CITATION: 1250264 Ontario Inc. v. Pet Valu Canada, 2014 ONSC 6056
COURT FILE NO.: CV-09-392962-CP
DATE: 20141031

2014 ONSC 6056 (CanLII)

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:	)	
1250264 Ontario Inc.	)	*Louis Sokolov, Jean-Marc Leclerc and Shane P. Murphy* for the Plaintiff / Responding party
Plaintiff	)	
– and –	)	
Pet Valu Canada Inc.	)	*Geoffrey B. Shaw, Derek Ronde and Eric Mayzel* for the Defendant / Moving party
Defendant	)	
	)	**HEARD:** October 8, 9 and 10, 2014

Proceedings under the Class Proceedings Act, 1992

SUMMARY JUDGMENT ON COMMON ISSUES

Belobaba J.:

[1] Pet Valu Canada Inc. ("PVCI") moves for summary judgment on the seven common issues that were certified in this class action.[1] The issues mainly involve

[1] See *1250264 Ontario Inc. v. Pet Valu Canada Inc*. 2011 ONSC 287 (the Certification Decision) and *1250264 Ontario Inc. v. Pet Valu Canada Inc*. 2011 ONSC 1941 (the Common Issues Decision).

contractual and documentary interpretation and are thus amenable to summary adjudication. For ease of reference, they are listed in the attached Appendix.

[2] The core issue is whether PVCI, as the franchisor, failed to share volume rebates with the class member franchisees. The gist of the plaintiff's case is this: the defendant said it had substantial purchasing power; it was contractually obliged to share the volume-related pricing benefits with the franchisees; it did not do so. The defendant denies that it had any contractual obligation to share volume-related rebates, but says that in any event, all of the volume rebates were in fact shared with the franchisees by way of reduced prices.

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Background

[3] The background facts were set out in some detail by Justice Strathy in the certification decision.[2] It is sufficient for the purposes of this summary judgment motion to note the following. PVCI sells pet food, supplies, and related services, and does so as both wholesaler and retailer. Its stores offer national and premium brand products, as well as private label products. There are currently 281 franchised stores in Canada and 287 corporate stores in Canada and the U.S. There are no franchised stores in the U.S.

[4] PVCI purchases and distributes its products through a wholly-owned subsidiary called Peton Distributors. Peton operates out of distribution centres, and trucks the products to both corporate and franchised stores.

[5] The plaintiff numbered company is a former PVCI franchisee that operated a Pet Valu store in Aurora, Ontario until 2012. The owner, Robert Rodger, acquired the plaintiff company in 2005 and sold it to a new franchisee in 2012 for a substantial profit. The class period covers some 8 years, from 2003 to 2011. There are about 150 class members – all are former franchisees. Most if not all of the current franchisees have opted out of this class proceeding.

[6] Before turning to the common issues, it may be helpful to make the following two points. First, although the franchise agreement (the "Agreement") provides in s. 22(f) that "volume allowances … shall be *allocated* [as is further described]," both sides agreed at the certification motion that "allocated" means "shared" and thus the common issues were drafted using the word "shared."[3] Secondly, because "volume allowances" was not defined in the Agreement, the certification judge adopted the phrase "Volume Rebates" and gave it a broad definition:

> "Volume Rebates" means all volume-based rebates, allowances and discounts given by suppliers and manufacturers to Pet Valu or its affiliates and includes any direct or indirect discounts of the price at

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[2] *Supra*, note 1.

[3] Dictionaries define "share" as "divide into portions." There is no dispute about the definition.

> which goods are supplied to the Pet Valu system, but does not include discounts tied to the performance of individual stores.[4]

[7] I can now turn to the common issues.

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Analysis of the common issues

Common issue no. 1

[8] The first common issue asks whether the defendant breached its contractual duty to the class members at any time during the class period by failing to share Volume Rebates with them. As already noted, this is the core issue. It has two prongs: was PVCI contractually obliged to share Volume Rebates with the class member-franchisees; if it was, did it do so?

[9] The plaintiff argues that on any reasonable interpretation of the Agreement, PVCI was contractually required to pass along the entirety of the Volume Rebates "minus a reasonable mark-up." I agree that the defendant was contractually obliged to share the Volume Rebates with its franchisees but not in their entirety – only in a reasonable manner. As it turns out, nothing actually turns on the two differing interpretations because the defendant in fact shared all of the Volume Rebates with the class member franchisees, subject only to a reasonable mark-up. However, for the sake of completeness, I will set out my reasons for interpreting the Agreement as meaning "share the Volume Rebates reasonably."

[10] I begin with the recitals to the Agreement, which "set forth the basis of the relationship between the parties" and record their "fundamental understandings." The recitals make clear that PVCI had "substantial purchasing power" and that this purchasing power would be used for the benefit of both the franchisor and the franchisees. It is important to note that the recitals in this particular franchise agreement are given considerable force. Section 1(a) of the Agreement provides that the recitals "form a part of this Agreement and are acknowledged by the parties to be true in substance and in fact," and that the Agreement must be "interpreted and acted upon in accordance with the recitals herein." Taken as a whole, the recitals strongly suggest that PVCI has significant purchasing power and this purchasing power will be used to obtain pricing benefits that will be passed along, at least to some extent, to the franchisees.

[11] The purchasing power/pricing benefits theme is continued in the body of the Agreement itself. In s. 27(a) of the Agreement, the franchisee acknowledges that "a fundamental component of the Pet Valu System" is "the ability of PVCI to coordinate and consolidate buying activities and to obtain lower prices for the benefit of all Pet Valu stores by purchasing in larger quantities on a centralized basis." This reflects and

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[4] Common Issues Decision, *supra,* note 1, at para. 8.

reinforces the franchisor's statement in the 'disclosure document' that PVCI's wholly-owned subsidiary, Peton Distributors, "supplies the vast majority of the products sold by the Pet Valu franchised stores," has "significant purchasing power," and therefore is "able to take advantage of volume discounts offered by suppliers."

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[12] I then come to s. 22(f) of the Agreement, which provides as follows:

> Volume allowances granted to PVCI by a supplier or manufacturer based upon PVCI's annual purchasing volume shall be allocated all as more particularly set forth in the Pet Valu Franchise Business System.

[13] One must turn to the Pet Valu Franchise Business System manual to find out how the volume allowances will in fact be "allocated." Pausing at this point to recap: both sides understand and have agreed that PVCI's purchasing power will result in pricing benefits for the franchisees and that volume-related allowances *shall* be allocated (i.e. shall be shared to some extent with the franchisees). In my view, at this point in the interpretive analysis, it is reasonable to expect that "shared" means something more than 99:1 in favour of the franchisor. It probably means "shared reasonably."

[14] The Pet Valu Franchise Business System manual, which forms part of the Agreement,[5] was amended by PVCI in November 2002 to provide that "…volume allowances may be included or not included in the landed cost of specific products, pursuant to the discretion of the franchisor".

[15] It is clear that on its face this provision confers a wide-ranging discretion upon PVCI in deciding the amount of Volume Rebates that will be shared with the franchisees. However, it is also clear, both in common law[6] and under provincial franchise legislation,[7] that this discretion must be exercised reasonably. As Strathy J. noted in *Fairview Donut*,[8] "where the franchisor is given a discretion under the franchise agreement, the discretion must be exercised reasonably and with proper motive, and … not … arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties."[9]

[16] Thus, interpreting the entire Agreement as a whole and in accordance with the reasonable expectations of the parties, as further informed by the case law, I have no difficulty concluding that PVCI is contractually obliged to share Volume Rebates with its franchisees in a reasonable manner.

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[5] See ss. 2(i) and 2(ff) which define the Pet Valu Franchise Business System, including all manuals as amended, and s. 42(a) which explicitly provides that "all schedules, addenda and appendices thereto, the Documentation and all other documents incorporated by reference, constitute the entire agreement."
[6] McCamus, *The Law of Contracts*, (2005) at 788-91 and case discussed therein. At 791: "Where discretionary powers are conferred by agreement, it is implicitly understood that the powers are to be exercised reasonably."
[7] *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c. 3, s. 3.
[8] *Fairview Donut Inc. v. The TDL Group Corp.*, 2012 ONSC 1252.
[9] *Ibid.*, at para. 502 (and cases cited therein).

[17] This is not the interpretation that was sought by the plaintiff. But, as I have already noted, nothing turns on this because when one considers the second prong of Common Issue No. 1, one finds overwhelming evidence that PVCI has indeed shared all of the Volume Rebates with the franchisees.

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[18] The second prong of Common Issue No. 1 - whether and to what extent the Volume Rebates were shared with the class member franchisees - turned out to be the core issue. In an effort to help focus the inquiry, Strathy J. had suggested the following approach:

> It … seems to me that the fair and expeditious determination of this proceeding may well lend itself to a process whereby, in the first instance, the analysis of Volume Rebates is confined to a representative group of suppliers, or a representative group of products, or both. If the plaintiff failed to establish an entitlement to share in rebates relating to those products, that might well be the end of the inquiry.[10]

[19] The parties accepted Strathy J.'s suggestion and focused on a representative sampling of products and product pricing. PCVI presented pricing information relating to Pet Valu's Top Ten suppliers and the Top 100 products that were purchased annually by the plaintiff during the class period. This pricing information was supplemented, on both sides, with numerous affidavits, expert reports and extensive cross-examinations. Even using the "representative sample" approach, the evidence filed by both sides was voluminous.

[20] The evidence established that the class member franchisees were the beneficiaries of lower product pricing. Indeed, it is undisputed that PVCI prices for the Top 100 products were on average 6 to 14 percent lower than competitors' prices. According to the minutes of the Canadian Franchisee Council executive meeting held in 2008 (the CFC is the Pet Valu franchisees' association) the "average Pet Valu franchise cost [for products] was about 15 percent below outside distributors' prices, after freight charges." One should also note that the franchisees were free to purchase from more than a dozen other distributors, and yet overwhelming they purchased product from PVCI – the plaintiff itself bought 90 to 95 percent of its products from the defendant.

[21] The fact that product prices were significantly lower for class member franchisees is enough, says PVCI, to show that Volume Rebates must have been and indeed were passed on and shared with the class member franchisees. But if more evidence is required, PVCI points to the multi-column spread-sheet that it generated summarizing pricing information about the Top 100 products. The spread-sheet identified each of the products by year and number and provided the following information:

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[10] Certification Decision, *supra,* note 1, at para. 109.

Product	List Price	Volume Discount	Other Discounts (Co-op, I&E)	Realized Cost	Mark-up	Net Store Cost	SMRP
A	B	C	D	E=B-(C+D)	F	G=E+F	H
2009-13	$59.87	$5.69	$10.25	$43.93	$7.25	$51.18	$76.99

[22] The first column identifies the year and the product, here the year 2009 and product number 13. The second column shows the amount PVCI (or more accurately Peton) paid suppliers for the product, in this case $59.87. The next several columns set out any volume or other discounts, the realized cost to PVCI, the PVCI mark-up, the net store cost (here $51.18) and the suggested retail price (here $76.99). The spread-sheet shows that if any volume or other discounts were received from the supplier, they were shared with the franchisee by way of a reduced realized cost. PVCI then added a mark-up, resulting in a final franchisee cost. Note that PVCI marked up this particular product by $7.95 or 16.5 percent; the franchisee marked up the product by $25.81 or about 50 percent.

[23] The product pricing evidence shows that all of the volume-related and other non-volume related discounts were fully passed on to the franchisees by way of dollar for dollar price reductions. The plaintiff, however, says that even so, all of the price reduction benefits were "wiped out" or "clawed back" by unreasonable mark-ups.

[24] I pause here to note the following about PVCI's right to add a mark-up in its pricing model. First, the plaintiff concedes that mark-ups are allowed by the franchise agreement and are needed for PVCI's financial viability, but argues that the mark-ups cannot "wipe out" the volume discounts and must be "reasonable." The plaintiff, however, provided no credible evidence that the PVCI mark-ups "wiped out" the volume-related discounts or were otherwise unreasonable. On the other hand, the defendant presented evidence that, over the class period, the mark-up as a percentage of net realized cost on volume-discounted products averaged around 21 percent, which was described by the defendant, again without contradiction, as being "within the normal range."[11] Recall as well that product prices paid by class member franchisees were 6 to 14 percent lower than otherwise available.

[25] The plaintiff's final gambit was to focus on the "list price" column and argue, given the defendant's purported purchasing power, that the price paid by PVCI to the supplier for a particular product was substantially lower than the price paid by another, smaller competitor and that these "savings" were akin to a Volume Rebate that should have been passed on to the franchisees.

[11] The mark-up on products that did not enjoy a volume discount was about 31 percent.

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[26] The plaintiff pointed to the pricing data that was disclosed after PVCI acquired Bosley's, a small chain of pet food stores in western Canada. The data showed that, for the same product, Bosley's paid the supplier $45.42 and PVCI only paid $25.98. The plaintiff argues that the $19.44 difference is a volume-related discount that should have been passed on to the franchisee by deducting it from the $49.05 price that Bosley's charged its own franchisees. The problem with this analysis is obvious: until PVCI acquired the Bosley stores and gained access to its confidential pricing data, it had no idea what Bosley's was paying for its products or charging its franchisees. Likewise, says PVCI, when it is presented by the supplier with its own "list price" (as set out in Column A of the spread-sheet discussed above) it has no idea what other competitors are paying and it certainly has no idea what these competitors are charging their own franchisees. Put simply, the defendant cannot pass on what it cannot identify or quantify. The plaintiff offered no evidence to suggest otherwise.

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[27] I find on the evidence before me that PVCI negotiated the best price it could obtain and this (hopefully lower) price became the starting point in its pricing model. Various volume and non-volume discounts were then deducted for the franchisees' benefit and a reasonable mark-up was added. There were no "phantom rebates" that were not disclosed on this pricing spread-sheet. There was no failure to share volume-related rebates. And, as I have already noted, the plaintiff offered no evidence to suggest otherwise.

[28] The Bosley pricing data does not support the plaintiff's submissions. It does, however, reinforce my earlier finding that Pet Valu franchisees paid lower prices and enjoyed higher returns than smaller competitors such as Bosley's. For example, when one compares a basket of products in the Top 100 that was also carried by the Bosley's franchise system between 2006 and 2009, one finds that Pet Valu sold the basket of products to its franchisees for $2,931.24 less than Bosley's sold to its franchisees, and that Pet Valu's franchisees earned $6,164.19 more in mark-ups than Bosley's franchisees earned on those products. The Bosley data also shows that PVCI shared approximately two-thirds of all savings with its franchisees in the form of lower prices, and that the Pet Valu franchisees earned 20 percent more in gross profits than Bosley's franchisees on the sale of the same products.

[29] In sum, for the reasons set out above, I conclude that there were no undisclosed or "phantom" rebates; that all of the Volume Rebates were passed on and shared with the franchisees; and that the franchisor's mark-ups were not unreasonable.

[30] Common Issue No. 1 is answered "No."

Common Issues 2, 3, 4 and 5

[31] Given that the answer to Common Issue 1 is "No" there is no need to answer Common Issues 2 and 3. Common Issue 4 must be answered "No" because I have found

that PVCI shared all of the Volume Rebates with the franchisees via price reductions, the mark-ups were not unreasonable and thus there was no unjust enrichment. Common Issue 5, which deals with aggregate damages, need not be answered because there is no basis for either a damages or an unjust enrichment claim under Common Issues 1, 2 or 3.

Common Issues 6 and 7

[32] Common Issue 6 asks, in essence, whether PVCI had an ongoing obligation under s. 3 of the *Arthur Wishart Act*[12] to provide franchisees with information about the Volume Rebates – such as the amounts received and the criteria for distribution. Common Issue 7 follows up by asking about the need for an immediate disclosure order and about damages. Note that the questions are grounded in the obligations set out in s. 3 of the *Arthur Wishart Act* and not in the disclosure obligations set out in s. 5 of the Act.

[33] Sections 3(1) and (3) of the *Arthur Wishart Act,* provide in combination that every franchise agreement imposes upon each party a duty of good faith and fair dealing "in its performance and enforcement." It is generally accepted that section 3(1) is a codification of the common law.[13] Section 3(2) gives a party a right to damages against the other party for the breach of this duty of good faith and fair dealing.

[34] The interesting legal issue is whether the good faith and fair dealing language in s. 3 can be used to compel ongoing disclosure. In *Spina*[14] *v. Shoppers Drug Mart*, Justice Perell concluded that s. 3 of the *Arthur Wishart Act* does not impose a continuous post-sale disclosure regime and there is no obligation on the part of the franchisor to provide ongoing disclosure, at least not for routine or non-material information.

[35] Because Common Issue 6 was focused on the continuing disclosure under s. 3 of financial information that was arguably non-material, such as the receipt and the amount of volume-related discounts, I was initially of the view that given this court's decision in *Spina*, the answers to Common Issues 6 and 7 should be "No."

[36] The plaintiff, however, proceeded to argue that PVCI failed to disclose material financial information that went to the very root of the franchise agreement and is now moving to amend the common issues to add a new common issue about purchasing power. This being the case, I am deferring my ruling on Common Issues 6 and 7 until after this motion to amend has been heard and decided.

[37] Let me explain this in more detail.

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[12] *Supra,* note 7.
[13] *Fairview Donut, supra,* note 8, at para. 495 and cases cited therein.
[14] *Spina v Shoppers Drug Mart Inc.,* 2012 ONSC 5563.

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The motion to add a new Common Issue dealing with purchasing power

[38] As the hearing of this summary judgment motion progressed, it became apparent that the plaintiff was shifting its focus from Volume Rebates to purchasing power. The plaintiff alleged repeatedly that many class members were facing declining margins and growing unprofitability. The initial complaint, however, as set out in the statement of claim, focused on the defendant's alleged failure to share volume-related rebates. But in a supplementary affidavit filed this past summer (i.e. years after this action was commenced) Thomas McNeely, PVCI president, stated that PVCI in fact had "little to no purchasing power." Specifically, he said this:

> Pet Valu has little to no purchasing power with its major suppliers … This is the case now and it has been the case historically.
>
> Pet Valu has less than a one percent share of the Canadian/U.S. pet food and supply market. This market is estimated at $28.7 billion in 2008, based on a report by BMO Capital Markets (the "BMO Report"). Pet Valu's system sales were approximately 7/10ths of 1 percent of this market that year. Pet Valu, with less than one percent of the Canada/U.S. pet food and supply market, has little bargaining power when dealing with this concentrated group of large suppliers …
>
> Pet Valu has little to no ability to influence the price at which it is supplied product.

[39] Counsel for the plaintiff was, to say the least, surprised by these statements. But on further reflection, this new information about the defendant's overall lack of purchasing power may explain why the plaintiff itself received only $14,147 in volume discounts over the eight years of the class period, equivalent to a meager 1.3 per cent of net store costs.

[40] The plaintiff argued that PVCI falsely represented the nature and extent of its purchasing power and that these misrepresentations have caused enormous damage to the class members who relied on these representations when agreeing to become or continue on as franchisees.

[41] Counsel for the plaintiff then tried to shoe-horn the "little to no purchasing power" revelation into the various sub-parts of Common Issue No. 6. It was not an easy fit. I suggested to both sides that they might consider a more direct approach – namely, amending the common issues by adding a new one dealing specifically with the purchasing power question. The plaintiff considered this suggestion and has now advised that it will be moving to amend the statement of claim and the common issues to add a

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new Common Issue No. 8 that will deal more directly with the purchasing power statement.[15]

[42] The motion to amend the statement of claim and add a new Common Issue No. 8 will be heard in December. If the plaintiff prevails on the motion and the new common issue is added, then Common Issues 6 and 7 will likely be answered "No" on the basis of the decision in *Spina*.[16] It remains to be seen how the new common issue will be answered. If the plaintiff does not prevail and the proposed Common Issue No. 8 is not added, then it is only fair that both sides be allowed to complete their submissions on Common Issues 6 and 7.

[43] Thus, I am deferring my answers on Common Issues 6 and 7 until the motion to amend has been decided.

Disposition

[44] Common Issues 1 and 4 are answered "No." Common Issues 2, 3 and 5 need not be answered. Common Issues 6 and 7 are deferred.

[45] The defendant, PVCI, has prevailed substantially on this summary judgment motion and is entitled to costs. The assessment of costs payable on this motion, however, is deferred until the motion to add a new common issue has been resolved.

Belobaba J.

Released: October 31, 2014

[15] The plaintiff proposes a new Common Issue No. 8 that asks if PVCI had and breached a duty at common law or under ss. 3 or 5 of the *Arthur Wishart Act* to disclose to franchisees in the disclosure document, the franchise agreement or otherwise during the course of the parties' relationship, whether it possessed substantial purchasing power and received significant volume discounts offered by suppliers? And if so, what are the damages?

[16] *Supra*, note 14, as discussed above in paras. 34-35.

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Appendix – Certified Common Issues

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Definition of 'Volume Rebates':

> *Volume Rebates" means all volume-based rebates, allowances and discounts given by suppliers and manufacturers to Pet Valu or its affiliates and includes any direct or indirect discounts of the price at which goods are supplied to the Pet Valu system, but does not include discounts tied to the performance of individual stores.*

Common issues:

1. Has the defendant breached its contractual duty to the Class Members at any time during the Class Period by failing to share Volume Rebates with them?

2. If the answer to common issue # 1 is yes, has the defendant breached its contractual duty to the Class Members at any time during the Class Period by:

   (a) charging a mark-up on private label products without giving Class Members credit for their proportionate share of Volume Rebates in respect of such products?

   (b) imposing a distribution charge on the price of products without giving Class Members credit for their proportionate share of Volume rebates in respect of such products?

3. Has the defendant breached the duty of fair dealing to the Ontario Class Members under section 3 of the *Arthur Wishart Act (Franchise Disclosure) 2000,* S.O. 2000, c. 3 (the "A.W.A.") by any of the conduct described in common issues 1 and 2 above, if so found?

4. If the conduct described in common issues 1 and 2 above did not constitute a breach of the Franchise Agreement, has the defendant been unjustly enriched by such conduct, if so found?

5. What is the aggregate amount of damages for the breaches of any of the duties referred to in common issues 1, 2 and 3 above, or the aggregate amount of compensation for unjust enrichment, if so found?

6. Did the defendant have a duty at common law to the Class Members or under section 3 of the A.W.A. to the Ontario Class Members to disclose the following information to the Class Members or to some of them, and if so, did it breach such duty:

   (i) whether the defendant or its affiliates receives Volume Rebates in respect of purchases which are made by the defendant or its affiliates for wholesale to the Class Members;

(ii) the defendant's policy in respect of the allocation of Volume Rebates to Class Members and, in particular, whether the defendant complied with sections 22(e) and (f) and 23(c) of the Franchise Agreement;

(iii) the amount of Volume Rebates received by the defendant or its affiliates during the Class Period;

(iv) the amount of Volume Rebates retained by the defendant or its affiliates and the amount, if any, that was shared with Class Members;

(v) the criteria that were used by the defendant to determine how much of the Volume Rebates were retained and how much, if any, were shared with the Class Members?

7. If the answer to common issue 6 is yes, is the plaintiff entitled to an order requiring the defendant to disclose such information forthwith and what damages, if any, is the defendant required to pay for the breach of such duty?

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ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

1250264 ONTARIO INC.

Plaintiff

– and –

PET VALU CANADA INC.

Defendant

REASONS FOR JUDGMENT

BELOBABA J.

Released: October 31, 2014