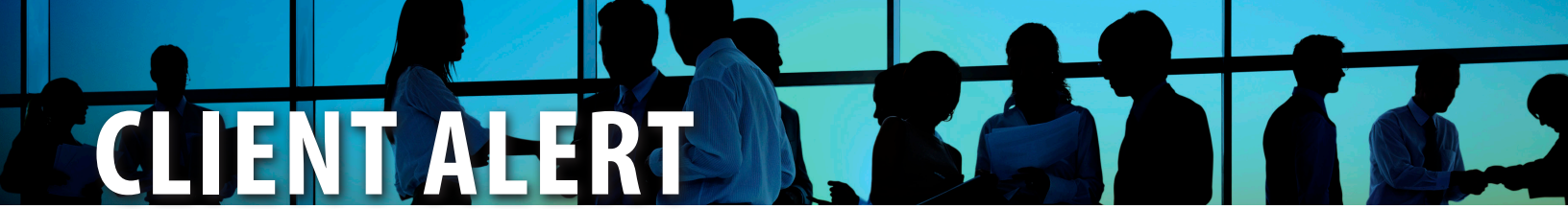


SUB-PAR CLAIM: FRANCHISEE'S BEEF WITH SUPPLIER LEAVES BAD TASTE

By Edward (Ned) Levitt and Richard J. Schuett

HIGHLIGHTS

- In general, a supplier's obligation is to ensure the safety of its goods to the end consumer. A supplier does not owe a duty of care to other commercial parties in a supply chain.
- Courts are reluctant to recognize that commercial parties in a chain of contracts are provided additional rights outside of a contract where the parties had the chance to address any risks through the contract.
- Franchisees should not necessarily rely on extra-contractual claims to protect against potential risks and should negotiate these risks ahead of time or insure against them.
- Franchisors entering into exclusive supply agreements for their franchise system should consider alternative supplier clauses in the event the supply of products is interrupted.

1. Background

In 2008, Maple Leaf Foods ("**Maple Leaf**") recalled meat products linked to a listeria outbreak at one of its factories. Among those products recalled were ready-to-eat meats ("**Meat**") supplied to some Mr. Sub franchisee ("**Franchisees**") locations. Following the recall, the Franchisees experienced a shortage of Meat of up to two months. At the time, the relationship between the Mr. Sub franchisor ("**Franchisor**") and Maple Leaf was governed by an exclusive supply agreement whereby Maple Leaf would supply Meat to the Franchisor. The Franchisor would then distribute the Meat to the Franchisees. Under this arrangement, there was no contractual relationship between Maple Leaf and the Franchisees. Instead, the Franchisees and Maple Leaf were indirectly linked through separate contracts with the Franchisor.

In their certified class action suit against Maple Leaf, the Franchisees argued Maple Leaf owed the Franchisees a duty of care to supply Meat fit for human consumption, and the contaminated meats posed a real and substantial danger. The Franchisees claimed damages for economic loss and reputational injury, seeking compensation for lost sales, profits, capital value, and goodwill.

2. Supreme Court Decision: Not Analogous to Established Categories

In order to recover damages for negligence, a party must prove the following:

a. that the defendant owed a duty of care to the plaintiff;
b. the defendant's conduct breached the standard of care;
c. the plaintiff sustained damage; and
d. the damage was caused by the defendant's breach.[1]

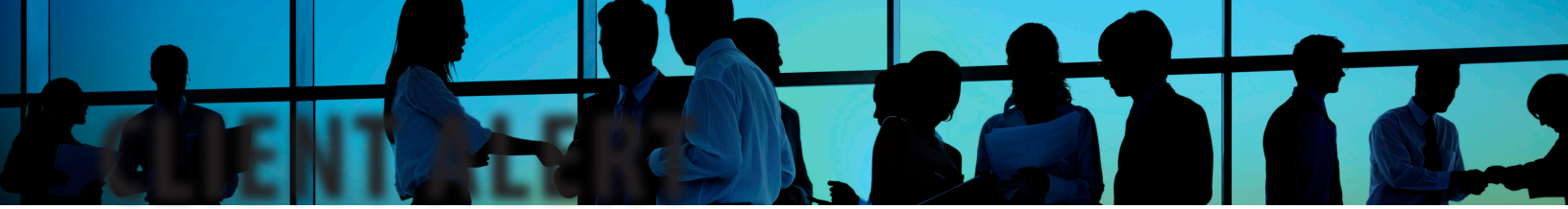
In negligence claims, the plaintiff must prove sufficient proximity between the parties, and that the injury is foreseeable – both of which proved paramount in this case. To establish proximity, the plaintiff must show that its relationship with the defendant is analogous to a previously recognized category.[2] The plaintiff may also seek to establish a new category. In this case, the Supreme Court was required to consider whether the Franchisees' loss could be categorized as pure economic loss and whether the law has, or should recognize a duty of care for economic loss in these circumstances.

Ultimately, the Supreme Court held Maple Leaf did not owe a duty of care to the Franchisees under the circumstances of pure economic loss. There is no general right in tort to be protected against the negligent or intentional infliction of pure economic loss.[3]

The Supreme Court's narrow majority stated that the common law has been slow to recognize the protection of pure economic interests, but that these interests could be recoverable in certain circumstances. In the present case, the Franchisees relied on two recognized categories to establish pure economic loss: (1) negligent misrepresentation or performance of a service; and (2) the negligent supply of shoddy goods or structures.

With regard to the first category of negligent misrepresentation or performance of a service, the Supreme Court, relying on *Deloitte & Touche v. Livent Inc.*,[4] confirmed that to establish negligent misrepresentation or performance of a service, two factors are considered to determine whether proximity is established. The first factor is that the defendant must have made an undertaking, and the second is that the plaintiff must have detrimentally relied on the defendant's undertaking. On the first factor, the Supreme Court found that while Maple Leaf was supplying its products indirectly to the Franchisees, the undertaking by Maple Leaf was to supply ready-to-eat meats fit for human consumption, but that its undertaking was made to end consumers. Therefore, as a supply chain or

[1] 1688782 *Ontario Inc. v. Maple Leaf Foods Inc.*, 2020 SCC 35, at para. 18 ("**Maple Leaf**").
[2] A novel test is conducted through the *Anns/Cooper* test. See *Anns v. London Borough of Merton*, [1977] 2 All E.R. 492 (H.L.). The *Anns* test was refined by the Supreme Court of Canada in *Cooper v. Hobart*, 2001 SCC 79, [2001] 3 S.C.R. 537.
[3] *Maple Leaf, supra* note 1 at para. 19.
[4] 2017 SCC 63.



commercial intermediary, the Franchisees' interests were outside of the scope of the undertaking. On the second factor, the Supreme Court found that the Franchisees could not demonstrate that they detrimentally relied on Maple Leaf's undertaking to consumers.

Maple Leaf was not under a duty to avoid supplying shoddy goods to the Franchisees. This is a narrow duty that only applies to dangerously defective goods. It does not apply to goods that can be easily disposed of and where the said disposal only creates pure economic loss for the disposing party. In this case, the duty did not apply because any danger was to the end consumer, and not the Franchisee as it was simply an intermediary. Moreover, there was no evidence that any of the Franchisee's customers became sick from consuming the contaminated product.

3. Supreme Court and Multi-Contracts: Still No Proximity

Although the Court concluded that the Franchisee's claim did not fall into an established category of negligence, it went on to consider whether the contracts (and its terms) between Maple Leaf, the Franchisor, and the Franchisees created a novel duty of care.[5]

The agreement between Maple Leaf and the Franchisor specifically referenced the Franchisees[6] and gave them a dedicated sales representative, a toll-free number, and other ways to directly contact Maple Leaf. However, this was not enough to establish proximity between Maple Leaf and the Franchisees. Instead, the Court held that these references and the contractual arrangement between Maple Leaf, the Franchisor, and the Franchisee as a whole must be taken into account to demonstrate the proximity of the parties.

The Franchisees further argued that as a franchisee, they were vulnerable to the franchisor, as they were put in a position where they were unable to negotiate due to the power imbalance. The Supreme Court disagreed. The franchise agreements provided the Franchisee with significant benefits that they would otherwise not be able to obtain on their own. These benefits included the use of the Franchisor's "Mr. Sub" trademark, the brand's goodwill, the benefit of the established advertising and marketing systems, and the buying power to secure supplies, among others. In exchange for these benefits, the Franchisees knew they would have to cede some control, including control over their operations, the products used and supplied, and the training that employees would have to undergo. The loss of control over suppliers is an inevitable constraint on Franchisees that they knowingly accept when entering into an agreement as a franchisee.

The Supreme Court also found that the terms of the franchise agreement were an unremarkable incident of a franchise model – the agreement itself was "standard form".[7] The Franchisees were not coerced into entering into the franchise agreements. They did so in order to obtain the advantages described above, but also, with full knowledge and acceptance of the restrictions that would be included.[8] Finally, the Franchisees were free under the Mr. Sub franchise agreement to find suitable supplier alternatives upon approval of the Franchisor and could obtain insurance against the circumstances they were complaining about.

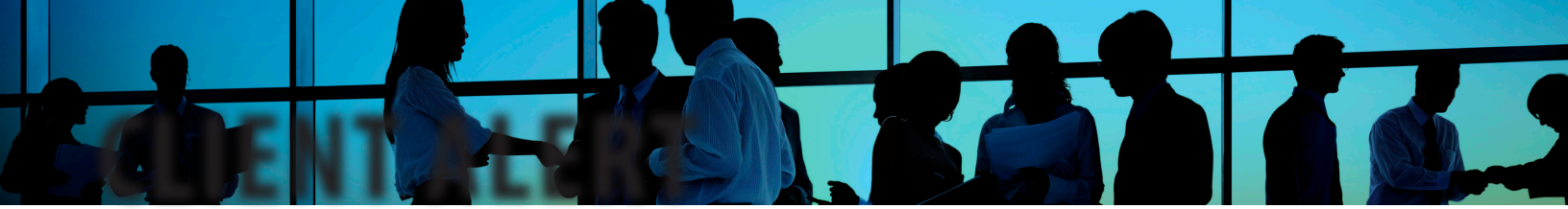
4. Implications for Franchises: Supply Chain Agreements Matter

This decision contains many lessons for franchisors and franchisees.

If a franchisor intends to be the exclusive supplier of product to their franchisee, it should create contingencies to mitigate any potential disruptions on franchisees if the franchisor experiences a supply issue itself. One example would be including a clause in the franchise agreement that permits franchisees to seek alternative suppliers in case of a disruption. Franchisors should also include a limitation of liability clause in their franchise agreement which limits the remedies available to franchisees in case of a disruption in their supply chain. Finally, franchisors should include a term in their contract with suppliers that allow them to make alternative arrangements if there is a disruption.

Prior to signing a franchise agreement, franchisees should understand the system they are entering into, as well as the risks and control they will be giving up. Established systems typically contain an exclusive supplier agreement, whereby the franchisor purchases products and supplies such products to the franchisee and participates in a similar distribution arrangement as in this case. If such an arrangement exists, franchisees should understand what their options or remedies are in case of delivery of unsatisfactory goods. For example, franchisees may want to consider whether the agreement allows them to find alternative suppliers, or if this right does not exist, whether insurance would be appropriate to protect against these risks.

[5] *Maple Leaf, supra* note 1 at para. 87.
[6] *Ibid*, at para. 86.
[7] *Ibid*, at para. 88.
[8] *Ibid*.



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