CITATION: Waterloo v. MXM, 2024 ONSC 1823
COURT FILE NO.: CV-22-0069310-0000
DATE: 20240326

ONTARIO SUPERIOR COURT OF JUSTICE

RE: WATERLOO BREWING LTD., Applicant

-And-

MXM BEVERAGES LTD., Respondent

BEFORE: Justice J. S. Shin Doi

COUNSEL: *Nadia Campion*, *Zain Naqi*, and *Joseph Stonehouse*, for the Applicant

J. Kenneth McEwan and *Stephanie Stephenson*, for the Respondent

HEARD: September 12 and 19, 2023

ENDORSEMENT

[1] The Applicant seeks a declaration that the Respondent is required to pay fees in the amount of $4,088,440.00 for failing to meet contractually imposed minimum orders pursuant to an agreement and that the Respondent pay the Applicant for unpaid invoices in the amount of $64,483.44 plus interest.

[2] The parties had negotiated and executed an agreement that the Applicant would manufacture and package a line of alcoholic beverages for the Respondent.

[3] I order that the Application be converted into an action pursuant to Rule 38.10 (1)(b). The determination of the dispute by way of an application under Rule 14.05(3)(d) is not appropriate in this particular case. The issue of whether the Respondent is required to pay the Applicant involves several distinct issues. The issue of whether the contract clause is valid is a separate legal issue from whether the contract clause is enforceable against a party and whether there are any defences. The relief sought by this Application blends those distinct issues against the backdrop of the COVID-19 pandemic and the issues should be determined at trial on a fulsome record. There are also material facts in dispute and discoveries are required.

Facts

[4] The Applicant is a corporation incorporated under the *Business Corporations Act* (Ontario) on February 20, 1984, with its head office in Kitchener, Ontario. The Applicant is Ontario's largest Canadian-owned and Canadian-based publicly held brewery. The Applicant manufactures and packages alcoholic beverages for its own brands and those of other companies. The Respondent is a British Columbia corporation sells and distributes alcoholic beverages across Canada under the brand name "Nude".

[5] In 2018 and 2019, the Respondent had discussions with the Applicant to manufacture and package a line of alcoholic beverages. The Applicant submits that the Respondent represented that its production volume had increased and that the Respondent would agree to order a minimum annual volume. The parties negotiated and entered into the Contract Manufacturing Agreement dated as of January 1, 2020 (the "Agreement") before the COVID-19 pandemic ensued.

[6] Section 4.2 of the Agreement provides a minimum 12-month volume,

> 4.2 Minimum 12 Month Volume. Nude shall purchase not less than the minimum amount of seventy-five thousand (75,000) hectoliters of the Products ("Minimum 12 Month Volume") for each calendar year of the Agreement. Subject to sections 4.3 and 4.4, in the event Nude orders less than the Minimum 12 Month Volume for any period of the term, Nude shall pay to Waterloo upon receipt of an invoice from Waterloo an amount equal to the difference between the Minimum 12 Month Volume less the actual twelve (12) month purchased volume of Product multiplied by twenty ($20.00) per hectoliter.

[7] The Applicant explains that the purpose of the Minimum Purchase Requirement was to protect the Applicant in circumstances where it had to reserve production capacity at its facilities for the exclusive purpose of manufacturing the products. The Applicant submits that the parties agreed that the Respondent would pay the Applicant any difference between the minimum annual volume of 75,000 hectoliters and the actual volume it purchased in the relevant 12-month period multiplied by $20 per hectoliter, which the Applicant refers to as "Take-or-Pay Fees".

[8] The term of the Agreement is for 3 years after which the Agreement would continue indefinitely subject to termination on six months written notice. The effective start date of the Agreement is the date of first production, which occurred on February 25, 2020.

[9] The Applicant argues that from the very beginning of the Agreement, the Respondent consistently failed to order the minimum annual volume. The Applicant submits that during the first three years of the Agreement, the Respondent ordered only nine percent of the total minimum volume, representing 20,578 hectoliters of the 225,000 hectoliters to which it had committed. Accordingly, the Applicant argues that based on section 4.2, the Respondent is required to pay the Applicant the sum of $4,088,440 in fees. The Respondent refuses to pay these fees. It also refuses to pay outstanding invoices issued by the Applicant in the amount of $64,483.44 plus interest.

[10] The Respondent argues that on March 18, 2020, the Applicant advised its customers that it may have to reduce customer order volumes due to anticipated labour and material shortages associated with the COVID-19 pandemic. The Respondent further argues that on June 10, 2020, the Applicant advised that it could not accommodate an order from the Respondent until late August and that they would let the Respondent know if anything earlier became available. The Respondent argues that it repeatedly inquired about scheduling orders during May 2020 to August 21, 2020, but the Applicant responded that it could not produce for the Respondent within the timeframes set out in the Agreement.

[11] On November 19, and December 7, 2020, the Respondent reduced its 2021 production forecast from 165,000 to 85,000 hectoliters and then to 80,000 hectoliters. The Applicant pleads that the reductions amount to approximately $5,000,000 of lost revenues. At the end of May 2021, the Respondent cancelled its entire production for July 2021 and the parties entered into discussions and negotiations about a possible amendment to the Agreement.

[12] The Respondent did not provide a production forecast for 2022 and the last order issued by the Respondent was on August 4, 2021.

[13] The Applicant alleges that the Respondent breached the Agreement because it wanted to pay less by placing orders with another brewery. The Applicant alleges that the Respondent breached its duty of good faith and honest performance to the detriment of the Applicant's interests under the Agreement.

[14] On November 11, 2021, the Respondent wrote to the Applicant to advise it would not be able to meet the minimum volumes. On January 25, 2022, the Applicant wrote to the Respondent demanding payment of $4,088,440.00 plus interest pursuant to the Agreement. The amount of the demand represented the minimum 12-month volume payments for 2020, 2021, and 2022. The Applicant also sought payment of issued invoices.

[15] The Respondent informed the Applicant that the Agreement was terminated and provided formal written notice of termination on June 28, 2023. The Applicant states that there was no termination right in the first three years of the Agreement.

[16] The Respondent opposes the relief sought on the basis that determination by way of an application under Rule 14.05(3)(d) is not appropriate and says the Application ought to be converted to an action. The Respondent argues that the Applicant is asking the court not for a determination of its rights under the Agreement, but rather an evaluation of the parties' conduct and the enforceability of a penalty clause.

Rule 14.05 (3)(d)

[17] Rule 14.05(3)(d) provides, in part, that a proceeding may be brought by application where the relief claimed is, the determination of rights that depend on the interpretation of a contract.

[18] In *Jackson v. Solar Income Fund Inc.*, 2016 ONCA 908, the Court of Appeal considered Rule 14.05(3)(d) at para 6,

> Rule 14.05(3)(d), which the respondent relies on, authorizes proceeding by way of application where the matter involves "the determination of rights that depend on the interpretation of a … contract or other instrument". This sub-rule is not applicable here. **What is at issue is not the interpretation of the promissory note, but the determination of whether the promissory note was modified by a subsequent agreement such that, despite its clear wording, it is not enforceable on demand. This requires an understanding of the broader factual matrix, which includes the other agreements that may or may not conflict with the promissory note.** This cannot be determined simply by reading the promissory note in isolation from the larger transaction of which it appears to be a part, or of understanding what the various agreements together were expected to achieve. [Emphasis added.]

[19] As in *Jackson v. Solar Income Fund Inc.*, the interpretation of the Agreement is not at issue in this case but the determination of whether the Agreement was modified by a subsequent agreement between the parties such that, despite its clear wording, the Agreement is not enforceable on demand. This does require an understanding of the broader factual matrix including the implications of the COVID-19 pandemic.

[20] The Applicant argues that *Jackson v. Solar Income Fund Inc.* is distinguishable because the Agreement was not modified by subsequent agreements or transactions that are part of a larger factual matrix. I disagree. It is arguable that the parties faced unexpected events during the COVID-19 pandemic and those events led to subsequent agreements between the parties. The determination of enforceability of section 4.2 of the Agreement does require engaging with the broader factual matrix including the issues raised by the Respondent and the defences available to the Respondent against the backdrop of the COVID-19 pandemic.

[21] The Applicant argues that courts routinely enforce contractual obligations by way of applications under Rule 14.05(3)(d). The Applicant cites *Parc Downsview Park v. Penguin Properties Inc.*, 2018 ONCA 666, which concerned an application to enforce an indemnity under a commercial lease. Penguin Properties Inc. submitted that it was unfair to decide the dispute by way of application because the nature of the dispute required full production by way of affidavits of documents, examinations for discovery, followed by a trial. The Court of Appeal held at para 27 that there was no unfairness resulting from the application judge determining the contractual dispute by way of application, instead of directing a trial. The Applicant argues that the Court of Appeal stated at para 25 it was "difficult to understand what further material evidence about the representations could emerge from a conventional discovery process..."

[22] The Court of Appeal in *Parc Downsview Park v. Penguin Properties Inc.* also held at para 20 that the "suitability of using an application, rather than an action, to decide a contractual dispute depends upon the specific facts of the case, including the nature and extent of any factual dispute." As discussed below, the specific facts of this case, including the nature and extent of the dispute during the COVID-19 pandemic, warrants an action to determine the dispute between the parties. Further material evidence could also emerge from discovery.

Interpretation of the Agreement

[23] There is no dispute about the meaning of the Agreement. There is a dispute as to whether section 4.2 of the Agreement can be characterized as a penalty and therefore, not enforceable against the Respondent.

[24] The Applicant submits that the Agreement is clear and unambiguous. The Respondent does not deny the plain language meaning of section 4.2 of the Agreement and the Applicant does not deny it failed to provide the Respondent with the reserved production capacity it was entitled to under the Agreement. The Respondent argues that the Applicant is seeking not how to interpret section 4.2 but whether it can be enforced. The Respondent submits that where the parties disagree is whether the Applicant holds an enforceable right to recover against the Respondent for product volume shortfalls from 2020-2022.

[25] The Applicant submits that stipulated remedy clauses are enforceable absent penal consequences and unconscionability (*Peachtree II Associates-Dalla L.P. v. 857486 Ontario Ltd.,* 2005 CanLII 23216 (ON CA)). The Applicant argues that the analysis only applies on breach or non-performance of the contract and does not apply to a conditional event that is governed by the contract (*Bidell Equipment LP v. Caliber Midstream GP LLC,* 2020 ABCA 478 at para 23). The Applicant states section 4.2 deals with a conditional event - inability to meet the minimum - and therefore, the penalty analysis does not apply. The Applicant further argues that absent unconscionability or oppressive conduct, a court will give effect to stipulated remedy clauses. The Applicant states that the provision must be examined at the time the contract was entered into, which was before the COVID-19 pandemic, and therefore the COVID-19 pandemic is irrelevant.

[26] The Respondent argues that section 4.2 is a penalty clause and not enforceable. The Respondent states that section 4.2 is not a genuine pre-estimate of damages and therefore, cannot be a liquidated damages provision. The Respondent makes persuasive arguments about the lack of evidence supporting facts underpinning the Applicant's losses. The Respondent reasons that if the argument is successful that section 4.2 is a penalty clause then section 4.2 operates as an upper limit on the general damages that the Applicant can claim, rather than as a stipulated sum to be paid. The Applicant's claim to damages must be proved and is subject to mitigation. The Respondent argues that there is no evidence of the Applicant's actual, or even potential losses under the Agreement.

[27] In my view, further evidence is required. Further evidence would assist in determining whether the clause is penal or unconscionable, in light of the COVID-19 pandemic. I disagree with the Applicant that the COVID-19 pandemic is not relevant in this case.

Converting the Application to an Action

[28] Rule 38.10 (1)(b) provides that on the hearing of an application, the presiding judge may order that the whole application or any issue proceed to trial.

[29] The Court of Appeal held in *Family and Children's Services of Lanark, Leeds and Grenville v. Co-operators General Insurance Company*, 2021 ONCA 159 at para 48, "An application will however be converted to an action where there are material facts in dispute,

complex issues requiring expert evidence or the weighing of evidence, or other need for discoveries or further pleadings: see *Fort William Band v. Canada* (Attorney General), 2005 CanLII 28533 (ON SC), 76 O.R. (3d) 228 (S.C.), at paras. 5 and 28-31."

[30] There are material facts in dispute and there is a need for discoveries or further pleadings. The Respondent submits that in its Notice of Examination to Mr. Henry of the Applicant, the Respondent sought production of documents relevant to the greatest loss that could conceivably be proved to have resulted from breach of the minimum volume requirement, such as documents relating to other products produce by the Applicant during the relevant period and documents related to the Applicant's profits at the time. The Respondent argues that the Applicant referred to its financial statements filed on SEDAR but did not produce copies of any financial documents and the Applicant's most recent annual report filed on SEDAR is for the fiscal year ending January 31, 2022.

[31] The Respondent also sought any documents that relate to the Applicant's manufacturing line availability for the years 2020, 2021, and 2022. The Applicant responded in its answers to undertakings that it has provided all documents it has relating to line availability, which consists of emails from 2020 advising of disruptions to the line caused by the COVID-19 pandemic. It also referred to Mr. Henry's answers to questions on this topic under cross-examination. The Respondent argues that the Applicant did not provide any internal documents showing its manufacturing line capacity during the relevant period. Against that assertion, its financial statement filed on SEDAR for its 2021 fiscal year indicates that it was still experiencing line capacity constraints as of April 7, 2021 when the statement was prepared. Material facts are clearly in dispute.

[32] The Respondent further argues estoppel and frustration of the contract. In the summer of 2020, the Applicant advised the Respondent that it could not schedule its orders until the end of that summer, with the intention that the Respondent would not place any orders during that period. The Respondent states that these facts raise the issue of whether the Applicant is now estopped from denying the truth of that representation or relying on circumstances contrary to that representation: i.e., whether the Applicant can now rely on the Respondent allegedly failing to place minimum orders at a time when it was representing that such orders could not be filled.

[33] The Applicant argues that the Respondent appears to be relying on estoppel by convention, which prevents a contracting party from relying on a contract where, by its words or conduct, it evinces an intention not to rely on the strict terms of the contract and leads the counterparty to believe the contract will not be relied on. The Applicant cites *Grasshopper Solar Corporation v. Independent Electricity System Operator*, 2020 ONCA 499 at para 55 for the principle that estoppel by convention arises "when both parties to a contract act based on a shared assumption concerning circumstances relevant to their contract". The Applicant submits that there was no shared understanding that the Agreement would not be enforced. I disagree. The evidence indicates that the parties engaged in multiple discussions about the how much the Respondent could and would order and whether the Applicant had capacity to satisfy the order.

[34] The Respondent submits that the contract was frustrated by the COVID-19 pandemic. In *T-City Construction Inc. v. Arivuchelvan*, 2020 ONSC 4502, the court noted that whether and to what extent the COVID-19 pandemic had prevented the applicant from fulfilling its obligations under the contract was a material fact that would likely be in dispute. The Applicant concedes that at most the Respondent could obtain an abatement on the section 4.2 fees for a 3-month period when the Applicant's capacity had constraints. Whether and for how long a contract was frustrated is a fact-specific analysis.

[35] The Respondent complains that there is no evidence in the record of the Applicant's actual production capacity or its pre-existing obligations to other customers or other evidence. The Respondent requested documents that would show the Applicant's actual manufacturing line availability and profits for 2020, 2021, and 2022 but the Applicant advised that documents relating to line availability, consisting of emails had been provided. The Respondent complains that the emails discussing production line availability are entirely correspondence with the Respondent and do not allow the Respondent to test the Applicant's evidence on whether what it said at the time was accurate. The Respondent argues that such evidence was not available to adduce without the benefit of discovery. The Respondent further alleges that the Applicant saw an increase in revenue generated from co-manufacturing contracts, a growth of co-manufacturing volume, and a net revenue increase. It is clear that the issues stemming from the Application are deeply factual and require discoveries.

Disposition

[36] Accordingly, I order the whole Application be converted to an action and proceed to trial. I am not ruling on payment of outstanding invoices, even though it is not disputed, in an effort to avoid an inconsistent finding or a fractured proceeding.

[37] I am not inclined to award costs to any party given the outcome. Also, I have considered the Applicant's submissions that the Respondent did not raise an objection to the matter proceeding by way of an application until later in the process and that both parties had to make additional submissions on issues raised in the hearing.

JUSTICE J. S. SHIN DOI

Released: March 26, 2024