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IN THIS ISSUE

Steven Rosenhek provides a useful review of Canadian law regarding good faith obligations, in the context of a recent case involving termination of a distribution agreement. Those whose clients have Canadian distributorships should take note.

Termination of Canadian Distribution Agreements and Contractual Duties of Good Faith

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In a recent decision, the Ontario Superior Court of Justice granted an injunction against Miller Brewing Company ("Miller") in its ongoing dispute with Molson Canada 2005 ("Molson") over Miller's termination of the companies' longstanding distribution agreement. The injunction prevented Miller from terminating its distribution agreement with Molson.

This case is notable for the fact that the Court granted the injunction in the face of a written distribution agreement that contained termination rights (the validity of which were disputed by Molson).

In addition, the Court considered the good faith obligations owed based on the terms of the distribution agreement which incorporated obligations to negotiate in good faith.

Factual Background

A complicated factual matrix underlies the dispute between Miller and Molson.

Molson distributed Miller products in Canada since 1982. The most recent licensing agreement was in effect since January 1, 2003 (the "Agreement").

The primary Miller-brand beer sold by Molson is Miller Genuine Draft ("MGD"). However, Miller brands (including MGD and other products) accounted for less than 5% of Molson's Canadian beer sales in 2012.

Amendment No. 1 to the Agreement was entered into as of January 1, 2007.. . Amendment No. 1 altered Miller's rights of termination in two respects: (i) it provided that Miller could only terminate without cause after September, 2017; and (ii) it provided Miller with a right of termination where Molson's sales of MGD in any two consecutive years fell below the established volume targets for those years. Amendment No. 1 also gave Miller the right to approve of Molson's annual brand plans.

Molson met its minimum volume targets from 2007-2009 but failed to do so from 2010-2012.

The Industry Standard Bottle Agreement (the "ISBA") is an agreement between forty Canadian brewers that established Canada wide standards for beer bottle production. The ISBA prohibits the production of beer in clear bottles. As a result, beer in clear bottles (such as MGD) must be imported.

In 2011, Anheuser Busch InBev ("ABI"), a signatory to the ISBA and the world's largest brewer, indicated to Molson that it was interested in pursuing an amendment to the ISBA to allow for the production of clear bottles in Canada. This presented an opportunity to Molson and Miller to avoid costs associated with importing Miller products from the US.

However, at this point, Molson had not met its 2010 target for MGD sales, and it was not on track to meets its 2011 target. As a result, Molson was not prepared to invest in negotiating a potential ISBA amendment without assurances from Miller that it would not exercise its right of termination based on Molson's failure to meet its 2010 and 2011 targets.

Amendment No. 2 to the Agreement was executed in December, 2011. The relevant terms of the Amendment included:

- A provision stating that if the ISBA was not amended to allow for local production of clear bottles prior to January 1, 2013 that the Amendment would automatically terminate and the pre-existing Agreement would continue in effect without regard to the modifications provided for in the Amendment. **In this situation, the parties were to "negotiate in good faith" to, among other things, reset the minimum volume targets for MGD**;

- Miller waived its right to terminate the Agreement based on Molson's failure to achieve volume targets in 2010 and 2011; and

- Assuming the ISBA amendment went through, there would be no volume targets from January 2012-December 2015.[1]

In December 2012, Molson was advised that Miller intended to terminate the License Agreement on the basis of Molson's failure to achieve the minimum volume targets in 2011 and 2012. After advising Miller that it did not anticipate that the ISBA would be amended before January 1, 2013, Molson expressed its readiness to commence "good faith negotiations" to amend the Agreement.[2]

On January 18, 2013, Miller delivered a Notice of Termination to Molson.

Molson commenced an action against Miller on January 30, 2013, seeking declarations that (a) the Agreement remained in effect; (b) Miller's purported termination constituted a breach of contract and a breach of Miller's duty of good faith; and (c) no events had yet transpired that would permit Miller to unilaterally terminate the Agreement. Molson sought injunctive relief and specific performance.

The Test for an Injunction

Justice Wilton-Siegel cited the test for an injunction from *RJR MacDonald v. Canada (Attorney General)* [1994] 1 SCR 311 at para 48:

1. Whether there is a serious question to be tried;

2. Whether the applicant would suffer irreparable harm if the injunction was refused; and

3. Which party would suffer greater harm from the granting or refusal of an injunction (balance of convenience).

1. Serious issue to be tried.

In determining whether there was a serious issue to be tried, Justice Wilton-Siegel considered two of Molson's arguments with respect to the alleged deficiency of Miller's Notice of Termination: (a) whether the waiver in Amendment No. 2 had legal effect notwithstanding the IBS not being amended (the allegation of permanent waiver); and (b) whether Miller failed to exercise its option to terminate in good faith.

a) Allegation of permanent waiver

Justice Wilton-Siegel noted that the standard of "serious issue to be tried" was not high. He held that it was "at least arguable" that the arrangements reflected a waiver of any termination right that Miller would otherwise have had based on Molson's failure to achieve the minimum targets for MGD sales.

[1] *Ibid.* at para 43.
[2] *Ibid.* at para 47.

b) Allegation of failure to exercise right of termination in good faith

Section 2.1(b) of Amendment No. 2 stated:

> If the ISBA is not amended to allow local production of Miller Brands (MGD, Miller Chill, and Miller High Life) in clear bottles in Canada prior to January 1, 2013, then this Amendment will automatically terminate, effective as of January 1, 2013, and the Agreement (as in effect immediately prior to the Amendment Effective Date) will continue in effect without regard to the modifications provided for in this Amendment. **However, the Parties will negotiate in good faith to (i) reset the minimum Volume Targets for Miller Genuine Draft set forth in Section 2.7 of Amendment No. 1, which relate to Part E 2(b) of the Agreement, (ii) provide for additional brand launches, including, specifically, Miller High Life, with an agreed equitable split of profits, (iii) insure an equitable profit split across the Miller portfolio, and (iv) any other provision or matters that the Parties wish to discuss** [emphasis added].[3]

The question flowing from this provision was whether good faith negotiation was a precondition to termination. Justice Wilton-Siegel observed that this issue turned on whether this provision was a legally binding obligation.

In keeping with the current state of the law, Justice Wilton-Siegel concluded that Canadian law did not recognize a tortious duty to bargain in good faith. The question, however, was whether a contractual commitment to negotiate in good faith could give rise to an enforceable obligation to do so. Ultimately, Justice Wilton-Siegel emphasized that any covenant to negotiate in good faith must be interpreted in accordance with the intention of the parties in the context in which the agreement was negotiated and executed. The question is:

> …not whether a court should imply an obligation to negotiate in good faith as a matter of commercial morality but rather whether the parties themselves understood from the circumstances in which an express commitment to negotiate in good faith was given, and intended in those circumstances, that any breach of the specific commitment was to have some legal consequences.[4]

This, he held, was in line with a more "nuanced and modern understanding" of commercial realities than the "arbitrary and formulaic approach evidenced in the case law which would exclude the possibility of an enforceable obligation to negotiate in good faith under all circumstances."[5]

Justice Wilton-Siegel determined that there was a serious issue to be tried with respect to Miller's alleged obligation to negotiate in good faith. He reached this conclusion for a number of reasons, including the *prima facie* language of the provision. He also noted that "it was possible" that more evidence on the communications between the parties could support the conclusion that such an obligation existed.

[3] *Ibid.* at para 43.

[4] *Ibid.* at para 108.

[5] *Ibid.*

Justice Wilton-Siegel therefore found that there were two serious issues to be tried: (1) the allegation that Miller's waiver of its right of termination continued to have legal effect; and (2) the allegation that Miller was not entitled to exercise its right of termination without satisfying the condition precedent to engage in good faith negotiations.

2. **Irreparable Harm**

Molson argued that it would experience irreparable harm if the injunction was refused because it would no longer be able to offer a full portfolio of beers. Molson argued that MGD was its only competitive product for the "hangout" segment of the market. In addition, Molson claimed that losing MGD would create a ripple effect across its entire portfolio.

Justice Wilton-Siegel accepted Miller's submission that proof of irreparable harm must be clear (not speculative) and supported by the evidence. His Honour was satisfied that this standard was met by Molson for two reasons. First, irreparable harm went to the nature, not the magnitude, of the harm. Citing *RJR MacDonald*, he held that "permanent market loss or irrevocable damage to a business reputation" qualified as irreparable harm. For Molson, losing MGD would leave the "real likelihood of some damage to Molson's existing client relationships."[6] Second, he found that harm could result from the disruption of Molson's marketing strategy for its entire portfolio.

3. **Balance of Convenience**

First, Justice Wilton-Siegel noted that if he granted the injunction it would also cause Miller irreparable harm as the company would be prevented from taking steps towards "re-invigorating" its brand in Canada.[7]

Having found that both parties stood to suffer irreparable harm, Justice Wilton-Siegel turned to the balance of convenience analysis. He considered various factors, ultimately giving weight to the following considerations which went in favour of preserving the *status quo*:

- **The time remaining before trial**: The trial was scheduled to proceed shortly. The injunction was only for a relatively short period of time. This factor, therefore, weighed in favour of preserving the *status quo* and granting the injunction.

- **The risk of disruption**: Molson would suffer irreparable harm if Miller commenced a new marketing strategy and then Molson won at trial. On the other hand, for Miller there was no risk to MGD's specific brand equity if the *status quo* was preserved until the trial of the action. Therefore, there was a "risk of disruption" threat that was unique to Molson. This weighed in favour of granting the injunction.

- **Preservation of the status quo**: Case law suggests that where other factors were evenly balanced, courts should preserve the *status quo*. This factor therefore favoured granting the injunction.

Since all three of these factors weighed in favour of granting the injunction, Justice Wilton-Siegel held that the balance of convenience favoured preserving the *status quo* and granted the requested injunction.

[6] *Ibid.* at para 134.

[7] *Ibid.* at para 141.

Given these conclusions, Justice Wilton-Siegel held that Molson had satisfied the requirements of the test for the granting of an injunction. Therefore Miller was prohibited from terminating the Licence Agreement pursuant to the Termination Notice pending the trial of the action.

Justice Wilton-Siegel's decision is significant to companies that enter into distribution agreements. It puts manufacturers on notice that courts are willing to play a supervisory role on their actions in terminating contracts, even at the interlocutory stage. Furthermore, it emphasizes the importance of establishing unambiguous terms for the termination of distribution agreements.

The trial of this action has not yet occurred. When it does, the Court will presumably reach a final determination on, among other issues, the duty of good faith owed by Miller to Molson. Hopefully, such a decision would provide further guidance for parties entering into distribution agreements and companies seeking to terminate them.

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