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Franchisees cannot beef with manufacturer over contaminated meat

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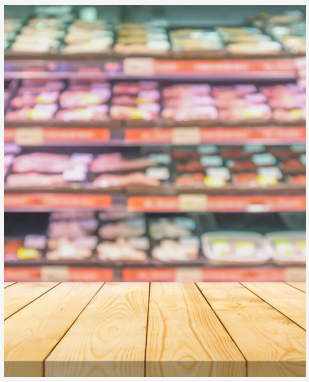

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In a 5:4 split decision released on November 5, 2020, a majority of the Supreme Court of Canada held in *1688782 Ontario Inc. v. Maple Leaf Foods Inc.* that a manufacturer's breach of its duty to supply products safe for human consumption does not entitle third-party franchisees within the supply chain to recover damages in tort for economic loss or reputational injury. However, Justice Karatkatsanis's clear and incisive dissent, which garnered the support of three of her colleagues, suggests that further debate surrounding the nature and extent of supply chain liability has not been foreclosed.

Case history

In the summer of 2008, Maple Leaf discovered that certain of its processed meats were contaminated by an outbreak of listeria. Maple Leaf issued a voluntary recall and temporarily closed the production plant where the contaminated meat originated. The recall resulted in a shortage of product for six-to-eight weeks, which affected certain menu offerings of franchisees of Mr. Sub Ltd. (Mr. Sub).

The franchisees had no direct contractual relationship with Maple Leaf. While Mr. Sub franchisees were required to purchase certain products from Maple Leaf under the terms of their franchise agreement with the franchisor, this was done through a distributor.

Following the recall, Maple Leaf reached a settlement with the franchisor. The franchisees were not a party to the settlement agreement.

The franchisees thereafter commenced a class action against Maple Leaf, claiming that Maple Leaf negligently manufactured and supplied potentially contaminated meat and negligently represented that the supplied meats were fit for human consumption. While there was no evidence that any Mr. Sub customer consumed or was harmed by any of the meat subject to the recall, the franchisees claimed damages for economic loss (including loss of past and future sales, loss of past and future profits and loss of capital value and goodwill) arising from the reputational harm allegedly experienced due to their close business affiliation with Maple Leaf.

Following certification, Maple Leaf brought a summary judgment motion on the basis that it owed no duty of care to the franchisees. The motion judge disagreed, and held that Maple

Leaf owed a duty of care to the franchisees "in relation to the production, processing, sale and distribution" of the meats supplied to the franchisees and a duty of care "with respect to any representations made that the [meats] were fit for human consumption and posed no risk of harm." Further, the motion judge held that Maple Leaf was under an obligation to be mindful of the franchisees' legitimate interests and that it was foreseeable for consumers to avoid buying food from a restaurant whose supplier was subject to a recall.

As we previously commented here, the Ontario Court of Appeal subsequently reversed the trial judge's decision, holding that Maple Leaf's duty of care did not extend to the franchisees' claim for losses arising from reputational harm. Maple Leaf's duty to supply meat fit for human consumption – a duty aimed at protecting human health – was owed not to the franchisees, but to the end consumer. The Court of Appeal did, however, find that the franchisees had a *de minimis* claim for disposal, destruction and clean-up costs as a result of the recall and therefore the trial judge's decision on the duty of care was set aside, except as it related to those costs. The franchisee plaintiffs subsequently appealed this appellate decision to the Supreme Court of Canada.

The issue before the Court

The sole issue facing the Supreme Court was whether there was a duty of care in respect of the economic losses claimed by the franchisees. The remainder of the test for negligence in tort law was not considered.

To find that a duty of care exists, Canadian courts have confirmed that the following considerations should be addressed:

- Does a relationship of "proximity" exist between the defendant(s) and the plaintiff(s)?
- Is the harm a "reasonably foreseeable" result of the defendant's conduct?
- What is the scope of this duty, having regard to the previous two factors?
- If the answer to the first two questions is yes, are there any residual policy considerations to negate finding a duty of care?

If a case falls within (or is analogous to) an established category of proximity and reasonable foreseeability is established, a *prima facie* duty of care arises. In such cases, it is not necessary to undertake a full proximity analysis.

The Supreme Court of Canada weighs in

In a divided decision, the Supreme Court of Canada ultimately declined to find that Maple Leaf owed a duty of care to the franchisees.

Writing on behalf of a narrow majority, Justices Martin and Brown stated that the common law has been slow to recognize the protection of pure economic interests; however, they may be recoverable in certain circumstances. In this case, the franchisees relied on two categories of claims for economic losses in which the requisite qualities of closeness and directness were recognized by the Supreme Court: negligent misrepresentation or negligent performance of a service, and negligent supply of shoddy goods or structures.

With respect to each category, Martin and Brown JJ. found that the claims advanced by the franchisees were distinguishable from previous cases in which a recognized proximate

relationship was established:

- In cases of negligent misrepresentation or performance of a service, two factors are determinative of whether proximity is established: the defendant's undertaking, and the plaintiff's detrimental reliance. To the extent that Maple Leaf provided an undertaking to provide foods fit for human consumption, this undertaking was made to consumers. The franchisees' business interests lie outside the scope and purpose of the undertaking. Further, the franchisees could not show that they detrimentally relied on Maple Leaf's undertaking to consumers.

- Where the negligent supply of shoddy goods is invoked, the crucial part of the analysis is the real and substantial danger posed by the threat, and the costs incurred to avoid the danger. In this case, the real and substantial danger was posed to consumers, not to the franchisees. Additionally, this danger was removed as a direct result of the issuance of the recall.

Having found that the established categories of proximity relied upon by the franchisees were not analogous to the case at issue, Martin and Brown JJ. proceeded to undertake a full proximity analysis to assess whether, in light of the nature of the relationship, the parties are in such a close and direct relationship that it would be just and fair to impose a duty of care in law.

As a preliminary matter, the majority noted that the mere fact that a particular harm is notionally foreseeable – or, indeed, was actually foreseen by the defendant – is not sufficient to establish a *de facto* proximate relationship or a corresponding duty. In other words, "the defendant's ability to reasonably foresee injury to a plaintiff is insufficient to ground a finding of proximity." Rather, a duty can only be established on the basis of the existence of a proximate relationship, which requires a free-standing inquiry into the *nature* of the relationship itself (over and above the foreseeability of the underlying injury). On the basis of this analysis, the majority concluded that "the pure economic losses the appellant seeks to recover do not fall within the scope of a proximate relationship and cannot be considered a reasonably foreseeable consequence of [the] alleged negligence." Notably, this finding was made in the face of an acknowledgement that the defendant in this case may well have foreseen – as a matter of fact – the injury to the plaintiffs.

Ultimately, Martin and Brown JJ. held that the reputational damages claimed by the franchisees did not fall within the scope of a proximate relationship, and therefore could not be "reasonably foreseen" (in a legally significant sense) by Maple Leaf.

In arriving at this decision, the Court was heavily guided by the notion that the parties could have opted to protect themselves against this type of loss through contract. Although not dispositive, this contractual matrix militated against finding a duty of care. The franchisees chose to operate as a franchise, as opposed to an independent restaurant, and as a result were subject to the attendant advantages (e.g.., buying power) and disadvantages (e.g., constraints on operational control) inherent to this business model. Where, such as in this case, parties had an opportunity to allocate risk in contract, courts must take care not to disrupt these allocations. While acknowledging that the franchisees were in fact vulnerable to interruptions in supply caused by negligent suppliers, Martin and Brown JJ. found that this is not a basis for a tort law duty, but rather a common feature of franchise models: the franchisee was "not a consumer, but a commercial actor whose vulnerability was entirely the product of its choice to enter into that [franchise] arrangement, and whose choice substantially informed the expectations of that relationship to which the proximity analysis

must have regard." A finding of proximity in this case would undermine the contractual framework the parties chose to negotiate.

Furthermore, Martin and Brown JJ. found that the franchisee's decision not to exercise their contractual right (subject to Maple Leaf's approval) to seek an alternate source of supply and thereby avoid or mitigate the problem of the interrupted supply posed by the recall also militated against a finding of proximity.

The dissent

In a diametrically opposed dissenting judgment, Justice Karakatsanis held that because Maple Leaf acted as an exclusive supplier of products integral to and closely associated with the franchisees' business, Maple Leaf owed the franchisees "a duty to take reasonable care not to place unsafe goods into the market that could cause economic loss to the franchisees as a result of reasonable consumer response to the health risk posed by those goods."

As a preliminary matter, Karatkatsanis J. considered whether the injury was reasonably foreseeable and whether the relationship between the parties was sufficiently proximate.

With regards to the first inquiry, the dissent concluded that the economic loss to the franchisees was indeed reasonably foreseeable. In particular, Maple Leaf was specifically aware that:

- the franchisees were putting the product into the marketplace for consumption;
- the centrality of Maple Leaf providing quality products to the franchisee's business; and
- Mr. Sub is known primarily as a deli meat sandwich shop whose brand is linked with Maple Leaf products.

With regards to the second prong of the test, proximity, Karatkatsanis J. found that Maple Leaf and the franchisees had a sufficiently "close and direct" relationship that it would be "just and fair having regard to that relationship to impose a duty of care in law." Central to this finding was the fact that Maple Leaf knew that it was the exclusive supplier of a product that is integral to, and identified with, its recipient. The franchisees were bound to use Maple Leaf meats in a business that was centred around such meats. Furthermore, by virtue of a partnership agreement with the franchisor, Maple Leaf had direct contact with the franchisees through a customer service hotline.

Whereas the majority found that the contractual matrix in this case militated against finding a duty of care, Karatkatsanis J. disagreed, primarily on the basis of the inequality of bargaining power inherent in the franchisee/franchisor relationship:

The fact remains, however, that franchisees are generally unable to negotiate more favourable terms to govern their relationship with the franchisor. The franchise agreement is usually a contract of adhesion, drafted by the stronger party and "whose main provisions are presented on a 'take it or leave it basis'" with no prospect for negotiation.

Although the franchisees gained other benefits pursuant to the franchise agreement, the contracts were silent as to the specific economic losses at issue in this case. Accordingly, Karatkatsanis J. was not prepared to find that the franchisees accepted a limit to their rights in tort for the losses at issue in this case.

With regards to the scope of this duty of care, Maple Leaf's relationship of proximity to the

franchisees contemplated the exclusive provision of a safe product that the parties understood to be integral to the franchisees' operations and identity.

As pointed out by the Court of Appeal, Maple Leaf as a manufacturer already owes a duty to consumers to put safe products into the marketplace. But in a situation where a franchisee is bound to an exclusive supply arrangement where the very product at issue is central to the franchisee's brand and who is therefore particularly vulnerable to customer concerns about product safety, the dissent was of the view that Maple Leaf also owes a duty to the franchisees.

Subject to the remainder of the test for negligence being met, Justice Karakatsanis would have found Maple Leaf liable for the direct economic consequences (which include lost profits, sales, goodwill and capital value, as well as clean up and disposal costs) of being associated with unsafe Maple Leaf products, but limited temporally to the period that the recalled meat posed a danger to consumer health.

Having found the existence of a new duty of care, Justice Karatkatsanis considered whether there are any policy considerations that would negate the existence of this duty. Maple Leaf raised three policy considerations, none of which was considered to be sufficiently compelling to justify overriding the existence of the duty. More specifically, the dissent reasoned as follows:

- Finding a tortious duty of care in this case would not raise the spectre of indeterminate liability, because the value and temporal scopes of the franchisees' damages would be limited to economic losses caused by reasonably foreseeable consumer responses to an identifiable safety concern about a particular type of product during a particular period of time.
- Concerns about possible intervening causes, such as media coverage or the "unusual or extreme reactions" of consumers in the face of a potentially unsafe product, that are not already dealt with by rigorous proximity and reasonable foreseeability tests are properly considered as issues of causation or remoteness.
- Manufacturers will not be discouraged from issuing recalls, because even voluntary recalls are regulated by statute, and furthermore, recalls actually help negligent manufacturers to mitigate losses caused by risky products because the failure to recall risky products exposes manufacturers to much greater liability.

What now? Product liability implications for supply chain participants

While manufacturers should certainly take comfort from the findings of the majority of the Supreme Court, which prescribe clear limits on potential supply chain liability, they should nevertheless be mindful of the dissent. Among other things, the reasons of Justice Karatkatsanis may provide a roadmap for future claims by supply chain participants against manufacturers. Accordingly, supply chain participants – and particularly those with exclusive supply arrangements – should carefully review their agreements (including, among other things, the contractual consequences of a product recall).

Supply chain participants should also consider applicable insurance policies with a view to

protecting themselves against supply chain risk. While Justices Martin and Brown suggested in their decision that the franchisees could have purchased insurance to protect against the types of harms alleged in this case, the franchisees took the position during oral argument that there was no evidence that an insurance policy could be obtained in respect of revenue shortfalls due to loss of reputational goodwill as a result of a manufacturer's negligence. Accordingly, even where insurance policies are put in place, it will be important to pay specific attention to the scope of the risks and losses covered by the particular policy.

Franchise law implications

Overall, the decision is also a positive outcome for franchisors insofar as it limits the ability of franchisees to sue a franchisor's supplier in negligence. This, in turn, has the effect of preserving the ability of franchisors to enter into favourable long-term contracts with suppliers by virtue of the apparent absence of direct liability on the part of the supplier to the franchisees.

Franchisors should nevertheless ensure that their franchise agreements, like the franchise agreement at issue in this case, contain a limitation of liability clause preventing a franchisee from seeking recourse from the franchisor for any direct or indirect loss or damage due to any delay in delivery, or inaccurate or incomplete shipments, of products that franchisees are contractually obligated to purchase. Also, where the franchise agreement contains a provision allowing a franchisee, with the franchisor's permission, to purchase from an alternative supplier, a franchisor, in accordance with its duty of good faith and fair dealing, will likely want to do so on a timely basis.

Furthermore, the decision reflects two starkly different conceptualizations of the realities of the franchise business model. Whereas the majority judgment described franchisees as commercial entities who have entered into an arrangement with eyes wide open to the attendant benefits and constraints, the dissenting judgment painted the franchise agreement as a contract of adhesion in which the franchisees' bargaining power is largely illusory. These contrasting views may be revisited in the next franchise case that comes before the Supreme Court.