

**ONTARIO  
SUPERIOR COURT OF JUSTICE**

BETWEEN:

FAIRVIEW DONUT INC. and BRULE FOODS LTD.

Plaintiffs

and

THE TDL GROUP CORP., ~~THE TDL GROUP LTD.,~~  
~~TIM DONUT LIMITED~~ and TIM HORTONS INC.

Defendants

*Proceeding under the Class Proceedings Act, 1992*

**FACTUM OF THE MOVING PARTIES/PLAINTIFFS  
RE CERTIFICATION**

**VOLUME 1 OF 2**

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**PART I. OVERVIEW**

1. The Plaintiffs, Fairview Donut Inc. ("Fairview Donut" or "Fairview") and Brule Foods Ltd. ("Brule Foods" or "Brule"), are franchisees of the Defendants operating Tim Hortons stores in Burlington, Ontario. They move to have their action certified as a class proceeding under the *Class Proceedings Act*, R.S.O. 1992, c.6, as amended (the "CPA").

2. The Plaintiffs' action concerns the limitations on a franchisor's ability to exercise powers under the franchise agreement in pursuit of its own business interests without reasonable or proper regard for those of the franchisees. The Plaintiffs challenge the Defendants' conduct in relation to two programs: the "Always Fresh ("AF") conversion"; and the Lunch Menu.

3. The first Tim Hortons restaurant opened in 1964. The Tim Hortons chain grew to approximately 2,200 restaurants across Canada as of 2002 on the strength of "scratch-baked" donuts, Timbits and other baked goods. Donuts and Timbits, for example, were

prepared by Tim Hortons franchisees, on-site, from donut mix, and other ingredients that were combined and deep fried in twice daily bakes (in most stores).<sup>1</sup>

4. From the Fall of 2002 to February 2004, this changed. Tim Hortons franchisees were required by the Defendants to implement the AF conversion. The franchisees were directed to stop preparing their donuts, Timbits, muffins and cookies from scratch on-site and, instead, to purchase from suppliers designated by the Defendants (including the Defendants' own joint venture ("JV") with the IAWS Group plc ("IAWS")) ready-made, partially baked ("par-baked") frozen products that were to be re-heated in their stores using specially designed ovens purchased by the franchisees from the Defendants.

5. The franchisees' capital contribution to the AF conversion at least equalled (and likely exceeded) the Defendants' capital contribution to the JV. The Defendants nonetheless disregarded the franchisees' legitimate business interests in ensuring that the cost of the new AF products would be commercially reasonable.

6. Throughout 2001, Tim Hortons Senior Management represented to its franchisees that the cost of the AF donut would be about 11¢ to 12¢. Tim Hortons Advisory Board members, whose role was to serve as a liaison between Senior Management and the franchisees, communicated their support for the AF conversion to Senior Management on that basis.

7. When the AF donut arrived, it cost 17.9¢, tripling the food cost to franchisees. The food cost of Timbits, muffins and cookies also rose significantly, reducing the contribution of all of these products to franchisee operating profits.

8. Requests for retail price increases to redress franchisees' eroded profit margins on these baked goods went unexplored and unheeded by Tim Hortons Senior

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<sup>1</sup> Some stores were non-producing and were commonly referred to as "satellites"; Satellite stores typically received their baked goods from a producing store owned by the same franchisee or, in some cases, owned by another franchisee: Jollymore, July 2010 Aff, para. 35, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, p. 1972.

Management. While retail prices for donuts, Timbits, muffins and cookies have increased to some extent since 2002, these increases were granted to offset other pressures (principally minimum wage increases) and, in any event, were insufficient to offset the new high food cost of the AF products. The economic losses imposed upon Tim Hortons franchisees by the AF conversion are therefore ongoing.

9. In stark contrast to franchisee losses, the Defendants' financial gains from the AF conversion were projected to be, and have been, spectacular. Their \$75 million capital investment yielded dividends, inducements and royalties totalling approximately \$190 million from 2001 to 2010, plus proceeds of sale of \$475 million in 2010 from their interest in the JV that established Maidstone Bakeries<sup>2</sup> (the plant that manufactured the AF donuts and Timbits). These gains exclude revenues received by the Defendants from the distribution of the equipment purchased by franchisees to implement the AF conversion and the distribution of AF products to franchisees from 2001 to date (which continues, despite the Maidstone sale).

10. Tim Hortons has had a Lunch Menu for many years. The Plaintiffs' issue is not the existence of this category of products *per se*. The franchisees take issue that they are required by the Defendants to sell this category of products at an ongoing and significant loss, in circumstances in which the Defendants control the cost of the products and equipment that must be bought by franchisees from the Defendants to sell the Lunch Menu items to customers and the retail prices to be charged.

11. Franchisees have experienced a shift, in that the Lunch Menu has not been profitable since at least 2003 as these menu items are now at a more or less "break-even" position to a significant and persistent loss. This loss significantly reduces franchisees' operating profits because there is no off-setting gain. The Lunch Menu does not function as a "loss leader"; i.e., it does not "drive" sufficient sales of profitable items so that franchisees make an overall profit.

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<sup>2</sup> On October 29, 2010, the Defendants sold their share of the JV to IAWS (known as ARYZTA AG as a result of a merger with Holding AG in August 2008): FTI Report, para. 25, Plaintiffs' 4<sup>th</sup> Record, Vol. 2, Tab 3A, p. 25.

12. The unprofitability of the Lunch Menu contributes to the vulnerability of franchisee operating profits by, in combination with the impact of the AF conversion, rendering them dependent on coffee and other drinks to earn a reasonable return on their investments in their stores and, therefore, more vulnerable to the risk that the business will fail.

13. While the Plaintiffs and other franchisees lose money on every Lunch Menu item sold, however, the Defendants gain: they earn a minimum of 16.5% of every dollar sold (through Rent, Royalty and Advertising payments made by the franchisees) plus distribution revenues on the related products and equipment that franchisees must purchase.

14. The Plaintiffs allege that the Defendants' conduct in relation to the AF conversion and the Lunch Menu was in breach of contract, contrary to the Defendants' statutory and common law obligations of good faith and fair dealing and constitutes unjust enrichment. In relation to the AF conversion only, the Plaintiffs also allege breach of relevant provisions of the *Competition Act*, R.S.C. 1985, c.C-34, as amended.

## **PART II. FACTS**

### **A. The Tim Hortons chain**

15. As of 2001, when the AF conversion was in development, Tim Hortons was "Canada's largest chain of shops...in the coffee and fresh baked goods segment." As of 2008, it was the "fourth largest publicly-traded quick service restaurant ["QSR"] chain in North America based on market capitalization and the largest in Canada," with annual revenues exceeding \$2 billion.

Reference: 2001 Ontario Disclosure Document, Ex. 7 to Cianachan, November, 2009 Affidavit, Defendants' 1<sup>st</sup> Record, Vol. III, Tab 137, p. 707

2008 Annual Report, Ex. 4 to Cianachan, November, 2009 Affidavit, Defendants' 1<sup>st</sup> Record, Vol. II, Tab B4, p. 451

16. From the point of view of corporate structure, the chain has undergone some changes over the years. The franchise was founded as Tim Donut Ltd. in 1964. By 1967, Tim Donut Ltd. was co-owned by Tim Horton (the Toronto Maple Leaf hockey player) and Ron Joyce (a former police officer in Hamilton). They built the chain together until Mr. Horton's death in 1974. Mr. Joyce became sole owner in 1975 and continued to expand the chain until 1996, by which point the Tim Hortons chain had over 1,000 restaurants across Canada.

Reference: Clanachan, November 2009 Aff, para. 17, Defendants' 1<sup>st</sup> Record, Vol. I, Tab B, p. 15

17. In 1995, Tim Hortons merged with Wendy's International Inc., a public company. The merger lasted until 2006, when Tim Hortons sold 18% of its outstanding common stock in an initial public offering ("IPO") on both the New York and Toronto Stock Exchanges. The IPO was followed by Wendy's distribution of its outstanding interest to Wendy's' stockholders of record. Tim Hortons then operated as a stand-alone public company, with approximately 54,768 registered shareholders as of December 2008.

Reference: Clanachan, November 2009 Aff, paras. 17-18, Defendants' 1<sup>st</sup> Record, Vol. I, Tab B, pp. 15 -16

18. The Defendant, Tim Hortons Inc. ("THI"), is a company incorporated under the *Canada Business Corporations Act*, R.S.C. 1985, c.C-44, as amended, which carries on business in Canada through its subsidiary, the Defendant, TDL Group Corp. ("TDL"). THI and TDL are referred to collectively in this factum as "Tim Hortons".

Reference: Amended Statement of Defence, para. 5,

Clanachan, November 2009 Aff, para. 1, Defendants' 1<sup>st</sup> Record, Vol. I, Tab B, p. 9

19. Management of the Tim Hortons brand or chain has been consistent over the years. The chain is governed by "Tim Hortons Senior Management", a group that has remained constant, by title and (largely) by individual, from at least 1997 to date despite technical changes in the corporate structure beneath them over time (referred to below as "Tim Hortons "Senior Management" or "Management").

Reference: Walton, Cx, Q. 51-60, Plaintiffs 5<sup>th</sup> Record, Tab 9

Tim Hortons Organizational Chart, Ex. 1 to Walton Cx, Plaintiffs' 5<sup>th</sup> Record, Tab A-1

20. It is an interesting feature of this case that Tim Hortons Senior Management over the years has included the principal deponents in these proceedings, for the Plaintiffs and the Defendants:

- a. Archibald Jollymore, principal of the Plaintiff, Brule Foods, is a former member of the Defendants' Senior Management team. Mr. Jollymore, joined TDL in 1977, becoming Vice-President, Operations in 1978 and, subsequently, Senior Vice-President and Executive Vice-President. When he held them, the latter two positions were the most senior in the company, next to its founder and owner at that time, Ron Joyce. Mr. Jollymore's tenure in Senior Management coincided with a period of rapid growth within the Tim Hortons chain, from 75 stores in 1977 to almost 1,000 stores in 1994. Mr. Jollymore has extensive knowledge in the fast food industry specializing in coffee and baked goods and, in particular, the business of Tim Hortons.

Reference: Jollymore, July 2010 Aff, paras. 3-6, Plaintiffs' 2nd Record, Vol. 7, Tab. 2, p. 1965

- b. Cyril Garland, a deponent on behalf of the Plaintiffs, is also a former member of Tim Hortons' Senior Management team. He is an experienced Chartered Accountant who held the successive positions of Corporate Controller, Senior Director of Finance and Vice-President, Finance with the Defendants from 1989 through 1998. Mr. Garland has extensive knowledge of, and experience with, Tim Hortons business and financial information and operations. During his time in Senior Management, Mr. Garland's responsibilities included all internal financial and other controls; all monthly financial and managerial reporting; all budgeting, long-range planning and forecasting; banking and cash management; due diligence on proposed corporate acquisitions; taxation and tax planning; and all information systems. Following Tim Hortons 1995 merger with Wendy's, Mr. Garland was TDL's primary contact with Wendy's from a finance, accounting, reporting and budgeting point of view.

In all of these positions, Mr. Garland would get involved from time to time with franchisees perceived by Senior Management to have developed financial problems. His role when this occurred was, generally speaking, to obtain an audit, review the franchisee's financial statements to identify the source of the problems and make related recommendations to Senior Management.

As TDL's most senior person with responsibility for (among other things) financial and managerial reporting and the position of financial and other systems of internal control, Mr. Garland received consistently high praise (from Mr. Joyce, Mr. House and others) for the quality and depth of his analysis throughout his tenure.

Reference: Garland, July 2010 Aff, paras. 2-5 and 35, Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 4, pp. 2565-66

- c. Paul House joined Tim Hortons in 1985 as Vice-President of Marketing and has held a number of positions since including President and Chief Operating Officer (as of 1995), followed by President and Chief Executive Officer in 2006 and Chairman of the Board in 2007.

Reference: House, November 2009 Aff, para. 1, Defendants' 1st Record, Vol. VIII, Tab E, p. 2629

- d. Roland Walton joined Tim Hortons in 1997 as Executive Vice-President Operations responsible for Canada and the U.S. and is currently (since March 2008) Chief Operations Officer Canada.

Reference: Walton, Cx, Q. 26-50, Plaintiffs' 5<sup>th</sup> Record, Tab 9

- e. David Clanachan is Tim Hortons' current Chief Operations Officer, U.S. and International. As of 2000, Mr. Clanachan was Vice-President, Research and Development and head of the team tasked with due diligence in relation to the AF conversion. He was assisted by Jeff O'Rourke, now Tim Hortons Director, Financial Analysis Franchise Operations.

Reference: Clanachan, November 2009 Aff, paras. 1, 92, Defendants' 1<sup>st</sup> Record, Vol. I, Tab B, pp. 9, 54

## **B. The Plaintiffs and proposed class members**

21. Brule Foods, Mr. Jollymore's company, has been a Tim Hortons franchisee for over 17 years, operating three stores over that period. Mr. Jollymore acquired Stores #750 and #737 pursuant to License Agreements signed with the Defendants in 1994. He has operated Store #750 continuously since, but sold Store #737 back to the Defendants in 2007. Mr. Jollymore assumed the operation of a corporate-owned store, Store #2267, pursuant to an Operating Agreement signed in 2002 and has operated that store continuously since.

Reference: Jollymore, July 2010 Aff, paras. 7-22., Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp. 1966-69

22. Fairview Donut has been a franchisee of the Defendants for over 23 years operating two stores over that period. Fairview's principal, Anne Jollymore, is a trained pastry chef and has been married to Mr. Jollymore since 1994. Ms. Jollymore acquired Store #368 in 1988 by License Agreement signed in 1988 and operated this store continuously to 2008, when the Defendants refused to renew her License Agreement.

She acquired Store #593 by License Agreement signed in 1992 and has operated it continuously since.

Reference: Anne Jollymore, July 2010 Aff, paras. 1-3, 5-13, Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 3, pp. 2253-56

Reference: Jollymore, July 2010 Aff, paras. 26-33, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp. 1970-71

23. From 2002 through 2010, each of the five stores operated by the Plaintiffs generated revenues of approximately \$1 million or more, with approximately 30 to 40 employees. Both Plaintiffs made the AF conversion in or about October, 2002, and have at all times served the full Tim Hortons Lunch Menu in their stores.

Reference: Jollymore, July 2010 Aff, paras. 10, 14, 19, 26, 29, 30, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp. 1966-71

24. Mr. Jollymore's engagement in the matters at issue in this action is long-standing, beginning with related discussions with his local Advisory Board member, other franchisees and members of Tim Hortons Senior Management in or about the Fall of 2003.

Reference: Jollymore, May 2009 Aff, paras. 34-36, Plaintiffs' 1<sup>st</sup> Record, Tab 2, pp. 20-21

Jollymore, July 2010 Aff, para.146, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp. 2003-04

25. Mr. Jollymore has demonstrated persistence and resilience in his efforts since 2003 to attempt to engage the Defendants in a constructive response to franchisee concerns about the high food costs imposed by the AF conversion, in particular.

Reference: Jollymore, July, 2010 Affidavit, paras. 138-146, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp. 1999-2004

26. Over the course of this period, both Mr. and Ms. Jollymore have been the subject of increasing aggression by members of Tim Hortons Senior Management and related criticism from some franchisees apparently influenced by these tactics.

Reference: Jollymore, May, 2009 Affidavit, para. 55, Plaintiffs' 1<sup>st</sup> Record, Tab 2, pp. 26-27

Jollymore, July, 2010 Affidavit, paras. 132-133, and 135-145, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp.

Anne Jollymore, July, 2010 Affidavit, paras 30-40, Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 3, pp. 2558-61

27. They have nonetheless persisted in bringing this matter forward for adjudication, and continue in their efforts to correct misinformation circulating about the proposed class action among franchisees and to engage in open exchanges of related questions and answers with franchisees in organized meetings and otherwise.

Reference: Jollymore, July, 2010 Affidavit, para. 145, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, p. 2003

28. Mr. and Ms. Jollymore understand the objectives of a class proceeding, are well motivated to represent the interests of the proposed class members, are (and have been from the outset) actively engaged in the conduct of the proceeding by instructing counsel and have no interest adverse to the proposed class members.

Reference: Jollymore, May, 2009 Affidavit, paras. 53-65, Plaintiffs' 1<sup>st</sup> Record, Tab 2, pp. 26-29

29. Mr. Garland, a deponent on behalf of the Plaintiffs, became a Tim Hortons franchisee in 1998, having declined the opportunity offered to him by Mr. House to become Executive Vice-President, Finance. Mr. Garland acquired four stores by License Agreement: Stores #385 and #1536 in 1998; Store #1957 in 2000; and Store #2402 in 2002. All of these stores were located in Brampton, Ontario.

30. Mr. Garland's Store #385 made the AF conversion in January 2003, and supplied Stores #1536 and #1957 (Esso kiosks that were non-producing "satellite stores") with AF baked goods from that date. Store #2402 opened for the first time in January 2003 with AF production. Stores #385 and #2402 served the Lunch Menu; Stores #1536 and #1857, the kiosks, did not.

Reference: Garland, July 2010 Aff, paras. 25, 27, Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 4, pp. 2572-73

31. Mr. Garland is no longer a Tim Hortons franchisee, having sold his stores back to the Defendants pursuant to confidential settlement terms.

Reference: Garland Cx, Q. 185

32. The proposed Class A Members, referable to the Plaintiffs' claims arising from the AF conversion, are:

"Class A Members", being all persons, including corporations, carrying on business or who carried on business in Canada as a Tim Hortons store under a license agreement with ~~The TDL Group Corp.~~ the Defendants, or its their predecessors, having executed

such license agreement prior to the conversion of their Tim Hortons store from the full production model to the Always Fresh frozen product model (as described in paragraph 45 17 below), including those persons, including corporations, whose license agreement(s) with ~~The TDL Group Corp.~~ the Defendants or their predecessors have since ended.

Reference: Amended Amended Statement of Claim ("Claim"), para 5a, Plaintiffs' 5<sup>th</sup> Record, Vol. 1, Tab 1.

33. The proposed Class B Members, referable to the Plaintiffs' claims arising from the Lunch Menu, are:

"Class B Members", being all persons, including corporations, carrying on business in Canada as a Tim Hortons store under a license agreement with ~~The TDL Group Corp.~~ the Defendants or its their predecessors, who have been forced by ~~The TDL Group Corp.~~ the Defendants or their predecessors to sell lunch menu items resulting in unreasonably low margins, as more particularly described in paragraph 48 71 below, including those persons whose license agreement(s) with ~~The TDL Group Corp.~~ the Defendants or their predecessors have ended following the introduction of the lunch menu.

Reference: Claim, para. 56, Plaintiffs' 5<sup>th</sup> Record, Vol. 1, Tab 1

**C. The franchise bargain: common system, common contract and common treatment**

34. As of 2008, franchisees operated 99% of Tim Hortons restaurants across the chain, as either "owners" of stores acquired by license agreement ("Licence Agreement") or "operators" of corporate-owned stores.

Reference: Clanachan, Nov 2009 Aff, para. 21, Defendants' 1<sup>st</sup> Record, Vol. I, Tab B, pp. 17

35. Franchisees who "own" their stores, such as the Plaintiffs and Mr. Garland, pay a substantial non-refundable initial licence fee to the Defendants used, together with the continuing Royalty fee (see below), for their "general business purposes" without allocation of any sum to any specific expense to be incurred by the Licensor under the Licence Agreement. In 1998, for example, Mr. Garland paid \$450,000.00 for the 10-year License Agreement for Store #385, with a 10-year right of renewal. Most franchisees have to borrow the money necessary to pay this initial franchise fee.

Reference: Tim Hortons 2001 Disclosure Document, Ex. 7 to Clanachan, November 2009 Aff, Defendants' 1<sup>st</sup> Record, Vol. 3, Tab B7, p. 714.

Garland, July 2010 Aff, para. 11, Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 4, p. 2568

36. In addition to the initial licence fee, Tim Hortons franchisees who "own" their stores make ongoing substantial payments to the Defendants as follows:

- a. Rent, typically in the amount of 10% of monthly sales;<sup>3</sup> higher rent (of 13-14%) is generally charged for kiosks (such as those operated by Mr. Garland);
- b. a continuing Royalty fee, typically in the amount of 3% of weekly sales; a higher royalty (of 4.5%) is generally charged for kiosks (again, such as those operated by Mr. Garland); The Royalty payment on sales compensates Tim Hortons for its ongoing support to the franchisee, i.e., the franchisor's knowledge and ongoing efforts to maintain and increase the brand's value; and
- c. an Advertising levy, paid currently in the amount of 3.5% of monthly sales (the actual contracted amount of the advertising levy is currently 4.0%, but its collection has been voluntary and temporarily limited to 3.5% by the Defendants).

Reference: Licence Agreement Store #593, ss. 4.00, 4.01, 4.02, Ex. Q to Jollymore, May 2009 Aff, Plaintiff's 1<sup>st</sup> Record, Tab 2Q, pp. 243-44

2001 Ontario Disclosure Document, Ex. 7 to Clanachan, November 2009 Aff, Defendants' 1<sup>st</sup> Record, Vol. 3, Tab B7, pp. 713-15

Fisher, July 2010 Aff, paras. 8-13, Plaintiffs' 2<sup>nd</sup> Record, Vol. 1, Tab 1, pp. 10-12

37. Storeowners must also:

- a. maintain the premises in good order, first-class condition and repair as determined at the franchisee's cost by the Licensor [i.e., Tim Hortons] "in conformity with the Licensor's high standards and public image";
- b. in addition to a., every five years spend up to 2% of the store's total gross sales for the past five years to refurbish the premises at the Licensor's request; and
- c. as a condition for renewing the License Agreement at the 10 year mark refurbish the store as determined by the Licensor to achieve the Licensor's then-current Tim Hortons System image; by way of example,

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<sup>3</sup> The vast majority of Tim Hortons stores are located on land that is either owned by TDL or a subsidiary of TDL or leased by TDL and sub-leased by TDL to the franchisee. In a few situations, the franchisee controls the land or lease on which a Tim Hortons store is located. In those situations, TDL usually requires an increase in the Royalty fee payable by the franchisee: Jollymore, July 2010 Aff, paras 23-24, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, p. 1969

Anne Jollymore is being required to renovate Store #593 at an estimated cost of \$358,000 to \$584,000.

Reference: License Agreement Store #593 ss. 2.01(d), 5.05, Ex. Q to Jollymore May, 2009 Aff, Plaintiffs' 1<sup>st</sup> Record, Tab 2k, pp. 247-48

Walton Cx, Q. 648-51, Plaintiffs' 5<sup>th</sup> Record, Tab 9

38. Franchisees operating Tim Hortons stores pursuant to Operating Agreements make essentially the same payments as "storeowners", but configured differently:

- a. instead of an initial licence fee and ongoing Royalty fee of 3 to 6%, operators pay a continuing Royalty fee of 20%;
- b. the same Advertising levy of 4% of monthly sales (currently voluntarily and temporarily collected at 3.5%); and
- c. a substantial lump sum damage deposit paid on acquisition (for Mr. Jollymore's Store #2267, this amount was \$37,500).

Reference: Jollymore, July 2010 Aff, paras 19-20, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp. 1968-69.

2001 Ontario Disclosure Document, Ex. 7 to Cianachan, November 2009 Aff, Defendants 1<sup>st</sup> Record, Vol. B7, pp. 713-15

39. It is a condition of every Operating Agreement that the franchisee executes a License Agreement, which is in substantially the same form as that signed by "storeowners", including requirements that the franchisee maintain the premises as required by the Licensor (see paragraph 37 a. above) and refurbish the premises every five years, spending up to 2% of the store's total gross sales for the past five years (see paragraph 37 b. above).

Reference: Walton Cx, Q. 662-63, Plaintiffs' 5<sup>th</sup> Record, Tab 9

Jollymore, July 2010 Aff, paras. 19-22, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab B, pp. 1968-69

40. By express provision of the License Agreement, Tim Hortons franchisees are independent business persons. No provision in the License Agreement grants to the Defendants the entitlement to determine or manipulate the profits earned by the franchisee. Rather, the franchisee is free to operate his or her store (while adhering to all provisions of the Licence Agreement) so as to maximize profitability.

Reference: Licence Agreement Store #593, Ex. Q to Jollymore, May 2009 Aff, Tab 2Q, p. 267

41. In exchange for the payments set out above, Tim Hortons franchisees (including both "storeowners" and "operators") gain access to the "TIM HORTONS SYSTEM" in accordance with the terms of the License Agreement. They also give up many of the rights and entitlements otherwise possessed by independent business owners and operators in the interests of protecting and enhancing the Tim Hortons brand. Franchisees are required, for example, to:

- a. attend and complete the Licensor's training program to the satisfaction of the Licensor and such refresher or retraining courses as the Licensor may reasonably require;
- b. purchase the number and style of all signs, equipment and machines from the Licensor or manufacturers or suppliers designated by the Licensor;
- c. use the store premises solely for the operation of a Tim Hortons store, and keep that store open 24 hours a day/7 days a week;
- d. purchase all ingredients, commodities, containers, cartons, bags, napkins, utensils, etc. from the Defendants or manufacturers or suppliers designated by the Defendants; this requirement is discussed in further detail in Part D below;
- e. operate the store in conformity with the uniform methods, standards and specifications prescribed by the Licensor in its Confidential Operating Manual or otherwise, "to insure [sic] that the highest degree of quality and service is uniformly maintained, [and] to refrain from any deviation therefrom" including the following requirements:
  - a. to use all materials, ingredients, supplies, paper goods, uniforms, fixtures, furnishings, signs, equipment, methods of exterior and interior design and construction and methods of product preparation prescribed by or which conform with the Licensor's standards and specifications;
  - b. to refrain from using or selling any product, materials, ingredients, supplies, paper goods, uniforms, fixtures, furnishings, signs, equipment and methods of product preparation which do not meet the Licensor's standards and specifications;
  - c. to offer for sale only such products as shall be expressly approved for sale in writing by the Licensor and to offer for sale all products that have been designated as approved by the Licensor;
  - d. to maintain at all times a sufficient supply of approved products for sale to the public.

- f. grant the Licensor the right to enter the premises at any time to inspect the franchisee's operations for conformity with the Licensor's specifications and to "immediately correct" any identified deficiencies;
- g. not offer any products for sale in excess of the prices "suggested by the Licensor";
- h. cede to the Licensor the acquisition of goodwill built up in the business through the efforts of the franchisee;
- i. advertise using whatever advertising materials the Licensor may approve or otherwise designate;
- j. maintain whatever books and records may be prescribed by the Licensor and to make those available for inspection by the Licensor;
- k. submit sales reports and audited financial statements to the Licensor regularly and tax returns and other "reports" upon request; and
- l. submit to audit by the Licensor without prior written notice.

Reference: License Agreement Store #385, ss. 5.00, 5.02-5.05, 5.07-5.09, 6.05, 7.00, 8.01, 9.00, 9.01, 9.03, 9.04, 9.06, 9.07, Ex. Q to Garland, July 2010 Aff, Vol. 9, Tab 4A, pp. 2622-27, 2629-30

42. When the License Agreement expires, or franchisees otherwise cease to operate their stores, they have no entitlement to sell the businesses that have built up over the years (in contrast with other QSR franchises). Rather, the Tim Hortons model is one in which franchisees must "make their money each year and not when they sell their store."

Reference: Advisory Board Minutes, p. 3, Ex 6 to Oliver Cx, Plaintiffs' 5<sup>th</sup> Record, Vol. Tab 9A-6  
Fisher, July 2010 Aff, paras. 256-27, Plaintiffs 2<sup>nd</sup> Record, Vol. 1, Tab 1, pp. 164-65

43. The License Agreement and other agreements by Tim Hortons franchisees are prepared by the Defendants and presented to prospective franchisees for execution.

Reference: Clanachan, November 2009 Aff, para. 36, Defendants' 1<sup>st</sup> Record, Vol. 1, Tab B, p. 25

44. In his November 2009 affidavit, Mr. Clanachan states that there are 21 existing forms of Tim Hortons license agreements and that there are "pertinent differences" between them.

Reference: Clanachan, November 2009 Aff, paras. 45, 59, Defendants' 1<sup>st</sup> Record, Vol. I, Tab B, pp. 31, 36

45. This statement obscures the *de facto* commonality between Tim Hortons franchisees as relevant to the matters at issue in this case. The Plaintiffs have analyzed all 76 License Agreements produced by the Defendants in support of Mr. Clanachan's contentions. In summary, as stated by Mr. Jollymore at paragraph 43 of his affidavit, sworn May 22, 2009, the License Agreements are substantially similar and only vary in some minor respects.

Reference: License Agreement Comparison Chart, Schedule E attached

Jollymore, May 2009 Aff, para. 43, Plaintiffs' 1<sup>st</sup> Record, Tab 2, pp. 22

46. By definition, the operation of Tim Hortons franchises is formulaic. The highly prescriptive nature of the requirement to which Tim Hortons franchisees must adhere in the day-to-day operation of their stores (and against which each store is inspected six times annually) is well illustrated by the following extracts from the current AF Standards Guide which forms part of the Defendants' Confidential Operating Memorandum:

- a. Franchise staff are directed to show "a sense of urgency" and acknowledge/greet guests "within 5 seconds or less", ensuring that "[g]ood eye contact is maintained throughout the entire transaction" and displaying "a genuine smile";
- b. exhaustive instructions are provided to govern the operation of drive-thrus (including the number of seconds within which cars must be greeted); and
- c. franchisees are provided similarly detailed directions for ensuring the maintenance of the facility (such as direction that the lights are "not damaged, flickering or burnt out").

Reference: Fisher, May 2011 Aff, para. 165, Plaintiffs' 4<sup>th</sup> Record, Vol. 5, Tab 4. p. 1729

Always Fresh Standards Guide, pp. 1, 3-4, 6-14, Ex. 2 to Walton Cx, Plaintiffs' 5<sup>th</sup> Record, Tab 9A-2

Walton, Cx Q. 98-129, Plaintiffs 5<sup>th</sup> Record, Tab 9

47. It is uncontested that no existing License Agreements for any Tim Hortons store owned or operated pre-AF were amended in anticipation of, or otherwise referable to, the AF conversion.

Reference: House Cx, Q. 447-49, Plaintiffs' 5<sup>th</sup> Record, Tab 3

**D. Tim Hortons franchisees a captive market for the supply of product**

48. The Defendants control the supply and distribution of products and equipment to all Tim Hortons franchisees. The following provision of the License Agreement is common to all franchisees:

The Licensee shall purchase items for the Tim Hortons Shop as follows:

(a) The Licensee agrees that all containers, cartons, bags, napkins, spoons, other utensils, as well as furniture, fixtures, equipment, machinery and signs (hereafter the "Equipment"):

(i) shall be purchased from:

(A) the Licensor; or

(B) TH; or

(C) manufacturers, suppliers, distributors or any other persons as designated by the Licensor from time to time (hereinafter any of which shall be referred to as the "Approved Supplier");

(ii) shall comply with the specifications provided by the Licensor from time to time.

The Licensee further agrees that any and all 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 Premises and, without limiting the generality of the foregoing, including donut, flour, toppings, fillings, frostings, flavourings, coffee, tea, chocolate, dairy products, vegetable oil, or soft drinks and vending machines, shall be purchased from the Licensor, TH, or an Approved Supplier. Payment for all of the aforementioned ingredients, commodities, supplies, and Equipment purchased from the Licensor or TH shall be made to Licensor or TH on delivery or within fifteen (15) days of delivery as specified by Licensor or TH, from time to time in Licensor's or TH's sole and absolute discretion during the currency of this Agreement. It is hereby acknowledged by the Licensee, that in purchasing such products or supplies, Licensor or TH will make a profit or receive a commission or rebate on the price of goods sold to the Licensee. The Licensee agrees that such profits, commissions or rebates shall be the sole and absolute property of Licensor or TH and the Licensee shall have no claim to them in law or in equity;

Reference: Licence Agreement Store #593, s. 5.04 Ex. Q to Jollymore Aff, May 2009, Plaintiffs' 1<sup>st</sup> Record, Tab 2Q, pp. 246-247

49. Tim Hortons asserts the power to determine not only what franchisees must purchase by way of products and equipment, but also the prices to be paid. The effect of this provision, in combination with the enforcement provision of the License Agreement, is therefore to render Tim Hortons franchisees a captive market vulnerable to potential abuse by the franchisor.

Reference: Garland Ex., February 2011 Aff, paras. 14-18, Plaintiffs' 3<sup>rd</sup> Record, Tab 1, pp. 5-6

50. The rationale underlying the captive supply provision -- which explains why franchisees accept them -- is two-fold:

- a. to enable Tim Hortons (the franchisor) to ensure consistency of quality so that a customer can expect a copy of coffee or donut purchased in one location to be as good as the same item purchased in any other store across the country; this uniform experience, believed to engender customer loyalty to the Tim Hortons brand, benefits both the franchisor and all franchisees by supporting sales across the Tim Hortons chain; and
- b. to enable Tim Hortons to maximize its buying power in relation to prospective suppliers of products for the franchisees, allowing the franchisor to obtain the best possible price for products consistent with the level of quality desired to maintain customer satisfaction; again, this objective benefits both franchisees and franchisor.

Reference: Jollymore, April 2011 Aff, paras 5-9, Plaintiffs' 4<sup>th</sup> Record, Vol. 1, Tab 2, pp. 8-9

51. On cross-examination, Mr. House agreed that, "TDL would generally use at least two independent suppliers for significant input, such as doughnut mix, as this allowed TDL to ensure that it was paying and ultimately the franchisees were paying a competitive price for the products." Mr. House also agreed that, "the effort of management as [he] understood it with respect to the product supplied to the franchisees was to negotiate the best or most reasonable commercial price that could be obtained in the marketplace."

Reference: House Cx, Q. 450-453, Plaintiffs 5<sup>th</sup> Record, Tab 3

52. The uncontested affidavit evidence of Mr. Jollymore and Mr. Garland establishes that, before the AF conversion, it was TDL's practice to ensure at least two sources of supply for all major components to the Tim Hortons product. This practice consistently provided franchisees with better prices for these products than they could obtain for themselves acting as individuals or even groups of individuals, enabling them to maximize the profitability of their businesses.

Reference: Jollymore, July 2010 Aff, paras. 64-66, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, p. 1981

Jollymore, April 2011 Aff, paras 4, 5, 10, 11 Plaintiffs' 4<sup>th</sup> Record, Vol. 1, Tab 2, pp. 8-9

Garland, Feb 2011 Aff, paras. 14-15, Plaintiffs' 3<sup>rd</sup> Record, Tab 1, p. 5

53. Tim Hortons franchisees are divided into six regions for the supply and distribution of products and equipment: British Columbia; the West; Ontario; Quebec; the East; and Newfoundland. Within each region, franchisees are all part of and subject to a uniform and systemic distribution chain.

Reference: Garland, Feb 2011 Aff, paras. 10-11, Plaintiffs' 3<sup>rd</sup> Record, Tab 1, p. 4

Tim Hortons Donut and Timbit Pricing Ex 5 to House Cx, Plaintiffs' 5<sup>th</sup> Record, Tab 3A-5

54. Before the AF conversion, most of the ingredients or "inputs" used to make donuts, Timbits, muffins and cookies were sourced by TDL, with TDL using its buying power to negotiate volume discounts (as described above).<sup>4</sup> TDL purchased the products from independent suppliers and distributed them to franchisees, charging a distribution mark-up consistent with what other (i.e., third party) distributors would charge.

Reference: Garland, Feb 2011 Aff, paras 14-15, Plaintiffs' 3<sup>rd</sup> Record, Tab 1, p. 5

55. In some cases, however, TDL did not purchase from the supplier. Rather, the supplier sold directly to a third party distributor at prices set by agreement between the supplier and TDL. The distributor would then deliver the product to franchisees at a mark-up controlled by TDL through distribution agreements it entered into with the third party distributors. As with its agreements with suppliers, TDL used the volume of product to negotiate the lowest possible prices with distributors for the franchisees.

Reference: Garland, Feb 2011 Aff, paras. 15-16, Plaintiffs' 3<sup>rd</sup> Record, Tab 1, p. 5

56. TDL's agreements with suppliers and distributors apply to the various regions and apply equally to all franchisees within a given region. There is uniformity within each region with respect to the price paid by the franchisee to the distributor for the

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<sup>4</sup> A "volume discount" is different from a "rebate". A volume discount is a reduction of the purchase price obtained from a seller by virtue of the quantity of product bought by the purchaser. A "rebate" by contrast, refers to an arrangement in which the purchase price remains the same, but the seller of the product makes a payment either to the purchaser of that product or to a third party: Garland, Feb 2011 Aff, paras. 8-9, Plaintiffs' 3<sup>rd</sup> Record, Tab 1, p. 4.

various products at issue in this litigation. The pricing across regions is generally very similar and often the same.

Reference: Garland, Feb 2011 Aff, para. 13, Plaintiffs' 3<sup>rd</sup> Record, Record, Tab 1, p. 5

**E. The AF conversion tripled the food cost of an unfinished donut to Tim Hortons franchisees**

57. The AF conversion tripled the food cost of an unfinished donut to Tim Hortons franchisees, from approximately 6¢ to 18¢ per donut.

58. "Food cost" in the restaurant and food service industry is a term of art. It is calculated by the price paid by a restaurant operator for the food coming in the door. It includes:

... the cost of ingredients, shipping and handling, special packaging, pick-up, delivery and rush charges, and is reduced by discounts available from early payment, manufacturer's rebate and/or volume purchases.

Reference: Fisher, May 2011 Aff, para. 38, Plaintiffs 4<sup>th</sup> Record, Vol. 5, Tab 4, p. 1694

59. A franchisee's ability to control food costs is critical to ensuring the profitability of his or her business, and therefore a focal point of concern at all times. The Defendants understood that profitability and the ability to control food costs was an important issue for franchisees.

Reference: Walton Cx, Q. 707, Plaintiffs 5<sup>th</sup> Record, Tab 9

60. After a Tim Hortons donut has been prepared from its raw ingredients and fully cooked, it is "finished" for sale by adding fondants, glazes, sprinkles, etc. The AF conversion did not change this process. At issue in this case, therefore, is the cost of a "raw" or "unfinished" donut.

Reference: Jollymore, May 2009 Aff, para. 86, Plaintiffs 1<sup>st</sup> Record, Tab 2, p. 11

61. It is undisputed that the food cost of the unfinished AF donut is and has been approximately 18¢ per unit:

- a. 17.9¢ per donut from the outset of the conversion to January 2007; and

- b. 18.3¢ per donut from February 2007.

Reference: Garland, July 2010 Aff, para. 56, Plaintiffs 2<sup>nd</sup> Record, Vol. 9, Tab 4, pp. 2582-83

Tim Hortons donut and Timbit Pricing, Ex. 5 to House Cx, Plaintiffs 5<sup>th</sup> Record, Tab 3A-5

62. The per unit food cost of the pre-AF scratch-bake donut, however, is in dispute. The Plaintiffs' evidence that this cost was in the range of 6¢ per unit is well grounded in evidence of both the Plaintiffs and Defendants:

- a. In his initial affidavit, the Plaintiffs' franchise and foodservice industry expert, Douglas Fisher, estimated the food cost of a scratch-bake donut at 6¢ per unit based upon the Defendants' July 2002 Product Cost Summary (yielding an average per unit cost of 7.8¢ per finished donut) less estimated finishing costs of 1.8¢ per donut as of 2002 (rising to 2.1¢ per unit in 2007);

Reference: Fisher, July 2010 Aff, paras. 57-59, Plaintiffs 2<sup>nd</sup> Record, Vol. 1, Tab 1, pp. 24-25

- b. The Defendants' production entitled "Existing Costs to Bake Donuts – Nationally" dated January 5, 2000 (not appended to any of their affidavits) sets out two analyses of the actual "real-world" cost of preparing a scratch-bake donut by five franchisees across the country;<sup>5</sup> this analysis fully supports Mr. Fisher's original estimates:
- i. the food cost for a finished donut at these stores ranged from a low of 7.4¢ to a high of 8.1¢, with a weighted average of 7.7¢ per donut (compared with Mr. Fisher's original estimate of 7.8¢);
  - ii. the food cost to finish a donut at these stores ranged from a low of 0.8¢ to a high of 1.5¢ with a weighted average of 1.6¢ per donut (compared with Mr. Fisher's original estimate of 1.8¢ for the period 2002-2007);
  - iii. the food cost of an unfinished donut at these stores ranged from a low of 5.6¢ to a high of 6.6¢ with a weighted average of 6.1¢ per donut (compared with Mr. Fisher's original estimate of 6.0¢);

Under cross-examination, Mr. Clanachan explained that this analysis was done, "to try to understand the many different baking methods that were happening throughout our system, everything from single store, all the way to multi-store,

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<sup>5</sup> Excluding the results of "Store XYZ" (acknowledged by the Defendants to be a theoretical rather than actual store: Clanachan, June 2011 Aff, para. 62, Defendants 3<sup>rd</sup> Record, Tab 2 pp. 34-35

commissary, mini-production facility-type baking versus theoretical model;” Given the variety of baking methods used by the five actual franchisees across the country, the uniformity of their experience with respect to the costs to make a scratch-bake donut is striking;

Reference: Existing Costs to Bake Donuts – Nationally, Ex F to Fisher Aff, paras. 46-51, Plaintiffs 4<sup>th</sup> Record, Vol. 5, Tab 4F, pp. 1763, 1766

Clanachan Cx, Q. 130, Plaintiffs 5<sup>th</sup> Record, Tab 5

c. In testimony under oath pursuant to Summons to Witness:

- i. Greg Gilson, a multiple store owner from Ottawa of twenty years’ standing in the Tim Hortons chain and a former Advisory Board member, stated that the cost to produce a scratch-bake donut for the franchises in his area at the time of the AF conversion was approximately 8¢ to 9¢ per unit, including the cost of ingredients, labour and finishing; and
- ii. John (Jack) Loiello, a Quebec-based former Tim Hortons Regional/District Manager (for seven years) and franchisee (for 10 years), stated that the cost to produce an unfinished scratch-bake donut at the time of the AF conversion was approximately 5¢ per unit;
- iii. Neither Mr. Gilson nor Mr. Loiello were challenged on this testimony under cross-examination;

Reference: Gilson Ex, Q. 8, Plaintiffs 5<sup>th</sup> Record, Tab 1

Loiello Ex, Q. 26, 34-35, 84, 112-23, Plaintiffs 5<sup>th</sup> Record, Tab 2

- iv. A “Throw Calculation Sheet” included in Tim Hortons 2002 training materials entitled “Maximizing Your Profits” to assist franchisees in tracking the number and cost of donuts “thrown” (or wasted) pre-AF conversion documents the cost of unfinished yeast donuts at 4¢ per unit and finished yeast and cake donuts at 7.5¢ per unit; under cross-examination, Mr. Walton acknowledged that this Throw Calculation Sheet was one of the tools Tim Hortons gave its franchisees to help them control the number of throws and the cost of throws pre-AF and that Tim Hortons made every effort to provide information that was as accurate as possible to enable franchises to do that;

Reference: Maximizing Your Profits, Walton Cx, Ex. 13, Plaintiffs 5<sup>th</sup> Record, Tab 9A-13

Walton Cx, Q. 695-710, Plaintiffs 5<sup>th</sup> Record, Tab 9

- v. the Defendants' production, "Par-Baked Products: Cost Analysis Canada" prepared by Mr. O'Rourke (as Manager of Special Operations and the employee tasked to assist Mr. Clanachan with the AF conversion, reporting directly to him) used 4.5¢ per donut as the total food cost for a finished scratch-bake donut in his estimates of the current and projected costs of AF products for British Columbia, Eastern Canada, Newfoundland, Ontario, Quebec and Western Canada, considerably lower than Mr. Fisher's original estimate of 7.8¢ per finished donut.

Reference: Par-Baked Products: Cost Analysis Canada, Fisher Aff, Ex. J, May 2011, Plaintiffs 4<sup>th</sup> Record, Vol. 6, Tab 4J, p. 1783

Fisher, May 2011, Aff, para. 54, Plaintiffs 4<sup>th</sup> Record, Vol. 5, Tab 4, p. 1699

63. In this proceeding, the Defendants try to obscure the low food cost of the pre-AF scratch-bake donut with confusing, contradictory and unsupported claims about the alleged impact of waste.

Reference: Clanachan, November 2009 Aff, paras. 89, 130, 146, 147, 170, Defendants 1<sup>st</sup> Record, Tab I, pp. 53, 73-75, 82, 83, 88-89

64. There are three potential sources of waste in the preparation and sale of Tim Hortons donuts:

- i. production waste i.e., through spillage and otherwise in the production process;
- ii. over-proportioning i.e., through making product in excess of specifications; and
- iii. throws i.e., product discarded because it cannot be sold.

Reference: Fisher, July 2010 Aff, paras. 60-62, Plaintiffs 2<sup>nd</sup> Record, Vol. 1, Tab 1, pp. 25-26

65. Production waste in the preparation of scratch-baked donuts was negligible.

Reference: Jollymore, July 2010 Aff, para. 54, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, p. 1978

Anne Jollymore, July 2010 Aff, para. 24, Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 3, pp. 2557-58

Garland, July 2010 Aff, para. 81, Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 4, p. 2591

Loiello Ex, Q. 89, Plaintiffs' 5<sup>th</sup> Record, Tab 2

Fisher, July 2010 Aff, paras. 483-85, Plaintiffs' 2<sup>nd</sup> Record, Vol. 1, Tab 1, pp. 148-49

66. The combined impact of over-/under-proportioning in the preparation of scratch-bake donuts was similarly negligible.

Reference: Clanachan, November 2009 Aff, para. 89, Defendants 1<sup>st</sup> Record, Vol. 1, Tab B, p. 53  
Jollymore, July 2010 Aff, para. 55, Plaintiffs 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp. 1979  
Anne Jollymore, July 2010 Aff, para. 24, Plaintiffs 2<sup>nd</sup> Record, Vol. 9, Tab 3, pp. 2557-58  
Garland, July 2010 Aff, para. 82, Plaintiffs 2<sup>nd</sup> Record, Vol. 9, Tab 4, pp. 2591-92  
Loiello Ex, Q. 89, Plaintiffs 5<sup>th</sup> Record, Tab 2

67. In his initial estimate of the cost of an unfinished scratch-bake donut, Mr. Fisher determined that it was not appropriate to factor an added cost to account for production waste and over-/under-proportioning. The reasonableness of this decision is well supported by the Defendants' own pre-AF survey ("Existing Costs to Bake Donuts Nationally"; discussed above) as the only documented, "real-world" evidence of the food costs of a scratch-bake donut (i.e., including the costs of production waste and over-/under proportioning). This survey documents the deviation of actual costs to produce a donut from theoretical at only 3.8%.

Reference: Fisher, July 2010 Aff, paras. 62, 483-85, Plaintiffs 2<sup>nd</sup> Record, Vol. 1, Tab 1, pp. 26, 148-49  
Fisher, May 2011 Aff, paras. 52-53, Plaintiffs 4<sup>th</sup> Record, Vol. 5, Tab 4, pp. 1697-98  
Existing Costs to Bake Donuts Nationally, Fisher Aff, Ex. F, May 2011, Plaintiffs 4<sup>th</sup> Record, Vol. 5, Tab 4F, p. 1760

68. Mr. Clanachan, by contrast, offers no documented proof of his repeated claims that the cost of waste should be understood to increase the per unit food cost of a scratch-bake donut by as much as 20% to 25%, and his evidence as to whether this number should be understood to include or exclude the cost of throws is contradictory.

Reference: Clanachan, November 2009 Aff, paras. 89, 130, 146, 147, 170, Defendants 1<sup>st</sup> Record, Vol I, Tab B, pp. 53, 73-75, 82-83, 88-89  
Clanachan, June 2011 Aff, paras. 5(c), (d), 8, Defendants 3<sup>rd</sup> Record, Tab 2, pp. 8-12

69. The Plaintiffs acknowledge the cost of the throws as an important element of food cost, but address this cost separately from the per-unit cost of a scratch-bake donut in relation to the overall food cost of the baked goods at issue in this action.

Reference: See paras. 156-157 below

70. Before leaving the subject of the per unit cost of the scratch-bake donut, it is important to note that -- once again -- the only documented evidence of the actual "real-world" cost of the labour required to make an unfinished donut, on a per unit basis, is found in the Defendants' January 5, 2000 production, "Existing Costs to Bake Donuts -- Nationally". This production documents that the cost of labour per unfinished donut ranged from a low of 3.5¢ to a high of 5.9¢, with a weighted average of 4.1¢ per donut (parenthetically consistent with Mr. Fisher's estimate in his first affidavit that the likely cost of labour was 4¢ or less per donut pre-AF). Combined with the food cost discussed above (at 6.1¢), therefore, the total cost of producing a pre-AF unfinished scratch-bake donut (on a weighted average basis) was -- according to Tim Hortons' own cross-country survey of a range of different franchisee operations -- 10.2¢ per unit.<sup>6</sup>

Reference: Fisher, May 2011 Aff, paras. 65-66, Plaintiffs 4<sup>th</sup> Record, Vol. 5, Tab 4, pp. 1701-02  
Fisher, July 2010 Aff, para. 475, Plaintiff's 2<sup>nd</sup> Record, Vol 1, Tab 1, p. 146

#### **F. Misrepresenting the cost of the AF donut**

71. As reviewed in Part G below, it is clear that the Defendants knew from at least September 2000 (and likely earlier) that the cost of the AF donut to franchisees would be 16¢ per unit, plus a further mark-up for distribution.

Reference: Business Plan Review, Garland Aff, Ex. E, February 2011, Plaintiffs 3<sup>rd</sup> Record, Tab 16, pp. 162, 164, 177

72. It is also clear, as noted above, that the Defendants at all times understood the central importance of controlling food costs and minimizing increases in food costs to franchisee profitability. With respect to the AF conversion, in particular, Mr. Clanachan characterizes the question "How much is Tims going to cost me?" as, "the question that every franchisee had" about the AF conversion.

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<sup>6</sup> Mr. Clanachan criticizes Mr. Fisher's consideration of this document because he does not factor in the labour associated with delivery costs. The only notation pertaining to delivery costs pertains to Mr. O'Neal's producing for 28 stores in New Brunswick; three of the five franchisees were one store operations which, by definition, would not have incurred delivery costs.

Reference: Clanachan, November 2009 Aff, para. 118, Defendants 1<sup>st</sup> Record, Vol. I, Tab B, p. 63  
Walton Cx, Q. 707, Plaintiffs 5<sup>th</sup> Record, Tab 9

73. Despite these facts, the AF conversion was not brought forward by Tim Hortons Senior Management to its franchisees on the straightforward premise of a “16¢ plus” donut. Had the Defendants done so, they would have allowed and enabled franchisees to make an informed decision as to whether to support the initiative as proposed or oppose it and pressure the Defendants for a better price.

74. The Defendants denied franchisees that opportunity. They represented to the franchisees -- and sought their “buy-in” to the AF conversion -- on the premise that the frozen donut could be brought to their stores for 11¢ to 12¢. This information was communicated to Tim Hortons franchisees by Senior Management, through Advisory Board members and at regional meetings held with the franchisees themselves.

Reference: Claim, paras. 19e, 21, Plaintiffs 5<sup>th</sup> Record, Tab 1

75. Mr. Jollymore, in his affidavits sworn May 22, 2009 and July 23, 2010, recounts his understanding (based on conversations sometime before November 2001 with various Advisory Board members) that members of the Advisory Board had expressed interest in Senior Management’s investigation of a par-baked donut to Mr. House (then Tim Hortons President and CEO) if the cost would increase to only 11¢ or 12¢ per donut. Mr. Jollymore also recounts his understanding based on discussion with one former Advisory Board member, Mr. Gilson, that Mr. Gilson had specifically questioned Mr. House as to why the cost of the AF frozen donut was 19¢ instead of 11¢ or 12¢ (as Mr. House had told the Advisory Board it would be) and that Mr. House had replied to Mr. Gilson that he had no recollection of ever discussing that a frozen donut would cost 12¢.

Reference: Jollymore, May 2009 Aff, para. 25-26, Plaintiffs 1<sup>st</sup> Record, Tab 2, pp. 15-16  
Jollymore, July 2010 Aff, paras. 135-36, Plaintiffs 2<sup>nd</sup> Record, Vol. 7, Tab 4, pp. 1998-99

76. Mr. Garland, in his affidavits sworn May 22, 2009 and July 23, 2010, similarly testified that he had been told by Joe Zoccolli, a Tim Hortons franchisee and former

Advisory Board member,<sup>7</sup> that when the possibility of a par-baked system was first presented to Advisory Board members, the per unit cost of the par-baked donut was represented as 12¢. Mr. Zoccolli told Mr. Garland that the Advisory Board members believed that a 12¢ frozen donut cost appeared reasonable and communicated this view to TDL.

Reference: Garland, May 2009, Aff, para. 9, Plaintiffs 1<sup>st</sup> Record, Tab 3, p. 372

Garland, July 2010 Aff, para. 135, Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 4, p. 2605

77. On cross-examination, neither Mr. Jollymore nor Mr. Garland were challenged on the affidavit evidence summarized above.

78. The evidence of Mr. Jollymore and Mr. Garland is, moreover, fully supported by the testimony of Mr. Gilson and Mr. Loiello.

79. Mr. Gilson testified that:

- a. he was a Tim Hortons Advisory Board member for Eastern Ontario for six years, departing in the Fall of 2001;

Reference: Gilson Ex, Q. 70-72, Plaintiffs 5<sup>th</sup> Record, Tab 1

- b. Advisory Board meetings during this period were attended by Mr. House, Mr. Walton and Mr. Clanachan among other Management representatives;

Reference: Gilson Ex, Q. 79-81, Plaintiffs' 5<sup>th</sup> Record, Tab 1

- c. the mandate of Advisory Board members was to bring forward for discussion issues or concerns for franchisees in their respective areas and, going in the other direction, to relay to franchisees information shared with the Advisory Board members by Management;

Reference: Gilson Ex, Q. 88, Plaintiffs' 5<sup>th</sup> Record, Tab 1

- d. in or about 2000, Advisory Board members were advised of Management's decision to pursue the AF conversion; Mr. Gilson understood that Advisory Board members were always able to share this information with franchisees, with the *proviso* that they try to make sure

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<sup>7</sup> On cross-examination, Mr. Walton confirmed that Mr. Zoccolli was an Advisory Board member (alternate) at the same time as Mr. Gilson, from 2000 to 2002: Walton Cx, Q. 551-53, Plaintiffs' 5<sup>th</sup> Record, Tab 9.

that franchisees would not share this information with their staff or the general public;

Reference: Gilson Ex, Q. 131-139, Plaintiffs' 5<sup>th</sup> Record, Tab 1

- e. the price of the new AF product was addressed on more than one occasion at the Advisory Board meetings attended by Mr. Gilson, with Mr. House advising that, "they [i.e. Management] felt they [i.e. Management] could bring the product to the store for somewhere between 11 to 12 cents";

Reference: Gilson Ex, Q. 161 – 163, Plaintiffs' 5<sup>th</sup> Record, Tab 1

- f. the price of the new AF product was a matter of interest to Mr. Gilson and to the franchisees in his area;

Reference; Gilson Ex, Q. 165, Plaintiffs' 5<sup>th</sup> Record, Tab 1

- g. Mr. Gilson and the franchisees in his area believed that they were baking product for approximately 8¢ to 9¢ per donut (including the cost of ingredients, labour and finishing); Mr. Gilson summarized his discussions with franchisees on this subject as follows:

Q. What did you report to the franchisees in your area with respect to what you understood to be the price of the new product as part of the "Always Fresh" conversion?

A. When I met with them, I said to them that they felt they could bring the product to the stores for 11 to 12 cents. We all knew that that was more than we were paying to bake in-house, but we all felt the same. The convenience of it would be worth the offset of the 3 to 4 cents that it was costing over and above what you had now.

We had all hoped to save money in labour to offset that cost.

Q. And in the advisory board meetings, did TDL management offer any views as to labour savings that could be achieved by the "Always Fresh" conversion?

A. We talked about that. We felt that one baker would be able to pretty much look after the kitchen and keep the – so there would be some cost savings there. That's what we had hoped to achieve on it.

Q. Who was the source of that information? You hoped to achieve it, but was that something that was conveyed –

A. We talked about it.

Q. -- by management?

A. TDL brought that forward as what they felt the kitchen or the store should be able to achieve.

Q. You shared that with the franchisees in your area?

A. I did, yes.

...

Q. So the reference you had earlier to a 3- or 4-cent increase to get this product to cause people to say that's a good idea to go to "Always Fresh" conversion, it was a comparison of its cost of 8 to 9 cents to do a finished doughnut in the store on average, and we'll be content to see that increase to 11 or 12 cents under the "Always Fresh" conversion to gain the convenience of not having scratch-bake?

A. That's correct.

Q. In terms of this 8 to 9 cents for a finished doughnut, did that seem to be the consensus amongst the franchisees in your area when you were having this discussion of --

A. Yes.

Q. -- how much is fair to increase it by?

A. Yes.

Reference: Gilson Ex, Q. 166 – 170, 176-178, Plaintiffs' 5<sup>th</sup> Record, Tab 1

h. the information Management shared with Advisory Board members on the price of the AF donut was not reduced to writing in any of the Advisory Board minutes (these minutes were prepared and disseminated by TDL staff);

Reference: Gilson Ex, Q. 122-125, C. 164, Plaintiffs' 5<sup>th</sup> Record, Tab 1

Jollymore, July 2010 Aff, para. 126, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, pp. 1996-97

i. at no time before Mr. Gilson's departure from the Advisory Board in the Fall of 2001, did anyone from Management report to Advisory Board members that the 11 to 12¢ cost of the new product was not accurate and the cost to be charged for the new product would increase; had he received this information he would have passed it along to the franchisees in his area;

Reference: Gilson Ex, Q. 184-185, Plaintiffs' 5<sup>th</sup> Record, Tab 1

j. Mr. Gilson became aware of the 18¢ cost of the AF donut "pretty much when it arrived at his store";

Reference: Gilson Ex, Q. 182-183, Plaintiffs' 5<sup>th</sup> Record, Tab 1

k. following the arrival of the AF donut at approximately 18¢ per unit, the franchisees in Mr. Gilson's area asked him regularly what had happened to the 11-12¢ donut; neither Mr. Gilson nor his replacement on the Advisory Board (Tom O'Kane) had any answer for them;

Reference: Gilson Ex, Q. 189, Plaintiffs' 5<sup>th</sup> Record, Tab 1

- l. having received calls from other franchisees about the price of the donuts, Mr. Gilson committed to them to ask Management for an explanation, he did so at the Spring regional meeting held in Kingston;

Reference: Gilson Ex, Q. 202-206, Plaintiffs 5<sup>th</sup> Record, Tab 1

- m. Mr. Gilson posed his question to Mr. House, who was surrounded on the podium by Mr. Walton, Mr. Clanachan, Bill Moir and others:

Q. What question did you pose?

A. I asked Mr. House, who was on the stage at the time, why the price of doughnuts had come out at the 18-cent mark when we had talked when I was on the advisory board or it had been indicated when I was on the advisory board that they would be 11 or 12 cents.

Q. And that question was directed to whom?

A. Mr. House, Paul House.

Q. What did Mr. House – what did you observe him to do when you asked the question?

A. He kind of looked around, and then looked at the others on the stage with him, and said that he did not recall ever having talked about the 11- to 12-cent doughnut.

Q. When you say he looked at others on the stage, you are referring to the other TDL management members?

A. That's correct.

Reference: Gilson Ex, Q. 207-218, Plaintiffs 5<sup>th</sup> Record, Tab 1

- n. following the meeting, quite a few franchisees came over and talked to Mr. Gilson:

Q. What was it that was on their mind? Where were they talking to you about?

O/B Ms. Royal: Objection.

The Deponent: They really had just said, you know, Thank you for asking the question. And there wasn't a whole lot that anybody could say.

Mr. Gilson did not feel he could take this matter further with Management, and did not do so;

Reference: Gilson Ex, Q. 212-222, Plaintiffs 5<sup>th</sup> Record, Tab 1

- o. this regional meeting was held in Kingston on a Friday; the following Monday Mr. Gilson received a visit in Ottawa from a member of Management, Nick Javor;<sup>8</sup>

Q. So you met with Mr. Javor, a TDL management member. What can you recall he said and you said?

O/B Ms. Royal: Objection, hearsay.

Mr. Morse: He is a representative of TDL. It's not hearsay evidence of a party. It's the evidence of a party.

By Mr. Morse:

Q. But in any case, go ahead.

A. After we had shook hands, said "hello" and sat down, one of his very first questions was, Why would you stand up and ask the president of the company why the cost of doughnuts were what they were?

Q. What did you say to that?

A. I explained to him that when I was on the advisory board, those were the numbers I heard, and he had attended quite a few of those advisory board meetings at that time. And it was a concern.

Q. Did he deny that he had heard the same 11 or 12 cent -

A. He didn't say one way or the other.

Q. What else did Mr. Javor say?

A. I could tell that he was not very happy with the fact that I had done that, and it was shortly after that we talked about maybe it would be time for me to give back some stores.

Reference: Gilson Ex, Q. 223-234, Plaintiffs 5<sup>th</sup> Record, Tab 1

- p. as of the date of the AF conversion, Mr. Gilson owned eight Tim Hortons franchises; he now owns two franchises.

Reference: Gilson Ex, Q. 10-49, 387, 401, Plaintiffs 5<sup>th</sup> Record, Tab 1

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<sup>8</sup> Mr. Javor was the Regional VP responsible for Mr. Gilson's area at the time of this meeting. He reported directly to Mr. Walton. Franchisees at that time would have understood that Mr. Walton was the person who made recommendations to Mr. House on franchisee terminations: Walton Cx, Q.593-599, Plaintiffs 5<sup>th</sup> Record, Tab 9

80. Mr. Loiello similarly testified that at a regional meeting in Montreal (which Mr. Loiello believes took place in 2001), Mr. House outlined the AF program, provided franchisees with the opportunity to see and taste the product and advised them that the price of the frozen donut would be 12¢ per unit. Mr. Walton, Mr. Clanachan, and Mr. Moir were present at this meeting.

Reference: Loiello Ex, Q. 73-83, Plaintiffs 5<sup>th</sup> Record, Tab 2

81. In response to the Plaintiffs' allegations regarding the misrepresented cost of the AF frozen donut, the Defendants deny that Mr. House or any other member of Tim Hortons Senior Management made a specific statement as to the amount of increase in the cost per donut.

Reference: Amended Statement of Defence, para. 19

82. Under cross-examination, however, none of the Defendants' deponents from Senior Management contradicted the evidence of Mr. Gilson. Mr. House, the person to whom Mr. Gilson's question was directed at the spring regional meeting, said only that he "could not recall" that interchange, while confirming that in all other respects Mr. Gilson's recollection of the meeting was likely accurate. The testimony of Mr. Walton and Mr. Clanachan was identical, with Mr. Walton admitting that he had no basis to dispute the accuracy of Mr. Gilson's evidence.

Reference: House Cx, Q. 244-65, Plaintiffs 5<sup>th</sup> Record, Tab 3

Walton Cx, Q. 573-87, Plaintiffs 5<sup>th</sup> Record, Tab 9

Clanachan Cx, Q. 283-94, Plaintiffs 5<sup>th</sup> Record, Tab 5

83. It is also noteworthy that both Mr. Cardella and Mark Angelini (two of the Affiant Franchisees who swore affidavits on behalf of the Defendants in these proceedings) were Advisory Board members at the same time as Mr. Gilson and Mr. Zoccoli. In their affidavits tendered and relied upon by the Defendants, however, neither discloses the fact of their membership on the Advisory Board during this highly relevant period nor offers evidence to contest that of Mr. Jollymore and Mr. Garland regarding Senior Management's representation that the frozen donut would be brought in at 11¢ to 12¢ donut.

Reference: Cardella, Cx Q. 175-77, Plaintiffs 5<sup>th</sup> Record, Tab 12

Angelini, Cx Q. 17-23, Plaintiffs 5<sup>th</sup> Record, Tab 14

84. Against this evidence Mr. Clanachan claims in his November 2009 affidavit that Tim Hortons Senior Management “kept the franchisees informed” of their investigations into par-baking “at a general level”, both through the Advisory Board and informally. He also identified a number of presentations to franchisees. Careful review of the documents and information referred to by Mr. Clanachan (and other such documents identified during the cross-examination in these proceedings) reveals their contents to be general in nature and essentially promotional:

- a. an extract from Advisory Board minutes dated June 15 and 16, 1999 reflects the first discussion of the investigation of par-baking technology (Ex. 5 to the cross-examination of Vince Cardella, one of the Affiant Franchisees who swore affidavits filed by the Defendants);
- b. further discussion of the frozen donut technology is documented in the extract from Advisory Board minutes dated February 1 and 2, 2000 (Ex. 6 to the cross-examination of Mr. Cardella);
- c. a copy of Mr. Clanachan’s presentation of the par-baking initiative to franchisees at the July 2000 Tim Hortons convention in Ottawa is attached as Exhibit 18 to Mr. Clanachan’s affidavit;
- d. at the Tim Hortons Fall regional meetings in 2000, questions from franchisees relating to par-baking were anticipated and answered by Senior Management in accordance with the memorandum attached as Exhibit 19 to Mr. Clanachan’s affidavit;
- e. Tim Hortons’ signature of the JV agreement with IAWS (Tim Hortons’ partner in the JV to manufacture par-baked donuts, Timbits and other products) was publicly announced on March 6, 2001; a copy of the press release is attached as Exhibit 20 to Mr. Clanachan’ affidavit;
- f. in the Spring 2001 meetings with franchisees, Tim Hortons Senior Management discussed the Maidstone JV, presenting the slides attached as Exhibit 21 to Mr. Clanachan’s affidavit;
- g. Senior Management provided an update on par-baking to Advisory Board members on June 13 and 14, 2001; relevant extracts from the minutes of this meeting are attached as Exhibit 22 to Mr. Clanachan’s affidavit;

- h. Senior Management provided a further update to the Advisory Board on November 7 and 8, 2001, including the information set out in the extracts of the Minutes attached as Exhibit 24 to Mr. Clanachan's affidavit;
- i. Mr. House and Mr. Clanachan both addressed franchisees at each of the four regional meetings in late 2001, with copies of their slide presentations attached as Exhibit 25 to Mr. Clanachan's affidavit; and
- j. At the Spring regional meeting in 2002, Senior Management "updated the franchisees on the progress of the Maidstone Bakery [sic] and the plan to roll out the first phase (of the conversion) in the Fall of 2002", with a copy of the relevant presentation extract attached as Exhibit 26 to Mr. Clanachan's affidavit.

Reference: Clanachan, November 2009 Aff, paras. 93-113, Defendants' 1<sup>st</sup> Record, Vol. I, Tab 2, pp. 55-61

85. Mr. Oliver's evidence provides a vivid illustration of just how far removed the franchisees were from the reality of the steps taken by the Defendants to introduce the AF conversion. In his two separate affidavits sworn November 2008 and November 2009, Mr. Oliver deposed that the franchisees "voted" in favour of the AF conversion at a regional meeting. Under cross-examination, Mr. Oliver testified that this vote took place at a meeting held in April or May 2002 – over a year after the Defendants' signed the JV agreement with IAWS.

Reference: Oliver, November 2009 Aff, para. 18, Defendants' 1<sup>st</sup> Record, Vol VIII, Tab I, p. 2652  
Oliver, November 2008 Aff, para 23, Ex 10A-1 to Oliver Cx, Plaintiffs' 5<sup>th</sup> Record, Tab 10  
Oliver Cx, Q. 289-305, Plaintiffs' 5<sup>th</sup> Record, Tab 10

86. Mr. Jollymore's recollection of this "vote", unchallenged on cross-examination, was that TDL provided no information regarding the costs of the AF conversion (Mr. Oliver agreed that "it was all pretty general back then"). Rather, Mr. House asked for a show of hands as to how many people wanted to get rid of their bakers. Management stayed in the room when the hands went up. Under cross-examination, Mr. House stated that he had, "no recall of how [he] posed the question."

Reference: Jollymore, July 2010 Aff, paras. 127-128, Plaintiffs' 2<sup>nd</sup> Record, Vol. 7, Tab 2, p. 1997  
Oliver Cx, Q. 287, Plaintiffs' 5<sup>th</sup> Record, Tab 10  
House Cx, Q. 356, Plaintiffs' 5<sup>th</sup> Record, Tab 3

**G. Negotiation of the JV and Senior Management's knowledge of the 18¢ donut**

87. The main pillar of the AF conversion was the creation of the JV between the Defendants and IAWS to manufacture par-baked frozen donuts, Timbits and other baked goods. Having undertaken a number of trips to Europe to investigate the possibility of par-baking, Tim Hortons Senior Management determined that it would pursue the JV with IAWS in or about December 1999.

Reference: Clanachan, November 2009 Aff, para 92, Defendants' 1<sup>st</sup> Record, Vol. I, Tab B, pp. 54-55

88. The Defendants undertook its negotiations with IAWS without any participation by any Tim Hortons franchisee or group of franchisees.

Reference: Clanachan Cx Q. 259-64, Plaintiffs 5<sup>th</sup> Record, Tab 5

89. The documentary record pieced together by the Plaintiffs from productions sought and obtained from the Defendants reveals that, from inception, the JV partners targeted the sale of the frozen donut out of the JV to Tim Hortons franchisees at 16¢ per donut plus a distribution mark-up likely to result in a cost to the franchisees of approximately 18¢ per unit.

90. As early as September 1999, a Cuisine de France<sup>9</sup> presentation entitled "Project Canada" suggests a per unit cost of 17.5¢ plus distribution costs (presumably for donuts, although Mr. House testified that he could not be sure about that).

Reference: Project Canada, Ex 1 to House Cx, Plaintiffs 5<sup>th</sup> Record, Tab 3A-1  
House, Cx Q. 19-34, Plaintiffs 5<sup>th</sup> Record, Tab 3

91. On August 1, 2000, Tim Hortons Senior Management obtained approval from the Wendy's Board of Directors to enter into a joint venture with IAWS for the manufacture and distribution of par-baked frozen donuts in Canada and the U.S. The Wendy's Board

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<sup>9</sup> Cuisine de France is a subsidiary of IAWS: Madden, March 2011 Aff, para. 2, Defendants' 3<sup>rd</sup> Record, Tab 1, p.

minutes from this meeting document the parties' stated intention to agree on a price for the frozen donut as part of the deal:

Mr. McNeely [a member of Tim Hortons Senior Management] described the tentative structure of the venture, noting among other things ... the joint venture partners would agree to the initial price at which frozen donuts would be sold to Tim Hortons franchisees, and future price adjustments would be escalated on a cost recovery basis....[Emphasis added]

Reference: Clanachan, November 2009 Aff, para 94, Defendants' 1<sup>st</sup> Record, Vol. 1, Tab B, pp. 54-55

House, Cx Q. 45-46, Plaintiffs' 5<sup>th</sup> Record, Tab 3

Wendy's Board Minutes, Ex 3 to House Cx, Plaintiffs' 5<sup>th</sup> Record, Tab 3A-3

92. The Wendy's Board minutes and related slide presentations highlighted other key features of the proposed JV that spoke to the anticipated profitability of the enterprise for the Defendants, and ultimately formed part of the deal as achieved:

- a. IAWS (through Cuisine de France) would invest 55% of the equity while the Defendants would contribute only 45%;
- b. the JV would nonetheless be equally owned by Tim Hortons/Wendy's and IAWS, and its profits shared 50/50 by the JV partners;
- c. the board of the JV would be comprised equally of representatives from Tim Hortons/Wendy's and Cuisine de France (for IAWS);
- d. the JV would pay Tim Hortons a maximum of \$24 million, "to compensate Tim Hortons for donut mix which would no longer be sold by Tim Hortons to its franchisees"; and
- e. using conservative assumptions, the projected internal rate of return ("IRR") on the initiative was 29% for the JV as a whole and 35% for Tim Hortons.

Reference: Wendy's Board Minutes, Ex 3 to House Cx, Plaintiffs' 5<sup>th</sup> Record, Tab 3A-3

93. Mr. House, who made the Tim Hortons presentation to the Wendy's Board with Mr. McNeely on August 1, 2000, acknowledged under cross-examination that the projections put forward at this meeting had to be based upon a projected sale price for the frozen donut to Tim Hortons franchisees. He indicated that he had, "looked at some international back up numbers that indicate numbers [for that projected sale price] in the range of 16¢." (His undertaking to confirm that information remains outstanding.)

Reference: House Cx, Q. 63-66, Plaintiffs' 5<sup>th</sup> Record, Tab 3

94. An Ernst & Young "Business Plan Review" dated September 30, 2000 (bearing both the Tim Hortons and Cuisine de France logos) reflects an assumed sale price for frozen donut of 16¢ per unit (and Timbits at 4.6¢ per unit). The Review states:

The forecast selling prices of manufactured goods are based on what Cuisine de France and Tim Hortons considers the market can sustain for these products and by analysis and comparison with competitor prices for doughnuts and breads. The standard selling price per doughnut as envisaged in the model is CDN\$0.16 and this is the basis of the turnover values incorporated therein. It is the intention of management to ensure that this doughnut price is stipulated in the heads of agreement when the document is eventually finalised. [Emphasis added]

Ernst & Young provided no independent analysis of the reasonableness of the proposed prices as modelled by Tim Hortons and Cuisine de France, but emphasized that these prices were "critical" to the project's ability to achieve the anticipated financial performance and that it was therefore, "essential that these prices are agreed in advance and the final pricing structure entered in the heads of agreement." A marginal note in the Review clarifies that the model at that time contemplated that product distribution would be outsourced "to Tim Hortons bagel distributors or alternative distributors." Ernst & Young repeatedly describes the project as "extremely cash rich".

Reference: Ernst & Young Business Plan Review, Ex G to Garland, February 2011 Aff, Plaintiffs' 3<sup>rd</sup> Record, Tab 16, pp. 164, 165, 177, 208

95. Peter Madden is a deponent for the Defendants who was employed by IAWS and Cuisine de France, and was involved in negotiating the JV. The following statement in his affidavit makes it clear that the JV partners agreed upon a sale price of 16¢ per donut before the JV agreement was signed:

On the basis of a sale price of \$0.16 per donut, I was prepared to recommend to IAWS Group Plc to contribute the significant capital costs required and enter into the Joint Venture agreement. [Emphasis added]

Reference: Madden, March 2011 Aff, para. 7, Defendants 3<sup>rd</sup> Record, Tab 1, p. 2

96. The Defendants and IAWS signed their JV agreement on March 6, 2001, and publicly announced the venture that same day. Exactly as contemplated by the Ernst & Young Business Plan Review, and consistent with the evidence of Mr. Madden, the Original Operating Plan attached as Schedule J to the JV agreement signed by Tim

Hortons and IAWS on March 6, 2001 documents the "average selling price" for donuts at 16¢ per unit and Timbits at 4.6¢ per unit (with Timbit pricing based on an average of 3.5 Timbits per donut).

Reference: JV Original Operating Plan, Clanachan, Ex A, March 2011 Aff, Defendants' 2<sup>nd</sup> Record, Vol. 2, Tab J, p. 493

Clanachan, November 2009 Aff, para. 96, Defendants 1<sup>st</sup> Record, Vol. I, Tab B, p. 56

JV Press Release, Clanachan, Ex 20, November 2009 Aff, Vol. V, Tab B20, pp. 1602-04

97. This Original Operating Plan for the JV is also noteworthy for its assumptions that:

- a. the "average ingredient cost" would be 3.6¢ per donut equating to 1.4¢ per Timbit based on a factor of 3.5 Timbits per donut; and
- b. distribution would add a 13% mark-up (i.e. in the hands of the franchisees).

Reference: JV Original Operating Plan, Clanachan, Ex. A, March 2011 Aff, Defendants' 2<sup>nd</sup> Record, Vol. 2, Tab J, p. 493

98. In March 2001, Mr. O'Rourke produced the Defendants' first analysis of the impact of the AF conversion on franchisees at the store level. This document reflects Mr. O'Rourke's assumed food cost for the AF donut at 18¢ per unit. An 18¢ donut is consistent with a selling price out of the JV at 16¢ per unit marked up by 13% for distribution ( $16¢ \times 13\% = 2.1¢$ , for a total of 18.1¢ per unit). Mr. O'Rourke admitted under cross-examination that he had this information (that the price of the donut should be assumed at 18¢) sometime prior to the creation of this document, but was unable to say who directed him to assume that cost.

Reference: O'Rourke, Cx, Q. 392-403, Plaintiffs' 5<sup>th</sup> Record, Tab 4

99. The price of the AF donut when introduced to the Tim Hortons franchisees in 2002 and 2003 was, as consistently assumed by the Defendants and their JV partner

from at least September 2000 forward, 16¢ per donut plus distribution costs for a total of 17.9¢ (or 18¢, rounded up) in Ontario, the East and Quebec.<sup>10</sup>

Reference: Garland, July 2010 Aff, para. 56(a), Plaintiffs' 2<sup>nd</sup> Record, Vol. 9, Tab 4, p. 2582  
House, Cx Q. 114-16, Plaintiffs' 5<sup>th</sup> Record, Tab 3  
Tim Hortons Donut and Timbit Pricing, Ex 5 to House Cx, Plaintiffs' 5<sup>th</sup> Record, Tab 3A-5

100. Mr. Clanachan asserts that he has no recollection of making a statement that the frozen donut would be 11¢ to 12¢ or hearing Mr. House make that statement, "for the simple reason that we were still in the process of doing the work to be able to make such estimates".

Reference: Clanachan, November 2009 Aff, paras. 105-107, Defendants 1<sup>st</sup> Record, Vol. I, Tab B, p. 59

101. Mr. House similarly states in his November 2009 affidavit:

... I am confident that I did not ever suggest in any such meetings that 12¢ donuts were our planning number. I say this for three reasons. First, as David Clanachan has set out, we were doing the work to come up with a number we could use in estimates and it was not my practice to put out a number as reliable until we were able to stand behind it. ...

Reference: House, November 2009 Aff, paras 4-5, Defendants 1<sup>st</sup> Record, Vol. VIII, Tab E, pp. 2630-31

102. The evidence of neither Mr. Clanachan nor Mr. House is credible on this point given the contents of the documents reviewed above, which provide clear evidence of an agreed upon price of 16¢ for the frozen donut as between the Defendants and IAWS as of at least March 6, 2001 when the JV agreement was signed.

#### **H. The JV structure and mark-ups on donuts and Timbits**

103. The JV structure for the manufacture of the AF frozen donuts and Timbits was never shared with Tim Hortons franchisees and is known to the Plaintiffs only as a result of documentary production sought and obtained in the proceedings.

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<sup>10</sup> The price was 17¢ per unit in BC, the West and Newfoundland presumably as a result of increased shipping costs: Garland, February 2011 Aff, para. 11, Plaintiffs' 3<sup>rd</sup> Record, Tab 1, p. 4

104. Two schematics to illustrate the corporate structure and the transaction flow for the manufacture and sale of AF donuts and Timbits are provided at paragraphs 22 to 24 of the expert forensic accounting report tendered by the Plaintiffs (co-authored by Howard Rosen and Neil Mizrahi of FTI Consulting).

105. The main players in the JV's corporate structure are as follows:

- a. CillRyan's Bakery Limited ("CillRyan"), a company with its registered office in Dublin, Ireland was (until the sale in October 2010) the JV corporation jointly owned and controlled, on a 50/50 basis, by Tim Hortons and IAWS; and
- b. 3052887 Nova Scotia ULC, a company incorporated pursuant to the laws of Nova Scotia, operated as Maidstone Bakeries ("Maidstone") was wholly-owned and subcontracted by CillRyan to manufacture the frozen donuts, Timbits and other products distributed to the Tim Hortons franchisees.

Reference: FTI Report, paras. 22-27, Plaintiffs' 4<sup>th</sup> Record, Tab 3A, pp. 341-43

3052887 Nova Scotia ULC / CillRyan Manufacturing and Supply Agreement ("Maidstone Supply Agreement") s.2.1(a), Ex 8 to Clanachan Cx, Plaintiffs' 5<sup>th</sup> Record, Tab 5A-8

106. The physical movement of frozen AF donuts and Timbits from their point of manufacture differs from the path of the product invoicing.

107. The physical products are shipped directly from Maidstone's plant in Brantford, Ontario to the warehouses of those distributors responsible (pursuant to distribution agreements with the Defendants<sup>11</sup>) for delivering the products to franchisees across the country.

Reference: 3052887 Nova Scotia ULC Transfer Pricing Review dated February 2001 ("Transfer Pricing Review"), Schedule I to JV Agreement, Ex. A to Clanachan March 2011 Aff, Defendants' 2<sup>nd</sup> Record, Vol. 2, Tab I, p. 323

Maidstone Supply Agreement, ss. 3.1, 5.1, Ex 8 to Clanachan Cx, Plaintiffs' 5<sup>th</sup> Record, Tab 5A-8

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<sup>11</sup> In or about 2006, TDL began to distribute frozen product (in Ontario only) to the point that it now distributes approximately 80% of Ontario product: Synopsis of Organization/Function, Ex B to Garland, February 2011 Aff, Tab 1B, p. 27.

108. The invoicing for the products contains an added step. Rather than moving with the product directly from the Maidstone plant in Brantford, Ontario to the distributors, the invoicing moves offshore to CillRyan in Ireland and then back again, as follows:

- a. Maidstone invoices CillRyan; and
- b. CillRyan, rather than Maidstone, invoices the distributors for products to be delivered to franchisees and across the country.

At each step along the way, the prices of the AF donuts and Timbits are marked up.

Reference: Transfer Pricing Review, Schedule I to JV Agreement, Ex. A to Clanachan March 2011 Aff, Defendants' 2<sup>nd</sup> Record, Vol. 2, Tab I, p. 323

Maidstone Supply Agreement, ss. 3.1, 5.1, Ex 8 to Clanachan Cx, Plaintiffs 5<sup>th</sup> Record, Tab 5A-8

109. The purpose of this additional structure, as conceived from the JV's inception and as ultimately established, was to minimize the tax paid by Tim Hortons and IAWS on the substantial profits yielded by the 16¢ frozen AF donut and other Maidstone products.

Reference: April 3, 2000 Presentation, Ex 4 to Walton Cx, Plaintiffs 5<sup>th</sup> Record, Tab 9A-4

Transfer Pricing Review, Schedule I to JV Agreement, Ex. A to Clanachan March 2011 Aff, Defendants' 2<sup>nd</sup> Record, Vol. 2, Tab I, p. 323

110. The effect of that tax-driven structure, interestingly, is to render transparent the nature and extent of profits taken on the 16¢ donut (again, 18¢ as delivered to franchisees). FTI's uncontested expert evidence on behalf of the Plaintiffs reveals the relevant costs and mark-ups for Maidstone's frozen AF donut from 2003 to 2009 as follows:

- a. the average cost of ingredients and packaging at Maidstone was 5¢ per donut;<sup>12</sup>

Reference: FTI Report, paras. 66-67, Plaintiffs 4<sup>th</sup> Record, Vol. 2, Tab 3A, p. 356

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<sup>12</sup> "Standard Costs Cards" from Maidstone appear to document the cost of ingredients (excluding packaging) for the frozen donut at approximately 3¢ per unit: Ex. 7 to Clanachan Cx, Plaintiffs 5<sup>th</sup> Record, Tab 5A-7.

- b. the average maximum total cost at Maidstone (including direct materials, labour costs, shipping and overhead) was 10¢ per donut;

Reference: FTI Report, paras. 66-69, Plaintiffs 4<sup>th</sup> Record, Vol. 2, Tab 3A, pp. 356-57

- c. Maidstone sold its donuts to CillRyan at an average price of 12¢ per donut, a mark-up of 100% over the average manufacturing cost of 6¢ excluding overhead and a mark-up of 20% over the 10¢ cost including overhead;

Reference: FTI Report, para. 73, Plaintiffs 4<sup>th</sup> Record, Vol. 2, Tab 3A, p. 358

- d. CillRyan then invoiced the donuts to distributors at 16¢ per donut, a further mark-up of approximately 33% over the Maidstone price and a premium of 168% over the average manufacturing cost of 6¢ excluding overhead and 61% over the 10¢ cost including overhead; and

Reference: FTI Report paras. 75-77, 97, Plaintiffs 4<sup>th</sup> Record, Vol. 2, Tab 3A, pp. 359, 365

- e. the distributors, finally, sold the donuts to the franchisees at approximately 18¢ per donut, reflecting a further mark-up of approximately 11.9% over the CillRyan price, 198% over the average manufacturing cost of 6¢ excluding overhead and 79% over the 10¢ cost including overhead.

Reference: FTI Report, para. 75, Plaintiffs 4<sup>th</sup> Record, Vol. 2, Tab 3A, p. 359

111. For the purposes of the Plaintiffs' motion for certification and the Defendants' motion for summary judgment, the Plaintiffs do not challenge the reasonableness of the costs incurred at Maidstone to produce the frozen AF donut at 10¢ per unit (including the costs of ingredients, packaging, labour, shipping, overhead, and finance and administration). This cost as calculated by FTI, for current purposes, therefore, includes a maximum allocation of overhead to the cost of each donut, which may not be warranted on further analysis with the benefit of full documentary production and examination for discovery should the action be certified.

Reference: FTI Report, para. 67, Plaintiffs 4<sup>th</sup> Report, Vol. 2, Tab 3A, p. 356

112. With respect to paragraph 110 c. above, it is undisputed that the price charged by Maidstone to CillRyan for the frozen donut was based on a formula recommended by PricewaterhouseCoopers ("PwC") further to a Transfer Pricing Review completed in February 2001 and incorporated into the JV agreement. The object of this Transfer Pricing Review, in summary, was to ensure that the price charged by Maidstone (a Canadian company) to CillRyan (an offshore company located in Ireland) could be