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Franchise and Competition Class Actions: Dismissal of Tim Hortons Class Action Is Good News for Franchisors

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In a sweeping decision with significant implications for franchise and other vertical distribution arrangements, the Ontario Superior Court of Justice has dismissed a $2 billion franchise and competition class action against Tim Hortons on the merits.[1] This important decision will have application to cases involving the pricing of products within franchise systems, the franchisor's duty of good faith and fair dealing, and the competitiveness of vertical pricing and distribution arrangements in Canada. The Court also provided significant guidance on the impact of a number of recent amendments to the *Competition Act* relating to horizontal conspiracies, price maintenance, vertical arrangements as well as strategic joint ventures.

Background

The plaintiffs' claims against Tim Hortons were based on two significant changes to the franchise system: (1) Tim Hortons' conversion to the "par baking" method for baking donuts and other baked goods, known as "Always Fresh"; and (2) the introduction of soups, sandwiches and other "lunch menu" items. The plaintiffs alleged that "Always Fresh" increased their costs to produce baked goods, cutting into their profit margins, and that Tim Hortons required franchisees to sell lunch menu items at a loss or at break-even prices while profiting through rent, royalties and advertising payments based on franchisee sales.

In support of these claims, the plaintiffs advanced various legal theories based on breach of express and implied terms of the franchise agreements, breach of the duty of good faith and fair dealing at common law and under Ontario's *Arthur Wishart Act (Franchise Disclosure), 2000* (the Arthur Wishart Act), unjust enrichment, and breach of the price maintenance and conspiracy provisions of the *Competition Act*, including the new *per se* conspiracy offence that came into force in March 2010.

The Decision

For procedural reasons specific to this case, Justice G.R. Strathy, an experienced class action judge who has previously certified three franchise class actions,[2] heard and decided the plaintiffs' certification motion together with Tim Hortons' motion for summary judgment. As Justice Strathy granted summary judgment dismissing the entire case, it was unnecessary for him to decide the certification motion, but he nonetheless provided reasons on the certification motion, concluding that he would have certified the class action, subject to further submissions on the suitability of the representative plaintiff.

For reasons summarized below, the Court dismissed all of the plaintiffs' claims:

- **No Breach of Contract** - The Court rejected a breach of contract claim based on the plaintiffs' interpretation of the franchise agreement that Tim Hortons was obligated to sell ingredients at either "commercially reasonable" prices or prices lower than Tim Hortons' suppliers' prices. The Court also rejected the existence of an implied term in the franchise agreements that ingredients would be sold to franchisees at "commercially reasonable" prices.

- **No Breach of Duty of Good Faith and Fair Dealing** - The Court concluded there was no breach of the common law and statutory duties of good faith and fair dealing principally because the conversion to "Always Fresh" and introduction of lunch menu items were decisions made honestly and reasonably for legitimate business reasons.

- **No Unjust Enrichment** - The Court rejected any claim based on unjust enrichment because any enrichment of Tim Hortons was the result of a lawful contract and hence there was a "juristic reason" for any such enrichment.

- **No Retail Price Maintenance** – The Court dismissed the claims based on the former price maintenance provision of the Competition Act because, *inter alia*, the pricing arrangements at issue involve the setting of a wholesale price through a joint venture, and they did not impair the ability of downstream purchasers to sell at any price they chose.

- **No Price Fixing** – In dismissing the price-fixing claim under the "old" section 45 of the Competition Act (Old Section 45), the Court found that there was no evidence of any anti-competitive intent on the part of Tim Hortons and no evidence of any undue lessening of competition.[3] Furthermore, in dismissing the price-fixing claim under the "new" section 45 of the Competition Act (New Section 45), the Court found that there was no evidence that Tim Hortons was a "competitor" with IAWS, its co-joint venturer in a facility to supply par baked donuts to franchisees. In addition, the Court held that Tim Hortons' agreement with IAWS was a joint venture agreement that should be properly reviewed under the reviewable civil agreements provision under section 90.1 of the Competition Act, as opposed to the criminal provisions of the Act. In any event, the Court also concluded that the Competition Act claims were statute-barred on the basis of the two-year limitation period under section 36 of theCompetition Act.

Below is a summary of the key points of the decision from the perspectives of franchise law and competition law.

Key Points: Franchise

- **Certification of Franchise Class Actions** – Although his decision on the plaintiffs' certification motion was moot, Justice Strathy stated that franchise disputes are frequently suitable for certification because of the "existence of a clearly identifiable class, a common standard form contract and a common business system, coupled with conduct of the franchisor that treats every franchisee in the same way".[4] In this regard, this decision continues the trend of certifying franchise class actions in Ontario. Justice Strathy did qualify his statement by stating: "This is not to say that a class action will be the preferable procedure for the resolution of every franchise case".[5]

- **Uniformity and Compliance** - The decision contains numerous statements recognizing the crucial importance of franchisees' compliance with the franchise system to both franchisors and franchisees.[6] These statements will be of interest to franchisors when defending aspects of the franchise system that are necessary to the system but unpopular

with certain franchisees or when enforcing the franchise agreement against a franchisee that fails or refuses to comply with the system.

- **Supply and Pricing of Products** - The Court firmly rejected the plaintiffs' claims that the franchisor was required by the statutory duty of fair dealing and/or implied terms of the franchise agreement to supply products to franchisees at the price obtained by the franchisor from its suppliers. The Court accepted that "[t]he law recognizes that the franchisor is not required to sell products to its franchisees at the lowest price available in the market"[7] and that "[t]here is no obligation on the franchisor to ensure that the franchisee makes a profit on every product it sells".[8] Further, the Court confirmed that the statutory duty of fair dealing, which includes a duty to act in accordance with reasonable commercial standards, does not require that the price of every commodity sold by a franchisor to the franchisee is commercially reasonable.[9]

- **Commissions and Rebates** - The Court's decision suggests that terms of a franchise agreement allocating commissions and rebates to the franchisor are not, in and of themselves, a breach of the duty of fair dealing or otherwise invalid. The Court rejected the plaintiffs' claim that Tim Hortons had breached an implied term of the franchise agreements that ingredients would be sold to franchisees at "commercially reasonable" prices by not selling the ingredients to franchisees at the price obtained by Tim Hortons from its suppliers. Among other reasons for dismissing this claim, the Court reasoned that implying such a term would be contrary to an express term that contemplated that Tim Hortons would make a profit, commission or rebate on the price of goods sold to franchisees and that the franchisee disclaimed any interest or right in such profits.[10] At no point did the Court suggest that this express term governing rebates and commissions was invalid or otherwise improper.

- **Pricing and Product Strategies** – When concluding that Tim Hortons had the right to require its franchisees to sell all menu items, not just the most profitable ones, the Court noted that if a franchisee lost money on the sale of certain products (i.e., breakfast sandwiches), it made up for the loss on the sale of complementary products (i.e., coffee).[11]

The Court's conclusions and findings on this point may be helpful to franchisors in defending loss leader or other legitimate product and pricing strategies that are most effective if implemented uniformly across the system but may be unpopular with certain franchisees. The Court also stated that "the decision of the franchisor to price the product at a level that generates a profitable return on its investment is not, on its own, an improper motive" that would breach the duty of good faith and fair dealing.[12]

- **Changes to the Franchise System** - Although it was speaking within the specific context of the Tim Hortons franchise agreement, the Court endorsed the right of the franchisor to make changes to the franchise system in accordance with the franchise agreement. The Court explicitly stated: "Even if [this Court] were to find that the immediate financial benefit to Tim Hortons [of certain changes to the system] was greater than the financial benefit to the plaintiffs, this would not constitute a breach of the duty of good faith and fair dealing".[13]

- **The Duty of Fair Dealing Does Not Trump the Franchise Agreement** - The Court firmly re-stated previous authority that the statutory duty of good faith and fair dealing does not replace or amend the express terms of the franchise agreement. In particular, the Court stated that it "is not a stand-alone duty that trumps all other contractual provisions".[14]

- **Fair Dealing Must Be Assessed within the Entire Relationship** – The Court repeatedly emphasized the need to assess a franchisor's good faith and fair dealing in the context of the entire relationship, stating, among other things, "[t]he statute does not require that every interaction between the franchisor and the franchisee be subjected, in isolation, to a standard of 'commercial reasonableness' "[15] and "[r]egard must be had to the conduct of the franchisor taken as a whole and the benefits — or disadvantages — obtained by franchisees as a whole".[16] This suggests that when defending claims for breach of the duty of good faith and fair dealing, franchisors should not permit the case to focus only on their impugned actions and should instead emphasize the benefits to franchisees of the system as a whole and the franchisors' performance of the contract as a whole.

- **Consultation With Franchisees** – The Court referred extensively to Tim Hortons' mechanisms for consulting with franchisees on products, methods and other issues in

general and to Tim Hortons' consultation with franchisees on the menu and pricing changes at issue in the case.[17] The Court's emphasis of this evidence suggests that formal and well-documented consultation with franchisees prior to implementing changes to the franchise system will assist the franchisor in defending allegations of breach of good faith and fair dealing from those franchisees unhappy with the changes.

- **Business Rationale for System Changes** – The Court emphasized that the changes to the franchise system at issue in this case were "rational business decision[s]" made for "valid economic and strategic reasons".[18] This highlights the importance of articulating and documenting the business rationale for decisions by the franchisor that affect the interests of the franchisees.

Key Points: Competition

- **Franchise Disputes and Claims of Anti-Competitive Conduct –** The Court's judgment highlights that many franchise disputes are simply commercial disputes that do not implicate any considerations of anti-competitive conduct contrary to the Competition Act. The core dispute in Tim Hortons revolved around the "commercial reasonableness" of the pricing and supply arrangements that had been negotiated between the franchisor and the franchisee in connection with a larger joint venture, and allegations of criminal conduct relating to conspiracy and price maintenance are imperfect vehicles for adjudicating such commercial disputes. The recent amendments to the Competition Act have further narrowed the application of competition offences to franchise disputes, particularly in light of Parliament's removal of the criminal price maintenance offence in 2009 and amendments to the conspiracy provision that came into force in 2010.

- **Price Maintenance – No Violation of the Former Price Maintenance Offence -** The Court found that the former offence of price maintenance that existed prior to 2009 had no application to Tim Hortons' conduct, since Tim Hortons was not "a person engaged in the business of producing or supplying a product". Rather, under the commercial and joint venture arrangements at issue, Tim Hortons and IAWS had agreed that Maidstone/CillRyan would supply and invoice distributors.[19] More substantively, the Court found that "the setting

of a wholesale price through a joint venture agreement that is specifically designed to supply ingredients to franchisees" was not a criminal offence.[20] While there may be commercial grounds for challenging the "reasonableness" of the wholesale price under the governing franchise agreements, the former criminal offence did not prohibit a supplier from making a profit on a product that *it sells* to a distributor. Rather, it prohibited a person who produces or supplies a product from attempting, by means of agreement, threat, promise or any like means, "to influence upward or discourage the reduction of the price at which *another person* sells the product". In this case, there was no offence, since the commercial arrangements at issue "[do] not impair or limit the ability of downstream purchasers to sell at whatever price they choose".[21]

- **Price Maintenance – No Anti-Competitive Purpose –** The Court further found that the other requirements of the former offence were not met. In short, there was no evidence that Tim Hortons had engaged in an "agreement, threat, promise or any like means" directed at distributors. Moreover, the Court found that there was no evidence that Tim Hortons had engaged in the conduct for an "anti-competitive purpose" or had formed the necessary criminal intent.[22]

- **Price Maintenance – No Offence in Respect of Conduct After 2009** – The Court found that following the repeal of the offence in 2009, Parliament created a civilly-reviewable practice that was subject to the exclusive jurisdiction of the Competition Tribunal. As a result, the franchisees had no claims for relief under the provision after 2009.[23]

- **Conspiracy** – **No Violation of Old Conspiracy Provision** – In their claim, the franchisees claimed that Tim Hortons' joint venture and distribution arrangements violated the former conspiracy offence under Old Section 45 of the Competition Act, on the basis that they constituted horizontal and vertical price-fixing agreements that, if implemented, would be likely to "unduly lessen competition". Since this provision was recently amended, the franchisee's claims under Old Section 45 were limited to Tim Hortons' conduct prior to March 2010. However, the Court found no violation of the provision. The Court noted that the franchisees had adduced no evidence relating to the relevant market or its

characteristics, and that the surrounding business environment appeared intensely competitive. Moreover, the Court found that there was no evidence of any "anti-competitive purpose" to establish the offence. It observed again that this franchise dispute appeared to centre on the "reasonableness" of the prices charged by Tim Hortons and its distributors, but "the taking of excess profits is still not prohibited by Old Section 45".[24]

- **Conspiracy** – **No Violation of New Conspiracy Provision** - The franchisees further claimed that Tim Hortons' joint venture and distributor arrangements violated the new conspiracy offence under New Section 45 of the Competition Act that had come into effect in March 2010. Under these amendments, Parliament had removed the requirement for an anti-competitive impact and had thereby created a *per se* offence (i.e., there is no longer any requirement for the Crown or a private plaintiff to establish that the alleged agreement, if implemented, would be likely to "unduly lessen competition").[25] However, at the same time, Parliament enacted language that restricted the new offence to an "arrangement with a competitor", and thereby strongly suggested that the new offence was limited to horizontal as opposed to vertical conspiracies. In reliance on this language, the Court found that Tim Hortons' vertical franchise arrangements did not violate New Section 45, since Tim Hortons was not a competitor of IAWS, and it did not compete with respect to par baked donuts.[26]

- **Conspiracy – Treatment of Joint Ventures under the Competition Act** – In his judgment, Justice Strathy also relied on the Commissioner's recently published Competitor Collaboration Guidelines regarding the treatment of "joint ventures" under the amended provisions of the Competition Act.[27] In particular, in reliance on this non-binding guidance from the Commissioner, Justice Strathy appeared to accept that joint ventures, strategic alliances and other forms of competitor collaboration should be properly reviewed under the new civil agreement provision under s. 90.1 of the Competition Act, rather than under New Section 45.[28]

- **Conspiracy – Ancillary Agreement Defence** – In any event, the Court found that Tim Hortons had satisfied the new "ancillary agreement" defence under s. 45(4) of the amended

Competition Act – since "the establishment of the price at which donuts would be sold by the joint venture was ancillary to the broader agreement for the construction of the Maidstone Bakeries and the production of par baked donuts". Indeed, the Court noted that if the "ancillary agreement" defence did not apply, the parties would be left with a "manifest absurdity" – since any price fixed by the agreement would subject to potential criminal prosecution.[29]

- **Civil Claims – The Franchisee's Claims Are Time-Barred under the Competition Act –** In its decision, the Court also provided some important guidance relating to the limitation period set out in s. 36(4) of the Competition Act. In short, under s. 36(4), a plaintiff seeking damages arising from criminal conduct under the *Act* must commence a claim within two years from the "day on which conduct was engaged in" or from the day when criminal proceedings are finally determined. In the decision, the Court held that this limitation period runs from the date of the "conduct" itself (i.e., the entry of the relevant agreements), rather than the anti-competitive effects of the conduct. Moreover, the Court accepted recent authority that suggested that the discoverability principle does not apply to s. 36(4), since the statutory limitation period is expressly tied to a specific event. As a result, since the relevant agreements were entered into in 2001, 2003 and 2004, the Court found that the limitation period under s. 36(4) operated to bar the franchisee's claims.[30] While the franchisee raised a number of arguments relating to "continuing conduct" and "fraudulent concealment", the Court found that there was no genuine issue for trial in respect of those arguments, and that the franchisee's civil claims under the Competition Act were time-barred.[31]

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[1] *Fairview Donut Inc. v. The TDL Group Corp.*, 2012 ONSC 1252 (CanLII) (the "Decision"). The defendants are The TDL Group Inc. and its parent, Tim Hortons Inc. For simplicity, they are referred to together as "Tim Hortons" throughout this update.

[2] *578115 Ontario Inc. v. Sears Canada Inc.*, 2010 ONSC 4571 (CanLII); *Trillium Motor World Ltd. v. General Motors of Canada Limited*, 2011 ONSC 1300 (CanLII), leave to appeal granted, 2011 ONSC 3939 (CanLII), appeal from certification order to Divisional Court heard and currently under reserve; and *1250264 Ontario Inc. v. Pet Valu Canada*

Inc., 2011 ONSC 287 (S.C.J.) [No CanLii decision available]. Osler has previously published analyses of certain of these decisions – see *1250264 Ontario Inc. v. Pet Valu Canada Inc.* and Inadequate Disclosure of Rebate Practices Increase Risk of Franchisee Class Actions.

[3] Decision, paragraph 624. Section 45 of the *Competition Act* was substantially amended in 2010. For a description of these amendments, see below as well as Osler Update, Significant Changes to Canada's Competition Law and Foreign Investment Regime (March 12, 2009).

[4] See, e.g., Decision, paragraphs 205, 211, 237, 351 and 352.

[5] Decision, paragraph 352.

[6] See, for example, pecision, Paragraphs 181, 182, 189.

[7] Decision, Paragraph 182.

[8] Decision, Paragraph 532.

[9] Decision, Paragraph 293

[10] Decision, Paragraph 476.

[11] Decision, Paragraphs 136-137.

[12] Decision, Paragraph 522.

[13] Decision, Paragraph 527.

[14] Decision, Paragraph 501.

[15] Decision, Paragraph 501.

[16] Decision, Paragraph 512

[17] See, e.g., Decision, paragraphs 30-32, 66, 677

[18] Decision, paragraphs 674-676.

[19] Decision, paragraphs 604-605, 614.

[20] Decision, paragraph 593.

[21] Decision, paragraphs 585, 593 [emphasisadded].

[22] Decision, paragraphs 598-601.

[23] Decision, paragraphs 584.

[24] Decision, paragraphs 620-623.

[25] See Osler Update, *supra*.

[26] Decision, paragraph 632.

[27] Competition Bureau, Competitor Collaboration Guidelines (published December 23, 2009).

[28] Decision, paragraph 631.

[29] Decision, paragraph 633.

[30] Decision, paragraph 643.

[31] Decision, paragraphs 644-650.