

Suppliers' termination obligations clarified in Cellular Baby decision

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Author: Paul Kotschorek

In its recent decision *Cellular Baby Cell Phones Accessories Specialist Ltd. v. Fido Solutions Inc.*, 2017 BCCA 50, the British Columbia Court of Appeal provided guidance for suppliers seeking to terminate dealer agreements. The Court's decision emphasizes the importance of exercising contractual termination rights within a reasonable period of time, and affirms that the duty to mitigate losses upon termination does not require a party to release claims it may have against a wrongdoer.

Background

Cellular Baby entered into a dealership agreement with Fido in 2003. Under the standard form agreement, Fido could immediately terminate the contract with written notice if Cellular Baby failed to meet specific performance criteria for any three quarters in a calendar year.

At first, Cellular Baby enjoyed significant success, and by 2009 provided roughly 27% of Fido's total sales. In 2010, Cellular Baby failed to achieve its performance quotas. However, while Fido sent perfunctory emails to Cellular Baby noting its underachievement, it did not overtly reserve its right to bring any remedial action.

By February 2011, Fido had the right to terminate the dealership agreement due to Cellular Baby's underperformance. Yet, it continued to do business with Cellular Baby until September 2011, pursuant to the agreement's terms. In late September 2011, Fido terminated the dealership agreement with Cellular Baby, but extended the effective termination date in order to allow Cellular Baby time to sell its business.

Over the extension period, Cellular Baby received an offer to purchase from Pepper Wireless for approximately \$1.6 million. As a condition for approving this sale, however, Fido insisted that Cellular Baby release it from any future liability. When Cellular Baby refused to do so, the potential sale to Pepper Wireless evaporated and Fido terminated the dealership agreement.

Cellular Baby sued Fido for wrongful termination, claiming damages for lost profits over the remaining term of the agreement and the lost opportunity to sell the business as a going concern. Fido counterclaimed for unpaid inventory, for approximately \$300,000.

The trial judge found that Fido had wrongfully terminated the agreement, holding that Fido's right to terminate the agreement "immediately" required it to exercise that right within a reasonable period of time. However, he also held that Cellular Baby failed to mitigate its losses by declining to sell to Pepper Wireless. As such, he awarded only nominal damages of \$500.

Cellular Baby appealed this decision, arguing that the trial judge had erred in his finding on mitigation and in his assessment of damages. Fido cross-appealed, alleging that the trial judge erred in finding it had wrongfully terminated the dealership agreement. Fido argued that its delay in exercising its right to terminate Cellular Baby for contractual breach did not constitute a waiver of that right.

Decision of the B.C. Court of Appeal

The Court of Appeal agreed with the trial judge that Fido had wrongfully terminated the dealership agreement by failing to exercise its termination rights within a reasonable period of time. Fido's decision to wait eight months before terminating the dealership agreement was found unreasonable in the circumstances. By late September 2011, Fido had lost the right to terminate the agreement for Cellular Baby's underperformance in 2010.

The Court of Appeal further held that Cellular Baby had lost the opportunity to sell its business as a going concern as a result of Fido's wrongful termination. Relying on previous case law regarding the availability of damages of lost opportunities, the Court of Appeal found Cellular Baby had shown, with some degree of certainty, that it had lost the opportunity to sell its business due to Fido's wrongful termination of the dealership agreement. While the exact value of the lost opportunity was uncertain, any ambiguity had to be resolved in the plaintiff's favour. The Court awarded significant damages to Cellular Baby, amounting to \$2,184,000.

Reversing the trial judge, the Court of Appeal found that Cellular Baby had acted reasonably to mitigate its damages, and that the award was not reduced for any failure to mitigate. The Court emphasized that it might have reached a different conclusion had Fido not made the potential sale of Cellular Baby's business conditional on it providing a release from all future liability. It would not be fair to allow Fido to demand that Cellular Baby release all future claims against it as a condition for approving a sale to a third party. While Cellular Baby had an obligation to take reasonable steps to attempt to mitigate its damages, this duty did not require it to release Fido from future liability.

Practical takeaways

The British Columbia Court of Appeal's decision provides some practical considerations for suppliers deciding whether or not to terminate a dealership agreement:

- The duty to mitigate does not require a party to release claims it may have against a wrongdoer.
- Exercise termination rights in a reasonable amount of time. If your dealership agreement permits you to terminate immediately for cause, it is best not to delay in exercising this right. While "immediately" is not explicitly defined in its decision, the B.C. Court of Appeal held that, in the factual circumstances of this case, eight months was too long to wait.
- Provide warnings before exercising termination rights. To defend against possible allegations of bad faith in termination, inform your dealer of performance issues (ideally in writing) and provide it with the opportunity to remedy these issues before terminating the dealership agreement.
- Ensure your termination letter is factually accurate. In this case, the Court of Appeal noted that Fido's termination letter contained a number of factual inaccuracies (i.e., no warnings

had been provided to Cellular Baby in advance of termination). Courts will look skeptically at claims made in termination letters which cannot be clearly evidenced.