

Show Me the Damages: No Presumption of Loss for Breaches of Contractual Duty of Honest Performance

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In December 2020, the Supreme Court of Canada released its landmark decision in *CM Callow Inc v Zollinger*, 2020 SCC 45 (“*Callow*”), establishing a contractual duty of honest performance. Since the decision, a multitude of questions have arisen as to the requirements of the duty, and the implications of any breaches thereof.

In *Bhatnagar v Cresco Labs Inc*, 2023 ONCA 401 (“*Bhatnagar*”), the Court of Appeal for Ontario weighed in on this second issue, and specifically, whether a breach of the duty creates a legal presumption of loss, regardless of whether any actual loss had been established by the innocent party. In considering this question, the Court of Appeal ultimately upheld the application judge’s decision that a finding of such a breach does not relieve a claimant from having to show an evidentiary foundation from which a court could conclude that a loss occurred.

Background

The Court of Appeal’s decision in *Bhatnagar* related to the sale of 180 Smoke, a retailer, wholesaler, and manufacturer of vaporized tobacco products.

Through a share purchase agreement dated February 19, 2019 (the “SPA”), the Appellants Boris Giller, Ashutosh Jha, and Gopal Bhatnagar sold 180 Smoke and its affiliates to CannaRoyalty Corp., operating as Origin House (“Origin House”). On April 1, 2019, Origin House announced that it had entered into an agreement with the Respondent, Cresco Labs Inc. (“Cresco”), under which Origin House would be purchased by Cresco (the “Cresco Transaction”).

Origin House paid the Appellants the sum of \$25,000,000 for the purchase of 180 Smoke on closing of the SPA. The SPA, however, also provided the Appellants with the opportunity to earn additional sums if 180 Smoke met certain revenue and licensing milestones.

Pursuant to the SPA, the Appellants had the opportunity to earn an additional \$12,500,000 if 180 Smoke achieved specified revenue milestones during the initial three years following closing of the SPA (the “Revenue Milestone Payments”), and an additional \$2,500,000 if 180 Smoke obtained a standard processing license for cannabis products within a specified period (the “License Milestone Payment”). The Revenue Milestone Payments were broken down into three installments of \$4,166,667 for each of the 2019, 2020, and 2021 calendar years.

The potential acquisition of Origin House was contemplated by the parties at the time that they negotiated the SPA. Accordingly, the parties negotiated a term into the SPA providing that if there was a change in control of Origin House during the three-year period in which Revenue Milestone Payments could be earned, the Appellants would be paid an “Unearned Milestone

Payment Commitment”, equal to the amount of all future entitlement to Revenue Milestone Payments.

When the Cresco Transaction was announced, it was expected to close before the end of 2019. If this were to occur, the Appellants would be entitled to the entirety of the Revenue Milestone Payments, regardless of whether or not 180 Smoke achieved the specified revenue milestones provided under the SPA.

It subsequently became known, however, that the closing of the Cresco Transaction would be delayed by several months. The Appellants’ acknowledged operating on the assumption that the transaction may not close, and that they would need to meet their revenue targets to be entitled to the Revenue Milestone Payments, despite Origin House’s assurance that there was no reason to doubt that the Cresco Transaction would close. The Appellants further acknowledged that by September 2019, it became clear that there was little or no chance that 180 Smoke would meet its 2019 revenue milestone.

Accordingly, 180 Smoke’s only opportunity to collect the 2019 Revenue Milestone Payment would be if the Cresco Transaction closed in 2019, and the Appellants were paid the Unearned Milestone Payment Commitment for all three years.

Ultimately, 180 Smoke did not meet its 2019 revenue milestone, and due to a weakness in market conditions and Cresco’s difficulty raising capital, the Cresco Transaction did not close until January 8, 2020. As a result, the Appellants were paid the Unearned Milestone Payment Commitment for the years 2020 and 2021 in the total amount of \$8,333,814.51, but did not receive the Revenue Milestone Payment or the Unearned Milestone Payment Commitment for 2019 in the amount of \$4,166,667.

As it turned out, Origin House learned in October 2019 that Cresco was proposing a new closing date for the Cresco Transaction of January 15, 2020, but did not directly disclose to the Appellants that the Cresco Transaction was being deferred to 2020.

Lower Court Decision

The Appellants subsequently brought an application in the Ontario Superior Court of Justice against Cresco, seeking payment of the 2019 Revenue Milestone Payment, in addition to the License Milestone Payment. The Appellants alleged that they were entitled to the 2019 Revenue Milestone Payment pursuant to the terms of the SPA, or in the alternative, that they were deprived of their ability to achieve the 2019 revenue targets or access the Unearned Milestone Payment Commitment due to Origin’s breaches of the SPA and of the contractual duty of honest performance.

In reasons dated March 21, 2022, the application judge determined that the Appellants were not entitled to the claimed payments. After dismissing the Appellants’ claims based on breaches of the SPA, the application judge considered the Appellants’ claims that Origin House breached its duty of good faith in contractual performance.

The Appellants alleged three breaches of the duty, two of which were rejected by the application judge. The application judge, however, found that Origin House breached its duty of honest performance of the SPA by repeatedly advising the Appellants that the Cresco Transaction would close in 2019, and not updating the Appellants when it learned in October 2019 that the Cresco Transaction would not close until January 2020. The application judge did not find that Origin House misled the Appellants, just that it failed to update the Appellants when it received new information regarding the Cresco Transaction.

While finding that Origin House breached its duty of honest contractual performance, the application judge made no award of damages for the breach. Rather, she determined that even had the deferral of closing of the Cresco Transaction been immediately disclosed to the Appellants in October 2019, 180 Smoke would still not have achieved its 2019 revenue target, nor would the Appellants have been able to force the closing of the Cresco Transaction to occur in 2019. The application judge refused to presume damages resulting from the breach, and because there was no evidence of lost opportunity, she held that the Appellants were not entitled to damages.

The Appeal

The Appellants subsequently appealed the application judge's decision to the Court of Appeal for Ontario. Amongst other grounds, the Appellants alleged that the application judge erred in failing to presume loss by the Appellants as a result of Origin Houses' breach of the contractual duty of honest performance. The Appellants relied on paragraph 116 of the Supreme Court's decision in *Callow*, which stated:

[E]ven if I were to conclude that the trial judge did not make an explicit finding as to whether Callow lost an opportunity, it may be presumed as a matter of law that it did, since it was Baycrest's own dishonesty that now precludes Callow from conclusively proving what would have happened if Baycrest had been honest. [Emphasis added]

The Appellants therefore argued that the Court is required to presume damages when a breach of the duty is found, even absent evidence of an opportunity being lost. Applying the presumption from *Callow*, the application judge should have presumed that the Appellants lost the opportunity of obtaining the 2019 Revenue Milestone Payment, and that loss should be compensated in damages.

In response, Cresco argued that the application judge correctly dismissed the Appellants' claim for damages on the basis that there was not an evidentiary foundation for the claim. Even if a lost opportunity is presumed, the evidentiary record must establish what was lost, and how it was lost due to a breach of contract. To hold otherwise would open the floodgates to all manner of speculative claims. Cresco also brought a cross-appeal, seeking to set aside the application judge's finding that Origin House had breached its duty of honest performance of the SPA due to its failure to disclose the deferral of closing of the Cresco Transaction.

Ultimately, the Court of Appeal dismissed the Appellants' appeal, and granted Cresco's cross-appeal. Despite finding that there was no breach of the duty of honest contractual performance, the Court of Appeal still provided detailed analysis as to whether there is a legal presumption of loss when a breach has been established, agreeing with the application judge's finding that there is not.

Analysis

In confirming the application judge's decision on the issue of damages, the Court of Appeal rejected the Appellants' submission that *Callow* requires the Court to presume that the aggrieved party has suffered damages when it has found a breach of the duty of honest contractual performance. Rather the Court of Appeal interpreted *Callow* to place the burden on the claimant to show some evidence of lost opportunity to be entitled to damages.

In addressing paragraph 116 of *Callow*, the Court first noted that the relied upon language was permissive – that it “may” be presumed that the claimant lost an opportunity. Thus, a Court would be entitled to presume that a claimant lost an opportunity, but is not obliged to do so, as alleged by the Appellants.

Second, the Court of Appeal noted that the Supreme Court's finding at paragraph 116 of *Callow* that a loss of opportunity may be presumed was followed by two qualifications. The Supreme Court in *Callow* held that a loss of opportunity may be presumed because (i) it was the breaching party's dishonesty that precluded the other party from (ii) conclusively providing what would have happened.

In terms of the first qualifier, the Court of Appeal found that Origin House's failure to advise the Appellants of the deferred closing of the Cresco Transaction in October 2019 did not in any way preclude the Appellants from proving what would have happened had they been so advised. The factual findings of the application judge established that that by October 2019, there was little or no chance that the Appellants could have hit the 2019 Revenue Milestone, and that there was nothing the Appellants could have done to require the Cresco Transaction close in 2019.

In terms of the second qualifier, the Court of Appeal emphasized the word “conclusively”, noting that the facts in *Callow* were distinguishable from the facts in the matter before it. In *Callow*, the Supreme Court found that there was “ample evidence” of lost opportunity, and that the breaching party's dishonesty precluded the claimant from “conclusively” proving the lost opportunity. In the within matter, the Appellants had no evidentiary foundation of their claim of lost opportunity.

Takeaway

The important takeaway from the Court of Appeal's decision in *Bhatnagar* is that the implications of a breach of the contractual duty of honest performance are no different than any other breach of contract or breach of duty in tort. A Court will not just assume that damages were suffered, and make an award of damages without an evidentiary foundation to support the claim. While an aggrieved party may feel empowered by the Supreme Court of Canada's

decision in *Callow* to advance a claim for breach of the contractual duty of honest performance, it must ensure that it has a sufficient evidentiary basis to prove not only the breach, but the lost opportunity resulting from the breach, before doing so.