervision, which in general terms provides that orders for specific performance will not be available where they require ongoing judicial supervision. While this principle is widely known, it has been applied inconsistently in Canada and its precise contours are not well understood. The modern leading authority on this rule is the House of Lords decision in *Co-Operative Insurance Society Ltd. v. Argyll Stores*,[2] which has been frequently cited by Canadian courts,[3] and

809963 Ontario Ltd. (2003), 122 A.C.W.S. (3d) 421, 2003 CarswellOnt 1789, [2003] O.J. No. 1305 (S.C.J.), at para. 1; *Kwik-Kopy Printing Canada Corp. v. Skoreiko* (2002), 324 A.R. 126, 116 A.C.W.S. (3d) 664, 2002 ABQB 835, at para. 6; *Canada Trustco Mortgage Co. v. Huron Shores Real Estate Inc.* (1994), 58 C.P.R. (3d) 68, 86 F.T.R. 19, 50 A.C.W.S. (3d) 1109 (T.D.), at para. 9; *Sir Speedy, Inc. v. Act Printing Inc.* (1995), 54 A.C.W.S. (3d) 11, [1995] B.C.J. No. 631, 1995 CarswellBC 2948, at para. 45; *Zippy Print Enterprises Ltd. v. Pawliuk* (1993), 44 A.C.W.S. (3d) 692, 1993 CarswellBC 1895 (S.C.), affd [1995] 3 W.W.R. 324, 100 B.C.L.R. (2d) 55, 20 B.L.R. (2d) 170 (C.A.), at para. 6; *Bawitko Investments Ltd. v. Kernels Popcorn Ltd.* (1991), 79 D.L.R. (4th) 97, 53 O.A.C. 314, 26 A.C.W.S. (3d) 350 (C.A.); *Arnold v. Imperial Oil Ltd.* [1979] S.J. No. 442 (Q.B.); *Trans-Canada Draperies Inc. v. 96955 Canada Ltd.* (1983), 35 C.P.C. 45, [1983] 5 W.W.R. 186, 23 Sask. R. 118 (Q.B.), at para. 2; *A & K Lick-a-Chick Franchises Ltd. v. Cordiv Enterprises Ltd.* (1981), 119 D.L.R. (3d) 440, 56 C.P.R. (2d) 1, 44 N.S.R. (2d) 159 (S.C.T.D.), at para. 1.

2. *Co-operative Insurance Society Ltd. v. Argyll Stores (Holdings) Ltd,*. [1998] A.C. 1, [1997] 3 All E.R. 297, [1997] 2 W.L.R. 898 (H.L.).

3. *E.g., Bell Canada v. Manitoba Telecom Services Inc.* (2004), 49 B.L.R. (3d) 17, 131 A.C.W.S. (3d) 743 (Ont. S.C.J. (Comm. List)), at para. 105; *Village Square (Burlington) Ltd. v. National Bank of Canada* (1997), 75 A.C.W.S. (3d) 359, 1997 CarswellOnt 4383, [1997] O.J. No. 4592 (Gen. Div.); *T. Eaton Co. (Re)* (1999), 14 C.B.R. (4th) 288, 92 A.C.W.S. (3d) 375, 1999 CarswellOnt 3542 (S.C.J.), at para. 13; *Centre City Capital Ltd. v. Bank of East Asia (Canada)* (1997), 76 A.C.W.S. (3d) 642, 1997 CarswellOnt 5138, [1997] O.J. No. 5218 (Gen. Div.), at para. 13; *West Nipissing Economic Development Corp. v. Weyerhaeuser Co.* (2002), 118 A.C.W.S. (3d) 575, 2002 CarswellOnt 4165, [2002] O.J. No. 4731 (S.C.J.), at para. 24; *Healthy Body Services Inc. v. Muscletech Research and Development Inc.* (2001), 107

which provides important lessons for counsel involved in litigation concerning franchise or distribution agreements. As will be seen, the rule set out in *Argyll* will preclude orders for specific performance that seek to enforce obligations of an ongoing nature. The application of the *Argyll* principle is illustrated in Section 2 through two hypothetical scenarios which demonstrate the potential availability of specific performance in limited classes of franchise/distribution disputes.

Section 3 of the article will explore the mutual trust doctrine which is the modern expression of the historical rule against specific enforcement of contracts for personal service. As will be seen, while the courts have made clear that franchise and distribution agreements are *not* contracts for personal service,[4] they have also emphasized that these contracts nevertheless give rise to mutual obligations of trust and confidence.[5] The courts have made clear that specific performance will not be available to enforce franchise or distribution agreements in the face of clear evidence of a breakdown in the parties' relationship.[6] Key to the application of this principle is actual evidence of a breakdown in the parties' relationship and detrimental impact on the business aspects of the relationship occasioned by that deterioration. Again, hypothetical examples are employed to illustrate the application of the doctrine.

Section 4 of this article will focus on the consumer surplus doctrine, which is an expression of the historical requirement that – to be a candidate for specific performance – the subject matter of a contract must be unique in the sense that damages would be an inadequate remedy. While historically the focus of the inadequacy of damages requirement has been on the nature and quality of the subject-matter of the contract at issue, the modern trend has shifted the focus to the nature and quality of the claimant's interests in that subject-matter

A.C.W.S. (3d) 476, 2001 CarswellOnt 2853, [2001] O.J. No. 3257 (S.C.J.), at para. 22.

4. *North West Beverages Ltd. v. Pepsi-Cola Canada Ltd.* (1971), 20 D.L.R. (3d) 341, [1971] M.J. No. 104 (Q.B.), at para. 14; *Yule Inc. v. Atlantic Pizza Delight Franchise (1968) Ltd.* (1977), 80 D.L.R. (3d) 725, 35 C.P.R. (2d) 273, 17 O.R. (2d) 505 (Div. Ct.), at paras. 10-11; *Ford Motor Co. of Canada, Ltd. v. Welcom Ford Sales Ltd.* (2011), 44 Alta. L.R. (5th) 81, 77 C.B.R. (5th) 278, 201 A.C.W.S. (3d) 890 (C.A.), at paras. 51-52.
5. *1193430 Ontario Inc. v. Boa-Franc (1983) Ltee.* (2005), 260 D.L.R. (4th) 659, 78 O.R. (3d) 81, 203 O.A.C. 320 (C.A.), leave to appeal to S.C.C. refused [2006] 1 S.C.R. vi, 262 D.L.R. (4th) vii, 223 O.A.C. 396*n*, at para. 60; *Healthy Body Services Inc. v. Muscletech Research and Development Inc.* (2001), 107 A.C.W.S. (3d) 476, 2001 CarswellOnt 2853, [2001] O.J. No. 3257 (S.C.J.), at para. 20.
6. *E.g.*, *Muscletech Research and Development Inc.*, *supra*, at para. 20.

and, in particular, whether those interests extend beyond what can be assessed on the basis of fair market value.[7] In the context of a franchise and distribution dispute, this doctrine will be a powerful tool available to defendants to avoid the remedy of specific performance. Again, the principle's application is illustrated through hypothetical examples.

2. The Supervision Principle

(1) Background and Governing Principles

Common law courts have long been reluctant to decree orders for specific performance that would require ongoing supervision by the courts.[8] This principle has become known as the rule against supervision and has an important role to play when considering the appropriateness of specific performance in the context of agreements with long-term performance obligations, especially franchise and distribution agreements. The policy underlying the supervision principle is to promote the efficient disposition of judicial resources by requiring that orders for specific performance provide definitional clarity to the parties. Definitional clarity will limit the situations in which the courts are called upon to provide ongoing supervision of the order in contempt proceedings brought by the plaintiff.[9]

While some courts and commentators have expressed reservations about the utility and continued role of supervision principle,[10] it remains an integral doctrine in the law of specific performance, continues to influence judges in franchise and distribution cases,[11] and was recently reaffirmed by the Supreme Court of Canada in *Pro*

7. See, *e.g.*, the cases cited in Section 3, such as *Wallace v. Allen* (2009), 93 O.R. (3d) 723, 53 B.L.R. (4th) 1, 173 A.C.W.S. (3d) 784 (C.A.), at para. 40; *Chuang v. Toyota Canada Inc.* (2007), 157 A.C.W.S. (3d) 1029, 2007 CarswellOnt 3262, [2007] O.J. No. 2069 (S.C.J.), at para. 26; *National Trust Co. v. 1117387 Ontario Inc.* (2010), 67 C.B.R. (5th) 204, 52 C.E.L.R. (3d) 163, 188 A.C.W.S. (3d) 332 (Ont. C.A.), at para. 53.
8. See, *e.g.*, *Blackett v. Bates* (1865), L.R. 1 Ch. 117.
9. J.B. Berryman, *The Law of Equitable Remedies* (Toronto, Ont.: Irwin Law, 2000), pp. 175-177.
10. R.J. Sharpe, *Injunctions and Specific Performance* (Aurora, Ont.: Canada Law Book, 1983); Berryman, *supra*, pp. 180-185; *A.L. Sott Financial (Newton) Inc. v. Vancouver City Savings Credit Union* (2000), 223 W.A.C. 114, 72 B.C.L.R. (3d) 383, 31 R.P.R. (3d) 56 (C.A.), at para. 11; *Patrick Stevedores v. MUA*, [1998] HCA 30, at paras. 78-80; *Bennison Lane Enterprises Ltd. v. Krause Logging Ltd.*, [1977] 6 W.W.R. 93, 1977 CarswellBC 418, [1977] B.C.J. No. 958 (S.C.), at para. 13; *Theatre Erebus (Hamilton) Inc. v. Hamilton Entertainment and Convention Facilities Inc.* (1993), 44 A.C.W.S. (3d) 479, [1993] O.J. No. 2993 (Gen. Div.).

Swing Inc. v. Elta Golf Inc.[12] In *Pro Swing*, the Supreme Court recognized the link between the supervision principle and considerations of efficiency:[13]

> The terms of the order [for specific performance] must be clear and specific. The party needs to know exactly what has to be done to comply with the order. Also, the courts do not usually watch over or supervise performance. While the specificity requirement is linked to the claimant's ability to follow up non-performance with contempt of court proceedings, supervision by the courts often means relitigation and the expenditure of judicial resources.

There is a voluminous case law discussing the supervision principle spanning hundreds of years in both England and Canada. However, the leading modern authority is the House of Lords decision in *Co-Operative Insurance Society Ltd. v. Argyll Stores*,[14] which provides helpful guidance on the parameters of the doctrine in the context of franchise and distribution disputes. *Argyll* has been cited frequently in Canada,[15] especially among the courts in Ontario, and establishes a principled framework for the operation of the supervision principle in commercial disputes. *Argyll* concerned a dispute over a provision in a lease requiring the lessee to operate a grocery store during usual business hours. When the defendant-lessee purported to terminate the lease and close the grocery store, the plaintiff sought specific performance of the ongoing performance obligation. The House of Lords reviewed the supervision principle and affirmed the general common law rule against the specific performance of ongoing commercial activities. According to Lord Hoffman, writing for the House of Lords, orders enforcing ongoing activities, such as running a commercial enterprise, are inherently uncertain and thus necessitate wasteful ongoing supervision by the courts:[16]

> It is the possibility of the court having to give an indefinite series of such

11. See, *e.g.*, *Natrel Inc. v. Four Star Dairy Ltd.* (1996), 62 A.C.W.S. (3d) 361, 1996 CarswellOnt 1205, [1996] O.J. No. 1145 (Gen. Div.), at para. 13.
12. *Pro Swing Inc. v. Elta Golf Inc.* [2006] 2 S.C.R. 612, 273 D.L.R. (4th) 663, 52 C.P.R. (4th) 321.
13. *Pro Swing Inc. v. Elta Golf Inc.*, *supra*, at para. 24.
14. *Co-Operative Insurance Society Ltd. v. Argyll Stores*, *supra*, footnote 2.
15. *E.g.*, *Bell Canada v. Manitoba Telecom Services Inc.*, *supra*, footnote 3, at para. 105; *Village Square (Burlington) Ltd. v. National Bank of Canada*, *supra*, footnote 3; *T. Eaton Co. (Re)*, *supra*, footnote 3, at para. 13; *Centre City Capital Ltd. v. Bank of East Asia (Canada)*, *supra*, footnote 3, at para. 13; *West Nipissing Economic Development Corp. v. Weyerhaeuser Co.*, *supra*, footnote 3, at para. 24; *Healthy Body Services Inc. v Muscletach Research and Development Inc.*, *supra*, footnote 3, at para. 22.
16. *Co-Operative Insurance Society Ltd. v. Argyll Stores*, *supra*, footnote 2, at p. 12.

> rulings in order to ensure the execution of the order which [the supervision doctrine] has been regarded as undesirable.
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> . . . the only means available to the court to enforce its order is the quasi-criminal procedure of punishment for contempt . . . The heavy-handed nature of the enforcement mechanism . . . to compel the running of a business is perhaps the paradigm case of its disadvantages . . .

The most significant aspect of *Argyll* is its distinction between "ongoing activities" and "specific results". According to the House of Lords, a court may specifically enforce contractual obligations that call for a specific result without running into the supervision principle, provided that the obligation is sufficiently certain to guide judicial enforcement.[17] By contrast, where a contractual obligation involves "ongoing activities", the supervision principle will usually intercede and preclude the remedy of specific performance. According to Lord Hoffman:[18]

> This is a convenient point at which to distinguish between orders which require a defendant to carry on an activity . . . and orders which require him to achieve a result. The possibility of repeated applications for rulings on compliance with the order which arises in the former case does not exist to anything like the same extent in the latter. Even if the achievement of the result is a complicated matter which will take some time, the court, if called upon to rule, only has to examine the finished work and say whether it complies with the order.
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> . . . . .
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> If the defendant is ordered to run a business [or to engage in other ongoing activities], its conduct becomes the subject of a flow of complaints, solicitors' letters and affidavits. This is wasteful for both parties and the legal system. An award of damages, on the other hand, brings the litigation to an end. The defendant pays damages, the forensic link between them is severed, they go their separate ways and the wounds of conflict can heal.

The House of Lords held that a decree of specific performance will normally be unavailable to enforce ongoing contractual obligations but may well be available to enforce obligations to achieve a particular result, provided the obligation is sufficiently precise to avoid "wasteful [subsequent] litigation over compliance".[19]

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17. *Ibid.*, at pp. 13-14. ("It by no means follows, however, that even obligations to achieve a result will always be enforced by specific performance . . . If the terms of the court's order, reflecting the terms of the obligation, cannot be precisely drawn, the possibility of wasteful litigation over compliance is increased.")
18. *Ibid.*, at pp. 13-16.
19. *Ibid.*, at pp. 13-14.

(2) Application of the Supervision Principle to Franchise and Distribution Agreements

The distinction between ongoing activities, on the one hand, and final results, on the other, provides considerable guidance to the question of whether specific performance will be available in a particular dispute under a franchise or distribution agreement. It is important in this context to emphasize that this distinction must be viewed from the perspective of the form that the putative court order will ultimately take, rather than from the perspective of the contractual obligations at issue in the dispute. The principle is concerned with supervision of the *order*, rather than supervision of the *relationship*. All franchise and distribution agreements contain obligations of an ongoing nature and, generally speaking, those ongoing obligations will lie at the heart of any significant dispute between a franchisor/producer and franchisee/distributor. *Argyll* does *not* preclude the availability of specific performance to every dispute arising under a franchise or distribution agreement; instead, it significantly limits the scope of the actual order that would decree specific performance. Two hypothetical scenarios can illustrate this distinction and the operation of the *Argyll* framework in the franchise and distribution settings.

Hypothetical Scenario 1

Two parties are governed by a three-year distribution agreement in which the distributor (the "Distributor") has an option to renew the agreement at the end of its term. Under the terms of the renewal option, the Distributor's right crystallizes at the expiry of the three-year term provided that the manufacturer (the "Manufacturer") did not terminate the agreement for cause prior to expiry. At the end of the three-year term, the Manufacturer takes the position that a change in circumstances within its larger business has made it economically imprudent for it to renew the distribution agreement and purports to allocate the Distributor's market area to another distributor in the Manufacturer's distribution network.

In this context, to fit within the *Argyll* framework, the distributor would be wise to frame its prayer for relief as seeking to compel the Manufacturer to achieve a specific result, namely, to present the Distributor with the renewal agreement for acceptance. In this way, there would no "ongoing activity" which the Distributor would be asking the court to specifically enforce. Once the Manufacturer presented the Distributor with the renewal agreement, and the

Distributor executed that agreement, the parties' relationship would be governed by the new agreement as opposed to the court order. In other words, the manufacturer's obligation under the court order would be discharged upon presentation of the renewal agreement and the circumstances in which court would be required to supervise the order's implementation would be greatly reduced.

On the basis of *Argyll*, this would be considered a decree of specific performance to achieve a specific result rather than to enforce an ongoing activity. A similar order to require parties to enter into an agreement was recognized in the English decision of *C.H. Giles & Co. v. Morris*.[20] The court in *Giles* emphasized that, by ordering a party to execute a contract, as opposed to ordering the enforcement of the contract as a whole, the necessity for judicial supervision of the order was greatly reduced.

Argyll also makes clear that an obligation to achieve a particular result must provide definitional certainty to the parties in order to be enforceable by way of specific performance. In the context of the first scenario, the requirement of certainty will depend upon the nature of the contractual right of renewal contained in the distribution agreement. Where there is uncertainty over the form of renewal agreement that must be offered to the distributor at the end of the term, it is likely that the provision will not be susceptible to an order for specific performance as there will not be certainty as to what result the manufacturer is supposed to achieve through the order. Indeed, any right of renewal must define the contractual obligations that will be created through the renewal or else it would be subject to attack on the basis that it is an enforceable "agreement to agree".[21]

For example, if the right of renewal provided that the renewal agreement would take the same form as the expired agreement, it is likely that the court would be able to specifically enforce the obligation as there is certainty. A similar result would likely follow if the agreement provided that the Manufacturer's current standard form of agreement employed with all of its distributors would be the

20. *C.H. Giles & Co. v. Morris* (1971), [1972] 1 W.L.R. 307, [1972] 1 All E.R. 960 (Ch. Div.), pp. 316-317.

21. *Walford v. Miles*, [1992] 2 A.C. 128, [1992] 1 All E.R. 453, [1992] 2 W.L.R. 174 (H.L.), pp. 138-139; *Edperbrascan Corp. v. 117373 Canada Ltd.* (2000), 50 O.R. (3d) 425, 9 B.L.R. (3d) 234, 37 R.P.R. (3d) 188 (S.C.J.), affd 22 B.L.R. (3d) 42, 112 A.C.W.S. (3d) 263 (C.A.), leave to appeal to S.C.C. abandoned [2002] S.C.C.A. No. 184, at pp. 446-47 (S.C.J.); *Cedar Group Inc. v. Stelco Inc.* (1995), 59 A.C.W.S. (3d) 1096, 1995 CarswellOnt 3896, [1995] O.J. No. 3998 (Gen. Div.), affd 66 A.C.W.S. (3d) 867, 1996 CarswellOnt 4335, [1996] O.J. No. 3974 (C.A.); *Labatt Brewing Co. v. NHL Enterprises Canada, LP.*, 2011 ONSC 5652, 209 A.C.W.S. (3d) 308.

one presented to the Distributor on renewal. However, any less certainty than this would likely pose problems under the *Argyll* framework. In *Argyll*, the House of Lords made clear that requirement for certainty in the context of specific performance had a higher bar than in other areas of the common law:[22]

> The fact that the terms of a contractual obligation are sufficiently definite to escape being void for uncertainty, or to found a claim for damages . . . does not necessarily mean that they will be sufficiently precise to be capable of being specifically performed. [As one court has put it] "the court [should be able to] sufficiently see what is the exact nature of the work of which it is asked to order the performance". [Citation omitted.]

Hypothetical Scenario 2

A franchisor (the "Franchisor") purports to terminate for cause the franchise agreement governing its relationship with one of its dealers (the "Franchisee"), invoking the termination provisions which allow for termination on the occurrence of specified acts of default by the Franchisee. The Franchisee immediately sues the franchisor, alleging that the termination constituted a breach of contract and seeks an order for specific performance of the franchise agreement.

In the context of this hypothetical scenario, it is likely that the *Argyll* framework would preclude the prayer for relief on the basis that it was seeking to enforce an ongoing activity rather than a specific result. By framing the prayer for relief as seeking to enforce the franchise agreement as a whole, the Franchisee required the court order to refer to the larger franchise agreement, and the obligations set out in it, as structuring the obligations to be specifically enforced. This would mean that Franchisee's ongoing performance obligations under the franchise agreement would be subject to enforcement through the quasi-criminal device of contempt which in theory would require ongoing judicial supervision. For example, the order would require ongoing compliance with the franchise agreement, including the supply of product to the Franchisee, meaning that contractual breaches would technically constitute violations of the order itself. A similar criticism can be made of the Alberta Court of Queen Bench's decision in *Unitech Energy Corp. v. International Datashare Corp.*,[23] where the court ordered the defendant to provide the plaintiff with an

22. *Co-Operative Insurance Society Ltd. v. Argyll Stores*, *supra*, footnote 2, pp.13-14.
23. *Unitech Energy Corp. v. International Datashare Corp.* (2003), 121 A.C.W.S. (3d) 457, 2003 ABQB 203, 2003 CarswellAlta 335, at para. 45.

ongoing supply of goods under a distribution agreement. The court even purported to remain vested with jurisdiction to "supervise" the continuing obligation, contrary to the concerns expressed in *Argyll*.

In the second scenario, it may have been possible to frame the prayer for relief so as to seek a specific result rather than to enforce an ongoing activity. For example, on the theory that the Franchisor had breached the termination provisions in the agreement, the Franchisee could have sought an order specifically enforcing the termination provisions by compelling the Franchisor to withdraw any notice of termination that had previously been issued. With the notice of termination withdrawn, it is arguable that the parties' contractual relationship would be restored to the pre-termination status. In this regard, it should be noted that the courts have emphasized that orders for specific performance can depart from the literal language of the agreement in appropriate cases.[24] If the Franchisee also sought a declaration that the previous termination had been unlawful, it would be difficult for the Franchisor to terminate the agreement again on the same basis without running into the declaration. The Franchisor's obligations under the court order would technically be discharged upon withdrawal of the notice of termination, thereby formally precluding the need for ongoing judicial supervision.

That having been said, it is arguable that an order to withdraw a notice of termination would give rise to serious issues of uncertainty. It is not clear what implications would flow from simply withdrawing a notice of termination, and what ongoing obligations, if any, the Franchisor would have in the face of the judicial declaration that the previous termination was unlawful. Moreover, it is possible that this manner of framing the prayer for relief would be viewed by the courts as a formalistic device to circumvent the distinction laid down in *Argyll*. The Franchisee may be incented to argue that any action of the Franchisor that is not in its best interest constitutes a collateral attack on the court order. In practical terms, this could involve the court in ongoing supervision despite the textual simplicity of the order. Indeed, the court may be called upon to supervise the parties' relationship on an ongoing basis through ongoing enforcement by the franchisee of its rights under the franchise agreement by reference to the court's previous order.

24. *UBS Securities Canada Inc. v. Sands Brothers Canada Ltd.* (2008), 168 A.C.W.S. (3d) 780, 2008 CarswellOnt 3436, [2008] O.J. No. 2309 (S.C.J.), affd 95 O.R. (3d) 93, 58 B.L.R. (4th) 60, 177 A.C.W.S. (3d) 383 (C.A.), at para. 6 (S.C.J.).

3. The Requirement for Mutual Trust and Confidence

(1) Background and Governing Principles

The common law has long confined plaintiffs suing to enforce long-term performance obligations to the remedy of damages wherever the contractual obligations are seen to be of a character requiring "mutual confidence" between the parties or containing elements of "personal service". The famous English case of *Lumley v. Wagner*[25] addressed this principle in the context of an exclusivity clause in a singing contract, with the court distinguishing between the positive obligation to sing, which it was not prepared to enforce, and the negative obligation not to sing for competitors, which it was prepared to enforce. The policy against specific enforcement of the positive obligation stemmed from a desire not to force parties into involuntary servitude and this has become known as the rule against specific enforcement of personal service contracts. The rule has since evolved to embrace all contractual relationships requiring ongoing trust and confidence and views it as undesirable to compel parties by way of judicial decree to remain in those relationships where there is evidence of relational deterioration.[26] We shall see that the application of this rule to the franchise and distribution sectors will now depend on the evidentiary record before the court.

The application of this principle in the franchise and distribution context has not been consistent. However, the modern trend is to view franchise and distribution agreements as something other than contracts for personal service. In *Yule Inc. v. Atlantic Pizza Delight Franchise (1968) Ltd.*,[27] the Ontario Divisional Court held that a franchise agreement was a commercial agreement between corporate entities and thus could not constitute a contract of personal service giving rise to an affirmative bar to specific enforcement. The same conclusion was reached by the Manitoba Court of Queen's Bench in relation to a distribution agreement in *North West Beverages Ltd. v. Pepsi-Cola Canada Ltd.*[28] Moreover, the Alberta Court of Appeal reached a similar conclusion in the context of statutory assignment of franchise agreements in *Ford Motor Company of Canada, Ltd. v. Welcome Ford Sales Ltd.*[29]

25. *Lumley v. Wagner* (1852), 42 E.R. 687, 1 De G.M. & G. 604, [1843-60] All E.R. Rep. 368 (Ch. Div.).
26. Sharpe, *op. cit.*, footnote 10, at ¶7.510 (p. 7.24.2).
27. *Yule Inc. v. Atlantic Pizza Delight Franchise (1968) Ltd.* (1977), 80 D.L.R. (3d) 725, 35 C.P.R. (2d) 273, 17 O.R. (2d) 505 (Div. Ct.), at paras. 10-11.
28. *North West Beverages Ltd. v. Pepsi-Cola Canada Ltd.* (1971), 20 D.L.R. (3d) 341, [1971] M.J. No. 104 (Q.B.), at para. 14.

The modern case law, however, is prepared to look beyond the strict definition of a contract for personal service. The courts will now look to the relationship created by the agreement and ask whether the relationship requires ongoing trust and confidence. One commentator has described the modern test as the "sufficiency of confidence test", where the court will examine the relationship to determine whether it requires high levels of mutual confidence which would make specific enforcement inappropriate.[30] As one court has described the modern analysis:[31]

> The remedy of specific performance becomes less realistic the more the performance itself involves the exercise of personal or professional judgment or evaluation and the application of art, in the general sense, rather than the provision of a general service which can be objectively appraised or monitored with some precision.

It would appear that franchise and distribution agreements are well suited to this analysis, as they require the parties to work closely together in the constant exercise of professional judgment. Indeed, in *1193430 Ontario Inc. v. Boa-Franc Inc.*,[32] the Ontario Court of Appeal held that "distributorship agreements are the type of contract that involve mutual trust" and for that reason the parties are free to walk away from their obligations "in the event there is a breakdown of that trust".[33] While the Court of Appeal's holding in *Boa-Franc* would normally be subject to express contractual language,[34] the decision appears to confirm that mutual confidence is an important reality in the franchise and distribution context.

(2) Application of the Mutual Trust Requirement in Franchise and Distribution Cases

Because franchise and distribution agreements are not, strictly speaking, contracts for personal service, the common law does not

29. *Ford Motor Co. of Canada, Ltd. v. Welcome Ford Sales Ltd.* (2011), 44 Alta. L.R. (5th) 81, 77 C.B.R. (5th) 278, 201 A.C.W.S. (3d) 890 (C.A.), at paras. 51-52.
30. Berryman, *op. cit.*, footnote 9, at p. 275. See also Sharpe, *op. cit.*, footnote 10, at ¶7.600 and 7.610.
31. *Western Broadcast Holdings Ltd. v. Winnipeg Football Club* (1982), 20 Man. R. (2d) 181, 1982 CarswellMan 218, [1982] M.J. No. 415 (Q.B.), at para. 13.
32. *1193430 Ontario Inc. v. Boa-Franc (1983) Ltee.* (2005), 260 D.L.R. (4th) 659, 78 O.R. (3d) 81, 203 O.A.C. 320 (C.A.), leave to appeal to S.C.C. refused [2006] 1 S.C.R. vi, 262 D.L.R. (4th) vii, 223 O.A.C. 396*n*.
33. *Boa-Franc*, *supra*, at para. 60.
34. Jonathan Lisus and Adam Ship, "Restrictions on Unilateral Termination of Franchise Agreements" (2010), 49 C.B.L.J. 113, at pp. 117-118.

automatically preclude specific enforcement of those agreements.[35] Instead of the question being resolved on the basis of the characterization of the agreement at issue, the courts inquire into the actual relationships of the parties before them and the business realities on the ground. In this sense, the question has become a factual one and there must be actual evidence of a breakdown in trust to found a bar to specific performance. This has been most clear in the case law concerning motions for interlocutory injunctions. For example, in *Healthy Body Services Inc. v Muscletech Research and Development Inc.*, [36] the Ontario Superior Court refused to grant an injunction to enforce a distribution agreement on the basis that "there [had] been a significant deterioration in the relationship between the parties". Because the relationship required "trust and co-operation", the court was not prepared to specifically enforce that relationship in the face of the deterioration. A similar conclusion was reached in *Axia Supernet Ltd. v. Bell West Inc.*,[37] although not a franchise or distribution case, where the Alberta Court of Queen's Bench refused to grant an injunction in the face of evidence that "clearly indicated [the parties'] inability to work together".

The nature of the evidentiary record will prove crucial in complex commercial cases. In the franchise case of *Erinwood Ford Sales Ltd. v. Ford Motor Co. of Canada*,[38] the Ontario Superior Court dismissed concerns about the deteriorated relationship because "there [was] no evidence that the breakdown in the relationship ha[d] caused any adverse financial impact on the operation of the [franchise] dealership or had any other impact on the performance . . . of [the parties'] obligations". A similar conclusion was reached in *1323257 Ontario Ltd. v. Hyundai Auto Canada Corp*,[39] where the court emphasized the strong performance of the franchisee despite the dispute and the lack of evidence to establish a breakdown in the business aspects of the relationship. It would appear that, in the absence of positive evidence of a breakdown in the relationship causing adverse effects on the business, the courts will presume that the parties, as "business

35. *Cf.*, see the *obiter* comments in *566719 Ontario Ltd. v. New Miracle Food Mart Inc.* (1994), 41 R.P.R. (2d) 22, 50 A.C.W.S. (3d) 304 (Ont. Ct. (Gen. Div.)).
36. *Healthy Body Services Inc. v Muscletech Research and Development Inc.*, *supra*, footnote 3, at para. 20.
37. *Axia Supernet Ltd. v. Bell West Inc.* (2003), 121 A.C.W.S. (3d) 734, 2003 ABQB 195, 2003 CarswellAlta 299), at paras. 33-36.
38. *Erinwood Ford Sales Ltd. v. Ford Motor Co. of Canada* (2005), 6 B.L.R. (4th) 182, 139 A.C.W.S. (3d) 562, 2005 CarswellOnt 1954 (S.C.J.), at para. 94.
39. *1323257 Ontario Ltd. v. Hyundai Auto Canada Corp.* (2009), 55 B.L.R. (4th) 265, 174 A.C.W.S. (3d) 830 (Ont. S.C.J.), at para. 121.

people", will have no difficulty returning to productive operations in the face of the court order.[40] Again, two hypothetical scenarios can illustrate the operation of the principle.

Hypothetical Scenario 1

A bottled water producer (the "Producer") restructures its national distribution network and in that process purports to terminate 20 per cent of its distributors. Through this process, the Producer amalgamates its distribution areas for Toronto and Hamilton and issues a notice of termination to its previous Hamilton distributer (the "Distributor"). The Distributor immediately commences an action seeking to specifically enforce its right to be an exclusive dealer under the distribution agreement.

In this scenario, it would be difficult for the Producer to invoke the mutual confidence exception to avoid specific performance. The termination was a system-wide initiative unrelated to any breakdown in trust in the business relationship. There would need to be actual evidence of a breakdown in trust and deterioration of the relationship and it is arguable that this evidence would need to be linked, at least in part, to the Producer's decision to terminate. The Distributor would be wise to introduce evidence showing its track record for performance over the course of the historical relationship to establish that the parties' working relationship was strong despite the Producer's decision to reorganize its distribution network.

Hypothetical Scenario 2

A franchisee (the "Franchisee") concludes a third consecutive year of low profitability, with performance metrics showing it operating below the twentieth percentile among its peers in the network. The franchisor (the "Franchisor") issues a letter documenting its continued monitoring and expressions of concern over the three previous years of low performance. The Franchisee responds with an antagonistic letter alleging preferential treatment by the Franchisor of other franchisees in adjacent market areas. Eventually, the Franchisor issues a notice of termination, citing low performance and invoking the "for cause" termination provisions in the agreement. The Franchisee sues for breach of contract and seeks to specifically enforce the franchise.

40. *Struik v. Dixie Lee Food Systems Ltd.* (2006), 150 A.C.W.S. (3d) 700, 2006 CarswellOnt 4932, [2006] O.J. No. 3269 (S.C.J.)., at para. 80.

In this context, the Franchisor is in a position to develop a strong evidentiary foundation for employing the mutual trust exception as a bar to specific performance. The Franchisee's allegation of preferential treatment can assist in establishing a breakdown of trust between the parties, and the poor performance of the Franchisee *vis-à-vis* its peers may provide the necessary link between the breakdown in trust and the Franchisee's overall business performance.

4. The Consumer Surplus Doctrine and Uniqueness

(1) Background and Governing Principles

The Supreme Court of Canada has made clear that permanent injunctive relief, which would include orders for specific performance, is unavailable to plaintiffs who can "be adequately compensated by money".[41] While the common law of specific performance has often described this principle as requiring evidence that the disputed asset is "unique", there is an emerging modern trend to take a close look at the interests of the parties themselves, rather than simply the asset in dispute, and to withhold specific performance in ordinary commercial situations despite the presence of unique commercial assets. In *Wallace v. Allen*,[42] a case dealing with the disputed sale of a business, the Ontario Court of Appeal held that the inquiry was not whether the subject-matter of the contract was unique but whether the plaintiff's *interest* in that subject-matter was unique. The court emphasized that every business could be argued to be unique, but that this is insufficient to justify extraordinary relief in the form of specific performance. The Ontario Court of Appeal reached the same conclusion in its earlier decision of *1110049 Ontario Ltd. v. Exclusive Diamonds Inc.*[43]

While every grant of a franchise to a franchisee is unique in the sense that no two franchises are precisely the same, the courts have now started to require evidence from franchisees that their own interests in the agreement are unique in the sense that those interests extend beyond market value profitability. In *Chuang v. Toyota Canada Inc.*,[44] for example, the Ontario Superior Court refused to

41. *Cadbury Schweppes Inc. v. FBI Foods Ltd.*, [1999] 1 S.C.R. 142, 167 D.L.R. (4th) 577, 83 C.P.R. (3d) 289, at paras. 88-89.
42. *Wallace v. Allen* (2009), 93 O.R. (3d) 723, 53 B.L.R. (4th) 1, 173 A.C.W.S. (3d) 784 (C.A.), at para. 40.
43. *1110049 Ontario Ltd. v. Exclusive Diamonds Inc.* (1995), 25 O.R. (3d) 417, 83 O.A.C. 391, 57 A.C.W.S. (3d) 748 (C.A.), at paras. 7-9.
44. *Chuang v. Toyota Canada Inc.*, *supra*, footnote 1, at para. 26.

grant an injunction in a franchise dispute, as the "the evidence . . . establishes that [the franchise] would be 'unique' only in terms of its profitability" and profitability "can be compensated for by monetary damages". A similar conclusion was reached by the court in the distributorship context in *Barton-Reid Canada Ltd. v. Alfresh Beverages Canada Corp.*[45]

This recent push back by the courts makes sense in terms of first principles. The guiding principle of contract remedies is the expectation principle, which awards the claimants "the value which . . . [they] would have received if the contract had been performed".[46] The Supreme Court of Canada recently recognized that the expectation principle of contract remedies would normally permit the "efficient breach" of contracts by defendants where plaintiffs can be fully compensated in damages on an expectancy basis. According to the Supreme Court:[47]

> Courts generally avoid [non-expectation] measure of damages so as not to discourage efficient breach (i.e., where the plaintiff is fully compensated and the defendant is better off than if he or she had performed the contract) . . . Efficient breach is what economists describe as a Pareto optimal outcome where one party may be better off but no one is worse off, or expressed differently, nobody loses. Efficient breach should not be discouraged by the courts. This lack of disapproval emphasizes that a court will usually award money damages for breach of contract equal to the value of the bargain to the plaintiff. [Citation omitted.]

Justice Sharpe has explained this principle in the context of specific performance. According to Justice Sharpe, the common law should not specifically enforce contracts in situations where the plaintiff's interest can be protected by way of damages:[48]

> It is suggested . . . that one of the primary policies of remedial rules in the contractual setting is limiting the burden of breach upon the defendant, so long as the plaintiff's expectation interest is protected . . . Expectation damage awards rather than enforced performance allow the defendant to buy peace at an objectively defined . . . price which is just enough to cover the ordinary commercial interests of the innocent party . . .

It is submitted that the principle of uniqueness has now developed to require evidence from the plaintiff that its interest in the dispute

45. *Barton-Reid Canada Ltd. v. Alfresh Beverages Canada Corp.* (2002), 117 A.C.W.S. (3d) 809, 2002 CarswellOnt 3653, [2002] O.J. No. 4116 (S.C.J.), at para. 18.
46. *Bank of America Canada v. Mutual Trust Co.*, [2002] 2 S.C.R. 601, 211 D.L.R. (4th) 385, 159 O.A.C. 1, at paras. 25, 30, 31.
47. *Bank of America Canada v. Mutual Trust Co., supra,* at para. 31.
48. Sharpe, *op. cit.*, footnote 10, ¶7.120, 7.130, and 7.160.

extends beyond the market value of the franchise or distributorship. Justice Sharpe has called this concept the "consumer surplus" doctrine:[49]

> The plaintiff may . . . have attached to the particular item bargained for a value, sometimes called the "consumer surplus", which is not reflected by objective measurement. In such a case, the value of the item to the plaintiff exceeds the market value . . . and it is difficult to justify forcing the plaintiff to accept . . . the lesser objective value.

The consumer surplus doctrine appears to have found favour with the Ontario Court of Appeal. In *Silverberg v. 1054384 Ontario Ltd.*,[50] the Ontario Court of Appeal affirmed an award of specific performance on the basis of the plaintiff's willingess to pay a "premium . . . in excess of market value" for the asset. Moreover, in *1117387 Ontario Inc. v. National Trust Co.*,[51] the Court of Appeal held that specific performance was unavailable where the plaintiff's "only interest" in the property was its market "value". The Ontario Court of Appeal has also justified orders for specific performance on the basis of the subjective "special value" that an asset has held to the plaintiff beyond simply economic profits.[52] The special value may in part be linked to problems of valuation or assessment. Where the evidentiary context makes the assessment of damages inherently "speculative and conjectural",[53] it may well be a case where specific performance is the appropriate remedy.

(2) Application of the Consumer Surplus Principle in the Franchise and Distribution Context

Hypothetical Scenario 1

An individual purchases a franchise in a small suburban market with a long history of underperformance by the previous owner (the "Franchisee"). Over the course of 15 years, the Franchisee works

49. *Ibid.*, ¶7.220.
50. *Silverberg v. 1054384 Ontario Ltd.* (2009), 84 R.P.R. (4th) 185, 181 A.C.W.S. (3d) 378, 2009 ONCA 698, at para. 20.
51. *National Trust Co. v. 1117387 Ontario Inc.* (2010), 67 C.B.R. (5th) 204, 52 C.E.L.R. (3d) 163, 188 A.C.W.S. (3d) 332 (Ont. C.A.), at para. 53.
52. *UBS Securities Canada Inc. v. Sands Brothers Canada Ltd.* (2009), 95 O.R. (3d) 93, 58 B.L.R. (4th) 60, 177 A.C.W.S. (3d) 383 (C.A.), at para. 100; *Erie Sand and Gravel Ltd. v. Seres' Farms Ltd.* (2009), 312 D.L.R. (4th) 111, 97 O.R. (3d) 241, 63 B.L.R. (4th) 161 (C.A.), at para. 108.
53. *United Gulf Developments Ltd. v. Iskandar* (2004), 235 D.L.R. (4th) 609, 44 C.P.C. (5th) 92, 222 N.S.R. (2d) 137 (C.A.), leave to appeal to S.C.C. refused [2004] 3 S.C.R. viii, 241 D.L.R. (4th) vii, 233 N.S.R. (2d) 200*n*, at para. 19.

hard to develop the brand of its franchise in the suburban market and to overcome challenges that had been experienced by the previous owner. This requires significant personal investment by the owner of the Franchisee, whose two sons also work with him full time. The franchisor (the "Franchisor") acknowledges the hard work of the Franchisee, and issues numerous letters of commendation. By the end of the 15-year period, the Franchises's performance has improved dramatically, with the franchise climbing from the bottom fifteenth percentile within the franchise network to the top twentieth percentile. The owner of the Franchisee announces his intention to have his eldest son take over the business after he retires. Unfortunately, a two-year national recession causes significant losses across the franchise system, and the Franchisor decides to reduce its network of franchisees. The Franchisee, along with 80 of its counterparts in the network, receives a notice of termination. The Franchisee immediately sues the Franchisor, seeking specific performance of the franchise agreement.

In the context of this scenario, it would be possible for the Franchisee to develop an evidentiary basis for meeting the consumer surplus doctrine, namely, that its subjective expectation with regard to the franchise was "unique" and extended beyond simple market value. The Franchisee could point to its long-term investment over the course of 15 years in terms of money and human capital in developing the market area for the franchise brand, something that would be very difficult to quantify and assess in terms of damages. The Franchisee may be able to assert a subjective interest in the anticipated long-term return of the franchise on the basis of its role in developing the market. Moreover, the Franchisee's owner may also be able to assert a unique interest, arguably recognized by the Ontario Court of Appeal in *Erie Sand and Gravel Ltd. v. Seres' Farms Ltd*,[54] flowing from the participation of his family in the franchise and future succession by his son. In this context, depending on how the evidentiary record is developed, it may well be difficult for the Franchisor to establish that the Franchisee's interest can be adequately addressed in damages.

Hypothetical Scenario 2

A retail store in a large urban market (the "Distributor") had for the previous five years been the exclusive distributor of boxes manufactured by the manufacturer (the "Manufacturer"). During

54. *Erie Sand and Gravel Ltd. v. Seres' Farms Ltd., supra,* footnote 52, at para. 108.

those five years, 15 per cent of the Distributor's total revenue was traceable to sales of boxes under its distribution agreement with the Manufacturer, with the remaining 85 per cent of the Distributor's sales flowing from the sale of other goods unrelated to the distribution agreement. At the end of the five-year term specified in the distribution agreement, the Manufacturer issues a notice of non-renewal to the Distributor, as the Manufacturer has decided to distribute its boxes directly in that urban market. The Distributor sues the Manufacturer for breach of contract, alleging a previous oral agreement to renew the distribution agreement at the end of its term, and seeks an order of specific performance to enforce the oral agreement.

In this context, it may be difficult for the Distributor to establish an interest in the subject-matter of the agreement that extends beyond fair market value that could constitute a consumer surplus. In this sense, the subject-matter of the contract, viewed from the perspective of the interests of the Distributor, would not be "unique". The Distributor's damages can fairly easily be assessed on the basis of historical revenue and a properly qualified expert would be able to opine on an appropriate methodology for presenting the lost future profits.

5. Conclusion

This article has analyzed the availability of the remedy of specific performance in the context of franchise and distribution agreements. These agreements create complex and ongoing performance obligations between two often sophisticated parties and require mutual trust and confidence in order to be effectual. While the ordinary remedy in disputes arising under these agreements will almost certainly be damages, there is scope for specific relief in appropriate cases. In terms of the legal principles considered in this article, appropriate cases would require that: (a) the court order simply direct the defendant to achieve a specific outcome, rather than engage in an ongoing activity; (b) the parties' business relationship remain functional despite the dispute, in the sense that there has been no breakdown of the business relationship making specific enforcement inappropriate; and (c) that the interests of the plaintiff in the subject-matter of the contract extend beyond future lost profits capable of assessment using fair market value principles.