Claim No: 347333

IN THE SMALL CLAIMS COURT OF NOVA SCOTIA
Cite as: Sloke Foods Ltd. v. Frederick, 2011 NSSM 45

BETWEEN:

SLOKE FOODS LTD.

Claimant

- and -

TAMMY FREDERICK and SCOTT FREDERICK

Defendants

REASONS FOR DECISION

BEFORE

Eric K. Slone, Adjudicator

Hearing held at Halifax, Nova Scotia on June 7, 2011

Decision rendered on June 20, 2011

APPEARANCES

For the Claimant James Enman, counsel

For the Defendant Erin Cain, counsel

BY THE COURT:

[1] This is a claim for the balance owing on a Promissory Note arising out of the sale of a restaurant.

[2] The Claimant, Sloke Foods Ltd. (“Sloke”) is one of (at least) two companies owned and operated by brothers Rick and Derek Swinemar (“the Swinemars”) and their families. The other of their companies that figures into this case is Big Red’s Enterprises (1990) Limited (hereafter “BREL”.)

[3] The Defendants are husband and wife. The Defendant Tammy Frederick (“Tammy”) was the one more actively involved in this matter as she is an experienced restauranteur and was the active participant in the restaurant business.

[4] Big Red’s is a well-recognized chain of pizza restaurants operating in Nova Scotia, which brand was founded by the Swinemars more than thirty years ago. BREL is the Swinemar’s company which franchises the Big Red’s name and business model.

[5] In late 2007, Sloke was operating a fully-equipped Big Red’s restaurant in Tantallon as a company store (i.e. not franchised). Tammy was operating “Fredies Fantastic Fishhouse” in Bayer’s Lake, and was looking to add another location. She had roots in the Tantallon community and entered into negotiations to buy the Tantallon Big Red’s from Sloke. The idea was that it would become a Fredies, featuring certain Big Red “signature” menu items.

[6] The deal was structured as an asset sale with no money down, financed by a Promissory Note (“the note”). The price was $100,000.00 plus an additional amount for inventory, which amount was not known at the time the deal was first struck but was later inserted into the note. The parties to the Asset Purchase Agreement were Sloke and the Defendants. A Modified Franchise Agreement was also entered into between the Defendants and BREL. Both sides of the transaction were legally represented.

[7] The text of the Promissory Note was:

PROMISSORY NOTE

Date of issue: February 1, 2008

TO: Sloke Foods Ltd.

For value received, the undersigned, Tammy Frederick and Scott Frederick (the "Borrower"), promises to pay to or to the order of the Holder where specified by the Holder, the principal amount specified below ("Principal").

The following are the terms and conditions of the note:

1. Principal: One Hundred and Three Thousand Six Hundred and Thirty One Dollars and Fifty-Eight Cents ($103,631.58).

2. Payment: The Principal shall be repaid in Forty Eight (48) monthly instalments of One Thousand Five Hundred Dollars ($1,500) each commencing March 1, 2008, and on February 1, 2012 the balance remaining to be paid in full. The first three monthly payments are to be interest only payments.

3. Interest Rate: Interest shall accrue on the outstanding principal balance from time to time at the Canadian Imperial Bank of Commerce commercial prime lending rate plus 1% per annum.

4. Presentment: The Borrower hereby waives presentment, demand, notice of dishonour, notice of protest, notice of nonpayment and any other notice required by law to by given to any obligor on this note in connection with the delivery, acceptance, performance, default or enforcement of this note.

Signed as of the date first above written

(Witnessed) (Signed) Tammy Frederick
(Signed) Scott Frederick

[8] Tammy operated the restaurant for approximately a year, and made the required $1,500.00 monthly payments on the note. In round terms, this would have left approximately $85,000.00 still owing on the note.

[9] In early 2009, she approached the Swinemars about possibly selling the business to her cousin Matthew Ryan and his wife Judy ("the Ryans.") As Tammy explained at trial, she was exhausted trying to run two restaurants, and the Ryans were experienced in the restaurant business (as employees, not owners) and were eager to get into restaurant ownership.

[10] The Swinemars testified, and I accept that they were not enthusiastic about this development, but in the end they went along with it and the Ryans became the new operators of the Tantallon location. There is no dispute that the Ryans commenced making payments of $2,000.00 per month, and did so for almost two years until they essentially threw in the towel and abandoned the business amidst much acrimony and recriminations all around. Money was still owed on the original purchase price as contained in the Promissory Note.

[11] The threshold question for me to answer is whether the events of 2009, and/or subsequent events, had the effect of releasing the Defendants from their

obligations to Sloke under the note. Depending on the answer to that question, there may be further issues to decide.

[12] The Swinemars on behalf of Sloke say that the Defendants were never released from their obligations. The Defendants contend otherwise, relying principally on a document entitled "Mutual Release" which was created on March 24, 2009, in connection with the transfer to the Ryans. That document reads:

MUTUAL RELEASE

IN CONSIDERATION of the payment of the sum of One Dollar ($1.00) and other valuable consideration, by each to the other, receipt whereof is hereby acknowledged.

THE UNDERSIGNED hereby for themselves, their successors and assigns do each,

(i) release and forever discharge the other (herein referred to as the "Releasee") from any action, cause of action, or claim with respect to the franchise agreement dated the 1st day of February, 2008 (the " Franchise Agreement").

(ii) declares that he/she/it waives its interest in the Agreement, to the effect that the Agreement has been terminated.

(iii) Tammy Frederick and Scott Frederick agree that the provisions in the Franchise Agreement with respect to confidentiality of the franchisor's confidential information and with respect to non-competition against the franchisor shall continue and be honoured by them for a period of 10 years from this date.

Signed this 24 day of March, 2009.
In the presence of:

Big Red's Enterprises (1990) Limited
per Rickey Swinemar (signed)

Tammy Frederick (signed)

Scott Frederick (signed)

[13] The Defendants were not legally represented in connection with the transfer of the business to the Ryans, or in connection with the document that

they say has the effect of releasing them from their obligations under the Promissory Note.

[14] It was pointed out to the Defendants on cross-examination that this release document is from BREL, and that Sloke is not a party thereto. Tammy, in particular, was forceful in her testimony to the effect that Rick Swinemar told her that this document had the effect of completely releasing her and her husband from the Promissory Note. She says that she relied on that assurance. She says also that because the original transaction involved both BREL and Sloke, and that the Asset Purchase Agreement required them to enter into a franchise agreement, that this essentially meant that a release by one was a release by both. Tammy was also adamant that she would not have sold the business to the Ryans had she believed that she would still be liable on the note.

[15] Both of the Swinemar brothers were adamant in turn that they had no intention of releasing the Defendants from the debt to Sloke, and never said that they would. They testified that the reason that they were originally willing to finance the sale of the restaurant to the Defendants, with no money down, was because they knew them to be people of substance, with assets that included a home and a business (Fredies). On the other hand, there was nothing to indicate that the Ryans had any assets to back up such a debt.

[16] The evidence before me did not include any other documentation in connection with the transfer to the Ryans. That is not to say that it does not exist; in fact, I am certain that some of it does. We know that the Ryans paid the Defendants $25,000.00 when they took over, which Tammy explained was to compensate her for some of the improvements that she had made during her year in the store, and for franchise rights to Fredies. Apparently there was some

form of franchise agreement between the Ryans and the Defendants in connection with the Fredies brand, and also an agreement between BREL and the Ryans in connection with Big Red's.

[17] What is missing (from the court record) is any sale document between the Defendants and the Ryans. One would expect something showing the business terms of the deal, including (if applicable) a covenant on the part of the Ryans to assume payments to Sloke. One might also expect something between Sloke and the Ryans binding the Ryans to making such payments.

[18] I do not draw any adverse inferences from the absence of such documentation, but it forces me to make findings as if such documentation does not exist.

The meaning of the Mutual Release

[19] On its face the Mutual Release does not mean what the Defendants contend. Sloke is not a party to the document. To suggest, as the Defendants have done, that this is a mere technicality - because the Swinemars are the principals of both BREL and Sloke - ignores the legal fact that a company is a separate legal entity with rights and obligations separate from its owners or related entities.

[20] A release from the note in favour of Sloke would have to come from Sloke. It did not. As such, the Defendants are simply not released by the Mutual Release document.

[21] The case law supplied by counsel for the Defendants does not really assist, given the facts of the case here. The case of *Ewachniuk Estate v. Ewachniuk* [2011] B.C.J. No. 580 (B.C.S.C.) essentially says that a party can release another from the debt referenced in a promissory note, by mutual agreement. The key distinction here is that there is nothing to indicate that Sloke was offering any such agreement.

[22] In my opinion, the only other way the Defendants might be released would be if clear representations to that effect were made to them by the Swinemars, who were the principals of Sloke, which might give rise to some form of an estoppel or other equitable basis for the court to decline to enforce the note. In other words, if I were to find that the Swinemars had led the Defendants to believe that they were being released, it might amount to a fraud on their part to turn around and sue the Defendants on the note anyway, and the court will not assist a party in perpetrating a fraud.

Was there a representation?

[23] Answering this question requires me to make a finding of credibility, given the contrary testimony of the parties. Did the Swinemars represent to the Defendants that they were being released?

[24] On the basis of the demeanor of the witnesses alone, it would be hard to make a finding one way or another. None of the witnesses was seriously shaken on cross-examination, although I will say that I was not impressed with Tammy's explanation for why she was willing to forego having legal representation in connection with the transfer of the business to the Ryans.

[25] Nevertheless, demeanor on the witness stand is not always the best indicator of truth. The choice of who to believe usually involves a weighing of the evidence for consistency with other evidence and its overall probability. This was well and famously stated by the British Columbia Court of Appeal in *Faryna v. Chorny* [1952] 2 D.L.R. 354 (B.C. C.A.), at p. 357:

> The credibility of interested witnesses, particularly in cases of conflict of evidence, cannot be gauged solely by the test of whether the personal demeanour of the particular witness carried conviction of the truth. The test must reasonably subject his story to an examination of its consistency with the probabilities that surround the currently existing conditions. In short, the real test of the truth of the story of a witness in such a case must be its harmony with the preponderance of the probabilities which a practical and informed person would readily recognize as reasonable in that place and in those conditions...

[26] Applying this approach, the surrounding circumstances have satisfied me that no such representation was made. I agree with the Swinemars when they ask, rhetorically, why would they have agreed to release people of financial substance from a debt that was about $85,000 (as I have observed) and taken on the covenant of two relatively young and inexperienced people such as the Ryans. It would surprise me to see experienced businessmen like the Swinemars do such a thing.

[27] It is more probable overall that the Swinemars went along with the sale because they knew that they retained the comfort of having the Defendants liable on the note, while the Ryans made payments to reduce the Defendants' exposure over time.

[28] There would have been nothing for the Swinemars to gain by representing to the Defendants that they were being released. The Swinemars were not the moving forces behind the transfer of the business to the Ryans and would have had no incentive to misrepresent their continued reliance on the covenant of the Defendants. From their perspective, they had every incentive to drive a hard bargain as it was Tammy who was anxious to sell the restaurant.

[29] Furthermore, the Swinemars' evidence makes sense when they explain the need for the Defendants to be released from the franchise agreement. The Swinemars needed to control their brand and protect themselves and other franchisees from anyone who might assert rights under the franchise agreement. It was necessary to cut those ties with the Defendants.

[30] None of the surrounding circumstances corroborates the Defendants' position.

[31] The fact that the Ryans began making $2,000.00 payments, rather than the $1,500.00 payments specified in the note, is a curious but equivocal fact. There was no direct explanation for why that occurred. It could have been the Defendants' requirement of the Ryans, as a way of getting themselves off the hook sooner. Or it could have been the Swinemars' insistence. In any event, it does not point to the Defendants being released from the note.

[32] I note that there are emails from the Ryans to the Defendants which suggest that the Ryans regarded themselves as indebted to the Claimant, but this too is equivocal. The Ryans may well have obligated themselves to the Claimant, without necessarily releasing the Defendants.

[33] As such, there is simply no basis for the court to refuse to enforce the note against the Defendants.

What is owing?

[34] The Claimant produced a calculation indicating that the amount owing on the note was $55,916.71. The Defendants did not question this amount. However, they contend that there should be a significant offset for the value of the equipment left behind when the Ryans abandoned the restaurant.

[35] The Defendants contend that they were not given a proper chance to salvage the value that may reside in the equipment. They say that what was probably over $100,000.00 worth of restaurant equipment three years ago should have retained some significant value.

[36] The evidence is that the Claimant gave the Defendants notice by email that they should go and retrieve the equipment. However, to complicate things, there was a dispute with the Landlord who was threatening to exercise a right of distraint. Events moved fairly quickly. The Claimant obtained a professional appraisal placing a value of $12,070.00 on the equipment, and when the Defendants were unresponsive to the notice to do something, the Swinemars had the equipment removed and stored at a cost of $4,900.00. As such, they extend a credit of $7,170.00 ($12,070.00 - $4,900.00) and reduce the debt owing to $48,746.71.

[37] The Defendants say that they had some informal inquiries and might have been able to sell the equipment for a much higher price.

[38] I take notice of the fact that the value of second or third hand restaurant equipment is notoriously less than its original cost. Even so, given that the Claimant has abandoned the excess of its debt over $25,000.00 to stay within the monetary jurisdiction of the Small Claims Court, the Defendants would have to inflate the value of the equipment to something more than $30,000.00 in order to gain any reduction in the judgment against them.

[39] On all of the evidence that I heard, I would not inflate the value of the equipment by that much, if at all. I cannot say that the Claimant was wrong to have acted the way it did, and I take no issue with the appraisal. There was some urgency to get the equipment out because of the issues with the Landlord. Given that the Defendants were maintaining that they had no liability, I consider it unlikely that they would have acted and salvaged the equipment.

Conclusion

[40] In the result, the Defendants are liable for $25,000.00, being the maximum that this court can order, and the Claimant will have judgment for that amount. It claims interest at 4% from the date of issuance of the claim, namely April 19, 2011, to the date of judgment (62 days) which adds $169.86.

[41] The Claimant is also entitled to its filing cost of $182.94 plus service cost of $200.39.

[42] The total of these amounts is $25,553.19.

Eric K. Slone, Adjudicator