

In the know Sotos

In this issue...

- Franchise Law Conference..... 1
Upcoming OBA event in Toronto - October 14, 2009.
- We Welcome New Associates..... 1
Andy Seretis and Vukica Djuric are our newest additions.
- Once is Never Enough: Fresh Disclosure During the Franchise Relationship 2
David Sterns explains the situations where fresh disclosure is required during the term of a franchise agreement.
- Gift Card Law in Ontario 3
John Sotos reviews the nuances of gift card law in Ontario.
- Certification of Quizno's Class Action to be Considered by The Ontario Court of Appeal 4
Allan Dick brings you up to date on the Quizno's class action as it moves through the Courts.
- Managing Your Brand Online. 5
Rachel Loizos covers the ways your brand may be affected by the internet and what you can do about it.
- Maintaining Accurate and Up-to-date Corporate Records. 6
David Gray discusses the importance of your corporate records.
- Disclosure and Franchise Consultant Liability 7
Sam Hall explains the risks of consultant liability in the disclosure process.

Contact List..

by order of the articles

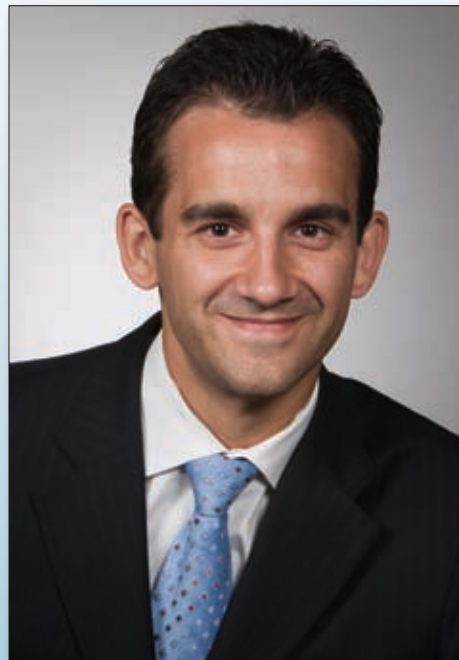
- David Sterns: dsterns@sotosllp.com
- John Sotos: jsotos@sotosllp.com
- Allan D. J. Dick: adjdick@sotosllp.com
- Rachel Loizos: rloizos@sotosllp.com
- David Gray: dgray@sotosllp.com
- Sam Oliver Hall: shall@sotosllp.com

Franchise Law Conference

The 9th Annual Ontario Bar Association Franchise Law Conference will be held on October 14, 2009 coordinating with this year's American Bar Association Forum on Franchising taking place in Toronto. Arthur Trebilcock of our firm is

Co-chairing the conference. Allan Dick who is the Vice-Chair of the OBA Joint Sub-Committee on Franchising responsible for the organization of the event, will be delivering this year's "Judicial Update".

We Welcome New Associates



Our firm is pleased to welcome back Andy Seretis who completed his articles and was called to the Ontario Bar. Andy will join our team of franchise lawyers on the commercial side of the practice.

The firm is equally pleased to welcome Vukica Djuric who has joined our litigation group as an associate following her call to the Ontario Bar.

Certification of Quizno's Class Action to be Considered by The Ontario Court of Appeal

by Allan D.J. Dick

The class action lawsuit commenced on behalf of the franchisees of the Quizno's franchise system in Canada against Quizno's and its designated distributor, GFS Canada, is headed to the Ontario Court of Appeal.

The Ontario Court of Appeal will consider whether the action was properly certified as a class proceeding by the Divisional Court of the Ontario Superior Court of Justice. That Court had overturned the decision of the class proceedings judge who denied certification at first instance.

The action concerns Quizno's requirements that the franchisees purchase designated products from its designated suppliers at prices controlled by Quizno's through its affiliate, Canada Food Distribution Company ("CFD"). The action includes a claim against the designated distributor, GFS, against which the action was also certified as a class proceeding and which is also appealing that finding to the Court of Appeal.

The action raises important issues of whether Quizno's scheme breaches its contractual and good faith duties to the franchisees and whether the scheme is in violation of the price maintenance provisions contained in Canada's competition law statute. CFD appears to have extracted approximately \$15,000,000 in 2006 alone from its role in the distribution scheme while the franchisees have, to a significant extent, been struggling to keep their stores viable.

In certifying the action as a class proceeding, the Divisional Court (in a 2-1 decision) accepted that the franchisees met all of the criteria for certification subject to the class representatives producing a litigation plan acceptable to the class proceedings judge. The criteria which the franchisees met are as follows:

- a) the pleadings disclosed a cause of action;
- b) there was an identifiable class;

- c) the claims of the class members raised common issues of fact or law;
- d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
- e) there is a representative plaintiff who would adequately represent the interests of the class without conflict of interest.

Each of these criteria has been the subject of significant judicial commentary and elaboration. It has been the primary position of Quizno's and GFS that the plaintiffs do not meet the tests for certification because the action raises numerous individual issues which are not common and which make a class proceeding not the preferable procedure for advancing the plaintiffs' cause as a result. Although the class proceedings judge agreed with Quizno's and GFS on these issues, the majority of the Divisional Court disagreed and found that the franchisees met the criteria for all of the reasons advanced by the franchisees.

The Divisional Court certified the following as the common issues to be determined in the case as submitted by the franchisees:

- (1.) Have the Quizno's Defendants, or any of them, engaged in conduct contrary to Section 61(1) of the Competition Act?
- (2.) Have the Defendants, or any of them, engaged in conduct that amounts to civil conspiracy?
- (3.) Have the Quizno's Defendants, or any of them, engaged in conduct which constitutes a breach of their contractual obligations to the class members?
- (4.) Have the class members suffered loss or damage as a result of any of the conduct referred to in issues (1.), (2.), or (3.)? If so, what is the appropriate measure or amount of such loss or damages?

(5.) Should the court award an aggregate assessment of monetary relief on behalf of some or all class members? If so, what is the amount of the aggregate assessment and how should the class members share in the award?

(6.) Should the Defendants pay punitive, exemplary or aggravated damages to the class members? Should such damages be assessed in the aggregate? If so, what is the amount of such damages including pre- and post-judgment interest thereon?

(7.) Are the class members entitled to recover from the Quizno's Defendants the full costs of their investigations and the full costs of this proceeding, including contingent legal fees on a complete indemnity basis, under s.36(1) of the Competition Act?

The issue of whether the action should not be allowed to proceed due to existence of a class action waiver provision in the franchise agreements in issue will not be considered by the Court of Appeal. As previously reported in this newsletter, when the class proceedings judge initially denied certification, he also ruled in favour of the franchisees that the class action waiver provision in the franchise agreements was unenforceable. Quizno's did not originally appeal that finding. Quizno's later tried to appeal but the Court of Appeal ruled against Quizno's to deny it the right to appeal that decision given Quizno's original decision not to file its appeal.

Our firm is representing the franchisee class in this action which, in addition to the certification motion itself, has been the subject of approximately 20 interlocutory motions brought primarily by the defendants. Our firm's website contains a summary of the procedural history of the action.

Once is Never Enough: Fresh Disclosure During the Franchise Relationship by David Sterns



In my last article for this newsletter I said that providing a disclosure document to a prospective franchisee before signing a franchise agreement is a one-time affair. My point then was that a disclosure document, in order to be valid, must include all required information and documents in one bound document delivered at one time at least 14 days before the franchisee enters into the franchise agreement or pays any money to the franchisor.

So you may be surprised by the title of this article. This time, my point is that the duty on a franchisor to provide disclosure to a franchisee does not end once the initial disclosure document is delivered to the prospective franchisee. In fact, there are times when it is essential to provide fresh disclosure to a franchisee long after the franchisee has entered into the franchise agreement. This is because the *Arthur Wishart Act (Franchise Disclosure), 2000 (AWA)*, requires a disclosure document to be given to a franchisee 14 days before any agreement relating to the franchise is signed. An 'agreement that relates to a franchise' includes more than just

a 'franchise agreement' as that term is ordinarily understood - i.e. the agreement granting the franchise.

It is well understood that franchisors must deliver to a prospective franchisee a complete disclosure document at least 14 days before the franchisee either a) pays any money to the franchisor or b) signs a franchise agreement. This is consistent with one of the overriding purposes of the legislation which is to ensure that a franchisee is fully informed of its rights and obligations, and has enough time to reflect on the decision and obtain proper advice before entering into the franchise relationship.

However, pre-contractual disclosure is not the end of the story. A plain reading of the AWA shows that the obligation to disclose also arises when an existing franchisee asks to, or is invited by the franchisor or its associate to sign a new agreement that relates to a franchise.

This comes up quite often in franchise relationships. Take for instance the case where

a franchisor develops a software program for the benefit of its franchisees and wishes to have the franchisee enter into a software license agreement. The software agreement could be construed as an agreement that relates to a franchise and, so, it could be argued that there is an obligation on the franchisor to provide the franchisee with a fresh disclosure document before the franchisee signs the software license agreement.

If no disclosure is given, the franchisee will have a right to rescind the agreement within two years of entering into it. In some cases, the nature of the agreement will be such that the risk of a franchisee rescinding the agreement will be minimal and the franchisor may make a calculated decision to forego the cost of providing fresh disclosure. Where the stakes are higher though, it becomes imperative to provide complete disclosure to the franchisee at least 14 days before any new or amending agreement is signed.

There are some exceptions to the obligation to re-disclose to an existing franchisee. For instance, a franchisor is not required to re-disclose when an existing franchisee renews or extends its franchise agreement if the franchisee has continually operated and there have been no material changes since the original franchise agreement was entered into. What exactly constitutes a 'material change' is something which reasonable people may disagree on. The cautious approach is to provide fresh disclosure even on renewals or extensions.

The duty to re-disclose before each new agreement relating to the franchise is signed is an integral part of the disclosure regime in Ontario. Franchisors and franchisees who contemplate entering into new agreements during the course of the franchise relationship would be well advised to seek legal advice as to whether or not the disclosure obligation exists and what the consequences are of failing to provide proper disclosure.

Gift Card Law in Ontario by John Sotos

Gift cards have become very popular for retailers and their customers in Canada in recent years. By 2006, 82% of retailers in Canada had begun the practice of offering gift cards, attracting consumers who have become increasingly interested in this easy gift-giving option.

Although retailers have been happy to respond to this recent purchasing trend, it has also presented a number of challenges. Namely, retailers are presented with the problem of how to encourage the consumption of these cards within a reasonable time period. Their early response to this problem has been to impose expiry dates or fees on unused balances over time.

The Ontario government amended the *Consumer Protection Act* in 2007 to address retailers' gift card practices in a number of ways:

1. Expiry Dates

The new legislation prohibits retailers from imposing expiry dates on gift cards that hold a specific dollar amount. A gift card which contains an expiry date is effective as if the expiry date was not present on the card. However, gift cards for specific goods or services (for example, a dinner for two) are exempt from the expiry date prohibition even when there is a specific dollar amount included with the card.

2. Fees

Fees are generally restricted from being imposed on gift cards but can be imposed in instances where a customer is seeking to customize a card or replace a lost or stolen card.

Dormancy fees are permitted when the card applies to purchases of products or services from multiple unaffiliated retailers.

Dormancy fees cannot be charged for the first 15 months. In addition, the fees cannot exceed \$2.50 per month. The fee information must be contained on the back of the card. The front of the card must direct the customer to read the fee information on the back of the card. The retailer is also obligated to disclose the information pertaining to the 15 months and \$2.50/month rule.

3. Disclosure

Retailers are obligated to fully and prominently disclose on the card all information pertaining to the conditions and terms of the card. For example, a retailer must disclose conditions relating to limits imposed on the redemption of the card. Other examples include: a retailer must disclose if the card cannot be exchanged for cash, the retailer is not responsible for lost cards, or returned purchases are refunded back onto the card.



Disclosure and Franchise Consultant Liability

by Sam Oliver Hall

Franchise business consultants provide a wide range of support services for franchisors and franchisees alike. For franchisees, these services include providing advice on evaluating the franchise investment, screening prospective business opportunities, formulating business plans, drafting franchise applications, and counseling on marketing strategies within the context of a franchise relationship. Franchisors use such consultants for such things as to develop operational manuals, screen prospective franchisee applicants, assist in purchase and sale transactions of existing franchise units and provide advice on franchise system expansion strategies.

Frequently, a franchise consultant is used to assist a franchisor in meeting its disclosure requirements. It is therefore crucial for the franchise consultant to have a deep understanding of the legislation which governs the disclosure process to minimize the risk of legal exposure *both* to the consultant and to his or her client.

The significance of a franchisor's obligation to provide a disclosure document to a franchisee that conforms with the strict requirements of Ontario's *Arthur Wishart Act (Franchise Disclosure), 2000* (the "Act"), is too regularly overlooked by participants to franchise transactions, including some franchise consultants.

The Act specifically contemplates that where:

(i) a franchisee does not receive a disclosure document; or,

(ii) receives a disclosure document which fails to set out all "material facts" (a defined term under the Act), which includes

prescribed *and* non-prescribed material facts that would be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire a franchise; or

(iii) where the disclosure document contains a misrepresentation (i.e. an untrue statement of material fact *or* an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made),

a franchisee may rescind its franchise agreement without penalty or obligation and may in addition to or alternatively bring an action in damages, as the case may be.

On first blush, it may seem that the duty to provide a disclosure document which conforms to the requirements of the Act is one that rests solely on the shoulders of a franchisor. However, this is not the case.

The rescission remedy may be exercised not only against the franchisor but also a "franchisor's associate".

Franchise consultants who participate in the disclosure process may inadvertently expose themselves to a claim for all losses incurred by the franchisee asserting the rescission remedy if such consultants are deemed to be "franchisor's associates" under the Act, which is defined as follows:

"franchisor's associate" means a person,

(a) who, directly or indirectly,

(i) controls or **is controlled by the franchisor, or**

(ii) **is controlled by another person who**

also controls, directly or indirectly, the franchisor, and

(b) who,

(i) is directly involved in the grant of the franchise,

(A) by being involved in reviewing or approving the grant of the franchise, or

(B) by making representations to the prospective franchisee on behalf of the franchisor for the purpose of granting the franchise, marketing the franchise or otherwise offering to grant the franchise, or

(ii) exercises significant operational control over the franchisee and to whom the franchisee has a continuing financial obligation in respect of the franchise. (emphasis added)

The activities of the franchise consultant who assists in the disclosure process can fit squarely within the definition of a "franchisor's associate". Franchise consultants may find themselves named as parties to claims brought by rescinding franchisees if appropriate care is not taken to ensure that disclosure documents are prepared and provided in accordance with the Act.

When it comes to the right of a franchisee to bring an action based on a misrepresentation contained in a disclosure document (rather than an action founded on the exercise of rescission rights), the Act is *even more* encompassing in its language as far as those against whom such an action can be brought.

The Act permits a franchisee to assert a statutory misrepresentation claim against a franchisor, every person who has signed the disclosure document (or statement

Continued on pg. 8

Maintaining Accurate and Up-to-date Corporate Records *by David Gray*

This bulletin is to remind all business owners, directors, officers, managers and advisors of the importance of maintaining accurate and up-to-date corporate records.

Jean Chretien, former Prime Minister of Canada, would be the first to advise of the importance of maintaining accurate and up to date corporate records. Back in 1999, controversy erupted when Mr. Chretien was listed as a corporate shareholder of the golf club at Grand Mere between the years of 1996 and 1998, a period in which the prime minister had admitted lobbying the Federal Business Development Bank for a loan to the Auberge Grand Mere, the hotel next to the golf club. The Opposition screamed conflict of interest; Mr. Chretien claimed he sold his shares in the golf course a full four years before he made the controversial call to the bank. Unfortunately, the minute books and share register of the company did not show the transfer of shares. Consider the wasted time and resources that were directed to contain the damage that resulted.

THE LESSON? Maintaining accurate and up-to-date records avoids problems, costs, aggravation and embarrassment.



The Importance of Accurate Minute Books

Although corporate minute books serve as official corporate records, keeping them up-to-date is sometimes a low priority. There are a number of reasons why minute books should be kept current including:

1. The minute book is the **official source of documents** that demonstrate share ownership of the corporation. The minute book should reflect exactly when and to whom shares of stock have been transferred. It should also contain the original stock certificates or share register of the owners.
2. A proper minute book **shows the chain of decision makers** (and those responsible at law for certain types of transactions) of the corporation, i.e. directors, officers and members of management committees. Equally, **it records when these individuals ceased their functions.**
3. The minute book **leaves a trail of the decisions and transactions of a corporation.** The minute book is an important audit backup. With it one can determine effective dates for tax purposes and establish justification for the accrual of expenses and fixed obligations.

4. As corporate records **grant corporate directors and officers the authority to act**, up-to-date records can help avoid challenges to the corporation's authority to take certain actions. These challenges might come from a number of sources including: minority shareholders, directors, employees or even taxing authorities.

5. The minute book **details the official standing of the corporation** and establishes the background record needed to facilitate corporate transactions including the issuance of shares and sale of the actual corporation. Having an inaccurate minute book can make even the simplest of corporate transactions into a lengthy, costly and hassle-filled experience for everybody involved.

6. The minute book is the **official recording of the compensation and dividends** that the corporation is required to pay. The minute book record is also effective at creating a paper trail in order to demonstrate to taxing authorities or the other various government authorities many of the payments the corporation has made.

It should be kept in mind that the failure to maintain an up-to-date minute book may be subsequently more serious (and costly) in the event parties become unwilling or unable to execute documents requiring their signature.

The Importance of Completing Annual Resolutions

An annual meeting of the shareholders of a corporation is another important source of corporate record keeping that should not be overlooked. Shareholder meetings may be required in various situations (such as matters requiring a special resolution of the shareholders, or upon requisition by the court, etc.), however, **annual shareholder meetings are prescribed by law.**

Continued on pg. 8

Managing Your Brand Online

by Rachel Loizos

Managing your brand online requires vigilance. It is important to keep abreast of developments in technology so that you can adequately protect your brand. All business owners should be wary of the ease with which goodwill can be compromised on the web and take adequate precautions.

Awareness

You cannot protect your brand online if you do not know what is out there. Business owners must be aware of the messages that are being put out online. There are many free tools available to you to monitor what people are saying about your business - Google Alerts, Google News, Yahoo Alerts, Technorati.com and BlogPulse.com are but examples. You utilize these tools by simply entering your business name. You will then receive the information you want. BoardTracker.com can be used to measure what is going on in online forums and Keotag.com will monitor what is going on in the social arena. Since these are free resources there is no reason not to take advantage of them. There are also subscription services available which will undertake the monitoring on your behalf.

Social Networks

The popularity of social networking sites cannot be underestimated. Many businesses are utilizing social networking sites to increase their web presence, advertise, build brand loyalty and reach new and existing customers.

Two of the most popular social networking sites in Canada are Facebook and Twitter. Facebook is by far the most popular site while Twitter is the fastest growing. Twitter's popularity with business boils down to the fact that it is easy to use and connects business with clients/customers in real time.

Twitter allows users to post brief updates called 'tweets'. Tweets allow those that are interested in following you or your company to be kept up to date. Many companies are taking advantage of the

public nature of Twitter to keep their clients/customers updated. While some business owners may not be interested in 'tweeting' it would certainly be worthwhile to know what others are tweeting about you, your brand, your services and the overall customer experience.

Control Your Brand

While more and more businesses are utilizing the web for marketing and brand awareness, those that are not are exposing themselves to the risk of 'name squatting'. Name squatting is becoming more prevalent as people improperly register internet names, (names that are the trade-marks or brands of others) and open Twitter or Facebook accounts for either mischief or profit. Because it only requires an email address to open a Twitter account, it is very easy for anyone to open an account and begin posting misleading material.

Protecting your brand or trade-mark from squatters should be part of your overall business strategy and should include, at a minimum, the following:

1. Register your trade-mark and obvious variations with social networking sites;
2. Continually monitor online sources for unauthorized uses of your brand or trade-marks; and
3. Where unauthorized use is found, immediately contact the site and demand the site terminate the squatting activity.

The online opportunities to promote your brand and connect with your customers abound, but businesses must remain on alert for those that would use online tools to create mischief and spread misinformation. Internal policies to monitor the internet will go a long way to ensuring that you can take swift action to protect your brand should anything untoward be discovered. With increasing frequency, our firm is being asked to assist companies in remedying and minimizing damage which they are experiencing because of unwanted internet activity. Your own vigilance can serve as an important first step in the protection of your interests.



Maintaining Accurate and Up-to-date Corporate Records *Continued from pg. 6*

According to Ontario law, directors are required to call an annual meeting of shareholders not later than 18 months after the corporation comes into existence and subsequently not later than 15 months after the holding of the last preceding annual meeting.

As prescribed by law, the requirements of an Annual Shareholders Meeting include:

1. Approval of financial statements
2. Election/appointment of directors
3. Appointment of the corporation's auditor/Dispensing of the appointment (unanimous shareholder consent required).

With appropriate documentation, the law provides that shareholders may merely sign written resolutions to see to the above-noted tasks rather than attending actual meetings. In either case, it is strongly recommended that these shareholder duties be duly attended to.

Problems Associated With Failing to Keep Accurate and Up-To-Date Corporate Records

It is important to comply with the law and hold annual shareholders' meetings as it will avoid a variety of problems, including both practical implications and legally imposed penalties.

Practical Implications

1. Many corporate manoeuvres will not be able to be accomplished as legal opinions regarding the corporation will not be able to be drafted until all of the corporate documents have been duly executed. This may cause costly delays or even the cancellation of valuable corporate opportunities.

2. Without proper documentation, decisions made by the officers/directors of the corporation will be barren of legal substance and therefore be vulnerable to scrutiny from disgruntled stakeholders, taxing authorities, and the courts.
3. To properly take advantage of the benefits of incorporation (limited liability and tax benefits), the courts may, in certain circumstances, require evidence of a duly operating corporation (i.e. with accurate and up-to-date records), rather than a corporation in form only.

Legal Penalties

According to law, a corporation that, without reasonable cause, fails to comply with the requirements to keep records is guilty of an offence and may be liable to a fine not exceeding \$25,000. Further, every director or officer who, without reasonable cause, authorized, permitted or acquiesced in such offence may also be guilty of an offence and on conviction may be liable to a fine of not more than \$2,000 or to imprisonment for a term of not more than one year, or to both. Reasonable cause is not defined in the law, however, it seems each situation will be judged according to the specific surrounding circumstances.

Conclusion

Apart from avoiding the troubles suffered by Mr. Chretien, there are numerous reasons why corporate minute books and annual resolutions should be vigorously maintained. When it comes to maintaining corporate records, an ounce of prevention is undoubtedly worth a pound of cure. Our firm has established a program to assist corporations to ensure the regular and proper maintenance of their corporate records.

Disclosure and Franchise Consultant Liability

Continued from pg. 5

of material change) and "the franchisor's associate", "the franchisor's agent", and "the franchisor's broker" (defined in the Act as being "a person other than the franchisor, franchisor's associate, franchisor's agent or franchisee, who grants, markets or otherwise offers to grant a franchise, or who arranges for the grant of a franchise.")

Franchise business consultants undoubtedly have an important role to play within the franchise industry and can offer expert advice on the problems faced by all participants in the franchise relationship. When it comes to the preparation of a disclosure document that conforms to the Act and its Regulation, franchisors and their consultants are well advised to seek the counsel of those with the requisite expertise in the highly nuanced area of disclosure.

