

## 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.

## BitTorrent File Sharing and Copyright Infringement: What Evidence is Needed

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BitTorrent is a peer-to-peer file sharing computer communication protocol, and one of the most used protocols for transferring large files, such as movies, over the Internet. It is well suited for transferring large files, due to its capability to first upload and then download bits of large files from a group of large file hosts, instead of from a single host server.

In *Voltage Holdings, LLC v Doe #1*,<sup>1</sup> the Federal Court of Appeal clarified what is required, in evidence, to prove copyright infringement in the context of file sharing. This decision affects the rights of Internet account holders who are named in lawsuits because other people have been using their account to download movies using BitTorrent file sharing software.

Voltage Holdings, LLC is a movie production company and the owner of the copyright to the film *Revolt* (the Work). Voltage detected that Internet users at certain IP addresses were making the Work available using BitTorrent software.

Unauthorized downloading of copyright protected movies using file sharing software is an infringing activity. It has the effect of making the movies available to other members of the public by telecommunication. In this way, file sharing engages the exclusive rights of a copyright owner under s 3(1)(f) and s 2.4(1.1) of the *Copyright Act*.<sup>2</sup>

At issue in the Federal Court of Appeal was whether the trial judge should have granted default judgment for copyright infringement against Internet account holders. There was evidence that the accounts had been used to download a copyright protected movie using file sharing software. But, Voltage, the copyright owner, had no direct evidence that the account holders were the ones that downloaded the movie. On the motion for default judgment, Voltage had argued that an adverse inference should be drawn against the defendant account holders. They had been sent multiple notices of infringement before being sued. The defendants had not defended the case, despite receiving the claim and a reminder. Therefore, Voltage argued, no further evidence was required to obtain default judgment for copyright infringement against them. Voltage asked the trial judge to find that the defendants had either downloaded the movie themselves or that they had authorized the infringing downloads by failing to control the use of their account. Either way, Voltage argued, default judgment should issue. The trial judge refused. The copyright owner appealed.

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<sup>1</sup> 2023 FCA 194

<sup>2</sup> *SOCAN v. ESA*, 2022 SCC 30

The Federal Court of Appeal said that the Internet subscribers cannot be assumed to have downloaded a movie just because there is evidence that their account was used to download a movie. In many cases, it was someone else. Such an assumption would make an Internet subscriber strictly liable for infringing activity on their account. But the person receiving a notice of copyright infringement on their account is entitled to a presumption of innocence. This presumption<sup>3</sup> was the effect of the Supreme Court's ruling in *Rogers Communications Inc v Voltage Pictures, LLC*.<sup>4</sup> To obtain default judgment, the copyright owner is obliged to provide sufficient evidence to support the claim of infringement on a balance of probabilities. The Federal Court of Appeal held that the receipt of multiple notices of infringement and a failure to respond to a claim was not enough:

Posting a work online and inviting others to view it engages the author's authorization right; however, sharing internet access after receiving notices of alleged infringement does nothing to the work in question, and does not therefore engage any copyright interest granted to the author exclusively ...<sup>5</sup>

Similarly, an Internet subscriber is not liable for authorizing infringement merely because they controlled (or failed to control) the Internet account that was used to download a movie. In accordance with the Supreme Court's ruling in *SOCAN v ESA*,<sup>6</sup> authorization of infringement in the context of file sharing of movies is directed to those who make the copyright material available for download. That is the activity that engages a protected copyright interest under s 3(1) of the *Copyright Act*. Allowing others to use an Internet account (which the Court referred to as "third party authorization"), even if the account holder is indifferent to how the account is being used, is not enough to establish liability for "authorizing infringement". The account holder must also be shown to have had control over the person who downloaded the movie, not just control of the account.<sup>7</sup>

In the result, the trial judge's decision not to grant default judgment was upheld. To obtain judgment the copyright owner will have to obtain additional evidence of infringement by the defendant account holders, such as, evidence establishing control over the person who downloaded the movie. This decision is an important development in the law of online infringement and will be of significant interest to Internet account holders who are named in lawsuits alleging copyright infringement based on the use of their account to download movies or other copyright works.

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<sup>3</sup> 2023 FCA 194, paras 61-64

<sup>4</sup> 2018 SCC 38

<sup>5</sup> 2023 FCA 194, paras 74-78, 85

<sup>6</sup> 2022 SCC 30

<sup>7</sup> 2023 FCA 194, paras 82-85

## Artificial Intelligence as Evidence in Civil Proceedings: Practical Perspectives for Litigators

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With the continued advancement and adoption of artificial intelligence (AI) in our daily lives, whether personal or in business, litigators will face an increased need to contend with AI as evidence in disputes. The AI system, including its decisions or determinations, may be the subject of the dispute itself, or the AI output may be adduced in support of a party's position in a case. In this article, we aim to discuss some practical considerations for litigators in preserving, disclosing, advancing and defending challenges against AI evidence in civil proceedings.

### Defining AI and AI Evidence

AI is an “intelligent” machine or computer program powered by mathematical rules or algorithms.<sup>1</sup> From a lay person's perspective, it is a type of technology, but in the world of computer science, AI is “an umbrella term for a number of research topics and underlying technologies aimed at furthering the application of computers to intellectual tasks, as well as the tasks themselves”.<sup>2</sup> “Machine learning”, “deep learning” and “language models” are types of these underlying technologies that make possible a number of AI applications currently in use across sectors.<sup>3</sup>

Many scholars have criticized the use of “intelligence” to describe lines of code.<sup>4</sup> This criticism can be reconciled by distinguishing between “weak AI” – like the various personal assistant applications we now use in our daily lives to turn lights on, choose music, navigate local streets, etc. – and “strong AI,” quasi-human level artificial intelligence which does not yet exist.<sup>5</sup>

Regardless of the type of AI system, for the purpose of our article, we refer to “AI evidence” as “evidence generated by AI.” Since this evidence is recorded in the form of electronic data,

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<sup>1</sup> John McCarthy, “What is Artificial Intelligence?” (12 November 2007), Stanford University, <https://www-formal.stanford.edu/jmc/whatisai.pdf> at p 2.

<sup>2</sup> Paul W. Grimm, Maura R. Grossman, and Gordon V. Cormack, “Artificial Intelligence as Evidence,” 19 Nw J Tech & Intell Prop 9 (2021) at p 10, <https://scholarlycommons.law.northwestern.edu/njtip/vol19/iss1/2>.

<sup>3</sup> IBM, “What is artificial intelligence (AI)?” (2023), <https://www.ibm.com/topics/artificial-intelligence>.

<sup>4</sup> See philosopher John Searle's famous “Chinese Room” argument. Searle argues that, in the same way a person instructed to respond using certain Chinese characters would not necessarily understand Chinese, a machine executing commands does not understand the import of what it is doing. John Searle, “Minds, Brains and Programs” (1980), *Behavioral and Brain Sciences* 3 (3): 417-457. doi:10.1017/S0140525X00005756.

<sup>5</sup> IBM, “What is artificial intelligence (AI)?”, *supra* note 3.

AI evidence also falls within the definition of digital evidence, or an “electronic record” under the *Evidence Act*.<sup>6</sup>

### AI Evidence in Civil Proceedings

Despite the present novelty of AI evidence, our existing rules of civil procedure and laws of evidence should assist litigators in addressing the challenges stemming from the use of such evidence in the context of civil disputes. In the US, for example, it has been argued by some authors that the Federal Rules of Evidence are sufficient to address AI evidence, so long as judges pay special attention to an AI system’s validity (its ability to do what it was designed to do) and reliability (its ability to produce consistent results when applied to similar inputs).<sup>7</sup> In the same vein, the Law Commission of Ontario (LCO) concluded in 2022 that, in the “short term,” Ontario’s *Rules of Civil Procedure* (*Rules*) and the laws of evidence did not require reforms outside of addressing the length and cost of “AI-based civil proceedings,” which “rais[e] concerning questions about access to justice for all but the best-funded litigants.”<sup>8</sup> The LCO rightfully identifies the importance of monitoring the law to consider whether AI-specific changes to the *Rules* and law of evidence should be made.<sup>9</sup>

The required level of scrutiny to be placed on AI evidence will depend on the nature of the case. The level of scrutiny should be at its highest when the AI system itself is the subject of the dispute. For example, a claim may center around an alleged defect in an AI system causing personal injury and economic loss to a plaintiff or a class of plaintiffs. In such cases, counsel will need to become, practically speaking, an expert on the AI system itself in order to drive strategy in proving the alleged defect or defend against such allegations. Counsel will want to grapple early on with issues such as AI evidence preservation, collection, and disclosure, and will be greatly assisted by leveraging qualified third-party experts to inform the evidentiary process and protect their client’s interests. On the other end of the spectrum are cases where AI systems are being relied upon as evidence in support of legal arguments. In such cases, counsel will need to be adept at challenging or defending the use of AI evidence at trial. In the latter example, the scrutiny required to determine admissibility may not implicate the entire AI system. In this circumstance, the focus of the scrutiny may be on one aspect of the AI system, for example whether bias in the data used by the AI system impacts the reliability of the outcome generated by the AI system.

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<sup>6</sup> *Evidence Act*, RSO 1990, c E.23, s 34.1(1): “‘electronic record’ means data that is recorded or stored on any medium in or by a computer system or other similar device, that can be read or perceived by a person or a computer system or other similar device...”

<sup>7</sup> Grimm et al., “Artificial Intelligence as Evidence,” *supra* note 2.

<sup>8</sup> Law Commission of Ontario, *LCO Final Report: Accountable AI*, June 2022, [https://www.lco-cdo.org/wp-content/uploads/2022/06/LCO-Accountable\\_AI\\_Final\\_Report.pdf](https://www.lco-cdo.org/wp-content/uploads/2022/06/LCO-Accountable_AI_Final_Report.pdf) at p 75 [*Accountable AI*].

<sup>9</sup> *Ibid* at p 79.

### *Preservation*

The technical complexities of AI evidence require parties and prospective parties in litigation to take due care in discharging their evidentiary preservation obligations. The duty to preserve entails taking “reasonable and good-faith steps to preserve potentially relevant electronically stored information” relevant to a pending or reasonably anticipated litigation.<sup>10</sup> In the context of AI evidence, this may well require early involvement of third-party experts to assist with educating counsel on the AI technology itself and identification of relevant evidence that will be required to be preserved. This may include the source code, data used to build and test the underlying algorithm, validation data, summary of error codes, internal and external studies undertaken prior to commercializing the AI technology, and associated manuals and guidelines that may accompany the specific technology.<sup>11</sup> Importantly, these efforts in the context of AI evidence may also necessitate the preservation of associated hardware and software required to interpret such AI evidence. The *Ontario Guidelines on Preservation of Electronic Documents* may well be of assistance to inform the preservation process for counsel.<sup>12</sup> A key consideration in this regard is ensuring that counsel issue appropriate instruction to their client to suspend personal practices that could somehow compromise the integrity of the AI system and/or lead to destruction of necessary evidence.

### *Discovery and Production*

Relevance and proportionality are the two guiding principles in the context of disclosure obligations in civil disputes. In Ontario, Rule 30.02(1) specifically requires parties to a dispute to make disclosure of every “document” relevant to any matter in issue in the action that is in their power, possession, or control. The *Rules* define “document” to include “data and information in electronic form”. Further, the *Rules* define “electronic” as including documents “created, recorded, transmitted, or stored in digital form or in other tangible form [...]”.<sup>13</sup> The disclosure obligation under the *Rules* does not however extend to “fishing expeditions” or production of documents relevant only to the issue of credibility.<sup>14</sup>

The principle of proportionality informs the extent of disclosure obligations and requires a recognition that the time and expense related to any civil proceeding must be proportionate both to the quantum of damages and the importance of the issues in dispute.<sup>15</sup> As demonstrated in the case of *SecurityinChina International Corp v Bank of Montreal*, the Court will consider

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<sup>10</sup> The Sedona Conference, *The Sedona Canada Principles Addressing Electronic Discovery, Third Edition*, 23 Sedona Conf J 161 (2022) at p 190, Principle 3, 2022 CanLII Docs 1167. See *Rules of Civil Procedure*, RRO 1990, Reg 194, r 29.1.03(4): “In preparing the discovery plan, the parties shall consult and have regard to the document titled ‘The Sedona Canada Principles Addressing Electronic Discovery’ developed by and available from The Sedona Conference.”

<sup>11</sup> Jesse Beatson, Gerald Chan, and Jill R. Presser, *Litigating Artificial Intelligence* (Toronto: Emond Publishing, 2020), Chapter 3, “Algorithmic Technology and Criminal Law in Canada,” p 152, fn 353.

<sup>12</sup> Ontario Bar Association, *Guidelines for the Discovery of Electronic Documents in Ontario* (2004), online: [http://www.oba.org/en/pdf\\_newsletter/E-DiscoveryGuidelines.pdf](http://www.oba.org/en/pdf_newsletter/E-DiscoveryGuidelines.pdf).

<sup>13</sup> *Rules of Civil Procedure*, RRO 1990, Reg 194, r 1.03(1).

<sup>14</sup> *SecurityinChina International Corp v Bank of Montreal*, 2019 ONSC 7183 at para 8 [*SecurityinChina*].

<sup>15</sup> *Meuwissen v. Perkin*, 2013 ONSC 2732 at para 48.

the principle of proportionality in the context of production motions. The case dealt with alleged unauthorized access to the plaintiff's account leading to 87 alleged unauthorized transfers out of the plaintiff's account, totalling approximately \$150,000 over a ten-month period. The plaintiff's disclosure request also included production of documents related to the defendant's security system applied to its website, which was interpreted as "conceivably" including "disclosure of the bank's software coding and algorithms." In refusing this request, the Court found that at the stage in the proceeding such request was both premature and disproportionate to the damages at stake.<sup>16</sup> Further, the Court also identified the grave risks associated with such disclosure for the defendant, which were viewed as incapable of being alleviated through a confidentiality agreement or a sealing order.

As highlighted in *SecurityinChina International Corp*, counsel may consider seeking a sealing order<sup>17</sup> or confidentiality agreement as part of any disclosure associated with an AI system. In fact, in the context of a motion for production of data associated with an owner's AI system, the party defending such a motion may well wish to bring a cross-motion to protect such interests in the event the Court orders disclosure of the requested AI system records.

Where the relevant AI evidence sought to be produced is not in the possession, power, or control of the parties to the litigation, counsel will want to carefully consider the appropriateness of a motion to compel third party productions.<sup>18</sup> Given the complexities associated with AI systems and the potential that third party owners of such systems do not reside in Canada, parties may well wish to engage in such efforts early on in the proceeding and well in advance of trial.

#### *Authentication and Admissibility of AI Evidence*

The complexities of the AI system and the evidence it generates will require close examination for the party seeking to admit or challenge the admissibility of such evidence at trial.

Authenticity, while generally a low threshold, should not be taken for granted in the context of AI evidence. Ultimately, the person seeking to introduce AI evidence has the burden of proving that such evidence is what the person purports it to be.<sup>19</sup> This can be established either by direct evidence – *i.e.* testimony or affidavit – or circumstantial evidence.<sup>20</sup> The Ontario *Evidence Act* also codifies the "best evidence rule" for electronic documents – that the evidence "accurately reflects the original information that was input" into the record.<sup>21</sup> The best evidence rule can be satisfied by proving the "integrity of the electronic record" or the system in which it was stored.<sup>22</sup> This may require leading evidence about what information was

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<sup>16</sup> *SecurityinChina*, *supra* note 14 at para 28.

<sup>17</sup> See the well-known test from *Sierra Club of Canada v. Canada (Minister of Finance)*, 2002 SCC 41 at para 53.

<sup>18</sup> See *Rules of Civil Procedure*, RRO 1990, Reg 194, rr 30.10, 31.10.

<sup>19</sup> *Evidence Act*, RSO 1990, c E.23, s 34.1(4).

<sup>20</sup> Gerald Chan and Susan Magotiaux, *Digital Evidence: A Practitioner's Handbook* (Toronto: Emond Montgomery, 2018) at 165 [*Digital Evidence*].

<sup>21</sup> David M. Paciocco, "Proof and Progress: Coping with the Law of Evidence in a Technological Age" (2013) 11:2 CJLT 181 at 193, <https://digitalcommons.schulichlaw.dal.ca/cjlt/vol11/iss2/1/>.

<sup>22</sup> See *Evidence Act*, RSO 1990, c E.23, ss 34.1(5)-(10).

inputted into an algorithm to generate the result being led, as well as how that subsequent result was electronically stored, and protected from any risk of being manipulated.

Authentication may, however, be particularly complicated in the case of AI evidence generated through machine learning or deep learning, where the system itself led to the creation of such evidence outside the parameters set by its programmers. In such contexts expert evidence may prove useful to challenge the authenticity of AI evidence.

Although in the context of a judicial review in Federal Court, the recent decision in *Barre v Canada (Citizenship and Immigration)*, serves as a reminder of the importance of challenging authenticity.<sup>23</sup> In that case, two Somali women were stripped of their refugee status on grounds of fraud, relying on photos that compared the women with two Kenyans admitted on student visas. The applicants objected to such photographic evidence on grounds that the Canada Border Services Agency failed to disclose the source of the photo comparison and asserted that the Minister used facial recognition software in this process.

On review, Justice Go was critical of the lack of disclosure of “the methodology used in procuring the evidence” to respond to claims that the photo comparison was based on an AI-generated photo comparison or otherwise.<sup>24</sup> Justice Go also highlighted the “danger of relying on facial recognition software.”<sup>25</sup> If this AI technology was indeed used, Justice Go held, “it may call into question the reliability of the Kenyan students’ photos as representing the Applicants, two women of colour who were viewed as being more likely to be misidentified by facial recognition software than their white cohorts as noted by the studies submitted by the Applicants.”<sup>26</sup> Indeed, a 2018 paper found that facial recognition technology has an error rate up to 34% higher for darker-skinned females, compared to lighter skinned males.<sup>27</sup>

The rule against hearsay<sup>28</sup> also has application to AI evidence. While some computer data is entirely auto-generated, and therefore is not an “out-of-court statement,”<sup>29</sup> most AI systems require a human to input data to produce a result. Thus, to avoid the hearsay rule, counsel may wish to make available the individual who inputted the data to provide that evidence directly, and be made available for cross-examination.

But even if AI evidence is otherwise admissible, a court can exclude it if it is more *prejudicial* to a party than *probative* of the issues.<sup>30</sup> Prejudice is an area that counsel will want to carefully consider in the context of AI evidence, particularly where one is able to establish inherent bias

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<sup>23</sup> *Barre v. Canada (Citizenship and Immigration)*, 2022 FC 1078 [*Barre*]

<sup>24</sup> *Ibid* at para 31.

<sup>25</sup> *Ibid* at para 46.

<sup>26</sup> *Ibid* at para 56.

<sup>27</sup> Joy Buolamwini and Timnit Gebru, “Gender Shades: Intersectional Accuracy Disparities in Commercial Gender Classification,” *Proceedings of Machine Learning Research* 81:1-15, 2018 Conference on Fairness, Accountability, and Transparency, <http://proceedings.mlr.press/v81/buolamwini18a/buolamwini18a.pdf>.

<sup>28</sup> Out-of-court statements adduced for the truth of their contents with no opportunity for contemporaneous cross-examination: *R. v. Khelawon*, 2006 SCC 57 at para 35.

<sup>29</sup> Chan and Magotiaux, *Digital Evidence*, *supra* note 20 at 176.

<sup>30</sup> David Paciocco & Lee Stuesser, *The Law of Evidence*, 2d ed (Toronto: Irwin Law, 1999) at 26-29.

in the data used by the AI system to generate a particular outcome, and said bias is relevant to the matters in issue.

Finally, much AI evidence may well need to be introduced through expert opinion – or arguably, the AI evidence itself might constitute opinion evidence. The AI evidence would thus need to follow the criteria for admissibility of expert evidence set out in *R v Mohan*.<sup>31</sup> As the LCO wrote:

When litigating an AI system - particularly anything more complex than a very basic algorithm - the proceedings risk becoming a battle of experts. Depending on the issue at hand, experts could be required to explain the source code of an AI system, the data the system relies on, the training method, the factors and their weighting, scoring, validation, efforts at correction for bias and discrimination, maintenance, and explainability of a particular system.<sup>32</sup>

Further, per *Mohan*, “expert evidence which advances a novel scientific theory or technique is subjected to special scrutiny to determine whether it meets a basic threshold of reliability and whether it is essential in the sense that the trier of fact will be unable to come to a satisfactory conclusion without the assistance of the expert. The closer the evidence approaches an opinion on an ultimate issue, the stricter the application of this principle.”<sup>33</sup> Thus, AI evidence, which often evinces a novel scientific theory or technique, is more likely to be subjected to special scrutiny by the trier of fact.

When evaluating the soundness of AI generated evidence, counsel may want to consider challenging such evidence by considering:

- (a) whether the AI system has been sufficiently tested;
- (b) whether the AI system has been subjected to peer review and publication;
- (c) the known or potential rate of error or the existence of applicable standards; and
- (d) whether the AI system’s reliability is generally accepted.<sup>34</sup>

### **Concluding Remarks**

The increased use of AI technology in our daily lives is likely to result in a proliferation of AI evidence in disputes and, therefore, in our courts. This will call on litigators to properly address the use of such evidence within the framework imposed by our existing laws of evidence, the *Rules*, and the jurisprudence. Whether the proliferation of such evidence will require specific changes to the current framework remains to be seen. In the meantime, litigators are best to engage with this type of evidence by doing what they do best: asking detailed questions and educating themselves about the technology they are confronting or attempting to rely upon.

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<sup>31</sup> *R v Mohan*, 1994 CanLII 80 (SCC), [1994] 2 SCR 9 at 20.

<sup>32</sup> Law Commission of Ontario, *Accountable AI*, *supra* note 8 at p 78.

<sup>33</sup> *R v Mohan*, *supra* note 31 at 25.

<sup>34</sup> Adapted from *R v J.-L.J.*, 2000 SCC 51, [2000] 2 SCR 600 at para 33, citing *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 US 579 at 593-94 (1993). See also Grimm et al., “Artificial Intelligence as Evidence,” *supra* note 2.

## Not Your Ordinary Cup of (Bubble) Tea: The Fickle Nature of Motions for Interlocutory Injunctive Relief

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As lawyers well know, to obtain an interlocutory injunction, the moving party will have to meet the well-established three-part test established by the Supreme Court of Canada in *RJR-MacDonald Inc v Canada*, [1994] 1 SCR 311, 333-34 (the "RJR-MacDonald test"):

1. Is there a serious issue to be tried?
2. Will the moving party suffer irreparable harm if the injunction is not granted; that is harm that cannot be compensated by damages?
3. Does the balance of convenience lie in favor of granting the injunction?

In the context of a franchisor/franchisee relationship, often it is the franchisor which seeks injunctive relief to prevent the continued operation of the (franchised) business by a (former) franchisee. However, there are instances in which a franchisee will seek injunctive relief against the franchisor. In this context, proof of irreparable harm, *i.e.*, harm which cannot be compensated by damages, is sometimes difficult to establish. The recent decision of 9925350 Canada Inc. and Hong Thuy Thi Nguyen (the "Plaintiffs") and Kevito Ltd. (the "Franchisor") is one example of the kind of evidence that a franchisee needs to assert in order to overcome this difficulty.

### BACKGROUND FACTS

The Plaintiffs had entered a franchise agreement dated November 10, 2016, with the Franchisor (the "FA") for the operation of a Chatime bubble tea franchise. The Chatime location operated by the corporate Plaintiff (the "Franchisee") was one of the most profitable locations in the Chatime system.

Over the course of several months in late 2020, and early 2021, the Franchisor conducted several inspections of the Franchisee's business. It is perhaps trite to state that franchise systems generally require that a franchisee adhere to the franchisor's standards and methods of conducting the franchised business, which standards and methods can be varied over the course of time. In this regard, the Franchisor's system was no different than any other franchise system. As a result of these inspections:

- A) the Franchisor alleged various breaches of the Franchisor's system standards including, *inter alia*, breaches of health and safety standards;

- B) a full-time inspector was stationed at the Franchisee's business to cure breaches of the system standards "in real time".
- C) additional financial obligations, and associated legal fees, were imposed on the Franchisee, which the Franchisee challenged;
- D) the relationship between the Franchisor and the principal of the Franchisee deteriorated; and
- E) the Franchisor took steps to terminate the FA and take over the Franchisee's location.

The Plaintiffs therefore moved for an interlocutory injunction preventing the Franchisor from terminating the FA and interfering with the Franchisee's franchise business pending a judgment on the merits.

### **THE PARTIES ARGUMENTS**

The Plaintiffs asserted that the Franchisor:

- A) was required to interpret the Franchisee's obligations, as set forth in the FA and the manual, consistent with its statutory duty of fair dealing in section 3 of the *Arthur Wishart Act (Franchise Disclosure) 2000*, SO 2000 c 3;
- B) had a duty of honesty in the performance of contractual obligations as set forth in the Supreme Court of Canada decision in *Bhasin v Hyrnew*, 2014 SCC 71; and
- C) intended to take over the Franchisee's profitable location without properly compensating the Franchisee.<sup>1</sup>

The Franchisee alleged that the Franchisor's conduct resulted in breaches of these statutory and common law duties. Examples cited by the Franchisee included breaches asserted by the Franchisor's inspectors noting that the floor of the shop was wet right after a customer had walked in and out on a rainy or snowy day.

The Franchisor asserted:

- A) that it was merely trying to enforce its system standards;
- B) that it was trying to protect its trademarks and brand standards, and by contrast the Plaintiff would suffer no reputational or livelihood loss; and

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<sup>1</sup> The Chattime FA, like most franchise agreements, permitted the franchisor, upon termination, to purchase the assets of the franchised business at their undepreciated capital cost, *i.e.*, without any component for the goodwill of the business.

- C) Further, the Franchisor argued that the case was nothing more than a fight about money and so there was no basis for interlocutory injunctive relief. If the Franchisee was successful at trial, it could be compensated by damages.

### THE DECISION

The court held that the “serious question” aspect of the RJR-Macdonald test was, in this instance, at the lower end of the threshold issue since the injunction was being sought to challenge whether the Franchisor had acted in good faith in trying to terminate the Franchisee. On this basis, the court concluded that preservation of the *status quo* so that there was something left for the parties to fight about at trial was the best outcome.

On the issue of irreparable harm, the court relied on several decisions which recognize that:

...where a failure to grant an injunction will result in the destruction of a business, irreparable harm will ensue regardless of whether a claim in damages is part of the plaintiff’s case: *Bark & Fitz Inc. v 2139138 Ontario Inc*, 2010 ONSC 1793, at paras 30-33. Courts in Ontario have for some time acknowledged that termination of a franchise, with its attendant loss of profits and business reputation for the owner, constitutes irreparable harm: *TDL Group Ltd. v. 1060284 Ontario Ltd.* (2001), 15 OAC 354. Moreover, the fact that the Defendant says that upon its takeover it will continue to operate the franchise out of its present location is no answer to the fact that the Plaintiffs will have had their own business undermined: *Golden Globe Pizza Inc. v. Domino’s Pizza of Canada Ltd*, 2010 BCSC 356, at para 19.<sup>2</sup>

Further, the court concluded that the point of the interlocutory injunction is whether:

... if no interlocutory injunction is granted, the business owner will have this business to come back to if her position is vindicated at trial.... The nature of the relationship between the parties is such that the franchisor holds the cards. It is necessary for the franchise to be preserved in the franchisee’s hands pending trial if the trial itself is not to be rendered in some respect moot by the franchisee’s irretrievable loss of the business.

Finally, in terms of the balance of convenience, the court was persuaded that permitting the Franchisee to continue to operate pending trial would not result in any harm to the franchise system.

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<sup>2</sup> This should be contrasted by the decision of the court in *2403744 Ontario Inc. v. Canadian Ice Cream Company Inc.* (unpublished). In that case, the franchisee brought a motion for an interlocutory injunction to prevent the termination of a franchise agreement, which the franchisee alleges was improperly terminated. The court stated that to find the franchisee’s assertion of irreparable harm valid that the court would have to determine whether the Franchisee had the right to continue to operate the franchised business, which was beyond the scope of the court, and that the harm could be compensated by damages.

For the reasons set forth above, the court restrained the Franchisor from:

- A) terminating or acting upon its purported termination of the Franchisee's business;
- B) interfering with the continued operation of the Franchisee's business; and
- C) carrying out inspections, absent specific leave of the court to the contrary, unless they were at pre-determined and pre-announced intervals which do not exceed the frequency and duration of inspections carried out by the Franchisor for most of its other franchisees.

### **CONCLUSION**

While not concluding that the Franchisor was attempting to expropriate the Franchisee's business without properly compensating the Franchisee, the court did find that there was some merit to the Franchisee's suspicions. Reading between the lines, the court likely formed the view that the Franchisor had improper or ulterior motives in trying to terminate the franchise relationship. As lawyers, we all have an obligation to try to identify, and inform, our clients when their conduct falls outside their statutory and common law good faith obligations of fair dealing and honesty in the performance of contractual relations. Although I have not discussed this case with Franchisor's counsel, given the respect that I have for the firm I can only assume that the Franchisor's counsel advised the Franchisor of its conduct and how this conduct might be interpreted by a court. It is too bad that the Franchisor did not listen to the advice of its counsel.