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Not the Optimum Result? Shoppers Drug Mart Franchise Litigation Leads to Mixed Success

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Earlier this year, a milestone was reached in a long-running franchise class action, *Spina v. Shoppers Drug Mart Inc*. The Court decided competing summary judgment motions brought by the plaintiffs and defendant franchisor drug store chain in respect of the franchisees' claims that Shoppers owed them substantial sums for the non-payment of professional allowances and the overpayment of various fees. The results of the motions for summary judgment were mixed, as the plaintiff succeeded on some claims but were defeated on others.

To summarize the results:

- The plaintiff failed to establish that Shoppers breached its contractual and good faith obligations as a result of the imposition of fees on its franchisees related to the Optimum loyalty plan program;
- The plaintiff also did not succeed in its claim that Shoppers breached its contractual and good faith obligations by charging franchisees fees in excess of actual costs in respect of service and equipment leasing fees;
- The plaintiff did not succeed in its claim that Shoppers was unjustly enriched by certain inventory and procurement policies imposed on franchisees. However, the Court did hold that Shoppers may have breached its statutory duty of fair dealing or its common law duty of good faith in respect of those inventory and procurement policies. That said, the Court also held that such claims were individual and could not be determined on a class-wide basis; and
- The plaintiff succeeded on its claim that Shoppers' retention of professional allowances constituted a breach of contract and a breach of the statutory and common law duties of good faith, but only in respect of franchisees that operated under certain older contracts that did not specifically address this particular unique revenue source.

The decision of Justice Perell of the Ontario Superior Court of Justice is a daunting read – approximately 170 pages – and provides a thorough analysis of Shoppers' business practices and franchise system. In particular, the decision focuses on the express contractual language in the parties' agreements as well as the specific performance and enforcement of these contractual rights and obligations. As such, it is somewhat difficult to parse broader themes or messages from the decision that have application to the practice of franchising in Canada. Nevertheless, there is some general guiding principles that can be extracted from the reasons:

- In respect of the Optimum Program fees claim, beyond its finding that the language of the parties' franchise agreements contemplated the fees, the Court held that the franchisees were estopped from alleging a breach of contract due to their "willing and eager" participation in the Program, which was a significant success for the franchise system. The Court wrote:

"Shoppers relied to its detriment on the words and deeds of the Associates that they were participants, supporters, and beneficiaries of the Optimum Program and that would pay the Optimum Charge. Relying on those words and deeds, Shoppers acted to underwrite the costs of the Optimum program. Shoppers incurred huge expenses relying on the words and deeds of the Associates."

Accordingly, beyond looking at the specific language of their agreements, franchisors faced with breach of contract claims should examine the conduct of the franchisees in respect of any alleged contractual breach for potential estoppel defences.

- The Court held that Shoppers was under no contractual obligation to charge franchisees service fees at cost and without any profit element. The express language of the franchise agreement provided that Shoppers' fees "shall be such amount or amounts as [Shoppers] shall, in the good faith exercise of its judgment, determine."

The takeaway from this finding is that franchisors who charge fees to their franchisees are well-served by having express contractual language that allows them to charge what they see fit for the services rendered.

- Regarding Shoppers' distribution center policies, which included the imposed delivery of certain inventory orders (MOGs, or mass-order generated goods), the Court held that on a class-wide basis, Shoppers did not systemically breach its contractual obligations (which were broad under the terms of the franchise agreements) or its good faith obligations. However, the Court held that franchisees might have individual claims about the manner in which Shoppers implemented its inventory policies and permitted individual trials on these issues.

Spina thus resulted in a partial victory for Shoppers as a result of its strong contractual language regarding policies and practices but opened the door to individual claims concerning franchisor misconduct. It remains possible that bad faith claims in the franchising context may be more suited to individual actions if systemic mistreatment cannot be established. Although there may be no common element to certain franchisor conduct, Justice Perell allowed that single franchisees should "have the opportunity to prove that where there is smoke there is the fire of claim."

- The plaintiff's Professional Allowance claim arose out of certain allowances from generic drug manufacturers that were permitted by the Ontario government. The Court permitted the franchisees' claim for breach of contract in respect of franchisees who operated under a 2002 version of the franchise agreement, which was operative before the Ontario Professional Allowance regime existed. However, the

Court denied the franchisees' claim in respect of franchisees who operated under a 2010 franchise agreement, which contemplated the allocation of the Professional Allowances in Shoppers' favour.

In respect of the 2002 version of the franchise agreement, the Court held that the Professional Allowances were "a different genus from "all discounts, volume rebates, advertising allowances" [which Shoppers was entitled to keep] but are revenue," which Shoppers was obligated to pass to franchisees. In respect of the quantum of damages for the failure to pass on these Professional Allowances, Justice Perell indicated that his "guestimate" was "that there may be claims worth approximately $86 million."

Using the reasoning in *Spina*, franchisors should be careful to ensure that their contractual language captures unique, significant revenue streams if there is a hint of a dispute concerning entitlement to those funds. In this case, Shoppers' amended 2010 franchise agreement defeated any franchisee claim to these funds. However, as noted in the judgment, these Professional Allowances were a peculiar result of legislative changes and it is unlikely that most franchise systems will wrestle with this issue. It is rare that franchisors will have to deal with allocating something outside of the standard "discounts, volume rebates, advertising allowances…or similar advantages" addressed in most franchise agreements.

In summary, the *Spina* decision provides at least an interim conclusion to a franchisee class action that has existed for over a decade. To the extent that a franchisor is wrestling with issues concerning the imposition of fees on franchisees or the allocation of revenue sources, *Spina* provides a useful refresher on contractual drafting and interpretation in the franchise context. To the extent that there is an appeal of the summary judgment decision, Cassels will keep you informed of the results.

A copy of the case can be found here.

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