

Table 30

Store 2267 category costs for 2008												
Item	Sales		Food cost		Paper cost		Gross margin		Op. expense*		EBITDA contribution	
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
Gross sales	\$1,730,524	101.3%										
RUTR	\$12,393	0.7%										
Combo costs	\$8,385	0.5%										
Staff discount	\$597	0.0%										
Net Sales	\$1,709,149	100.0%										
Coffee, tea, ice capp	1,019,975	59.7%	\$167,174	16.4%	\$68,011	6.7%	784,790	76.9%	629,494	61.7%	155,296	15.2%
Other drinks	127,937	7.5%	\$31,461	24.6%	\$6,361	5.0%	90,115	70.4%	78,958	61.7%	11,157	8.7%
Baked goods**	251,393	14.7%	\$108,936	43.3%	\$5,977	2.4%	136,480	54.3%	155,151	61.7%	(18,671)	-7.4%
Bagels	112,548	6.6%	\$38,422	34.1%	\$2,422	2.2%	71,704	63.7%	69,461	61.7%	2,243	2.0%
Breakfast	76,464	4.5%	\$27,333	35.7%	\$1,174	1.5%	47,957	62.7%	47,191	61.7%	766	1.0%
Lunch***	91,127	5.3%	\$46,927	51.5%	\$2,562	2.8%	41,638	45.7%	56,240	61.7%	(14,603)	-16.0%
Take home	22,373	1.3%	\$9,201	41.1%	\$46	0.2%	13,126	58.7%	13,808	61.7%	(682)	-3.0%
Staff discount	(597)	0.0%					(597)	100.0%	(368)	61.7%	(229)	38.3%
Variance	7,929	0.5%					7,929	100.0%	4,894	61.7%	3,035	38.3%
Total	\$1,709,149	100.0%	\$429,454	25.1%	\$86,553	5.1%	\$1,193,142	69.8%	\$1,054,828	61.7%	\$138,313	8.1%

NOTES:
 1. Net Sales = Gross sales - RUTR - Combo Costs - Misc
 2. Combo costs were taken out of lunch sales
 3. Percentage In Total column is against Net Sales as Per TDL practice
 4. Profit margin is calculated as a percentage of Net Sales
 5. RUTR discount was taken out of coffee sales

*NOTE: Operating expenses include:
 RRA
 Labour
 Fixed
 Labour has been assessed to all sales equally. However, it takes significantly more labour to make a sandwich than a coffee and donut.

**NOTE: Baked goods does not include bagel sales

*** NOTE: Lunch includes Lunch Items served

**** NOTE: Variance represents rounding errors to ensure totals add to reading

- Coffee has a 15.2% profit margin;
- Other Drinks has a 8.7% profit margin;
- Baked Goods has a -7.4% profit margin; and
- Lunch has a -16.0% profit margin.

270. For the year ending December 31, 2008, Mr. Jollymore earned:

- 120.3% of his operating profit from drinks (Coffee and Other Drinks);
- -13.5% of his operating profit from Baked Goods; and
- -10.6% of his operating profit from Lunch.

271. My review of the category sales and costs for Store #2267 in 2008 shows the following:

272. 120.3% of the operating profit for this store is generated from Coffee and Other Drinks sales. As in Mr. Garland's stores, I believe that the Baked Goods category used

to provide a significant contribution to operating profit before the Always Fresh conversion when the cost of a donut was \$0.078 rather than the current \$0.206¹⁰⁹ ($\$0.179 \times 1.021\% + \0.023), but has failed to keep pace since, resulting in a contribution to operating loss of only -13.5%.

273. The Lunch category at Store #2267 accounts for \$91,127 of sales. This category provides \$15,036 in RRA payment (at 16.5% of sales and without factoring in non-transparent income) to TDL, but yields the franchisee of this store a loss of approximately -\$14,603, a difference of almost \$30,000.

274. The low contribution of the Baked Goods and the loss on Lunch on overall contribution to operating profit are not in keeping with reasonable commercial standards, in my estimation. TDL derives a profit on the franchisees' efforts, while the franchisee loses money by carrying and selling the product.

Store #368, operated by The Plaintiff, Fairview Donut Inc. (Anne Jollymore)

Year ending December 31, 2005

275. Table 31 shows Mrs. Jollymore's results for Store #368 for the year ending December 31, 2005.

¹⁰⁹ See Table 43.

Table 31

Store 368 category costs for 2005												
Item	Sales		Food cost		Paper cost		Gross margin		Op. expense*		EBITDA contribution	
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
Gross sales	\$1,050,969	101.5%										
RUTR	\$4,365	0.4%										
Combo costs	\$9,041	0.9%										
Staff discount	\$2,285	0.2%										
Net Sales	\$1,035,278	100.0%										
Coffee, tea, ice capp	611,670	59.1%	\$102,383	16.7%	\$47,877	7.8%	461,411	75.4%	338,100	55.3%	123,310	20.2%
Other drinks	74,310	7.2%	\$20,681	27.8%	\$2,579	3.5%	51,050	68.7%	41,075	55.3%	9,976	13.4%
Baked goods**	183,832	17.8%	\$86,768	47.2%	\$4,282	2.3%	92,783	50.5%	101,613	55.3%	(8,830)	-4.8%
Bagels	55,873	5.4%	\$23,489	42.0%	\$1,659	3.0%	30,725	55.0%	30,884	55.3%	(159)	-0.3%
Breakfast	0	0.0%										
Lunch***	71,953	7.0%	\$33,588	46.7%	\$2,454	3.4%	35,911	49.9%	39,772	55.3%	(3,861)	-5.4%
Take Home	17,922	1.7%	\$9,643	53.8%	\$0	0.0%	8,279	46.2%	9,906	55.3%	(1,628)	-9.1%
Staff discount	(2,285)	-0.2%					(2,285)	100.0%	(1,263)	55.3%	(1,022)	44.7%
Variance	22,003	2.1%					22,003	100.0%	12,162	55.3%	9,841	44.7%
Total	\$1,035,278	100.0%	\$276,552	26.7%	\$58,850	5.7%	\$699,876	67.6%	\$572,249	55.3%	\$127,627	12.3%

NOTES:
 1. Net Sales = Gross sales - RUTR - Combo Costs - Misc
 2. Combo costs were taken out of lunch sales
 3. Percentage in Total column is against Net Sales as Per TDL practice
 4. Profit margin is calculated as a percentage of Net Sales
 5. RUTR discount was taken out of coffee sales

*NOTE: Operating expenses Include:
 RRA
 Labour
 Fixed
 Labour has been assessed to all sales equally. However, it takes significantly more labour to make a sandwich than a coffee and donut.

**NOTE: Baked goods does not include bagel sales

*** NOTE: Lunch includes Lunch items served

**** NOTE: Variance represents rounding errors to ensure totals add to reading

op costs \$572,249.25

- Coffee has a 20.2% profit margin;
- Other Drinks has a 13.4% profit margin;
- Baked Goods has a -4.8% profit margin; and
- Lunch has a -5.4% profit margin.

276. For the year ending December 31, 2005, Mrs. Jollymore earned:

- 104.4% of her operating profit from drinks (Coffee and Other Drinks);
- -6.9% of her operating profit from Baked Goods; and
- -3.0% of her operating profit from Lunch.

Store #593, operated by The Plaintiff, Fairview Donut Inc. (Anne Jollymore)

Year ending December 31, 2005

277. Table 32 shows Mrs. Jollymore's results for Store #593 for the year ending December 31, 2005.

Table 32

Store 593 category costs for 2005												
Item	Sales		Food cost		Paper cost		Gross margin		Op. expense*		EBITDA contribution	
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
Gross sales	\$1,512,640	101.0%										
RUTR	\$5,865	0.4%										
Combo costs	\$5,865	0.4%										
Staff discount	\$3,508	0.2%										
Net Sales	\$1,497,402	100.0%										
Coffee, tea, ice capp	883,670	59.0%	\$150,126	17.0%	\$65,903	7.5%	667,641	75.6%	463,147	52.4%	204,494	23.1%
Other drinks	140,826	9.4%	\$38,301	27.2%	\$8,606	6.1%	93,919	66.7%	73,809	52.4%	20,110	14.3%
Baked goods**	247,851	16.6%	\$105,450	42.5%	\$6,730	2.7%	135,671	54.7%	129,903	52.4%	5,768	2.3%
Bagels	90,353	6.0%	\$34,942	38.7%	\$2,978	3.3%	52,433	58.0%	47,356	52.4%	5,077	5.6%
Breakfast	0	0.0%	\$0		\$0		0		0		0	
Lunch***	100,748	6.7%	\$49,370	49.0%	\$2,540	2.5%	48,838	48.5%	52,804	52.4%	(3,966)	-3.9%
Take home	26,694	1.8%	\$14,427	54.0%	\$9	0.0%	12,258	45.9%	13,991	52.4%	(1,733)	-6.5%
Staff discount	(3,508)	-0.2%					(3,508)	100.0%	(1,838)	52.4%	(1,669)	47.6%
Variance	10,768	0.7%					10,768	100.0%	5,644	52.4%	5,124	47.6%
Total	\$1,497,402	100.0%	\$392,616	26.2%	\$86,766	5.8%	\$1,018,020	68.0%	\$784,814	52.4%	\$233,206	15.6%

NOTES:
 1. Net Sales = Gross sales - RUTR - Combo Costs - Misc
 2. Combo costs were taken out of lunch sales
 3. Percentage in Total column is against Net Sales as Per TDL practice
 4. Profit margin is calculated as a percentage of Net Sales
 5. RUTR discount was taken out of coffee sales -1717

*NOTE: Operating expenses include:
 RRA
 Labour
 Fixed
 Labour has been assessed to all sales equally. However, it takes significantly more labour to make a sandwich than a coffee and donut.

***NOTE: Baked goods does not include bagel sales

*** NOTE: Lunch includes Lunch items served

**** NOTE: Variance represents rounding errors to ensure totals add to reading

op costs \$784,813.93

- Coffee has a 23.1% profit margin;
- Other Drinks has a 14.3% profit margin;
- Baked Goods has a 2.3% profit margin; and
- Lunch has a -3.9% profit margin.

278. For the year ending December 31, 2005, Mrs. Jollymore earned:

- 96.3% of her operating profit from drinks (Coffee and Other Drinks);
- 2.5% of her operating profit from Baked Goods; and
- -1.7% of her operating profit from Lunch.

Year ending December 31, 2008

279. Table 33 shows Mrs. Jollymore's results for Store #593 for the year ending December 31, 2008.

Table 33

Store 593 category costs for 2008												
Item	Sales		Food cost		Paper cost		Gross margin		Op. expense*		EBITDA contribution	
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
Gross sales	\$1,946,882	101.4%										
RUTR	\$13,462	0.7%										
Combo costs	\$12,250	0.6%										
Staff discount	\$1,189	0.1%										
Net Sales	\$1,919,981	100.0%										
Coffee, tea, iced capp	1,099,899	57.3%	\$180,030	16.4%	\$77,709	7.1%	842,160	76.6%	586,895	53.4%	255,265	23.2%
Other drinks	167,113	8.7%	\$42,383	25.4%	\$5,647	3.4%	119,083	71.3%	89,170	53.4%	29,913	17.9%
Baked goods**	292,027	15.2%	\$119,596	41.0%	\$6,583	2.3%	165,847	56.8%	155,823	53.4%	10,024	3.4%
Bagels	115,411	6.0%	\$44,277	38.4%	\$2,869	2.5%	68,265	59.1%	61,582	53.4%	6,683	5.8%
Breakfast	87,526	4.6%	\$30,698	35.1%	\$1,368	1.6%	55,459	63.4%	46,703	53.4%	8,756	10.0%
Lunch***	134,526	7.0%	\$73,398	54.6%	\$3,310	2.5%	57,818	43.0%	71,782	53.4%	(13,964)	-10.4%
Take home	29,310	1.5%	\$13,439	45.9%	\$137	0.5%	15,734	53.7%	15,639	53.4%	94	0.3%
Staff discount	(1,189)	-0.1%					(1,189)	100.0%	(634)	53.4%	(555)	46.6%
Variance	(4,641)	-0.2%					(4,641)	100.0%	(2,476)	53.4%	(2,165)	46.6%
Total	\$1,919,981	100.0%	\$503,821	26.2%	\$97,624	5.1%	\$1,318,536	68.7%	\$1,024,483	53.4%	\$294,053	15.3%

NOTES:

- Net Sales = Gross sales - RUTR - Combo Costs - Misc
- Combo costs were taken out of lunch sales and added back
- Percentage in Total column is against Net Sales as Per TDL practice
- Profit margin is calculated as a percentage of Net Sales
- RUTR discount was taken out of coffee sales
- Combo costs have been taken from Lunch sales.

*NOTE: Operating expenses include:

- RRA
- Labour
- Fixed

Labour has been assessed to all sales equally. However, it takes significantly more labour to make a sandwich than a coffee and donut.

**NOTE: Baked goods does not include bagel sales

*** NOTE: Lunch includes Lunch Items served

**** NOTE: Variance represents rounding errors to ensure totals add to reading

- Coffee has a 23.2% profit margin;
- Other Drinks has a 17.9% profit margin;
- Baked Goods has a 3.4% profit margin; and
- Lunch has a -10.4% profit margin.

280. For the year ending December 31, 2008, Mrs. Jollymore earned:

- 97.0% of her operating profit from drinks (Coffee and Other Drinks);
- 3.4% of her operating profit from Baked Goods; and
- -4.7% of her operating profit from Lunch.

281. My review of the category sales and costs for Store #593 shows the following.

282. 97.0% of the system operating profit for this store is generated from Coffee and Other Drink sales. Clearly at a 3.4% contribution to operating profit, Baked Goods are not the contributor they once were when the raw product was \$0.078 or \$0.128 less expensive or 164.1% lower than it is in 2008; and are not near the 19.7% achieved in 2002 by Mr. Garland at Store #385.

283. The Lunch category at Store #593 accounts for \$134,526 of sales. This category therefore provides \$22,197 RRA payment to TDL (calculated at 16.5% and without factoring in non-transparent revenue) but yields the franchisee of this store a loss of approximately -\$13,964, a \$36,161 difference or 26.4 percentage points.

284. The low contribution to operating profit of the Baked Goods and the negative impact of the Lunch items on overall contribution to operating profit are not in keeping with reasonable commercial standards, given the benefits that TDL derives in both transparent and non-transparent income from requiring franchisees to sell those Lunch items at unreasonably low prices and by selling donuts at such an unreasonably high food cost.

Conclusion

285. While I have only had a chance to review the financial performance of the few Tim Hortons stores described and discussed above to this point in time, I am of the opinion that the findings from these stores are likely to be reflected in the vast majority of Tim Hortons franchise outlets. The issues related to the high (i.e., overpriced) cost of Always Fresh baked goods (including donuts, in particular given my analysis above), combined with the consistent losses that are incurred due to the Lunch program are clear in my opinion:

- (a) the profit contribution from donuts and other baked goods has dropped significantly at Mr. Garland's stores as seen, while the margins range from barely profitable to negative at Mr. and Mrs. Jollymore's stores. This is due to the change in price from \$0.078 in 2002 to \$0.197 in 2003 to \$0.206 in 2007, representing a 164.1% increase in cost while the retail price rose by only 30.77%;
- (b) the Lunch Menu items have driven significant negative contributions in that category.

286. In my opinion, the very low, and usually negative, contribution to franchisee profitability of the baked goods, and the negative contribution of the Lunch Menu on overall contribution to operating profit are not in keeping with reasonable commercial

standards, especially given the benefits (in the form of transparent and non-transparent income) that TDL derives from compelling franchisees to sell Lunch items at unreasonably low prices and by selling unfinished donuts at such an unreasonably high cost.

287. The consistency of the change in the operating profit from 2002 to 2008 and the similarity in category contributions is reflected in the following Table 34. All of the stores examined have the same or nearly the same category losses in 2008.

Table 34

2008 Year End Summary					
Item	Store 385 19-Jan-03	Store 385 27-Jul-08	Store 750 31-Dec-08	Store 2267** 31-Dec-08	Store 368 31-Dec-08
				Adjusted by 7% for 80/20	
Sales	\$2,611,997	\$1,962,987	\$2,346,369	\$1,709,149	\$1,497,402
Coffee, tea, ice capp*	24.7%	22.0%	20.2%	22.7%	23.1%
Other drinks	25.4%	23.6%	15.5%	15.7%	14.3%
Baked goods	19.7%	-0.5%	-0.4%	-0.4%	2.3%
Lunch	0.9%	-11.2%	-11.5%	-9.0%	-3.9%
EBITDA	20.0%	14.8%	12.6%	15.1%	15.6%
<p>* NOTE: I understand that the reason Mr. Garland's Other Drink margin is so high is that he still serves fountain soda rather than bottled soda. The margins on fountain drinks is significantly higher than that which can be earned from bottled drinks.</p>					
<p>**NOTE: Store 2267 is operated as a 80/20. As such it is rented from TDL for an additional 7% of sales. In order to show the impact of Always Fresh and Lunch menu items, I have added back the 7% rental fee to illustrate the similarity in drop from store 385 year end 2003 to all full stores in the system that I have reviewed thus far</p>					

288. Looking at the contribution of the Lunch Menu to operating profits over time (from 2002 to 2008, as reviewed above), the following conclusions can be drawn:

- (a) From 2002 to 2004 (and possibly before 2002) the loss of contribution to operating profits increased significantly;
- (b) While it seems reasonable to conclude that some change in franchisor policy or direction may explain that change,¹¹⁰ we cannot know this without examination of the relevant corporate documents;
- (c) A sampling of the financial results of representative stores would allow for the development of conclusions that could reasonably be applied to all franchisees within the system during the relevant time period;

289. The results achieved by Mr. and Mrs. Jollymore and Mr. Garland are likely chain-wide results. A review of the financial performance of the Defendants' supporting franchisees along with a random sample of average franchisees across the country should bear out my opinion that these results have likely been experienced nationally.

H. Whether franchisees obtained fair market value for equipment discarded in Always Fresh conversion

290. I have reviewed the asset disposition caused by the Always Fresh conversion.

291. I understand the Plaintiffs to allege that they were required by TDL to invest approximately \$35,000 per store for the new equipment required to effect the Always Fresh conversion. At the same time, they (along with the other franchisees) were required to discard existing kitchen equipment, for which they received compensation from TDL that it is contended was not in keeping with its fair market value.¹¹¹

292. It is my understanding from the materials that:

- (a) There is no dispute that all franchisees were required to purchase new kitchen equipment in order to implement the Always Fresh conversion, at

¹¹⁰ Two possibilities include, for example, a corporate decision to pursue Tim Hortons' growth through the Lunch Menu (Jollymore Affidavit, para. 39).

¹¹¹ Statement of Claim, para. 20.

a cost of approximately \$35,000 per store (including the costs of installation),¹¹²

- (b) TDL provided no compensation to franchisees to assist with this capital expenditure although some assistance with financing was available,¹¹³
- (c) Franchisees were required to discard specified pieces of existing kitchen equipment specific to the Full-Baking method that the Always Fresh conversion replaced;¹¹⁴
- (d) TDL made arrangements for a third party to buy the discarded equipment based upon the following sliding scale:

2002	\$15,000
2001	\$15,000
2000	\$10,000
1999	\$ 8,000
1998	\$ 6,000
1997	\$ 4,000
1996/1995	\$ 2,000
1994	\$ 1,000 ¹¹⁵

293. From my experience, cooking equipment (such as fryers, ovens, stoves, mixers, blenders and other similar equipment) has a working life long beyond its depreciated life from a business accounting point of view because the equipment is made from heavy duty steel and stainless steel, has industrial-sized motors and can last easily for 30-years or longer. I almost always recommend to clients who are opening new restaurants to purchase second hand equipment as it is less expensive than new, and if it has been maintained, can last for at least a 25-30 year total life, longer with some pieces of equipment.

294. In the case of Tim Hortons, it is my understanding from Mr. Jollymore that franchisees who wish to renew their license agreements with TDL must upgrade their stores as required by TDL. It is also my understanding that TDL did not force franchisees to sell off or discard their old cooking/baking equipment every ten years,

¹¹² Jollymore Affidavit, paras. 31-32; Clanachan Affidavit, paras. 102, 145.

¹¹³ Clanachan Affidavit, paras. 128, 145.

¹¹⁴ Jollymore Affidavit, para. 33; Garland Affidavit, para. 39; Clanachan Affidavit, paras.142, 145.

¹¹⁵ TDL Motion Record, Vol VI, Tab 35, p. 1911.

even though it had been fully depreciated and were allowed to do so. It is my understanding, rather, that any equipment in good working condition is kept by the franchisee and that the required renovations usually cover furnishings, floors, walls, ceilings and may require additions, changes to layout, exterior upgrade, etc.¹¹⁶ I understand from Mr. Jollymore, for example, that Mrs. Jollymore did not replace her mixers, hoods, and other related baking equipment at the time of renewal for Store #368 even though renovations to the front of the store were required and undertaken. Given that the equipment life is significantly longer than 10 years, this approach makes sense.

295. While it is difficult to value the assets sold by any one franchisee, as they no longer exist, it is likely that TDL has the cost of this equipment new in 2002 and could share this information. Further, I believe that I can easily develop an analysis of how many times Tim Hortons requires equipment upgrades by franchisees when a conversion such as the Always Fresh Baking is not being implemented, but rather when a franchisee is renewing their license agreement with TDL. Most franchisees have gone through a renewal prior to the 2003 renewal and a simple analysis of their redevelopment purchases and costs would yield the 'real' equipment life.

296. According to Mr. Jollymore, the equipment from Store #750 that was sold back to the TDL third party included the pieces listed in **Exhibit L** to this affidavit (prepared from Exhibit N to Mr. Jollymore's affidavit). This equipment was bought new by Mr. Jollymore in 1994 when he first executed the License Agreement for Store #750 and had not been replaced in the intervening period (with the exception, possibly, of inexpensive sundry items). Based upon TDL's sliding scale (described above), I understand Mr. Jollymore to have been paid \$1,000 total for this complete list of items sold for Store #750.

297. At paragraph 144 of Mr. Clanachan's affidavit, he states that the equipment from Store #750 discarded by Mr. Jollymore had a replacement cost of \$44,000, but provides no supporting equipment price lists or other information.

298. I retained the services of Paula Hicks, a colleague experienced in Foodservice Facility Design and with whom I have worked closely in the foodservice industry for over

¹¹⁶ Information from Mr. Jollymore.

25 years, to undertake the necessary enquiries to find identical or similar equipment to that discarded by Mr. Jollymore and to obtain a price for each. We were able to find prices for 10 of the 63 itemized pieces of equipment/smallwares. The pieces for which we found prices are certainly the most expensive of the group. We added a 25% cost for smallwares in order to obtain a general estimate of the total value of the equipment (i.e., if new) that franchisees were required to discard during the Always Fresh conversion. We were also able to obtain from equipment suppliers an estimate of the fair market value of the same equipment if it were 2 to 3 years old. Our findings are shown in Table 35 below.

Table 35

Equipment Value		
Equipment	Estimated value	
	2002	3 years old
Belshaw 634 Donut Fryer	\$8,500	\$6,500
HRD25 Dry Chemical System	\$1,500	\$500
7' Garland Exhaust Hood	\$6,000	\$3,000
Garland GEF12EL Fan & Curb	\$2,000	\$1,000
Bakers Table 6' long	\$1,935	\$1,200
36 Bun Divider	\$3,000	\$1,500
Bun Divider Mobile Stand	\$500	\$250
Brute Proofing Cabinet	\$2,700	\$1,500
Glazing Unit	\$1,200	\$800
Hobard 80 Qt Mixer & Accessories	\$24,000	\$18,000
Sub-total	\$51,335	\$34,250
Smallwares estimate (25% of equipment)	\$12,834	\$8,563
Total	\$64,169	\$42,813

299. The ten major pieces of equipment discarded had a value of about \$51,000 if purchased new between 2000 and 2002 and a 3 year old depreciated resale value of

approximately \$35,000. The smallwares value is a "guesstimate" but could be more accurately determined with the benefit of information from TDL setting out the actual costs of these items. Based on the work our firm has done, therefore, it is my opinion that the value of the new equipment was at least \$50,000 subject to review and consideration of information from TDL as to the actual costs at relevant time periods.

300. Based on the information my team has found to-date, I am also of the opinion that the value of the equipment purchased from Fairview Donut Inc. by TDL's third party vendor reflected the fact that the market was about to be saturated with Tim Hortons franchisees' old baking equipment and, as such, a deal was struck to buy the equipment at a discounted value.

301. In the circumstances of the Always Fresh conversion, it is unlikely that the Plaintiffs or any other franchisee could have obtained the true "fair market value" for this equipment by attempting to sell it independently of TDL. It must be remembered that TDL caused the market at that time to be flooded with baking equipment from the kitchens of approximately 2,400 units (less kiosks and other stores operating as satellites pre-Always Fresh) including, but not limited to: mixers, fryers, hoods, ovens, and so forth. Flooding the market with this volume of equipment can only force the selling price to be substantially less than the equipment value on the market if only one store were to seek to dispose of this equipment independently of such an initiative. While TDL ensured that Mr. and Mrs. Jollymore and the other franchisees got something for their equipment, it was well below fair market value in my opinion.

302. Given the growth of TDL in the late 1990s and early 2000s, it is probable that a large number of franchisees had to convert their 1-year old, 2-year old, 3-year old and 4-year old equipment to Always Fresh, receiving compensation of \$8,000 to \$15,000, significantly less than it was worth, in my opinion. By way of example, I understand from a conversation with Mr. Jollymore that there were a couple of franchisees who purchased a new franchise in 2002 who had to convert their franchise units over to Always Fresh Baking before they could even use the equipment bought from TDL under the Full-Baking Model.

303. While I have not had the time or the necessary information from TDL to determine the exact loss incurred by the Plaintiffs and other franchisees through the conversion process, I am certain that the compensation rate of those who had equipment for 3 years or less in particular, is significantly less than half the value the equipment would have been worth had TDL not been 'gutting' approximately 2,400 restaurants (qualified as noted above) Full-Baking equipment. Once I have the necessary data from TDL, I should be able to determine a reasonably precise value of the equipment and smallwares the franchisees were forced to sell due to the conversion to Always Fresh Baking (based upon the assumption, of course, that the equipment was in reasonable working condition at the time of disposition). It would also be important to know what TDL earned in the equipment transaction, if anything, as it is possible that TDL was able to negotiate a rebate for itself. It would then be a relatively simple exercise to develop a matrix or grid that would allow us to group franchisees by how old their equipment was and then apply what would have been the fair market price of the equipment less the price that TDL arranged for them in 2002/2003 plus quantify TDL's revenue on the sale of the new equipment.

304. There is no question that this may be the most difficult aspect of the Class to assess adequately. From what we have learned so far, however, the prices offered to the franchisees for their used equipment reflect the fact that TDL was forcing a 'sell-off' of the baking assets of the franchisees to one party.

305. I understand from Mr. Garland that at some point between 1998 and 2002, he purchased a second-hand mixer from TDL for \$7,500, a price stipulated by TDL, and that TDL often sold franchisees used pieces of equipment in this way. Assuming this is so, copies of related receipts, equipment price lists and other such records from TDL would be relevant sources of information to consider on this point.

306. Another way to determine if the TDL price was fair is by analyzing what TDL does with restaurants that it repossesses. I understand from Mr. Garland that his Store #1536, purchased in 1998 with a 10 year License Agreement, was repossessed by TDL in January 2009 approximately 15 months after the franchise term expired.

307. Mr. Garland received \$34,000 for the depreciated equipment in the store. TDL then entered into an operating agreement with an existing franchisee in the chain. My understanding from Mr. Garland is that the relevant terms of the operating agreement included the usual RRA for a kiosk operation of this nature, plus a rental fee of 7% of sales for the existing equipment.

308. I understand from Mr. Garland that the equipment contained in Store #1536 (which included some kitchen equipment, although not the same Full-Baking equipment discarded by franchises to effect the Always Fresh conversion) was purchased new by Mr. Garland in 1998, and he had fully depreciated it over the course of his 10 plus years operating the store. Contrary to Mr. Clanachan's suggestion in his affidavit that store equipment would have no residual value after a 10 year period, it is also my understanding that this new franchisee is now paying TDL a rental fee that amounts to about \$71,582 per year for use of this same fully depreciated equipment, with the only apparent exception being a new bagel toaster (if the franchisee has maintained the \$1,022,600 revenue base that Mr. Garland established for this store¹¹⁷).

309. It therefore seems clear that TDL recognizes that the equipment in its stores has a useful working life significantly longer than its depreciated book value, contrary to Mr. Clanachan's statements in his affidavit.

I. Critique of TDL Affidavits

Roger Ware

310. At the request of Plaintiffs' counsel, I have reviewed the affidavit of Roger Ware and make the following comments. Where possible I have tried to use Mr. Ware's headings in order to make cross-referencing easier. Mr. Ware has summarized the information provided through the affidavits of executives and franchisees supporting their position.

311. Mr. Ware has made some significant errors in his explanation of the franchise business, left out some key data when referring to the Lunch trade at Tim Hortons, and

¹¹⁷ See Table 14 above.

failed to discuss the significant additional revenue and likely profit that TDL obtained as a result of the implementation of the Always Fresh conversion and Lunch program. I believe, as noted earlier in this affidavit, that the additional profit generated was derived at the expense of the franchisees' operating profit. I have tried not to repeat points related to Mr. Ware's affidavit, made earlier herein.

Analysis of the Always Fresh conversion and the Lunch Menu

Paragraph 14

312. Mr. Ware states:

... franchisees reported many issues with this [Full-Baking] system: most significantly, they were highly dependent on the reliability and goodwill of their bakers. If the bakers reported sick, quit without notice, or were just unreliable in any way, the franchisee would bear the burden of late night callouts to the store, and lost business and profits if the product was not available as required.

313. While those franchisees who have sworn affidavits in support of the Defendants in these proceedings express the view that the Always Fresh conversion has relieved them of a significant burden in this regard, TDL (and its corporate predecessors) was obviously able to grow the Tim Hortons chain from its roots in 1964 to about 2,000 units by 2000, 2,400 by 2002 and 3,000 units by 2006.¹¹⁸ It is therefore difficult to accept the claim that reliance upon skilled bakers was having a negative impact on store profits.

Paragraph 15

314. Mr. Ware states:

Even given good performance from the bakers, this model was lacking in inventory control. A high level of waste or 'throws' was the norm, because demand for each type of donut cannot be accurately forecast when baking at infrequent intervals. The opposite problem also occurred: an unanticipated demand for a particular type of donut could not be met if the donuts had not previously been prepared or had run out.

315. In this paragraph, Mr. Ware suggests that the stores were lacking in inventory control and discusses the number of "throws" as a signifier of poor inventory control. As discussed above, Mr. Ware fails to point out that the standard number of throws used to be 12 dozen units at about \$0.078 per unit finished (i.e., as dictated by TDL) and, while

¹¹⁸ Clanachan Affidavit, Exhibit 24.

the number of throws dropped to 6 to 8 dozen¹¹⁹ post-Always Fresh, at about \$0.197 (e.g., the cost of the unfinished product plus the finishing cost applied at the store level) per “throw”, the dollars “thrown” increased from a maximum of \$11.23 to \$18.91 which is significant, actually an increase of about 68.4%¹²⁰.

316. In addition, the current situation as I have seen it from a customer’s point of view, is that when a particular Tim Hortons is out of a product, no one suggests that it can be made in 2.5 minutes and that they will offer a free coffee while I wait to be served a hot donut. Most service staff asks the customer to make a different selection ... at least that is my experience as a Tim Hortons customer for the past 35 years. I do not believe that unanticipated demand is actually an issue as I also know from my experience that customers will likely order a different donut if the one they prefer is not readily available.

317. Finally, it should be noted that TDL required that all franchisees prior to the conversion have at least 12 dozen donuts on display at all times.¹²¹ This could be the reason that the “throws” were so high prior to Always Fresh.

Paragraph 16

318. Mr. Ware states:

The impetus for the Always Fresh Baking system came primarily from franchisees who were frustrated with their lack of control over the baking process.

319. Mr. Ware is basing his comment on the Affidavit of Brian Archibald. However, in the Affidavit of David Clanachan, a reference is made to Exhibit 32, an incomplete series of Always Fresh Updates. In Volume 1, Issue 1 it says:

The Always Fresh Baker

The Baker

The skill of an Always Fresh Baker can make or break the success of Always Fresh Baking. No longer is the Baker task-oriented, focusing only on the flow of the donut bake. Finesse and speed are still required in order to react to customer demands, baking off and finishing product as needed. Multi-tasking is imperative, as the Baker is now responsible for baking, finishing and monitoring all products.

Afternoon shift:

¹¹⁹ Clanachan Affidavit, para. 130, Exhibit 37, p. 2153.

¹²⁰ See Table 7 above.

¹²¹ Clanachan Affidavit, para. 130.

Test market learning included the realization that the Afternoon shift is a crucial period in the success of Always Fresh Baking. In the absence of a dedicated Baker, a staff member has to be assigned to continue the Always Fresh Baking process – possibly a Supervisor or Manager. This staff member is responsible for baking off product as needed, throwing product and recording all information on the Production Tracking Sheet.¹²²

320. Mr. Ware then goes on to discuss some specific points:

a) Economics of scale and scope in production would ensure that overall production costs would likely be reduced. Concentration of donut preparation and baking in a single facility permits long production runs for each style of donut and allows unit costs to be lowered.'

321. I fully agree with Mr. Ware. The economies of scale have suggested that the donut production runs are longer, the cost of buying ingredients is likely much less expensive and the volume of labour is significantly reduced.

322. What used to be baked at 2,400 stores (again qualified to exclude kiosks and other non-producing satellite stores) over two shifts per day required that each store had at least 3 bakers on hand to cover off the shifts (14 baking shifts per week). That would mean the stores at the time would have likely had 7,200 bakers.

323. Maidstone Bakeries has approximately 300 employees (e.g., office, administration, baking, packing, storing, etc.), as reflected in the Google Maps webpage attached as **Exhibit M** to this affidavit. I have not as of yet been able to review the cost of producing a donut or any other baked good at the Maidstone plant.

324. The innovation that Mr. Ware talks about is the economies of scale. Consistent with reasonable commercial standards these economies of scale should benefit both TDL and the franchisees. TDL, however, appears to have taken the benefits of the economies of scale to offer the customer a smaller portion than the franchisees had offered in the past, and kept all of those benefits for themselves.

d) ... a significant reduction in wastage or 'throw' can be achieved.

325. As noted earlier, if unit "throws" are down from 12 dozen to 6-8 dozen as estimated by Mr. Clanachan, the total cost of these "throws" has increased by 26.3% to 68.4%.

¹²² Clanachan Affidavit, Exhibit 32, p. 1842.

326. Mr. Ware states:

... an unexpected spike in demand can be met by quickly baking the necessary donuts, thus reducing the required inventory and the expected waste on any given day. For example, a tour bus can be greeted with the message 'we will have those donuts ready for you in 10 minutes'.

327. This is conjecture as it is more likely that a busload travelling through will simply purchase those donuts that are in the display case, as is the case with most people, based on my own personal experiences and those of my clients.

Paragraph 17

328. Mr. Ware is simply restating what is in the affidavits of Susan Marshall, Mark Angelini and David Clanachan. The comments reflect the position of the Defendants in this proceeding and they are not supported by financial information from any of those quoted, and they certainly do not provide research or facts gleaned from identified data.

Paragraph 19

329. Mr. Ware states that:

TDL, as the custodian of the Tim Hortons franchise brand, has an incentive to innovate in order to increase the long run total value of the brand.

330. I also believe that this is true, but it should not occur at the direct expense of the franchisees.

Paragraph 20

331. Again, it is my opinion that Mr. Ware has it wrong. Mr. Ware states:

... Only a small group of customers was drawn to Tim Hortons for its limited Lunchtime offerings. Buildings and other overheads, machinery costs and fixed labour costs were all being incurred through the day, including at those 'slack times', and having to be paid for through revenues earned primarily in the busy morning period.

332. As explained elsewhere in this affidavit, most Tim Hortons costs are variable and not fixed. Mr. Ware may not have a full understanding of the Tim Hortons model. He talks of fixed overheads, but there are really very few of them. Rents along with most overheads are variable to sales. Labour can be easily reduced during slack times, so when business is driven into the restaurant, labour has to be increased as do almost all

other costs to run a Tim Hortons franchise. Since the introduction of Always Fresh, Lunch period sales have decreased from 18.8% to 17.8%, which is a 5.3% decrease¹²³. But most importantly, we have shown that, in fact, more than 82% of Tim Hortons Lunch-time business is generated from non Lunch Menu items.

Paragraph 21

333. Mr. Ware states that:

The opportunities that I have described above have in fact materialized into substantial gains for the company and for its franchisees. Tim Hortons has rebranded itself as an attractive Lunch destination and revenues have substantially increased. And, as anticipated, sales of coffee and donuts have also increased over the Lunch-time period...

334. I agree that TDL has expanded Tim Hortons to be an option as a Lunch destination. I question, however, whether there are any “facts”, as Mr. Ware claims, to show that the franchisees have made any gain whatsoever. Based on my analysis set out above, rather, it seems clear that the cost of donuts and other Baked Goods has risen, the cost of labour has remained relatively the same and the cost of Lunch products is so high and the margins so low, that it would be next to impossible for increased Lunch item sales to do anything but drop the margins of the franchisees. As explained above, moreover, the sales of ‘additional donuts and coffee’ outside of the ‘combo’ offerings is minimal and certainly do not offset the losses incurred by franchisees required to sell the Lunch Menu items. Finally, over the time period 2003 to 2008, the percentage sales during the Lunch period, on an overall Canada-wide basis, has declined by about 5%. Therefore, Mr. Ware’s statement is not correct.

335. In my opinion, and as discussed throughout this affidavit, the Defendants have put forth no financial information to support their claims of increased profits to the franchisees. There seems to be more labour needed at the kiosk (e.g., bakers, receivers, finishers), the raw donut product cost has tripled (i.e., \$0.06 to \$0.179), and it has not risen for 4.5 years according to Mr. Clanachan.¹²⁴ To me, that is a clear indication that the mark-ups in 2003 were excessive. Just how large these mark-ups were will be revealed with the analysis of documents and other related information that

¹²³ O’Rourke Affidavit, Exhibit 7.

¹²⁴ Clanachan Affidavit, para. 148.

will serve to establish the actual production costs at Maidstone (unavailable to me at the time of swearing this affidavit).

336. There may also have been a likely benefit to TDL on the purchase of all the new equipment requirements for the Always Fresh conversion.

Plaintiffs' claims of harm

337. It is clear to me that Mr. Ware did no factual research into the situation at hand. He has not recognized the cost increases on franchisees in terms of the raw product or food cost of donuts, has not looked carefully at the labour issue and does not appear to understand the variable costs associated with this restaurant business.

Paragraph 25

338. Mr. Ware states:

... Mr. Garland is incorrect when he states that margins on the Lunch menu must be positive when including an allowance for overhead. A new product will generate positive profits if it covers only variable costs (which clearly does not include overhead), at least in the short run. In addition, Mr. Garland fails to consider the additional sales of traditional products (coffee and donuts) generated by the enhanced Lunch-time traffic.

339. In the restaurant business, almost all costs are variable and very few are fixed. The largest component of fixed cost is usually rent. With a fixed rent, one would do almost anything to increase sales, as that is about the only cost that usually does not vary with sales. In this case, however, TDL very unusually, to my experience, charges a variable rent to franchisees, so that franchisees cannot leverage profit against sales as the rent goes up with every sale.

340. Each Tim Hortons sale includes the cost of product, labour, RRA and paper. Increased traffic creates increased demand on utilities, cleaning and other operating expenses, as explained earlier.

341. Mr. Ware is simply and clearly misinformed about both the restaurant industry and TDL's model.

342. I emphasize that:

- The Plaintiffs' Lunch Menu items have an average food cost ranging from 51.8% in 2005 to 53.5% in 2008. Mr. Ware does not dispute this fact.
- Paper cost averaged at 5.12% when reviewing the national averages for 2007.¹²⁵
- Labour cost is variable and is a function of sales. TDL's labour cost was 28.01% for the year ending 2007, Canada-wide.¹²⁶
- Royalty, Rent and Advertising costs are 16.5% of every sale in the standard stores, and 22% in the kiosks.
- Operating Expenses were 8.08%.

343. Assuming combined costs for Paper, Labour, RRA and Operating Expenses of a minimum of 57.71% nationally as at 2007¹²⁷, then the impact of Lunch food costs at 51.8% to 53.5% is obvious. The franchisee is likely to lose somewhere between 9.5% and 11.2%. This analysis does not even account for owners' salary, depreciation, income tax or a reasonable return on the franchisee's investment, all of which must be paid for by an operating margin that does not exist. For franchisees operating kiosks that serve Lunch, the picture is even worse: they will lose 4.5% to 5.5% more, depending whether their RRA payment is 21% or 22%.

Conclusions

344. Mr. Ware states in paragraph 32 that:

Franchisees have been made better off as a result of the innovations as detailed in this Affidavit and in the Affidavits of many franchisees.

345. This conclusion reiterates the Defendants' case as put forward by their deponents but Mr. Ware does not appear to have done any research (he certainly does not show any) and provides no other support for the conclusions he expresses.

¹²⁵ Ontario Regional Financial Review, Year End Report, p.2 attached as Exhibit K to this affidavit.

¹²⁶ Ontario Regional Financial Review, Year End Report, p.2 attached as Exhibit K to this affidavit.

¹²⁷ See Exhibit K, p.2

David F. Clanachan

Paragraph 39

346. Here Mr. Clanachan states:

...the items that can be sold by the license and the restriction in selling product at a price above that set forth by Tim Hortons.

347. This provides clarity that TDL controls all maximum price levels for all products. The fundamental point is that TDL sets the maximum price points of all products the franchisees sell regardless of how different they want to say their franchises are from one another. TDL also sets the product purchase price for each product the franchisee buys.

348. Further, Mr. Clanachan quotes the franchise agreement as saying:

'The Licensee shall, at its own expense, maintain the exterior and interior of the Shop and the Licensed Location. It shall also maintain its equipment, fixtures and signage in good condition and repair and shall purchase additional or replacement equipment as required by Licensor. The Licensees shall maintain records of all expenditures made for such purposes....

..The Licensee is obligated to purchase from TDL or its designated manufacturers or suppliers all of the ingredients and commodities which may form any part of the products or the whole product of any food or beverage made, sold or consumed on the Licensed Location ...

The Licensor may make a profit or receive a commission or rebate on the prices of goods sold to the Licensee...'

349. It has been my experience that these clauses are put in place to ensure that franchisees purchase what is required and ensures that the quality of goods is the same from store-to-store. It is further my experience that on occasion a franchisor may introduce a new product line that may require an additional piece of equipment that all franchisees are required to purchase. By way of example, the cappuccino machine that Mr. Clanachan refers to as an added piece of required equipment that provided a new product line with significant margins and did not take away from any other strong margin item. I can also look to McDonald's with its introduction of pizza many years ago which required the franchisees to purchase a pizza oven. Or one can look at the McFlurry also sold by McDonald's, where McDonald's developed a small but very effective machine to convert an ice cream cone that sold for approximately \$0.49 into a McFlurry

(a soft ice cream with chocolate bar bits whipped into it) that sold for approximately \$2.49. These are all simple purchases to implement related but enhanced product lines imposed on the franchisees that allowed the respective companies to grow their product line with little reconfiguration of space and without negatively impacting the existing margins.

350. It is not my experience, and I have never before seen, a wholesale swap out of good equipment to be replaced by new equipment, some of which did not even fit in the stores themselves (i.e., exterior walk-in freezers). The impact of this equipment swap was to allow TDL to supply an otherwise inexpensive product (e.g., donuts) for what some might call an inferior product at a significantly more expensive cost to the franchisees.

351. These clauses typically have been included to provide the franchisor rights to force a franchisee to replace broken or badly worn equipment with newer equipment or introduce a new piece of equipment from time-to-time. I express this opinion on the basis of what I understand to be reasonable commercial practices within the foodservice industry based on many years of experience which includes many significant franchisor clients. Franchisees whose equipment may have been fully depreciated in the past were not forced to replace their scratch baking equipment every ten years if that equipment was well maintained. Additionally, as we have seen, it seems TDL is happy to rent out fully depreciated equipment that is over 10 years old to franchisees for 7% of sales per year.

Paragraph 42

352. All of the costs described in paragraph 42, subparagraph 7 parts 'a' to 'g' relate to operating expenses, and even though Mr. Clanachan uses the words 'fixed' quite often when referring to these operating expenses, almost all of them vary with the level of sales and therefore should be referred to as 'variable costs'.

353. With the exception of some minor percentage of wages (e.g., 10% to 20%), manager's salary and property tax, almost all expenses vary with sales. The higher the sales, the more utilities are used, the more repair and maintenance is required, the

more the kitchen supplies are needed, the more the store front supplies are needed, etc. Almost all restaurant expenses vary with the volume of sales achieved. While I agree there are some minimum base costs, most vary with sales.

Paragraph 67

354. Counsel and the courts must deal with the contractual issues outlined in this paragraph. In my experience, it is unprecedented to impose the wholesale change of the kind which occurred here from on-site production to on-site warming which in my opinion only benefits the franchisor and harms the franchisee.

355. It is my experience, and it is very standard within this industry, that franchisees benefit from the volume purchasing power of the franchisor and products be made available to them at a price lower than the market price for their single units. Therefore, if a product would cost a non-franchisee \$1 and due to the purchasing power of the franchisor, the system can obtain the product for \$0.80, then I believe, and it is my experience that, the franchisor will add a 5% to 10% added value for negotiating the deal for themselves, thus obtaining the product for the franchisee at \$0.84 to \$0.88. In this manner, both the franchisee and franchisor benefit.

356. As Mr. Clanachan stated in paragraph 6:

franchisees are the heart of our business... we work collaboratively and strategically with our franchisees as they represent and champion the brand to our customers.

357. And in paragraph 7, he states:

A central element of the Tim Hortons operating philosophy is that if our franchises are successful, then our shareholders will be successful. Our powerful business model is focused on responding to the changing needs of our customers and helping our franchisees be successful.

358. These two claims of Mr. Clanachan seem to be in contrast to the power and rights that he says TDL has over all aspects of the franchisees' business, including TDL's rights to sell goods at whatever price it wants to charge its franchisees.

Paragraphs 68 to 74

359. These paragraphs discuss the Advisory Board. In short the Advisory Board, from my understanding, was developed to provide feedback as to how TDL was spending the franchisees' advertising money, and then evolved into a more comprehensive sounding board for TDL management.¹²⁸ While the concept of the Advisory Board¹²⁹ is very good, the fact that there are more TDL corporate employees than franchisee Advisors, seems contrary to the expected composition of a franchise Advisory Board. There were 17 elected members of the Advisory Board and 18 or 19 TDL staff at the September 14 and 15, 1999, meetings¹³⁰. Similarly, TDL had more corporate members at the Advisory Board meetings held in June 2001¹³¹, November 2001¹³², June 2002¹³³, September 2002¹³⁴, and February 2003¹³⁵, than franchisee representatives.

360. In paragraph 69 Mr. Clanachan suggests that this group meets three times per year and sometimes more, however, he only provides partial notes as exhibits and only for one meeting in 1999, no meetings in 2000, two meetings in 2001, two meetings in 2002 and one in 2003.

361. In the minutes shown by Mr. Clanachan in his Affidavit there is little if any reference to the Always Fresh conversion. A review of the minutes provided reveals the following:

September 1999	Topic not discussed.
2000	No meeting notes provided.
June 2001	There were just 6 lines and no real information shared.

¹²⁸ Clanachan Affidavit, para. 68.
¹²⁹ Clanachan Affidavit, para. 69.
¹³⁰ Clanachan Affidavit, para. 70.
¹³¹ Clanachan Affidavit, Exhibit 22.
¹³² Clanachan Affidavit, Exhibit 24.
¹³³ Clanachan Affidavit, Exhibit 31.
¹³⁴ Clanachan Affidavit, Exhibit 34.
¹³⁵ Clanachan Affidavit, Exhibit 36.

Nov 2001	5 full lines of data on transition, when roll-out will start and an estimate of the cost of equipment (\$30,000 to \$35,000) to franchisees ¹³⁶ .
June 2002	22 stores testing, other reporting information from TDL and still no prices or cost estimates of donuts ¹³⁷ . Only 1 page of notes.
September 2002	Just a short reporting on where TDL is at regarding roll-out ¹³⁸ .

362. These are hardly the notes of an active participatory Advisory Board regarding their thoughts and input to a roll-out that will cost the estimated 775 franchisees that they represent¹³⁹ a total of approximately \$72 to \$84 million (i.e., \$30,000 to \$35,000 per store x 2,400 stores) to retrofit their stores plus the losses associated with discarding the Full-Baking equipment. Unless the notes say more, which is yet to be revealed, there does not seem to be any participation of the Advisory Board in the decision to look into, analyze benefits, or how to roll-out, the Always Fresh Baking conversion.

Paragraph 70

363. At paragraph 70, Mr. Clanachan makes reference to his Exhibit 15 as a typical Advisory Board meeting. The top of page 14 of Exhibit 15 refers to a potential change in Coke products from Fountain to Bottled drinks. The relevance of bringing this up, is that it clearly illustrates TDL's interest in increasing gross sales vs. franchisee profitability.

364. In the first paragraph of that page it states:

The following chart illustrates that there is no change in the margin

¹³⁶ Clanachan Affidavit, Exhibit 24.

¹³⁷ Clanachan Affidavit, Exhibit 31.

¹³⁸ Clanachan Affidavit, Exhibit 34.

¹³⁹ Clanachan Affidavit, Exhibit 25.

	Fountain	Bottle	Increase
Selling price	\$1.02	1.59	
Product cost	.17	.62	
RRA	.17	.27	58.8%
Margin	.68	.70	2.9%

365. While the dollar income is virtually the same for the franchisee, the franchisee's profit margin changes from 66.7% to 44%. TDL's income increases from \$0.17 to \$0.27, a 58.8% increase while the franchisee only obtains a 2.9% increase. This illustrates that TDL makes price changes that benefit itself over its franchisees. This price increase has to be passed on to the consumer, which may impact customer counts, provides the franchisee with virtually no additional profit, yet provides a 58.8% increase to TDL's RRA from this one product alone. This profit is derived from the consumer without any real benefit to the franchisee.

366. The next two charts on page 14 of Exhibit 15, illustrate that a Sandwich Deal with a fountain drink has a food cost of 28% to 31%, while the same combo with a bottled drink has a food cost of 39% to 40%.

367. TDL eventually moved to bottled products.

Paragraphs 82 to 90

368. In paragraphs 82 to 90, Mr. Clanachan discusses the reasons for the Always Fresh conversion.

Paragraph 83

369. Mr. Clanachan states here that:

The products that were scratch baked represented (depending on the franchise) in between 10-15% of overall sales of the store.

370. With a statement like that, one would get the impression that the bakery products are not so relevant to operations.

371. However, it should be noted that while bakery accounted for 10% to 15% of overall sales, the franchisees have stated in their affidavits that the Lunch portion of their sales ranged from 8%¹⁴⁰ to 18%¹⁴¹ of overall sales. In other words, bakery accounts for approximately 50% of food sales at Tim Hortons franchise or licensed stores that sold both Baked Goods and Lunch products. This, in my opinion, is very significant. In addition, a sandwich costs about 5 times more than a donut, so while they represent about half of the dollar sales spent on food, they represent only about 10% of all food item transactions.

372. In some cases, however, those stores that do not sell the full Tim Hortons food line-up (some stores do not sell the Lunch menu), the bakery line-up could be 100% of the food offerings.

Paragraph 85

373. Mr. Clanachan talks here of the difficulty in finding, hiring and retaining bakers. He states that:

A very large number of franchisees informed us over and over again of the problems that they had in keeping and paying for a trained baker. The training of a baker took significant resources and time. ... They would spend three months training and getting a baker up to speed and then that baker would leave for employment elsewhere.

374. I would have expected to find some evidence to support exactly how many franchisees made up this 'very large number of franchisees' claim. If this was becoming a real problem in the 1990s, then I think it would have been identified long before the business grew to become the largest foodservice franchisor in Canada.

375. The franchisee-training program, which I understand is 'an intensive eight week training program'¹⁴² teaches all aspects of running a Tim Hortons franchise. The course offers 'an intensive hands-on experience in the preparation of all Tim Hortons products.

¹⁴⁰ Cordella Affidavit, para. 21.

¹⁴¹ Guilmette Affidavit, para. 4.

¹⁴² www.timhortons.com/ca/enjoin/franchise_ca_training.html

Strong emphasis is placed on food handling and hygiene procedures, employee relations, equipment maintenance and in-store security systems'.¹⁴³

376. I understand that the program was also 8 weeks long prior to the implementation of the Always Fresh conversion.

377. While I do not know how long it should take to train a baker (Mr. Clanachan suggests it takes 2 weeks¹⁴⁴), it is certainly clear that it takes TDL less than 8 weeks to train a non-skilled franchisee in all the elements of running a Tim Hortons restaurant, including how to bake every product, and teach the franchisee how to train a new baker.

378. Mr. Clanachan's statement at paragraph 85 that it takes a franchisee 3 months to train a baker should be read in the context of the following franchisee statements:

- Brian Archibald states that 'his stores employed skilled bakers'.¹⁴⁵
- Mark Angelini states: 'under the scratch bake system, it was very difficult to obtain skilled baking staff.'¹⁴⁶
- Graham Oliver states: 'The scratch baking had to be performed by trained bakers, as it required particular baking expertise.'¹⁴⁷
- James Shaw states; 'It had also become very difficult to recruit skilled donut makers, and very expensive and time-consuming to train these individuals properly.'¹⁴⁸
- Mr. Reinke states; 'It took approximately a year to fully train a baker'¹⁴⁹
- Vince Carella states; 'Training a new baker was a long and expensive process'¹⁵⁰
- Danny Murphy states; 'On average, it took approximately 6-8 months to properly train a baker'¹⁵¹

¹⁴³ www.timhortons.com/ca/en/join/franchise_ca_training.html

¹⁴⁴ See para. 377 below.

¹⁴⁵ Archibald Affidavit, para. 11.

¹⁴⁶ Angelini Affidavit, para. 15.

¹⁴⁷ Oliver Affidavit, para. 11.

¹⁴⁸ Shaw Affidavit, para. 11(b).

¹⁴⁹ Reinke Affidavit, para. 18.

¹⁵⁰ Carella Affidavit, para. 11.

¹⁵¹ Murphy Affidavit, para. 9.

379. In paragraph 120 of Mr. Clanachan's Affidavit, he sets out information presented in Exhibit 33 (although I do not believe he referenced the exhibit properly), I believe this information was taken from a presentation he made to the franchisees on the Always Fresh Baking program. It is clearly spelled out in paragraph 120 of his Affidavit addressing the anticipated training expense changes, benefit cost changes and operating expense changes that:

Training expense changes

...

Baker Training Time Reduced Dramatically

o From 2 weeks to be up to speed, but with Always Fresh, this can be cut to 5 days

...

380. The franchisee can be trained to bake the product and operate the store to TDL standards in 8 weeks; in paragraph 120 Mr. Clanachan outlines how baker training will be cut from 2 weeks to 5 days; in his affidavit paragraph 85 he says it takes 3 months to train a baker, and his supporting franchisees claim, it takes 12 to 52 weeks to train a skilled baker.

381. Back-up material to support these claims has not been provided. TDL's growth of this chain from one store in 1964 to over 2,400 stores in 2004 belies the contention that bakers were scarce, hard to train and unreliable. Obviously the stores had the capability of producing what was needed on a daily basis and if a baker could not perform the task the franchisee stepped in. I do not believe that one would need a 'trained baker' to work at a Tim Hortons but rather someone willing to 'bake' who would be called a 'baker' and would be responsible for the baking process.

382. By way of example, my wife has been a foodservice operator for over 25 years. She was a partner at the Senator Restaurants for ten years, opened and ran Ruth's Chris Steak House for 5 years, managed the opening of Harbour 60 Steak House, was Vice President of Chez Cora and Vice President of SIR Corp (operating reds, Far Niente and others). She currently runs the foodservice at the Royal Ontario Museum and the Estates of Sunnybrook. My wife has told me, and I believe, that the head baker at C5 (named as one of the top 10 restaurants in Toronto by *Toronto Life Magazine* in 2008 and 2009), earns \$20 per hour and her assistant, formerly the baker at the AGO's

FRANK restaurant, about \$14 per hour. These two women are professional, skilled bakers who create their own recipes and make outstanding desserts at the leading edge of what the market has to offer. The skills needed for this are quite different than those needed to knead and fry donut dough.

Paragraph 87

383. Mr. Clanachan states:

The solution of baking on one site and delivering through vans or cars to other locations also added significant costs. It also led as one franchisee said to me, to the kiosk or delivered store having 'Always Cold' product. We were also increasingly aware of the food storage and safety issues that this van delivery practice presented.

384. I have been eating at Tim Hortons stores since 1975 when I first moved to Toronto. Over the course of the past 35 years, I do not recall ever getting a hot or warm donut from Tim Hortons. In any event, had the food storage or safety issue come to light through a customer complaint or litigation related to food poisoning, I suspect this would have been put forth as evidence. I would like to believe, as a customer of Tim Hortons, that TDL, which sanctioned this type of van delivery for so many years, ensured that the food handling practices were of the highest standard. I understand from Mr. Jollymore that the delivery trucks were inspected by both TDL and the local health boards that monitor restaurants, and were always deemed appropriate for the safe transportation of product. I further understand that the vans were not refrigerated, and therefore, I do not understand where the 'Always Cold' statement came from.

385. As this case moves forward, and we are provided with more materials from TDL through the discovery process, we will be able to develop a spreadsheet that would enable us to determine if the cost of delivery via a van is more or less expensive for the franchisee than the new method of installing ovens, freezers, paying higher utility charges and higher price for the donuts. This would pertain to all stores that used to receive delivered products. In any event, I have shown earlier that Mr. Garland still delivers product to an Esso kiosk using a van, and is earning significantly more profit than the Ontario average.¹⁵²

¹⁵² Exhibit K to this affidavit, p.7.

Paragraph 88

386. The majority of restaurants in North America have a grease fryer, including, but not limited to: McDonald's and Burger King, both being Tim Hortons competition. Neither of these operations are 'dirty' because of the grease fryer and Mr. Clanachan's assertion that this impacted the cleanliness of the stores is difficult to understand and cannot be substantiated. I do, however, agree that the fryers are more challenging to keep clean, but it is certainly something the vast majority of restaurants manage well.

Paragraph 89

387. Mr. Clanachan says:

In addition, given the individual baking element, there were also problems with either oversized or undersized product and the lack of uniformity as between stores would have negative impact on the brand as a whole.

388. It is difficult to understand how a company that is growing at a rate that far surpasses any competitors in Canada, with same store sales increasing by¹⁵³ :

8.0% in 1997
10.2% in 1998
10.3% in 1999
9.7% in 2000 (a recession year)
7.8% in 2001 (a recession year)

and whose store numbers climbed from:

1,500 units in 1997 to
2,000 units in 2000, and,
3,000 units by 2006¹⁵⁴,

was experiencing any discernable 'negative impact on the brand as a whole'. Mr. Clanachan's statement is not supported by available data.

Paragraphs 91 - 98

389. Mr. Clanachan discusses Always Fresh "par baking" in paragraph 91 through 98, and says that:

¹⁵³ Clanachan Affidavit, Exhibit 24, p. 1700.

¹⁵⁴ www.timhortons.com/ca/en/about/index.html

- In 1999 TDL started to look at par-baking process;
- In December 1999, TDL determined that IAWS Group plc had the optimal technology for the production of donuts;
- In July 2000, Mr. Clanachan claims he introduced this to the franchisees;
- In August 2000, TDL senior management started to negotiate the joint venture with IAWS;
- In the Fall of 2000 and Spring of 2001, TDL negotiated the underlying contracts of the joint venture with IAWS;
- In December 2000, the Always Fresh Baking was being tested in stores; and,
- In March 2001 the joint venture was signed.

390. In 2001 Mr. Clanachan admits in paragraph 98 that:

... we had not developed a detailed economic analysis of the impact at the store level but our general sense was that the franchisees food cost would go up and that the labour cost should go down over time, which was my consistent message to the franchisees always with the proviso that we were doing the testing and work necessary to establish more definite number and that the franchisees would be fully briefed and trained in Always Fresh Baking.

391. At this point it is clear that TDL entered into a joint venture agreement to build the commissary (i.e., Maidstone) and was committed financially to its 50% funding of the joint venture, but had not determined what the impact would be on its franchisees. This is not commercially reasonable in my opinion.

Paragraph 99

392. The information provided at the June 2001 Advisory Board meeting, as outlined in paragraph 99, did not provide any meaningful information as to the costs nor impact that the Always Fresh Program would have on the franchisees.

Paragraph 100

393. Mr. Clanachan states:

'Although I cannot now recall the specifics, I am absolutely sure that the topic was discussed over the two days at every Advisory Board meeting and regional meeting in 2000 and 2001 and that the reaction of the franchisees was that they were still having major problems with scratch baking and really wanted Always Fresh Baking. In fact,

