

**ONTARIO
SUPERIOR COURT OF JUSTICE**

B E T W E E N:

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 PLAINTIFFS/RESPONDENTS
RE SUMMARY JUDGMENT**

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A. Overview

1. This motion for summary judgment is tenuous. The onus is squarely on the Defendants to establish that there is no genuine issue requiring a trial on the central allegations at issue in the Plaintiffs' proposed class action.

2. The Defendants rely on a factum of 230 pages, having filed:

- 6 affidavits from 4 senior executives;
- 11 affidavits from 11 affiant franchisees;
- 1 affidavit from 1 fact witness;
- 3 affidavits from 1 expert;
- 3 reports from 2 other experts to counter 8 affidavits filed by the Plaintiffs (principals Arch and Anne Jollymore) and Cyril Garland, and
- 2 affidavits from 1 expert and 2 reports from 2 other experts filed by the Plaintiffs,

generating a total of 9,214 pages of record and cross-examinations of:

- 8 Plaintiff witnesses (2 witnesses summoned under Rule 39); and
- 13 Defendant witnesses resulting in 2,120 pages of transcript with 190 exhibits entered during these cross-examinations,

yet the Defendants overlook certain incontestable fundamental aspects of the record and the guiding principles in the case law.

3. As to the record:

- a. When cross-examined, neither Cyril Garland nor Arch Jollymore were substantively challenged on their analyses as to how the AF conversion diverted franchise profits on scratch-bake donuts, Timbits, muffins and cookies to the Defendants or the unprofitability of the Lunch Menu. Where the analyses of Mr. Garland and Mr. Arch Jollymore diverge from the evidence of the Defendants' senior executives who testified (Paul House, David Clanachan, Jeff O'Rourke and Roland Walton) or the Affiant Franchisees, there is therefore a genuine issue requiring a trial to resolve the conflicts.
- b. If the Defendants' submission that neither Mr. Garland nor Mr. Jollymore may offer admissible opinions or have their opinions afforded any meaningful weight finds favour with the Court, then the same must be said for the opinions offered by the Defendants' senior executives referred to above and the Affiant Franchisees, with the result that the Defendants offer no opinions on the allegations pleaded by the Plaintiffs and so the Defendants' onus on this motion is not met given the state of the record summarized in d. and e. below;
- c. When cross-examined, neither of the Plaintiffs' experts, Douglas Fisher or Howard Rosen, were substantively challenged on their opinions that the AF conversion and Lunch Menu caused economic harm to the franchisees, so the record is clear there is a genuine issue requiring a trial as to whether these expert opinions withstand the criticisms of the Defendants' experts;
- d. Neither of the Defendants' experts, James McAuley or Robert Davis of KPMG, in three reports, undertook any analysis or offered any opinion as to whether the AF conversion caused economic harm to franchisees or the Lunch Menu was unprofitable (in the case of McAuley) or (in the case of Davis) whether the prices charged to the franchisees for Maidstone frozen donuts was in excess of fair value;
- e. In the case of the Defendants' expert, Professor Roger Ware, he did not undertake any independent analysis or offer any opinion on whether the

AF conversion caused economic harm, whether the Lunch Menu was unprofitable, or whether the price per donut charged franchisees was in excess of fair value;

- f. The Defendants' senior executives conceded they had not undertaken the analysis of whether the AF conversion caused franchisees economic harm; and
 - g. Mr. Rosen's conclusion that the evidence relied upon by the Defendants' senior executives did not establish that franchisees realized an economic benefit or have offset increased food costs due to AF conversion was not challenged on cross-examination or disputed by Mr. McAuley.
4. As to the law:
- a. There is no franchise case law in Canada that supports the Defendants' summary judgment motion;
 - b. The contract, good faith and unjust enrichment case law offered by the Defendants is not determinative of the summary judgment motion; and
 - c. The only case law on the *Competition Act* and waiver of tort is that the law is unsettled and such issues should proceed to trial.
5. Boiled down to its essence, the Defendants' over-arching argument is that as long as franchisee margins remain "reasonable", the franchisor should be afforded free rein to make whatever demands of franchisees they see fit at any cost to the franchisees -- unless and until they drive franchisees to the threshold beyond which the, "businesses of the franchisees [are] marginally profitable or unprofitable for even its good operators."

Reference: Defendants SJ Factum, para. 6

6. The "rationale" to justify such franchisor entitlement is that in the estimation of the franchisor the "overall profit margins" of franchisees are "good". In the governing License Agreement, there is no limitation on the "overall profitability" of franchisees and no entitlement on the part of the franchisor to manipulate the relationship to increase franchisor profitability by reducing franchisee profitability to a level that suits the Defendants. Neither the franchisor's transparent direct income entitlement in the Licence Agreement in the nature of the initial license fee or ongoing RRA (Rent, Royalty and Advertising) payments, nor the franchisor's non-transparent indirect income

entitlement in the Licence Agreement in the nature of reasonable profit associated with the supply and distribution of inputs, affords the franchisor the power/entitlement argued for by these Defendants.

7. If the premise of the Defendants' summary judgment motion finds favour, then it follows that the Defendants may: (1) manipulate the profitability of franchisees by charging any amount it sees fit for inputs, using a non-transparent revenue source to, in effect, increase its royalty fee (ordinarily characterized as a transparent revenue source) diverting profits previously earned by franchisees on what was a profitable category of sales (baked goods); and (2) impose pricing on categories of products for which sales yield profits only to the franchisor (the Lunch Menu).

8. The Plaintiffs take a different view. No express term in the License Agreement grants the Defendants the far-ranging power they assert. To the contrary, by express term the franchisees are independent business contractors. They invest enormous amounts of money (often borrowed) to become operators of Tim Hortons stores and, after they take on that role, must work diligently to fulfil their ongoing responsibilities. By express provision in the License Agreement, Tim Hortons stores must remain open 24 hours a day/seven days a week, and franchisees must work full time in their businesses. One of the franchisees examined in this proceeding even testified as to his understanding of a corporate expectation that the spouses of franchisees work in the enterprise.¹ Upon termination of the License Agreement, franchisees must abide by comprehensive non-compete covenants by express provision. At the same time, the Defendants arrogate to themselves (by express provision) all goodwill built up in the location through the franchisee's efforts. Unlike franchisees in competitor chains such as McDonalds (who at the end of their terms are entitled to sell their locations for multiples of earnings²), the Tim Hortons model limits its franchisees to what they earn year over year during the course of the License Agreement. Franchisees earn every penny of profit they make.

¹ Gilson Ex. Q.292, Plaintiffs' 5th Record, Tab 1

² Fisher, July 2010 Aff, paras. 526-530, Plaintiffs 2nd Record, Vol. I, Tab I, pp. 164-166

9. It is also important to recognize that the EBITDA (or “operating”) margins relied upon throughout the Defendants’ submissions do not tell the whole story. As emphasized by the Defendants in the following communication to their franchisees in the anticipation of a forthcoming article in *Maclean’s* (the national magazine),

- Those figures are before taxes, and don’t take into account a restaurant owner’s salary.
- They don’t reflect the significant initial investment an owner makes to establish a franchise.
- They don’t reflect the re-investment you make into the business.
- They don’t describe the 24/7 responsibilities required with being a small business owner.³

10. The disconnect between EBITDA margins and how much is actually left for the franchisees has been a long-standing point of controversy for Tim Hortons franchisees. As summarized by one of the Defendants’ Regional VPs in a January 2004 email to Roland Walton, Chief Operations Officer Canada and a member of Senior Management:

The disbelief in our P&L presentation derails every discussion for a lot of owners. We have heard this over and over again and we have to change this. Profit to many means “how much is left for me” and while this defies our sense of business logic that’s what our audience thinks. Once again, don’t assume this is coming from the nuts alone.

The following extract from a September 2008 memorandum tells the same story:

The issue that I hear quite a bit are pricing, costs (food and utilities), and profits. Every owner that I have talked to, has expressed dissatisfaction with the bottom line, the feeling is that TDL’s attitude is “We’re still the best game in town, if you don’t like it or aren’t happy, there is a waiting list to get stores”.

11. The Defendants purport to stand on the history and achievements of the past 45 years that built the Tim Hortons chain into a Canadian icon. But the company works under different pressures now; the pressures of a public company answering to 54,768 shareholders for whom no amount of revenues or annual increases in revenues can

³ Walton, Cx, Q.617-651, Plaintiffs’ 5th Record, Tab 9. Parenthetically, Mr. Walton, who was involved in the preparation of this communication to franchisees, was unable to explain how the Defendants obtained a copy of Mr. Friscolanti’s article ten days before it was published.

never be enough. As admitted under cross-examination by Mr. Walton, a member of Tim Hortons Senior Management since 1997:

Q. ... there's an awareness within senior management that senior management is accountable to the shareholders, that's fair?

A. Yes.

Q. And is it fair to say that creates pressure from time to time to demonstrate growth in revenue, pressure on senior management?

A. Yes.

Q. And that's fair year over year and quarter over quarter?

A. Yes.

In September 2008, Tim Hortons franchisees put it this way:

There is a fear amongst owners that ever since we became a public company, that the stores are the only source of revenue and that it has become more of an us vs. them attitude.⁴

12. It is reasonable in these circumstances for the Plaintiffs, seeking to act on behalf of the proposed Class A and Class B Members, to insist upon strict performance of the bargain the Defendants have made with them to allow the franchisees to make what they can of the opportunities they have bought and paid for, and earned to the best of their abilities.

13. The essence of the Defendants' summary judgment motion is that the Court may rewrite the licence agreement for the parties and afford the Defendants an unfettered discretion to determine the level of profitability of the franchisees.

14. This motion must fail because as a matter of settled contract law the Court may not rewrite the licence agreement to afford the franchisor an unfettered discretion to manipulate the relationship to divert profits to the franchisor at the expense of the franchisee. Similarly, as a matter of franchise law, reflecting the underlying rationale for statutes such as the *Arthur Wisart Act (Franchise Disclosure), 2000* and the common

⁴ The email from which this passage is extracted is quoted more fully at para. 191 of the Plaintiffs' Certification Factum.

law duty of good faith in the franchise context, the Court will be vigilant to require performance of the obligations in the Licence Agreement in accordance with commercially reasonable standards and expectations between the franchisor and the franchisee to ensure the vulnerability of the franchisee is not exploited by the superior position of the franchisor. The law referable to the causes of action and damages sought pursuant to the *Competition Act* and waiver of tort is unsettled and so the Defendants' summary judgment motion is doomed to fail on these points since the law is settled that such cases should proceed to trial with complete evidentiary records.

B. This case is not appropriate for determination on summary judgment

15. The Defendants' motion for summary judgment is governed by Rule 20.04(2), which now provides that the Court shall grant summary judgment only if it is satisfied that there is no genuine issue requiring a trial.

16. The Plaintiffs generally accept the statements of principle contained in paragraphs 338-348 of the Defendants' factum on their motion for summary judgment, subject only to the additional legal principles discussed below.

17. The moving party bears at all times the onus of satisfying the Court that a trial is not required.

Reference: *Vincorp Financial Ltd. v. Hope's Holdings Inc.*, 2010 Carswell Ont 9740 at paras. 11-17 (S.C.J.)

18. Although the amendments to Rule 20 have clothed judges with greater powers, it is critical to note that the case law post-January 1, 2010 has been nearly unanimous in concluding that complex matters with real factual disputes are not appropriate cases for granting summary judgment precisely because these issues cannot safely be determined on a motion.

19. The Honourable Coulter Osborne foreshadowed this sensible conclusion when he said in his report that the summary judgment mechanism should be available for the efficient and early resolution of "non-complex" cases. Madam Justice Pepall expressed

the same view in the *Canadian Premier* case, in which Her Honour recognized the difficulty of granting summary judgment in complex cases:

With these considerations [the principles underlying the new rule 20] in mind, I turn to a discussion of the issues before me. In doing so, I note that the evidentiary record on this motion was extensive. There were twelve affidavits and nine cross-examinations of witnesses. In addition, there were numerous exhibits, books of authorities, supplementary books of authorities, two facta and numerous loose cases handed up during the course of argument. While summary judgment is not precluded with such a record, a court may exercise caution in providing a remedy on a summary basis in such circumstances [emphasis added].

Reference: *Canadian Premier, supra* at para. 71

20. That case involved a dispute about whether the provisions of a contract executed in 1992 applied to the transactions between the parties that took place over the next 17 years (until 2009), despite the fact that the contract had not been formally amended to apply to those transactions. The plaintiff argued, *inter alia*, that the 1992 contract had been amended by the parties' conduct over those 17 years. Justice Pepall reflected upon the difficulty of assessing a 17-year relationship on a summary basis in a case in which there were real and legitimate differences in the evidence:

I am of the view that the issue of amendment by conduct should not be addressed summarily nor do I consider it appropriate or just to order a mini-trial. As mentioned, the evidentiary record is extensive, contradictory and contentious. \$80 million in damages is claimed and the amounts in issue are substantial. CPL's evidence on conduct is compelling but, as evident from the factual outline, not uncontroverted. In my mind, there is a real issue as to the parties' true intentions, what they did, and why they did it. These facts are difficult to assess on a paper record. Why do so many of the witnesses including Ms. Garow-Turner and Messrs. Rainville, Costigan and Borg have such different perspectives on what they had intended and agreed upon? There should be a trial so that the contradictory evidence from a number of witnesses may be assessed, weighed and considered within the entire panoply of evidence that a trial offers [emphasis added].

Reference: *Canadian Premier, supra* at para. 88

21. Justice Pepall's comments are equally apposite in this case. Here as in *Canadian Premier* there are acute differences in the evidence with respect to the critical issues including: whether the conversion to Always Fresh was a "benefit" or an "improvement" for the franchisees; whether Senior Management represented to the franchisees that the frozen donut could be brought to their stores for 11 to 12¢; whether the Defendants have delivered products to the franchisees at commercially reasonable prices or have instead abused their power under the License Agreements to strip

franchisee profits for their own gain and priced the Lunch Menu unreasonably so that only the franchisor earns a profit on a category of business that is growing.

22. Justice Pepall is not alone in calling for caution where summary judgment is sought in the face of an extensive record and genuine factual disputes. Justice Brown stated in *Lawless v. Anderson* that, "cases involving multiple, complex issues which require evidence from a large number of witnesses not often will present themselves as appropriate ones in which to consider bringing a summary judgment motion."

Reference: *Lawless v. Anderson*, 2010 Carswell Ont 3212 at para. 16 (S.C.J.)

23. The complex cases with voluminous records are to be contrasted with straightforward cases in which the Court can readily weigh any disputed evidence and safely determine the issue. Cases in which the evidence is uncomplicated or the dispute is essentially a legal one are amenable to decision on a summary judgment motion under the new rule.

Reference: *Lawless, supra*; see also *Healey, supra* and *TA & K Enterprises Inc. v. Suncor Energy Products Inc.*, 2010 CarswellOnt 9703 (S.C.J.)

24. Where as here the factual issues are complex and both sides have put significant records before the court that raise real factual disputes, then it will be very difficult for the court safely to determine the issues. That is why the courts are nearly unanimous in holding that summary judgment is not appropriate in those cases, as recognized by Justices Pepall (in *Canadian Premier*), Brown (in *Lawless*) and Perell (in *Healey* and *TAK*).

25. There are two further issues that make this case inappropriate for summary judgment.

26. First, there are credibility issues that should not be resolved on a paper record. In particular, the Defendants have gone on at great length in their facta questioning the reliability and motives of Cyril Garland, a key witness for the Plaintiffs. The Defendants characterize Mr. Garland as a bitter former member of Senior Management who has not only an axe to grind, but also a financial interest in the litigation. The credibility of the Defendants' deponents from Senior Management franchisees is also critical and will be

informed by the Court's assessment of the parties' conflicting evidence as to what franchisees were told and when about the likely cost of the frozen donut.

27. Second, the Defendants have refused and/or failed to provide a substantial amount of information that is both relevant and important to the Plaintiffs' claims. The Defendants' refusals and the gaps in the Plaintiffs' knowledge are highlighted throughout this factum and need not be repeated here, but it is important to note that these gaps in the evidence lie at the feet of the Defendants and render their motion for summary judgment inappropriate. It does not lie in the Defendants' mouths to argue that the Plaintiffs have failed to prove their claims in circumstances where the Defendants themselves have denied access to relevant information and/or failed to adduce evidence from critical sources.

C. Genuine Issue Requiring a Trial as to whether the Defendants have breached relevant terms of the License Agreement

Interpretive principles:

28. The Plaintiffs accept the general principles of contractual interpretation set out at paragraphs 351 to 354 of the Defendants' factum.

29. This summary is, however, incomplete. While the general principles of interpretation that are applied to commercial agreements are of course relevant, the Defendants cite only one case in the franchise context and fail to acknowledge the Ontario Court of Appeal's clear pronouncements as to the marked inequality of bargaining power between the parties in the context of a franchisor-franchisee relationship and that franchise agreements are contracts of adhesion, mandating that they be construed *contra proferentum*.

Reference: *Landsbridge Auto Corp. v. Midas Canada Inc.*, [2009] O.J. No. 1279 at para. 11 (S.C.J.) [Landsbridge]

Shelanu v. Print Three Franchising Corp. (2003), 64 O.R. (3rd) 533 at paras. 31-36, 58 (C.A.) [Shelanu]

The License Agreements generally

30. At paragraphs 366 to 370, the Defendants overstate the Plaintiffs' position.
31. The Plaintiffs agree:
- a. that the Defendants are entitled by section 3.00 (g) of the License Agreement to provide franchisees with a Confidential Operating Manual ("COM") that establishes the "standards, specifications, procedures and techniques" of the TIM HORTONS OPERATING SYSTEM;
 - b. that franchisees are required by section 5.06, 7.00 and 7.03 to adhere to the "standards, specifications, procedures and techniques" set out in the COM in the operation of their Tim Hortons stores;
 - c. that section 7.03(a) entitles the franchisor to revise the COM and to require franchisees to comply with changes to "methods, procedures and techniques [used] in the preparation, merchandising and sale of donuts and other food items"; and, even,
 - d. that changes to the COM, as long as they are introduced in compliance with the License Agreement and are otherwise lawful, could require franchisees to change their method of production for donuts, Timbits, muffins and cookies from scratch-baked to re-heating frozen donuts and other baked goods.

Reference: License Agreement Store #593, sections 3.00(g), 5.06, 7.00, 7.03, Ex. Q to Jollymore, May 2009 Aff, Plaintiffs 1st Record, Tab 2Q, pp. 243, 248, 251, 252

32. The Plaintiffs do not agree, however, with the argument at paragraphs 372 to 376 of the Defendants' factum (and elsewhere) that the franchisor's right to impose such changes is unlimited. This position is stated most clearly at paragraph 373:

... it is clear that TDL has the discretion to revise the [Confidential] Operating Manual from time to time and the Franchisees are obligated to comply with all changes that the Franchisor in its discretion elects to make. [Emphasis added]

Reference: Defendants SJ Factum, para. 373

Plain language requiring benefit/improvement limits the right to modify the COM

33. The Defendants' argument that their entitlement to modify the COM encompasses improvements, further developments, and other modifications as

disjunctive possibilities unencumbered by any overall requirement that such changes constitute a “benefit” or “improvement” to the franchisee has four significant flaws.

34. First, although they acknowledge in principle that all terms in a contract must be given effect in accordance with their “plain meaning”, the Defendants’ submission ignores the introductory words of section 7.03(a) of the License Agreement:

In order that the Licensee may benefit from new knowledge gained by the Licensor as to improved methods, procedures and techniques, in the preparation, merchandising and sale of donuts and other food items, and in the operation of the Tim Hortons Shop, the Licensor may from time to time revise the contents of the Confidential Operating Manual and such other manuals and materials, if any, as it may develop and the Licensee covenants to forthwith comply with all changes to the contents of the Confidential Operating Manual and such other manuals and materials, if any, as the Licensor may develop, made by the Licensor from time to time during the term of this license Agreement provided that such changes shall not unreasonably alter the Licensee’s rights or obligations under this Agreement. [Emphasis added]

Reference: Defendants SJ Factum, paras. 351-352

License Agreement Store #593, s. 7.03(a), Ex. Q. To Jollymore, May 2009 Aff, Plaintiffs’ 1st Record, Tab 2Q, p. 252

35. The Plaintiffs submit that the plain meaning of these words is to limit the franchisor’s entitlement to impose changes in the methods, procedures and techniques to be used by franchisees in the preparation of donuts, Timbits, muffins and cookies to changes that constitute a “benefit” to franchisees and are an “improvement” of method, procedure or technique.

36. Second, while ignoring the limiting effect of the introductory words to section 7.03(a) (an operative provision of the License Agreement) the Defendants rely upon a phrase in the Agreement’s recitals (a non-operative provision) as the basis for their argument that there are no such limits.

Reference: Defendants SJ Factum, paras. 367, 369, 371

37. This approach is inconsistent with two well established principles of contractual interpretation that:

- a. where the operative terms of a contract are (as here) clear and unambiguous, it is not proper to refer to the prior recitals to alter this plain meaning; and

Reference: *Elliott Estate (Re)*; [1962] O.J. No. 164 at para. 11 (C.A.)

1124980 Ontario Inc. v. Liberty Mutual Insurance Co., [2003] O.J. No. 1468 at para. 71 (S.C.J.)

Lanston Monotype Machine Co. v. Northern Publishing Co. (1992), 63 S.C.R. 482

- b. in the event of an inconsistency between a recital and an operative provision in a contract, the operative provision prevails.

Reference: *On-Line Finance & Leasing Corp. v. Canada*, [2010] T.C.J. No. 380, at paras. 50-51 (Tax Court of Canada)

38. Should the Court conclude that there is ambiguity between section 7.03(a) as the operative provision and the recital relied upon by the Defendants, moreover, the principle of *contra proferentum* will apply to resolve that inconsistency against the Defendants.

Reference: *Landsbridge Auto Corp. v. Midas Canada Inc.* [2009] O.J. No. 1279 at para. 14 (S.C.J.) [Midas]

Guarantee Co. Of North America v. Resource Funding Ltd., [2008] O.J. No. 4339 at para. 142 (Ont. C.A.)

39. Third, the interpretation advanced by the Defendants (affording it the right to manipulate franchisee profitability from the bottom line) is inconsistent with the License Agreement's express provision that Tim Hortons franchisees are independent contractors and therefore, as noted above, entitled to conduct their operations as efficiently as possible in accordance with all relevant provisions of the License Agreement and their own abilities (which may vary) to maximize the return on their investment.

Reference: Licence Agreement #593, s. 15.00, Ex. Q. to Jollymore, May 2009 Aff, Tab 20, p. 267

40. Fourth, having regard to the relevant factual matrix (i.e., the genesis of the agreement, its purpose and the commercial contexts in which it was made), the interpretation advanced by the Plaintiffs is consistent with "sound commercial principles [and] good business sense" whereas that advanced by the Defendants would give rise to an absurdity. In this case, the relevant factual matrix includes:

- a. the many operational matters ordinarily controlled by independent business owners over which franchisees have already ceded control to the Defendants in exchange for the right to operate a store as part of the TIM HORTONS SYSTEM; the most important of these are summarized at

paragraph 41 of the Plaintiffs' Certification Factum and will not be repeated here; the point is that, having given up so much control already, it accords with good commercial sense to conclude that franchisees would not, and could not reasonably be expected to, afford the Defendants an unlimited right to dictate any change in method, procedure or technique regardless of cost or the potential for detrimental impact to the franchisee; and

- b. the AF conversion was a fundamental change in operations that required franchisees to collectively invest approximately \$75 million (and likely more, including the losses absorbed in the disposition of scratch-bake equipment) to replace their functional scratch-bake kitchens with special convection/microwave ovens and walk-in freezers; interestingly, in their 230 page Factum, the Defendants make only passing reference to the fact of the franchisees' capital investment in the AF conversion (at paragraph 247 of their factum) and afford that investment no legal consequence.

Reference: Plaintiffs Certification Factum, paras. 130-137

41. The Defendants' attempt to respond to the absurdity inherent in granting them unfettered discretion to impose changes in the COM upon the franchisees with the submission that it neither could, nor would be in the franchisor's interest to act to the detriment of its franchisees. This assertion, made not just by the Defendants but their expert economist, Prof. Ware, fails to appreciate an important nuance.

42. As explained by the Plaintiffs' expert in foodservice and franchising, Mr. Fisher, the franchisor needs the franchisee to remain in business in order to collect both transparent income (the initial franchise fee and ongoing RRA payments) and non-transparent income (in the form of mark-ups on the distribution of products and equipment sold to franchisees and rebates). The franchisee's level of profit is not relevant to the franchisor, however, as long as it is adequate to incent the franchisee to remain in the business. There is therefore room for the interests of franchisor and franchisee to diverge:

If, for example, a franchisor was able to "drive" a new business segment (e.g., Lunch) by offering similar or better food items well below the cost of its competitors at Lunch, it would likely draw some of that market and expand Lunch sales. If Lunch sales rose by \$200,000 per year, the franchisor would then benefit from increased product sales, RRA fees, product rebates and so forth. In TDL's case, these benefits would include a minimum of 16.5% in transparent revenue and some non-transparent revenue, as discussed above. On an increase in franchisee gross sales of \$200,000, TDL, as the franchisor, would benefit by at least \$33,000 (16.5% of \$200,000).

Alternatively, from the franchisees' point of view, these sales will likely generate Lunch-time requirements for: increased equipment, labour and supervision (as more staff are needed to prepare Lunch and bake breads); increased utility demands (as the doors open and close more often the heat or air conditioning demands are higher); increased repairs and maintenance (as a result of more traffic in the building); increased restroom use expenses (toilet paper, paper towels, soap and cleaning); increased paperwork (in ordering and documenting sales); and increased storage demands; together with the 16.5% transparent payments (RRA) to the franchisor. If these sales do not provide a reasonable margin enjoyed on other sales, it is not worth the franchisee's time or risk to generate the sales where the profit margin may be significantly reduced, negligible or if a loss is incurred.

While the franchisor clearly benefits from driving the additional sales by offering such low prices to gain sales from their competition, the franchisee may gain nothing in return. While the overall margins of the business may generate a profit, they are not as good when a component of the business benefits only the franchisor.

Reference: Fisher, July 2010 Aff, paras. 8-30, Plaintiffs 2nd Record, Vol. 1, Tab 1 pp. 10-17

43. For these reasons, the Plaintiffs submit that the Defendants' argument that there is no genuine issue requiring a trial because, as a matter of law, the right to impose changes of method, procedures and techniques upon the franchisees is not limited to "benefits" or "improvements" must fail.

44. The same is true with respect to the clear limiting words at the conclusion of section 7.03(a):

... provided that such changes shall not unreasonably alter the Licensee's right or obligations under this Agreement.

Reference: See para. 34 above

There is no credible evidence of franchisee "benefit" or "improvement" as a result of the AF conversion

45. The Defendants submit that,

... even if there was a requirement that the only modifications allowed are "improvements"... there is overwhelming evidence that Always Fresh was, in the view of TDL and many franchisees, a significant improvement over the previous system.

Reference: Defendants SJ Factum, para. 373

46. It is incontestable on this record such contention presents a genuine issue requiring a trial.

The "benefit" or "improvement" must have a financial component

47. It is uncontested that the "benefit" or "improvement" that was to flow to Tim Hortons franchisees from the AF conversion included a financial or economic component. As represented by the Defendants, franchisees would pay an increased food cost for the frozen donuts, Timbits, muffins and cookies, but would gain operational savings associated with the lack of reliance on skilled bakers and the ability to better target production to demand such that the overall impact of the AF conversion would be, at minimum, cost neutral to franchisees at the store level. As summarized by Susan Marshall, one of the Affiant Franchisees whose evidence is relied upon by the Defendants:

A. ... So I would reduce labour in the production of the Always Fresh donuts which would help compensate that, plus I would reduce labour in other areas in my operation which would make it -- it would make the labour rate the same or better than before Always Fresh.

Q. But with respect to the Always Fresh products.

A. Yes.

Q. When compared to the scratch bake product.

A. Yes.

Q. All right. And I take it that was your assumption following the Always Fresh conversion?

A. I'm sorry. I'm confused.

Q. Your assumption following the Always Fresh conversion is that if you did an analysis of production costs pre conversion and post conversion you would find there's a reduction in production costs that would offset the increased food costs of Always Fresh?

A. I was led -- I assumed that my labour before Always Fresh and after the conversion of Always Fresh were -- it wasn't just the labour. You had to add the labour, the paper and the food together would be the same as the food, paper and labour. It just would be distributed differently after Always Fresh.

Reference: Clanachan, November 2009 Aff, para. 12, Defendants' 1st Record, Vol. I, Tab B, p. 13

Marshall, Cx. Q. 165-169, Plaintiffs' 5th Record, Tab 13

48. It is also reasonable to require a demonstrated financial benefit to franchisees from the AF conversion given their substantial capital contribution to this fundamental

shift in process. As represented by the Defendants at a January 1999 Advisory Board meeting in relation to the automated kitchen (precursor to the AF conversion):

... Costs may be in the \$100,000 to \$150,000 range so obviously the system has to demonstrate an ROI [return on investment] for the store owner. [Emphasis added]

Reference: Cardella, Cx. Q. 178-189, Plaintiffs' 5th Record, Tab 12

49. The capital costs of the AF conversion to franchisees were in this same range. Vincent Cardella, one of the Affiant Franchisees, agreed that approximately \$40,000 per store was a reasonable estimate of the average cost incurred by franchisees to acquire and install the new equipment required for the AF conversion, and testified that it cost him approximately \$160,000 to convert his four stores. Greg Gilson, another franchisee who testified that he spent approximately \$70,000 to convert one of his stores and approximately \$30,000 to \$40,000 for each of the six others he converted (for an estimated total of \$250,000 to \$310,000).

Reference: Cardella, Cx. Q. 187-189, Plaintiffs 5th Record, Tab 12

Gilson, Cx. Q. 286-289, Plaintiffs' 5th Record, Tab 1

50. The Defendants' economist, Prof. Ware, also considered it obvious that franchisees are entitled to expect both, "a competitive wage for the Franchisee's time put into the business, plus a competitive rate of return on funds invested by the franchisee in the business." [Emphasis added]

Reference: Ware, November 2009 Aff, para. 7, Defendants 1st Record, Vol. III, Tab Q, p. 2695

51. Interestingly, Prof. Ware expressed the further opinion on cross-examination that he would expect franchisees to be earning competitive rates of return on the baked goods that were the subject of the franchisor's innovation (i.e., donuts, Timbit, Muffins and cookies), before the AF conversion and after. As to whether franchisees did, in fact, maintain that profitability, Prof. Ware conceded that he did not have the answer to that.

Reference: Ware, Cx. Q. 197-203, Plaintiffs' 5th Record, Tab 8

52. The Plaintiffs submit that Defendants have failed to adduce credible evidence that franchisees have obtained a financial benefit from the AF conversion. The problems

with the case advanced on this point are as follows (and addressed at greater length below). The Defendants:

- a. have adduced no expert evidence to establish that franchisees have obtained a financial benefit from the AF conversion;
- b. rely upon expressions of opinion by Mr. O'Rourke, Mr. Clanachan and Mr. Walton, all fact witnesses who lack a sound factual foundation for the views they express; and
- c. rely upon the testimony of certain of the Affiant Franchisees, which also suffers from important defects.

Reference: Defendants SJ Factum, paras. 258-289

The Plaintiffs have adduced strong evidence of financial harm to franchisees

53. Against what can only be viewed as a deliberate choice by the Defendants not to analyze available data to get to the bottom of a central question in dispute in this action, and on the Defendants' motion for summary judgment, the Plaintiffs have advanced clear evidence as to the financial harm suffered by Tim Hortons franchisees as a result of the AF conversion, as follows:

- a. The analysis and related evidence of Mr. Garland, regarding the reduction in profitability experienced by his stores as a result of the AF conversion and the resultant increased vulnerability of his business;

Reference: Plaintiffs Certification Factum, paras. 161-164

Garland, May 2009 Aff, paras. 12-51, Plaintiffs' 1st Record, Tab 3, pp. 373-383

Garland, July 2010 Aff, paras 56-96, 98-130, Plaintiffs' 2nd Record, Vol. 9, pp. 2582-96, 2597-2604

- b. The affidavit evidence of Mr. and Ms. Jollymore regarding the failure of labour and other operational savings to offset the increased food cost of the AF products as well as the increased business risks associated with the sole-sourced Maidstone donuts and Timbits; neither Mr. nor Ms. Jollymore were cross-examined on their evidence as to the impact of the AF conversion;

Reference: Jollymore, May 2009 Aff, paras. 10-33, Plaintiffs 1st Record, Tab 2, pp. 11-20

Jollymore, July 2010 Aff, paras. 36-77, Plaintiffs 2nd Record, Vol. 7, Tab 2, pp. 1972-85

Anne Jollymore, July 2010 Aff, paras. 21-29, Plaintiffs 2nd record, Vol. 9, Tab 3, pp. 2557-58

- c. The category costs analyses pertaining to the Plaintiffs and Affiant Franchisees and related analysis provided by Mr. Fisher, together with Mr. Fisher's analysis of the increased food cost of AF products (including donuts, in particular);

Reference: Plaintiffs Certification Factum, paras. 57-70, 154-162, 165-171

- d. Mr. Gilson and Mr. Loiello, franchisees from Ottawa and Montreal who testified under Summons to Witness, confirmed that they incurred increased food costs as a result of the AF conversion that were not offset by savings in waste, labour or other operational expenses; Mr. Gilson's overall profit margins dropped by 3 to 4% following the AF conversion⁵; Mr. Loiello ultimately went bankrupt and lost his stores;

Reference: Gilson, Ex. Q. 258-270, 290-291, Plaintiffs' 5th Record, Tab 1

Loiello, Ex. Q. 84-86, 88-106, 107-126, 131, Plaintiffs' 5th Record, Tab 2

- e. The expert evidence of forensic accountants retained by the Plaintiffs (Howard Rosen and Neal Mizrahi of THI Consulting);

- i) as to the harm caused to franchisees as a result of the CillRyan Mark-up (and related distribution mark-up) on donuts and Timbits with no corresponding value to franchises; and

Reference: FTI Report, paras. 58-116, Plaintiffs 4th Record, Vol. 2, Tab 3A, pp. 355-372

- ii) concluding that the information provided by the Defendants, "does not establish that franchisees realized an economic benefit, or have offset increased per-unit food costs, after the conversion to [AF]".

Reference: FTI Report, paras. 29-52, Plaintiffs' 4th Record, Vol. 2, Tab 3A, pp. 344-353

54. With respect to Mr. Garland, it is striking that the Defendants have taken no steps to analyze the data they now characterize as responsible for the genesis of this class proceeding. Under cross-examination, each of Mr. House, Mr. Clanachan and Mr. Walton acknowledged receiving Mr. Garland's January 12, 2004 memoranda and supporting analyses in 2004. It was attached to Mr. Garland's May 2009 affidavit (and further explained in his July 2010 affidavit). Then 3 executives provided no evidence as

⁵ While Mr. Gilson was cross-examined as to the accuracy of his testimony based on productions from the Defendants' franchisee database, it became clear that the significant gaps in this information (especially the pre-AF data) were such that he was unable to say what his profitability was): Gilson Rx Q. 625-649, Plaintiffs' 5th Record, Tab 1

to any steps taken to understand, evaluate and respond to his analysis and the concerns raised. The only reasonable explanation for the Defendants' conduct can be that they were fixed upon a course of conduct with IAWS (in particular, the 16¢ donut out of CillRyan as clearly deposed by the Defendants' own witness, Peter Madden) that could not be undone without significant penalty.

Reference: See para. 113 below

Madden, March 2011 Aff, para. 7, Defendants 3rd Record, Tab 1, p. 2

55. The experts retained by the Defendants similarly were not instructed to, and made no effort to, analyze Mr. Garland's data and related conclusions as presented or verify the completeness and accuracy of the financial data underlying the reports prepared by Mr. Garland from the financial records of his companies from 2003 to date.

Reference: McAuley, Cx, Q. 21, 26, 123-125, 136-139, 142-143, 153-156, 165-166, 244-261, Plaintiffs 5th Record, Tab 6

Ware, Cx. Q. 85-89 156-166, 174-175, 180-181, 295-301, 307-332, Plaintiffs 5th Record, Tab 8

56. In the case of Professor Ware, while he asserted that Mr. Garland's credentials as a CA were insufficient to allow him to analyze financial statements to determine the impact of the AF conversion (not being a "trained econometrician"), he did concede that there was nothing wrong with Mr. Garland's analysis beyond the fact that in his view it was "too small a sample."

Reference: Ware, Cx, Q. 317-322, Plaintiffs 5th Record, Tab 8

57. Rather, than confronting the substance of Mr. Garland's analysis on its merits, the Defendants have instead resorted to highly personalized attacks against him: first, trying to present him as a "poor operator", an ill-conceived strategy now abandoned;⁶ and more latterly, as an "embittered" former member of senior management with an "axe to grind" who has now "sold-out". It is highly instructive that there was no

⁶ Although the Defendants now seek to resile from the statements to this effect, the fact that this was an element of their defence as originally conceived was well understood by this Court: Endorsement of Justice G.R. Strathy dated February 2, 2010 re confidentiality.

substantive cross-examination of Mr. Garland on any of his analyses or supporting financial data as to the impact of the AF conversion.

Reference: Defendants' SJ Factum, paras. 12, 15

Garland, July 2011 Aff, paras. 30-55, Plaintiffs 2nd Record, Vol. 9, Tab 4, pp. 2574-82

58. The superficiality of this new line of attack was revealed on the cross-examination of Mr. House, the Defendants' current Executive Chairman. While a member of Senior Management at Tim Hortons, Mr. Garland worked closely with, and reported to, Mr. House. In his July 2010 affidavit, Mr. Garland noted that as TDL's most senior person with responsibility for (among other things) financial and managerial reporting and the imposition of financial and other systems of internal control, he received consistently high praise from Mr. House and others for the quality and depth of his analysis. Mr. House's continued regard for Mr. Garland's truthfulness and financial acumen was evident in repeated statements on cross-examination.

Q. Okay. He refers -- I'll skip the sentence. He refers to Exhibit A, if you want to take a look at that, and he showed you that spreadsheet to substantiate his point that he had a three percent -- . . .

Q. To make his case for the three percent cost increase.

A. If he said that he showed it to me, then he must have shown it to me. ...

Q. All right, and do you agree, based upon your knowledge of Cyril Garland, it would be pretty unlikely that he wouldn't operate his stores in an optimal fashion to generate the best possible profits?

A. He's been a good financial operator, yes.

Q. All right, but not only is he extremely knowledgeable about the financial goings on of a Tim Hortons store or franchisee because of his extensive financial knowledge, he conducts the operations of his store in a highly efficient fashion? He would be an exemplary store operator in terms of operating as best as one can to create the best possible product, to create the best possible profits for he and the franchisors?

A. I can't comment on that. I can comment that Cyril is very -- always been drilled down very strongly on the numbers and so forth.

Q. All right. So you would --

A. But I have only been in Cyril's store maybe once or twice in the time that Cyril has been in the business, so it wouldn't be fair for me to comment any further.

Reference: House, Cx, Q. 358, 364-365, 367-369, Plaintiffs' 5th Record, Tab 3

Garland, July 2010 Aff, para. 35, Plaintiffs 2nd Record, Vol. 9, Tab 4, p. 2575

59. The Defendants argue, finally, that Mr. Garland's opinions as expressed in his affidavits are inadmissible because of his ongoing financial interest in the outcome.

Reference: Defendants SJ Factum, para. 12

60. In its 1982 decision, *R. v. Graat*, the Supreme Court of Canada addressed comprehensively the circumstances in which lay witnesses may offer opinion evidence. The Court in that case decided that such evidence may be received where it is sufficiently helpful to the trier of fact and that the witness has the necessary experience to offer the opinion.

Reference: *R. v. Graat*, [1982] 2 S.C.R. 819

61. The authors of *The Law of Evidence in Canada* review *Graat* and its progeny, and state that lay witnesses may now offer opinion evidence where: (1) the witness has personal knowledge of the matters; (2) the witness is in a better position than the trier of fact to form the opinion; (3) the witness has the necessary experiential capacity to draw the conclusion; and (4) the witness could not describe the facts as accurately and adequately without providing the opinion.

Reference: Sopinka J., Lederman, S. and Bryant, A., *The Law of Evidence in Canada*, 3rd ed. sections 12.9-12.15

62. On the basis of this authority, the Plaintiffs submit that the Defendants' effort to persuade the Court to rule Mr. Garland's opinions inadmissible is misguided. He has intimate personal knowledge of the matters that are the subject of the opinions expressed; by virtue of his professional training, and his experience as both the Defendants' former VP Finance and a franchisee, he is in a better position than the Court to form the opinions expressed; he has the necessary experiential capacity to draw the conclusions he has; and he could not describe the facts as accurately and adequately referable to the matters at issue without providing the opinions he has expressed.

Defendants' failure to adduce credible evidence of a "benefit"

No expert evidence that franchisees have obtained a financial benefit

63. The Defendants have adduced no expert evidence on the question whether franchisees experienced a financial gain or loss as a result of the AF conversion or whether the impact was cost neutral to them (as represented).

64. James McAuley of KPMG, the forensic accountants retained by the Defendants in this matter, prepared two reports. His mandate for both was limited. In his first report, Mr. McAuley was directed only,

... to review and provide comments on analysis, comments and conclusions in the Fisher affidavit that are within [their] professional expertise.

Reference: KPMG/McAuley Report #1, Sched. D, Defendants 3rd Report, Tab 3, p. 171

McAuley, Cx, Q. 21, 26, Plaintiffs 5th Report, Tab 6

65. In relation to his second report, Mr. McAuley was directed:

... to review and provide comments on analysis, comments and conclusions within the FTI report that are within their professional expertise.

Reference: KPMG/McAuley Report #2, Defendants 3rd Record, Tab 5, pp. 234

McAuley, Cx Q. 155-156, Plaintiffs 5th Record, Tab 6

66. In keeping with the main limited scope of his retainer, each of Mr. McAuley's reports expressly states that it:

... does not contain a conclusion as to the quantum of gain/loss, or does it contain all of the adjustments that may be necessary to arrive at a conclusion of quantum of financial loss. [Emphasis added]

Reference: KPMG/McAuley Report #1, p. 8, Defendants 3rd Record, Tab 3, pp. 99

McAuley, Cx Q. 153, Plaintiffs 5th Record, Tab 6

KPMG/McAuley Report #2, Defendants 3rd Record, Tab 5, p. 200

67. Under cross-examination, Mr. McAuley confirmed that he did not do an independent analysis or offer any opinion as to:

- a. whether and by how much the food costs of donuts increased as a result of the AF conversion;

- b. whether the increased food cost of donuts as a result of the AF system were or were not offset by reductions in the costs of labour and other costs;
- c. whether the AF conversion resulted in a diversion of profit to TDL on the sale of donuts and other AF baked goods;
- d. whether and how much there was an economic loss resulting from the AF conversion; and
- e. whether there were economic losses or consequences from the mark-up of the donuts and Timbits.

Reference: McAuley, Cx Q. 123-125, 136-139, 142-143, 155-166, Plaintiffs 5th Record, Tab 6

68. On the issue of the harm caused to franchisees by the CillRyan Mark-up, Mr. McAuley's colleague at KPMG, Mr. Davis,⁷ similarly confirmed that the scope of his retainer was limited to commenting upon FTI's analysis of the economic consequences from mark-ups on the Maidstone donuts and Timbit (Part 5 of the FTI Report). It formed no part of Mr. Davis's retainer to undertake an independent analysis of the nature and extent of the mark-ups or whether they caused harm to Tim Hortons franchisees (as concluded by FTI).

Reference: Davis, Cx. Q. 19-30, Plaintiffs' 5th Record, Tab 7

69. Prof. Ware, for his part, relied upon Exhibit 2 to Mr. O'Rourke's November 2009 affidavit as the basis for his (Prof. Ware's) stated conclusion that,

After a period of learning, the margins and overall earning of franchisees increased on average as a result of the introduction of the new system.

Reference: Ware, Cx, Q. 156-169, Plaintiffs 5th Record, Tab 8

As to whether the impact of the AF conversion was to reduce or eliminate profits for franchisees, Prof. Ware stated that he could answer the question, "But no one has asked me to and I haven't attempted to."; in the absence of that analysis, he could not say whether profits went up, down, or stayed the same as a result of the AF conversion.

Reference: Ware, Cx. Q. 156-166, 187-188, 344, Plaintiffs 5th Record, Tab 8

⁷ Mr. Davis is put forward by the Defendants as having expertise in transfer pricing.

70. Prof. Ware confirmed on cross-examination that he did not analyze or verify Mr. O'Rourke's database in Exhibit 4 (to Mr. O'Rourke's November 2009 affidavit).

Reference: Ware, Cx. Q. 174-175, Plaintiffs' 5th Record, Tab 8

71. Nor did Prof. Ware undertake any analysis to assess by how much, EBITDA (or operating margin) would be reduced by depreciation, taxes, owner's salary or the cost of financing.

Reference: Ware, Cx. Q. 180-181, Plaintiffs' 5th Record, Tab 8

The franchisee database and O'Rourke's related analyses do not answer the question

72. In support of their contention that franchisees have benefited from the AF conversion, the Defendants therefore rely heavily (indeed, exclusively) upon Mr. O'Rourke's analysis of the franchisee database (as revealed in Exhibit 4 to his November 2009 affidavit) and his conclusion that operating margins have improved in most years and in most regions after 2003.

Reference: Defendants SJ Factum, para. 210

73. Mr. O'Rourke is a fact witness purporting to offer opinions relevant to the matters at issue, and the employee of a party with a financial interest in the proceeding. If Mr. Garland's ability to offer opinion evidence is limited by the Court, then the Plaintiffs submit that Mr. O'Rourke's ability to offer such evidence should be similarly circumscribed.

74. Mr. O'Rourke is a Grade 12 graduate without any post-secondary education. He joined Tim Hortons in 1999 and began collecting data that makes up the Defendants' franchisee database in 2001, and has retained responsibility for it since. There is no evidence that a Chartered Accountant had any involvement with the collection or analysis of the data prior to 2008.

Reference: O'Rourke, Cx Q. 52-53, 58-81, Plaintiffs 5th Record

75. Mr. O'Rourke confirmed on cross-examination that to his knowledge:
- a. KPMG had not carried out a financial audit or made any attempt to verify the accuracy of the information referred to in Exhibits 2 and 4 to Mr. O'Rourke's November 2009 affidavit;
 - b. KPMG does not offer any opinion as to the quantum of financial gain or loss referable to the impact of the AF conversion from scratch-bake to AF; and
 - c. Over the entirety of his (Mr. O'Rourke's) work experience with the Defendants, no consultant with qualifications of the kind listed at pages 14 and 15 of Mr. McAuley's report⁸ have ever offered an opinion on the quantum of financial gain or loss due to the impact of the AF conversion.

Reference: O'Rourke, Cx Q. 85-95, 131, Plaintiffs 5th Record, Tab 4

76. In any event, Mr. O'Rourke forthrightly acknowledged on cross-examination that he offers no opinion in his November 2009 affidavit relied upon by the Defendants that franchisee profitability margins improved as a result of the AF conversion:

Q. Where in your affidavit do you offer an opinion with respect to whether there was a gain or loss with respect to the financial impact of the scratch baked Always Fresh conversion?

A. I don't believe I offered an opinion that was directly related to Always Fresh.

Q. All right. I'll suggest to you sir, one of the reasons why you didn't is you haven't undertaken that analysis?

A. Not on a specific store by store basis. We have looked at the aggregated data over a whole over that period, and the sum of all the data which is a significant amount of data was an indicator that margins improved. The cause for those margins to improve over that period, I can't speak specifically to what the cause was. [Emphasis added]

Reference: O'Rourke, Cx Q. 102-103, Plaintiffs 5th Record, Tab 4

77. Mr. O'Rourke understood that FTI, the forensic accountants retained by the Plaintiffs, concluded that the contents of Exhibits 2 and 4 to Mr. O'Rourke's November

⁸ These qualifications include: Chartered Accountant ("CA"); Certified Management Accountant ("CMA"); Certified General Accountant ("CGA"); Certified Business Accountant ("CBV"); Chartered Financial Analyst ("CFA"); and Investigative and Forensic Accountant ("CA IFA"); KPMG (McAuley Report #1, Defendants' 3rd Record, Tab 3, pp. 105-106

2009 affidavit⁹ relied upon by the Defendants could not be relied upon to answer the question whether franchisees suffered a detrimental financial impact due to the AF conversion (or, by extension, a financial benefit). Mr. O'Rourke furthermore agreed with all of the reasons given by FTI for that conclusion, including that:

- a. the data is not comparable from one year to the next;
- b. the data is not comparable from one month to the next;
- c. further to b., approximately 40% fewer stores report in the last quarter of the year on a total basis;
- d. the aggregated data does not capture timing of the AF conversion for each franchisee with a clear cut-off point as to which data is "pre-AF" versus "post-AF"; and
- e. the data is not presented in the level of detail necessary to determine the impact of AF at the franchisee level.

Reference: O'Rourke, Cx. Q. 112-122, Plaintiffs 5th Record, Tab 4

FTI Report, paras. 50-52, Plaintiffs 4th Record, Vol. 2, Tab 3A, pp. 351-353

Gilson, Cx Q. 625-649, Plaintiffs 5th Record, Tab 1

78. Other weaknesses in the franchisee database, well known to Mr. O'Rourke and the Defendants generally from in or about January 2008 as a result of an Internal Audit Report performed at or about that time, included the following:

- a. For the purpose of presenting the data a "plug" of 16.5% RRA is used, which has the effect of over-stating profit margins because kiosks and other non-traditional stores pay higher RRA (for some, as high as 21 or 22%).

Mr. O'Rourke acknowledged that this same "plug" is used in Exhibits 2 and 4 to his November 2009 affidavits although, contrary to Recommendation 10 of the Audit Report, nowhere in Mr. O'Rourke's affidavit or Exhibits 2 and 4 does he disclose that this "plug" was used. In fact, when Plaintiffs' counsel sought related information in their production requests moreover, they were inaccurately advised by counsel to the Defendants: "The figure was not a "plug" but was based on actual."

⁹ As explained at para. 50 of the FTI Report, FTI reviewed the data underlying the tables presented at Exhibits 2 and 4 of Mr. O'Rourke's November 2009 affidavit: FTI Report, para. 50, Plaintiffs' 4th Record, Vol. 2, Tab 3A, p. 351

Reference: Internal Audit Report, p. 8, O'Rourke, Cx, Ex. 1, Plaintiffs 5th Record, Tab 4A-1
O'Rourke, Cx Q. 231, 311-318, Plaintiffs 5th Record, Tab 4

- b. The Defendants' guidance document for submitting P&L's to the franchise database recommended that some items be reported by franchisees on a "cash" basis (RRA and labour) and others on an "accrual" basis (utilities and cost of goods sold), with the result that, "Franchisee financial results could fluctuate..., reducing comparability between the franchises"; on his cross-examination, Mr. O'Rourke acknowledged this as a possibility.

Reference: Internal Audit Report p. 8, Ex 1 to O'Rourke Cx, Plaintiffs 5th Record, Tab 4A-1
O'Rourke, Cx Q. 232-236, Plaintiffs 5th Record, Tab 4

- c. Quebec results may not be comparable to those of the rest of the country due to different reporting data; Exhibit 4 to Mr. O'Rourke's November 2009 affidavit nonetheless provides national data including Quebec.

Reference: Internal Audit Report p. 9, O'Rourke, Cx Ex 1, Plaintiffs 5th Record, Tab 4A-1
O'Rourke, November 2009 Aff, Exhibit 4, Defendants 1st Record, Vol. VIII, Tab D4

- d. The database started in 2001 with P&L's from approximately 300 stores, growing by approximately 300 to 400 stores every year following (to 2007), with the result that the contents of the database have changed substantially over time.

Reference: Internal Audit Report p. 10, O'Rourke Cx, Ex 1, Plaintiffs 5th Record, Tab 4A-1
O'Rourke, Cx Q. 239-240, Plaintiffs 5th Record, Tab 4

- e. Upon receipt of P&L's from franchisees, some District Managers ("DMs") were altering the data before submitting it for inclusion in the database.

Reference: Internal Audit Report p. 10, O'Rourke Cx Ex 1, Plaintiffs 5th Record, Tab 4A-1
O'Rourke, Cx. Q. 241, Plaintiffs 5th Record, Tab 4

- f. Perhaps most importantly, the Audit Report revealed that the method used by the Defendants to present the average franchisee results (aggregating all of the data and dividing the totals by the number of stores as opposed to averaging the actual margins of each store), could serve to significantly overstate the operating (i.e., profit) margin. The example set out in the Audit Report illustrated that the "presentation method" yielded an operating margin of 15% whereas the alternative method identified in the Report (noted to weigh all stores equally) yielded a margin of 11.67%. On cross-examination Mr. O'Rourke admitted that the Defendants continue to use the "presentation method" despite the distorting effect identified by the Internal Audit Report.

Reference: Internal Audit Report p. 12-13, O'Rourke Cx. Ex 1, Plaintiffs 5th Record, Tab 4A-1

O'Rourke, Cx. Q. 244-251, Plaintiffs 5th Record, Tab 4

79. Mr. O'Rourke agreed with KPMG's opinion that, "only including franchisees who consent to participate (in a sampling to assess operating results) may skew the results and make the result unrepresentative of the larger population". He stated that this was a possibility in relation to the Defendants' franchisee database (which contains only the P&L's of those franchisees who consent to submit them to the Defendants), but that analysis has not been undertaken to determine whether or not this is so.

Reference: O'Rourke, Cx. Q. 134, 233, Plaintiffs 5th Record, Tab 4

KPMG/McAuley Report, Defendants 3rd Record, Tab 5, p. 211

80. Mr. O'Rourke also agreed with KPMG's opinion on behalf of the Defendants that:

Q. ... "the overall financial information provided in the O'Rourke affidavit without further review and analysis, does not address whether there were other factors or changes within the overall TDL system that might have also impacted in some notable way the food and labour costs."

A. I agree. [Mr. O'Rourke]

Q. You haven't done that analysis?

A. That is correct.

Reference: O'Rourke, Cx. Q. 141-142, Plaintiffs 5th Record, Tab 4

81. In summary, Mr. O'Rourke confirmed that the data in the Defendants' franchisee database is not a complete dataset and that while, in his view, the data "showed an indication that the margins were improving" (emphasis added), he could not comment as to whether that indication of improvement is, or is not, related to the AF conversion without undertaking the necessary refinement and analysis of the data, neither of which have been done.

Reference: O'Rourke, Cx. Q. 144-147, Plaintiffs 5th Record, Tab 4

82. As briefly explained in the Plaintiffs' Certification Factum, the reason that reports of overall store margin increases do not assist the Court to understand whether the AF conversion resulted in a financial harm or benefit to franchisees (or was neutral in its impact) is that many other factors can impact food and labour costs and, therefore, franchisee operating margins. Again, these factors include: sales volume changes; retail

price changes; products added to or dropped from the menu; changes in operating costs; increases in numbers of kiosks and drive-thrus and owners taking on more work with the result that the associated cost is not reflected in the cost of labour (as owner's salary is deducted following the calculation of EBITDA, i.e., "below the line").

Reference: O'Rourke, Cx Q. 168-218, Plaintiffs 5th Record, Tab 4
KPMG/McAuley Report #2, Defendants 3rd Record, Tab 5, p. 215
Plaintiffs Certification Factum, para. 174

83. By way of concrete example in the AF context, Mr. Jollymore explains in his July 2010 affidavit that the reason Anne Jollymore's stores experienced an apparent reduction in labour costs following the AF conversion is that (among other changes to the management structure and costs) she eliminated the payroll company she had previously hired and learned to do the work herself. This served to reduce the cost of management rather than production labour, and moved the "saved" management expense "below the line" as a component of owner's salary.

Reference: Jollymore, July 2010 Aff, paras. 51 and 87, Plaintiffs 2nd Record, Vol. 7, Tab 2, p. 1977-78, 1987-88

Clanachan and Walton rely upon the flawed franchisee database and O'Rourke analyses

84. The Defendants also rely upon the evidence of Mr. Clanachan and Mr. Walton in support of their argument that Tim Hortons franchisees are financially better off as a result of the AF conversion. Like Mr. O'Rourke, these individuals are fact witnesses who purport to express opinions with respect to the financial performance of Tim Hortons franchisees post-AF. Neither is a CA, nor hold any of the other designations identified by the Defendants' forensic accountant, Mr. McAuley, as generally accepted to demonstrate accounting, finance or business valuation expertise.

Reference: Defendants SJ Factum, paras. 252-253
KPMG/McAuley Report, Defendants 3rd Record, Tab 4, p. 105
Clanachan, CV, Clanachan November 2009 Aff, Ex 1, Defendants 1st Record, Vol. I, Tab B1, p. 94
Walton CV, Ex 1, November 2009 Aff, Defendants 1st Record, Vol. VIII, Tab C1, p. 2612

85. As submitted above with respect to Mr. O'Rourke, both Mr. Clanachan and Mr. Walton are Senior Management employees of the Defendants, which have a financial interest in this proceeding. Mr. Clanachan, moreover, has a performance aspect to his compensation. The details of Mr. Clanachan's compensation, and that of Mr. Walton and Mr. O'Rourke, remain outstanding as refusals.

Reference: Clanachan, Cx. Q. 335-339, Plaintiffs 5th Record, Tab 5
House, Cx. Q. 531, Plaintiffs 5th Record, Tab 3
O'Rourke, Cx. Q. 424, Plaintiffs' 5th Record, Tab 4

86. Should the Court conclude, as the Defendants urge, that the opinions expressed by Mr. Garland as to what conclusions may be drawn from the records of his stores' financial performance are inadmissible on the basis of his financial interest in the outcome of this action or to be afforded no weight for that reason, the Plaintiffs submit that the evidence of both Mr. Clanachan and Mr. Walton should be found inadmissible or afforded no weight. More fundamentally, the opinions Mr. Clanachan and Mr. Walton purport to express are wholly undermined by the weaknesses in the Defendants' franchisee database and the related analyses put forward in this proceeding, reviewed at length above. At paragraphs 135 and 136 of his November 2009 affidavit, Mr. Clanachan deposed:

... It took a few months for the early converts to realize the full economic benefits of Always Fresh baking. By the fall of 2003, the store margins were recovered (and bettered) and the revenue gains were being realized as is demonstrated in the Ontario fall presentations.

... Those results bore out what we had expected and that the margins were being impacted positively.

He expresses similar opinions at paragraphs 141 and 162 of that affidavit.

Reference: Clanachan, November 2009 Aff, paras. 135, 136, 141, 162, Defendants 1st Record, Vol. I, Tab B, p. 79-80, 87

87. Under cross-examination, Mr. Clanachan acknowledged that the source of the data relied upon in support of the views expressed in these paragraphs was one or more of Exhibits 2 and 4 to Mr. O'Rourke's November 2009 affidavit and the franchisee database administered by Mr. O'Rourke. Indeed, Mr. Clanachan agreed that,

... the entirety of [his] affidavit where it refers to individual store results is a reference to the data that Mr. O'Rourke was collecting that he has summarized in Exhibits 2 and 4.

This includes the post-AF reporting of food and labour costs.

Reference: Clanachan, Cx. Q. 192-194, 221-225, Plaintiffs 5th Record, Tab 5

88. Mr. Clanachan also acknowledged that TDL has conducted no analysis as to whether the AF conversion negatively impacted a particular franchisee's profitability.

Reference: Clanachan, Cx. Q. 195, Plaintiffs 5th Record, Tab 5

89. With respect to Mr. Walton, after quoting at length Mr. Walton's statement on cross-examination setting out the benefits he says accrued to franchisees as a result of the AF conversion, the Defendants omit Mr. Walton's acknowledgment that in arriving at his conclusion that franchisees' labour costs went down as a result of the AF conversion, he was (like Mr. Clanachan) relying upon the financial information and data as collected and analyzed by Mr. O'Rourke.

Reference: Walton, Cx. Q. 237-239, Plaintiffs 5th Record, Tab 9

D. Testimony from the Affiant Franchisees does not assist the Defendants

90. The Defendants rely upon the evidence of the Affiant Franchisees in further support of their argument that the case is "overwhelming" that Tim Hortons franchisees derived a benefit from the AF conversion. The Plaintiffs submit the opinions these witnesses express are inadmissible and may be afforded no weight if the criticisms of the Garland and Jollymore opinions are valid. If they may be considered, there is a genius issue requiring a trial since they contest the evidence of Mr. Garland and Mr. and Mrs. Jollymore.

Reference: Defendants SJ Factum, para. 373

91. The Defendants' own experts raise issues of concern with respect to this evidence:

- a. Mr. McAuley raises the important concern of selection bias:

... only including franchisees who consent to participate in the sampling process may skew the results and make the results unrepresentative of the larger population.

Under cross-examination, Mr. O'Rourke agreed that the Affiant Franchisees all consented to provide affidavits and financial data, and that this might produce skewed results and be unrepresentative of the larger population. Indeed, Mr. McAuley himself criticized Mr. Fisher's reliance upon evidence pertaining to the Affiant Franchisees as "limited and unrepresentative". On this point, it is also noteworthy that while Mr. Clanachan has deposed that the average Tim Hortons franchisee has 3.1 stores, ten of the 11 Affiant Franchisees have more than three stores, and only three of the 11 have not been Advisory Board members (and the wife of one of those, Jocelyn Guilmette, is a long standing Advisory Board member).

Reference: KPMG/McAuley Report #2, Defendants 3rd Record, Tab 5, pp. 211

O'Rourke, Cx Q. 134-138, Plaintiffs 5th Record, Tab 4

KPMG/McAuley report #1, Defendants 3rd Record, Tab 3, p. 136

Fisher, May 2011 Aff, para. 109, Plaintiffs 4th Record, Vol. 5, Tab 4, p. 1713

Clanachan, November 2009 Aff, para. 184, Defendants 1st Record, Vol. I, Tab B, p. 93

- b. Mr. McAuley did not request, nor did he analyze, financial data pertaining to the Affiant Franchisees.

Reference: McAuley, Cx, Q. 163, Plaintiffs 5th Record, Tab 6

92. Prof. Ware, for his part, also stated that he did not "like small samples" by way of explanation as to why he had dismissed out of hand the affidavit evidence of Mr. Garland, an experienced CA, former VP Finance for the Defendants and long-standing franchisee. Prof. Ware argued further that, despite his professional qualifications as a CA, Mr. Garland was not capable to determine causality with respect to the impact of the AF conversion because he was not "a trained econometrician". There is no evidence that any of the Affiant Franchisees (or for that matter, any of Mr. O'Rourke, Mr. Clanachan or Mr. Walton) is a "trained econometrician".

Reference: Ware, Cx, Q. 314-233, Plaintiffs 5th Record, Tab 8

93. The Affiant Franchisees' evidence is problematic for other reasons. In summary, their affidavits offer only general statements as to the impact of the AF conversion upon their stores' profitability without reference to any underlying financial information or analysis. The reliability of these statements was, moreover, seriously undermined on cross-examination.

94. Susan Marshall, the first of the Affiant Franchisees relied upon by the Defendants, converted six stores in Edmonton, Alberta to the AF system in the summer of 2003. In her affidavit, she states:

While under Always Fresh each individual donut costs more, taking into account reduced labour costs and increased sales, my stores have ultimately been more profitable as a result of the conversion.

Reference: Defendants SJ Factum, para. 258

Marshall, November 2009 Aff, para. 16, Defendants 1st Record, Vol. VIII, Tab P, p. 2690

95. Ms. Marshall's understanding was that the increased food costs of the AF conversion would be offset by savings in labour:

I was led – I assumed that my labour before Always Fresh and after the conversion of Always Fresh were – it wasn't just the labour. You had to add the labour, the paper and the food together would be the same as the food, paper and labour. It just would be distributed differently after Always Fresh.

Reference: Marshall, Cx, Q. 169, Plaintiffs 5th Record, Tab 13

96. In her analysis of the impact of the AF conversion for the purpose of her affidavit, Ms. Marshall explained that she simply did an aggregate analysis from memory (sales less costs); she did not undertake any kind of category-by-category analysis to see how revenues, expense and profitability changed before and after the AF conversion.

Reference: Marshall, Cx, Q. 170-174, Plaintiffs 5th Record, Tab 13

97. Ms. Marshall also admitted under cross-examination, that when she swore her affidavit:

- a. She did not refer to the financial information for these stores for the period prior to 2004 (i.e., pre AF) as this data is no longer available to her;

Reference: Marshall, Cx, Q. 70, 73-96, Plaintiffs 5th Record, Tab 13

- b. She swore her statement as to the impact of the AF conversion on her stores' profitability "from memory" without reviewing financial information; Ms. Marshall was unable to say, however, what the annual revenue or percentage profitability was for any of these stores in the 12 months preceding the AF conversion (or even for last year), nor could she remember what the difference in profitability was as either a percentage of sales or on a gross basis;

Reference: Marshall, Cx. Q. 46-50, 173-174, Plaintiffs 5th Record, Tab 13

- c. She did not review her payroll summaries for the stores nor did she have available to her any other financial data to allow her to compare the cost of production, labour pre- and post AF or the stores' management costs pre- and post AF;

Reference: Marshall, Cx, Q. 63-64, 129-137, Plaintiffs 5th Record, Tab 13

- d. She did not review throw data (because she does not keep it for longer than three months);

Reference: Marshall, Cx, Q. 65, Plaintiffs 5th Record, Tab 13

- e. She did not have available to her, and did not review, data pertaining to donut sales over time but, again, "dealt strictly from memory"; despite the suggestion in paragraph 16 of her affidavit that donut sales have increased since the AF conversion, however, Ms. Marshall was not able to say on cross-examination whether this was the case ("I don't think I know that").

Reference: Marshall Cx, Q. 138-148, Plaintiffs 5th Record, Tab 13

98. Graham Oliver is another Affiant Franchisee heavily relied upon by the Defendants, and operates stores in Kitchener, Ontario. In two affidavits sworn approximately one year apart, November 2008 and November 2009, Mr. Oliver contended that the claims advanced by the Plaintiffs "are patently wrong and cannot be supported" and that "all franchisees across Canada have benefited from the [AF] conversion".

Reference: Oliver, November 2008 Aff, para. 13, Oliver Cx, Ex.1, Plaintiffs 5th Record, Tab 10

Oliver, November 2009 Aff, para. 8, Defendants 1st Record, Vol. VIII, Tab I, p. 2650

99. On cross-examination, Mr. Oliver admitted that:

- a. before swearing his November 2009 affidavit, he did not analyze the financial information that Mr. Garland identified in his affidavit established the proposition that the AF conversion was financially detrimental; rather he "just skimmed over" Mr. Garland's affidavit; and

Reference: Oliver, Cx, Q. 34-35, Plaintiffs 5th Record, Tab 10

- b. he has not analyzed the financial data for any other franchisees, but simply extrapolated what he believed to be the aggregate financial data for his own stores to other franchisees;

Reference: Oliver, Cx, Q. 451-452, Plaintiffs 5th Record, Tab 10

c. that before swearing his affidavits, he was aware of information that:

i) a number of franchisees were concerned with the accuracy of the P+Ls circulated by the Defendants' Management team;

Reference: Oliver, Cx, Q. 119-121, Plaintiffs 5th Record, Tab 10

ii) franchisees, including himself, were concerned about the poor quality of the AF product at launch;

Reference: Oliver, Cx, Q. 124-125, 127, Plaintiffs 5th Record, Tab 10

iii) franchisees had expressed a fear of retribution if they expressed themselves honestly to the Defendants' Management;

Reference: Oliver, Cx, Q. 142-145, 174, Plaintiffs 5th Record, Tab 10

iv) franchisees had complained about pricing and food and utility costs and unsatisfactory levels of profits;

Reference: Oliver, Cx, Q. 146-147, 190-204, 208-216, 220-228, Plaintiffs 5th Record, Tab 10

v) franchisees had expressed the fear that, since Tim Hortons became a public company, "the stores are the only source of revenue and that it has become more of an us vs. them attitude"; and

Reference: Oliver, Cx, Q. 167, Plaintiffs 5th Record, Tab 10

vi) some franchisees had expressed the view that Mr. Jollymore's proposed class action has merit.

Reference: Oliver, Cx, Q. 171, Plaintiffs 5th Record, Tab 10

100. With regard to his own stores, Mr. Oliver stated on cross-examination that before swearing his November 2008 affidavit, he reviewed the financial statements for all of his stores pre-AF (including those he owned himself and those he operated on his father's behalf) at a "top-line level". On the basis of this review, he concluded that the stores' profitability as a percentage margin of sales changed "a little bit" for three to six months but that they were "pretty much lined up" by April/May 2003 (having converted to AF in October 2002).

101. Mr. Oliver was presented on cross-examination with two tables (marked as Exhibit 14 to his cross-examination) which he acknowledged accurately set out the

operating results for all 12 of his stores as owned and operated in 2002 (pre-AF) and 2004 (post-AF). Mr. Oliver agreed that the analysis set out in Table 1 was the "top-line" analysis he would have had before swearing his November 2008 affidavit, showing that his operating margins (or EBITDA) increased from 12.8% in 2002 to 13.6% in 2004.

Reference: Oliver, Cx, Q. 372-404, Plaintiffs 5th Record, Tab 10

102. The problem with Table 1, however, is that it compares the results of the 11 stores operated pre-AF with the 12 stores post-AF. Table 2 limits the analysis to the 11 stores operated both pre- and post-AF, with the result that profits actually decreased rather than increased both in absolute dollars (a drop of \$286,700) and as a percentage of sales (from 16.0% in 2002 to 15.1% in 2004). Mr. Oliver agreed that his profitability on a "same store" basis was reduced post-AF, and that the reason he enjoyed a profit as indicated in Table 1 (showing 12 stores in 2004) was the addition of a new store (Store #2252), with sales over \$2.7 million and profits of \$598,500).

Reference: Oliver, Cx, Q. 408-449, Plaintiffs 5th Record, Tab 10

2002/2004 Store Comparison, Oliver Cx, Ex. 14, Plaintiffs 5th Record, Tab A-14

103. Reviewing a comparable table of the operating results for Mr. Oliver's twelve stores of 2009, Mr. Oliver acknowledged further that the aggregate profitability of these stores had dropped to 10% in 2009, considerably less than in either 2002 or 2004 as a percentage of sales.

Reference: Oliver, Cx, Q. 408-449, Plaintiffs 5th Record, Tab 10

2009 Store Data, Oliver Cx, Ex. 18, Plaintiffs 5th Record, Tab A-180

104. Mr. Beebe, a franchisee from Prince George, BC, and also cited by the Defendants, testified to much the same effect. In his affidavit, sworn November 2009, Mr. Beebe stated:

In terms of profitability, in the first year of the conversion to Always Fresh I believe that we were less profitable than we had been previously, but once we learned how to operate efficiently under the Always Fresh system our profitability returned to pre-Always Fresh levels and our sales numbers increased significantly.

Reference: Defendants SJ Factum, para. 262

Beebe, November 2009 Aff, para. 21, Defendants 1st Record, Vol. VIII, Tab L, p. 2669

105. On cross-examination, Mr. Beebe (who converted his stores in late 2003):

- a. Explained that this statement was based on his “belief” given the knowledge of his business rather than based upon a review of any financial data available to him;

Reference: Beebe, Cx Q. 19-21, Plaintiffs 5th Record, Tab 11

- b. Admitted that the financial statements for Store #806, his most profitable store, reveal that post-AF he experienced reduced profitability from 12% to 8.9% in 2005 to 5.9% in 2008 (less than half of what it was pre-AF);¹⁰

Reference: Beebe, Cx Q. 24-74, Plaintiffs 5th Record, Tab 11

Table re: Store #806, Beebe Cx, Ex. 2, Plaintiffs 5th Record, Tab 11A-2

- c. Agreed that his wage and benefit costs in 2001 did not permit analysis of production costs and whether these changed over time; and

Reference: Beebe, Cx Q. 85-86, 106-112, Plaintiffs 5th Record, Tab 11

- d. In any event, explained that he assumed that his labour costs would be reduced post-AF based on TDL’s information that the donuts were going to cost more but the labour would be less.

Reference: Beebe, Cx Q. 103-105, 113-115, 126-128, Plaintiffs 5th Record, Tab 11

106. Similar problems with the Affiant Franchisees’ presentation of financial information are apparent even on the face of the financial data belatedly appended by Mr. Clanachan to his June 2011 affidavit. For example, Jocelyn Guilmette (a Quebec franchisee) stated in his affidavit:

In my view, there are several advantages to the Always Fresh system. Sales and profits at the Saint-Nicholas store [#1173] have risen through diversification of product offerings, reductions in labour costs, and uniform product quality.

What Mr. Guilmette failed to disclose to the Court is that while sales also went up in Store #1215 from 2002 to 2003, his profits in that store dropped from 5.2% to 2.9%. The Defendants produced no financial statements for Store #1215 for 2005 or 2008.

¹⁰ Mr. Beebe testified that he has been taking more income out of the business over time by way of management salary, but acknowledged that this information was not included in the financial statements and was unable to say how much he and his wife earned as compared with employed managers.

Reference: Guilmette, November 2009 Aff, para. 9, Defendants 1st Record, Vol. VIII, tab B, p. 2646.

Financial Statements Store #1215, Ex. P to Clanachan, June 2011 Aff, Binder V, Tab P

107. As did Mr. Gilson (see paragraph 176 of the Plaintiffs' Certification Factum), all of the Affiant Franchisees who were cross-examined and for whom the Defendants produced data from the franchisee database administered by Mr. O'Rourke, confirmed the existence of large gaps in the data pertaining to their stores, providing further evidence of the weaknesses and inherent unreliability of the Defendants' franchisee database as set out above.

Reference: Marshall, Cx. Q. 104-125, Plaintiffs 5th Record, Tab 13

Beebe, Cx, Q. 130-147, Plaintiffs 5th Record, Tab 11

Cardella, Cx, Q. 112-140, Plaintiffs 5th Record, Tab 12

Angelini, Cx, Q. 41-87, Plaintiffs 5th Record, Tab 14

108. It is also noteworthy that none of the Affiant Franchisees who produced Clearview data analyzed by the Plaintiffs in their category costs analyses (produced in their totality to counsel for the Affiant Franchisees with all related back-up) filed responding affidavits to dispute the method or results of these analyses.

Reference: Jollymore, April 2011 Aff, paras. 15-26, Plaintiffs 4th Record, Vol. 1, Tab 2, pp. 10-14

109. Finally, and significantly, in their various statements as to the advantages of the AF conversion there is no suggestion that any of the Affiant Franchisees swore their affidavits with knowledge of the fact of the CillRyan Mark-up and the corresponding lack of value to the franchisees as analyzed by FTI. Consistent with questions raised at Advisory Board meetings following the AF conversion (see paragraph 187 of the Plaintiffs' Certification Factum), Mr. Oliver acknowledged on cross-examination that he has heard franchisees express the view that they are entitled to know what the Defendants' profitability was on the Maidstone plant. It is therefore reasonable to conclude that this information would be of interest to the Affiant Franchisees and might well affect their assessment of the reasonableness of what has transpired.

Reference: Oliver, Cx, Q. 135-137, Plaintiffs 5th Record, Tab 10

Plaintiffs Certification Factum, para. 187

The franchisor's "right to be wrong"

110. In response to the Defendants' assertion of the franchisor's "right to be wrong" the Plaintiffs rely upon their failure to take reasonable steps to consider the merits of franchisee concerns (expressed beginning in 2002) that the high AF food costs were reducing their profitability and by failing to respond to these concerns with retail price increases or otherwise.

Reference: Defendants SJ Factum, para. 14

111. The record is clear that the Plaintiffs and Mr. Garland were not the only franchisees concerned about the high food costs of the AF products.

Reference: Plaintiffs Certification Factum, paras. 197-189, 191

Oliver Cx, q. 146-147, Plaintiffs 5th Record, Tab 10

Loeillo Ex. q. 85-86, Plaintiffs 5th Record, Tab 2

112. In particular, however, the Defendants took no meaningful steps to respond to the concerns and analysis raised with them by Mr. Garland beginning in late 2002. For example:

- a. In a meeting held September 10, 2002, Mr. Garland shared with Mr. Walton his assessment that the AF conversion would have an adverse impact on franchisee profitability and proposed to Mr. Walton that the franchisor share in that loss by absorbing 50% of it. Mr. Walton stated under cross-examination that this proposal "would not have registered in any meaningful way" because the 4% "was not felt to be an accurate assessment". He conceded, however, that he had not done, and did not do, any specific analysis. Mr. Walton did not ask Mr. Garland for his financial analysis although he understood Mr. Garland had no doubt prepared one, and did not ask anyone to look into his analysis as conveyed verbally to see if there might be merit in what he was saying. Instead, (using Mr. Walton's words), he questioned Mr. Garland as to whether he should be in the chain and told him that he "needs to change", "needs to stop pushing" and was "going too far now". Mr. Walton agreed that he repeated these messages "in many different ways" over the course of a long, frustrating meeting. Mr. Garland understood Mr. Walton, who was (and is) the key person in Senior Management involved in franchisee terminations, to threaten him with removal as a franchisee if he did not implement the AF system.

Reference: Walton, Cx, Q. 209, 220-231, 296-316, Plaintiffs 5th Record, Tab 9

Garland, May 2009 Aff, para. 14, Plaintiffs 1st Record, Tab 3, p. 374

- b. In a meeting held March 6, 2003, Mr. Garland shared with Mr. House and Mr. Clanachan a period P+L statement showing profit margin results under the AF system for his Store #385 (a "standard" store). These results (attached as Exhibit A to Mr. Garland's May 2009 affidavit) revealed donuts and Timbits yielding a profit margin of -11.3%, with muffins and cookies at 3.9% and -2.4% respectively. Neither Mr. House nor Mr. Clanachan disputed Mr. Garland's data or asked that he re-check his data or calculations. Under cross-examination, Mr. House acknowledged receiving Mr. Garland's memorandum. He left it to Mr. Clanachan to follow up on the matters raised but was unaware of any related follow up.

Reference: Garland, May 2009 Aff, paras.16-18, Plaintiffs' 1st Record, Tab 3, pp.374-375

Store #385 P+L, Ex A to Garland, May 2009 Aff, Plaintiffs' 1st Record, Tab 3A, p.387

House, Cx, Q.363-365, 372-375, Plaintiffs' 5th Record, Tab 3

- c. Mr. Clanachan acknowledged receiving Mr. Garland's memorandum dated January 12, 2004, to which Mr. Garland had appended Store #385's 20 week P+L statements showing pre- and post-AF margins for the baked goods category (donuts, Timbits, muffins and cookies). These statements highlighted that the pre-AF margin on Mr. Garland's baked goods sales was 11.7% of sales, compared to the post-AF margin of -0.1%. A copy of these results is attached as Exhibit B to Mr. Garland's May 2009 affidavit. At the conclusion of this memorandum, Mr. Garland stated:

We need to at least attempt to price Baked Goods so as to get closer towards the Pre-Always Fresh Profit Margins.

Mr. Garland received no response to his memorandum.

Reference: Garland, May 2009 Aff, paras.21-22, Plaintiffs' 1st Record, Tab 3, pp.376

Garland Memo to Clanachan dated January 12, 2004, Ex B to Garland, May 2009 Aff, Plaintiffs' 1st Record, Tab 3B, p.389-391

- d. On cross-examination, Mr. Clanachan had no recollection of discussing the information provided in Mr. Garland's January 12, 2004 memorandum with Mr. House or Mr. Walton and, in his words, "did not instruct anyone to do anything from that memo." In particular, Mr. Clanachan took no steps to analyze similar records of other franchisees. Instead, the Defendants monitored franchisees' post-AF labour costs using the aggregate data contained in the database maintained by Mr. O' Rourke.

Reference: Clanachan, Cx, Q.207-225, Plaintiffs' 5th Record, Tab 5

- e. Mr. Garland sent a further memorandum dated January 12, 2004 to Mr. Walton. In this memorandum, Mr. Garland set out the financial analysis in support of his position that he would not convert his kiosks to introduce

on-site AF production but would, instead, continue to supply them from Store #385. A copy of this memorandum, to which Mr. Garland received no response, is attached as Exhibit C to his May 2009 affidavit. Under cross-examination, Mr. Walton admitted that he received and reviewed the memorandum, but had no recollection or documentary record to suggest he had done anything with it.

Reference: **Garland, May 2009 Aff, para.23, Plaintiffs' 1st Record, Tab 3, pp.376-377**

Garland Memo to Walton dated January 12, 2004, Ex C to Garland, May 2009 Aff, Plaintiffs' 1st Record, Tab 3C, p.393-394

Reference: **Walton, Cx, Q.326-345, Plaintiffs' 5th Record, Tab 9**

113. In the context of this proceeding, the Defendants maintain that the Plaintiffs have failed to take into account the price increases applied to donuts since the AF conversion. This is not so but, as explained at paragraphs 148 and 149 of the Plaintiffs' Certification Factum:

- a. all such increases were in response to increases in the minimum wage and other costs, never the increased food cost of the AF product; and
- b. the Defendants persist in omitting from their comparison of increased food costs with increased retail prices the pre-AF starting point. Properly considered, retail prices for donuts have increased 28.6% against a food cost increase of 97% (using the Defendants' pre-AF numbers) and 164.1% (using the Plaintiffs' pre-AF numbers).

Reference: **Defendants SJ Factum, para. 289**

Plaintiffs Certification Factum, paras. 148-149

Loiello Cx Q. 133-135, Plaintiffs 5th Record, Tab 2

114. At paragraph 467(f) of their Factum, the Defendants state: "In simple terms, a donut at present costs the franchisees at most 21-22 cents to make and sells for 90 cents." This statement misleads by omission. It is undisputed that Tim Hortons donuts are sold in packages of 6 and 1 dozen, not just as singles. This fact brings down the average selling price (or "average sales revenue" per donut). According to a presentation given by Mr. Clanachan in the Spring of 2004, the 'Average Sales Revenue Per Donut' was 57.11 cents, in the same "ballpark" as Mr. Garland's estimate of a blended price of 56¢ per donut. As well, the food cost associated with (production waste (likely negligible) and throws (significant) must be taken into account. This fact adds to the food cost of selling a single donut, from 21 to 22 cents to some higher

number. Mr. Fisher provides a detailed explanation of this issue at paragraphs 534 to 541 of his July 2010 affidavit (responding to the Defendants' argument – difficult to understand in view of Mr. Clanachan's own presentation – that the notion of a blended price is not valid conceptually).

Reference: Defendants SJ Factum, para.467(f)

Fisher, July 2010 Aff, paras. 534-541, Plaintiffs 2nd Record, Vol. 1, Tab 1, pp. 167-169

Spring 2004 Presentation, Ex 43 to Clanachan. November 2009 Aff, Defendants' 1st Record, Vol. VII, Tab B43, p.2557

Garland, May 2009 Aff, para. 17, Plaintiffs 1st Record, Tab 3, p. 375

115. Given the evidentiary record reviewed above, the Plaintiffs submit that their contentions that the AF conversion was not a "benefit" or "improvement" for Tim Hortons franchisees as plainly required by Section 7.039(a) of the License Agreement and/or unreasonably altered franchisees' rights or obligations under the License Agreement, present genuine issues requiring a trial for their resolution.

Defendants' breach of the implied term to sell products to franchisees at lower prices

116. The Plaintiffs allege that the Defendants breached the implied term in the Licence Agreements that,

... the ingredients and commodities the Plaintiffs and Class A Members were required to purchase from the TDL Distribution System would be sold to franchisees at lower prices than they could obtain for the same products in the marketplace...

Reference: Claim, para. 34, Plaintiffs' 5th Record, Tab 1

117. The Defendants advance three arguments to the contrary, which the Plaintiffs dispute while nonetheless accepting the general statements of principle set out at paragraphs 355 to 363 of the Defendants' Factum.

No consistency with express terms in the Licence Agreement.

118. The Defendants submit that this alleged implied term is contrary to the express wording of the following phrase in section 5.04 of the Licence Agreement, which reads:

