Cassels

Ontario Court Finds Franchisee Personally Liable for $1.7 Million Dollar Costs Award in Failed Class Action - May 2018

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Cassels Brock litigators successfully enforce Pet Valu's contractual and guarantee rights to claim the costs of a failed class action against the individual principal of the representative plaintiff franchisee.

On May 29, 2018, the Honourable Madam Justice Nishikawa of the Ontario Superior Court of Justice released a decision in *Pet Valu Canada Inc. v. Rodger*, 2018 ONSC 3353, which held that the individual officer, director, shareholder, and guarantor of the representative plaintiff in a $100 million class action commenced against Pet Valu Canada Inc. (Pet Valu) in 2009 was personally liable for the significant costs awards which Pet Valu had been awarded after defeating the class action. These costs awards totalled in excess of $1.7 million.

Justice Nishikawa's decision helpfully recognizes the enforceability of guarantees and indemnification provisions in franchise agreements. It also provides some key lessons to representative plaintiffs in class actions, clarifies principles regarding limitation periods under a guarantee and in respect of collecting costs awards, and offers consolation to successful defendants in class proceedings who are faced with collecting significant costs awards against representative plaintiffs who have dissipated their assets.

Background to the Case

This decision arose as a result of a class action commenced on behalf of all Pet Valu franchisees alleging breach of contract, breach of the *Arthur Wishart Act (Franchise Disclosure), 2000*,[1] and other causes of action against Pet Valu (the Class Action). The Class Action was litigated over the course of seven years, during which Pet Valu first successfully narrowed the scope of the proposed common issues on certification, and then was ultimately successful in defending the entire proceeding, which concluded in October 2016 with the Supreme Court of Canada's refusal to grant the representative plaintiff's application for leave to appeal.

After the dismissal of the Class Action, Pet Valu was awarded its costs in the amount of $1,703,896.94, inclusive of taxes and disbursements. In addition, a number of other costs awards awarded to Pet Valu over the course of the Class Action remained outstanding, such that the representative plaintiff owed Pet Valu a total of $1,736,675.54, plus applicable interest (collectively, the Cost Awards). The decision regarding the Class Action costs award can be found here.

However, by this time, the representative plaintiff, 1250264 Ontario Inc. (125) was a former franchisee and functionally a shell corporation with no assets. With no practical hope of recovering the Costs Awards against 125, Pet Valu instead turned to its sole officer, director, and shareholder, Robert Rodger (Rodger), who had personally signed the franchise agreement as a franchisee and provided a personal continuing guarantee of 125's performance of its obligations to Pet Valu, including under the franchise agreement.

Pet Valu commenced an action against Rodger personally, and brought a motion for summary judgment in respect of his liability for the Costs Awards. In response, Rodger brought a cross-motion to dismiss Pet Valu's claim.

Justice Nishikawa's Decision

Justice Nishikawa granted Pet Valu's motion for summary judgment and dismissed Rodger's cross-motion to dismiss the claim, holding that Rodger was personally liable for the Costs Awards on the basis of both the franchise agreement and guarantee. In doing so, she dismissed a number of defences raised by Rodger, including (i) a limitations period defence, (ii) arguments that the provisions relied on by Pet Valu did not apply, and (iii) the assertion that Pet Valu had released its claims against Rodger in the course of previous litigation between the parties.

(a) The Indemnification Provision Under The Franchise Agreement Was Enforceable

First, Justice Nishikawa reviewed the indemnification provision in the franchise agreement, pursuant to which the "Franchisee" (as defined in the agreement) agreed to indemnify Pet Valu for its costs incurred in defending "any action or claim" brought by the 125 against Pet Valu. Given the broad wording of the provision, Justice Nishikawa rejected Rodger's argument that it did not apply to class actions. She also accepted Pet Valu's submission that indemnification for legal costs in the franchise context is not unusual, noting that where there is a contractual right to costs, the court will generally exercise its discretion to reflect that right.

Justice Nishikawa similarly rejected Rodger's argument that as a representative plaintiff, 125 should only be responsible for a proportionate share of the Costs Awards. She cited the Ontario class proceedings regime's adoption of ordinary costs rules and also took note of Rodger's admission on cross-examination that he had not shared costs awards owing to 125 with other class members.

Having found that the indemnification provision applied to the Costs Awards, Justice Nishikawa turned to Rodger's assertion that he was not personally bound by that provision. She found that Rodger had signed the franchise agreement on his own behalf, as well as on behalf of 125, and accordingly, that he intended to be personally bound to the agreement as a "Franchisee". In reaching that conclusion, Justice Nishikawa relied on Rodger's admissions on cross-examination that he had received independent legal advice and was aware that he was exposed to the risk of a potential adverse costs award in the Class Action.

Justice Nishikawa also rejected Rodger's argument that the franchise agreement was a contract of adhesion, as there was no ambiguity in the provision that ought to have been construed in favour of Rodger. Finally, she rejected Rodger's argument that Pet Valu was precluded from relying on the indemnification provision as a result of its alleged breach of other provisions of the franchise agreement, noting that over the entire Class Action, no court had found any breach of the agreement by Pet Valu (nor was there evidence before her to support one).

As a result of these conclusions, Justice Nishikawa found that there was no genuine issue requiring a trial regarding Rodger's liability for the Costs Awards. However, she also went on to consider his liability under his personal guarantee of 125's obligations.

(b) The Guarantee Was Enforceable

Justice Nishikawa considered both parties' interpretations of the language of the guarantee, and favoured Pet Valu's interpretation over Rodger's, concluding that Rodger had guaranteed 125's: (a) performance of the terms of the franchise agreement; (b) payment of all debts and liabilities to Pet Valu; and (c) unpaid balances on the preceding two types of obligations.

Justice Nishikawa rejected Rodger's characterization of the agreement and found that the unpaid Costs Awards qualified under all three categories of obligations, creating multiple bases for Rodger's personal liability under the guarantee. Justice Nishikawa also noted that having received the benefit of signing the guarantee (without which the franchise agreement would not have been executed), Rodger could not avoid his obligations thereunder.

In reaching these conclusions, Justice Nishikawa noted that Rodger had admitted to dissipating 125's assets after selling its Pet Valu franchise and had not availed himself of funding sources for the Class Action (such as an indemnity from class counsel, the Class Proceedings Fund, or any third party litigation funders). She commented that "[t]he consequences of these choices should not be borne by Pet Valu, which was ultimately entirely successful in defending the Class Action, but rather by Mr. Rodger, who made the choices, in full awareness of his obligations under the agreements that he signed."

(c) The Franchisee's Other Defences Were Rejected

Justice Nishikawa also considered various other defences raised by Rodger. For instance, Rodger had argued that the claims for the Costs Awards were statute-barred, and pointed to Pet Valu's counterclaim for costs in the Class Action and the dates of some of the interlocutory awards (totalling $4,500), which had been awarded more than two years prior to the commencement of Pet Valu's claim.

Justice Nishikawa accepted Pet Valu's argument that its counterclaim, which predated any of the Costs Awards, was for future costs and could not have crystallized until it had successfully defended the Class

Action. She rejected Rodger's argument that the claim had been discovered at that time, with the quantum of costs being the only issue to be determined. She noted that even at the hearing to fix the final of the Costs Awards, 125 had asserted that no costs should be ordered. She held that Pet Valu's claim was not discoverable until that final cost award was granted in 2016, if not later, at the expiry of the appeal period for that award.[2]

With respect to the older Costs Awards, Justice Nishikawa agreed with Pet Valu that so long as the Class Action remained ongoing, so too did the possibility that those awards would be set-off against others. Accordingly, to require Pet Valu to commence their action within two years of those awards would have resulted in unnecessary litigation.

In addition, Justice Nishikawa noted that a limitation period does not begin to run in respect of a continuing guarantee until the debtor defaults or a demand is made.

Finally, Rodger had argued that Pet Valu was precluded from bringing its claim by a release it had signed in connection with an injunction it had brought to shut down Rodger's operation of a pet store in breach of his non-competition covenant under the franchise agreement some years prior. Justice Nishikawa found that the release specifically applied to "all matters unrelated to the Class Action", and that the Costs Awards, which arose out of the Class Action, fell outside the scope of the release. Further, she noted that each of the Costs Awards had been ordered after the execution of the release.

Rodger Is Found Liable

Given Rodger's liability for the Costs Awards under both the franchise agreement and guarantee, there was no genuine issue requiring a trial. Justice Nishikawa granted Pet Valu's motion for summary judgment in the amount of $1,736,675.54 (representing all of the Costs Awards), plus pre- and post-judgment interest, and dismissed Rodger's cross-motion to dismiss.

Key Take-Aways

This case provides a number of lessons for parties to both franchise litigation and to class proceedings. First, it illustrates the enforceability of indemnification provisions and guarantees in the franchise law context, and shows that principals of franchisee corporations who signed agreements indemnifying those corporations with their eyes wide open will be held to them. It further shows that where a principal receives the benefits of a franchise agreement on the security of their personal guarantee, they will not be permitted to easily escape the obligations of that guarantee.

In the class action context, the decision underscores to would-be representative plaintiffs that there may be serious personal costs consequences for bringing unsuccessful class proceedings, and highlights the importance of securing indemnification from class counsel, the Class Proceedings Fund, or a third party

litigation funder. At the same time, it provides consolation to successful defendants in a class action that they may not have to bear the price of a plaintiff's failure to do so.

Finally, the decision provides clarification regarding limitations periods for collecting costs awards and for enforcing continuing guarantees. First, it illustrates that (a) a cause of action concerning costs does not crystallize until costs are granted, and (b) a claim to collect on an interlocutory costs award against a non-party may not crystallize until the conclusion of the litigation, due to the practical reality that costs awards will be set-off against each other until the matter comes to an end. This should provide comfort to successful defendants who, faced with insolvent representative plaintiffs, are able to rely on a guarantee. In addition, it confirms that the limitation period for an action to enforce a continuing guarantee will not run until a demand is made (in the case of a demand guarantee) or until the debtor defaults.

Pet Valu was represented by Derek Ronde and Kate Byers, with the assistance of Geoffrey B. Shaw, all of the Cassels Franchise Law Group's litigation team.
< br />< a href="https://www.canlii.org/en/on/onsc/doc/2018/2018onsc3353/2018onsc3353.html" target="_blank">A copy of Justice Nishikawa's decision can be found here.

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[1] SO c. 3 2000.

[2] These findings were specifically with respect to Pet Valu's discovery of its claim against Rodger personally. There is no limitation period in respect of a cause of action to enforce a costs award against the party that owes it, and so Pet Valu's cause of action against 125 was not subject to any limitation period.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.