

Court File No.: 06-CV-311330CP

**ONTARIO  
SUPERIOR COURT OF JUSTICE**

**BETWEEN:**

2038724 ONTARIO LTD. and 2036250 ONTARIO INC.

Plaintiffs

- and -

QUIZNO'S CANADA RESTAURANT CORPORATION,  
QUIZ-CAN LLC, THE QUIZNO'S MASTER LLC,  
CANADA FOOD DISTRIBUTION COMPANY, GORDON FOOD  
SERVICE, INC. and GFS CANADA COMPANY INC.

Defendants

**STATEMENT OF DEFENCE**

1. The defendants Quiznos Canada Restaurant Corporation, Quiz-Can LLC, the Quiznos Master LLC and Canada Food Distribution Company ("CFD") (collectively, "Quiznos") admit none of the allegations contained in the amended amended statement of claim (the "claim").
2. Quiznos has no knowledge in respect of the allegations contained in paragraphs 10, 11, 12 and 26 of the claim.
3. Quiznos denies each and every allegation contained in the claim, except as expressly admitted herein, and puts the plaintiffs to the strict proof thereof.

**Overview**

4. Quiznos is a well known quick service restaurant ("QSR") chain serving sandwiches and other food products. Since its Canadian inception in 1996, it has grown to include over 450 restaurants in Canada. There are over 6000 Quiznos restaurants world wide. All Quiznos restaurants in Canada are franchised. Quiznos' unique brand offers toasted sandwiches with larger and higher quality products all in an upscale surrounding.

5. Quiznos' success hinges on the success and profitability of its franchisees. Quiznos' goal is to maximize the value of its brand. Quiznos has no incentive to diminish the profitability of its franchisees because to do so would diminish the brand itself.

6. In order to maintain the uniqueness and consistency of the Quiznos brand, and in accordance with the terms of its standard Franchise Agreement, franchisees are required to purchase all of their food products and supplies from Quiznos' authorized distributors.<sup>1</sup>

7. GFS Canada Company Inc. ("GFS") has been the exclusive distributor of supplies to Quiznos' Canadian franchisees since 2003. A sole-source Canada-wide distribution system greatly increases efficiencies thereby reducing overall distribution costs. Most franchisors in the QSR industry utilize sole-source distributors.

8. The Distribution Agreement between Quiznos and GFS sets the maximum price that GFS can charge to deliver the products to Quiznos' franchisees. GFS is entitled to charge less for delivery if it wishes. This is a common practice in distribution agreements. The maximum delivery fee that GFS can charge is a flat fee for each product delivered to each franchisee. Franchisees are charged for delivery based on a "flat fee" model so that franchisees obtain similar products at more or less similar prices, regardless of their location.

9. During the class period (May 16, 2006 to November 23, 2009) the number of Canadian franchisees increased from 401 to 454. During this period, on an annualized basis, the average franchisee's gross profit margins increased from approximately \$156,080 to \$202,184<sup>2</sup>, a 29.5 percent increase. The average return on investment increased from \$18,055 to \$37,198<sup>3</sup>, an increase of over 100 percent.

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<sup>1</sup> Franchisees may purchase fresh produce locally.

<sup>2</sup> This value is based on actual numbers to November 15, 2009 and amortized for the 1.5 months remaining in 2009.

<sup>3</sup> See note 1.

From January 2007 to the end of the class period, 10 percent of all franchise transfers and 76 percent of all stores that were re-opened were purchased by existing Quiznos franchisees. These metrics reflect a healthy franchise system with increasingly profitable franchisees and low franchisee failure rates. This stands in stark contrast to the plaintiffs' bald allegations about franchisees' lack of profitability.

10. Through its affiliated company Canada Food Distribution Company ("CFD"), Quiznos sources nearly all of the supplies used by its franchisees. Quiznos uses its volume buying power to secure low-cost and competitive prices for these products from various suppliers and manufacturers in Canada and the United States. Quiznos determines the re-sale price of each product to its franchisees which includes: the base cost of the product, a sourcing fee and a standard mark-up for GFS.

11. Neither GFS nor any of Quiznos' suppliers determine the re-sale price of the products to Quiznos' franchisees. Quiznos' suppliers establish the base price available to Quiznos. The mark-up GFS is entitled to charge Quiznos' franchisees is determined in the Distribution Agreement. Quiznos' sourcing fee, where one is applied, is determined by Quiznos alone.

12. There is no mystery about the existence of CFD. Its establishment was fully disclosed to franchisees in disclosure documents. Quiznos uses CFD's revenues to make up shortfalls in the Canadian advertising and marketing fund (the "Ad Fund"). In 2002, franchisees contributed \$6,712,824 to the Ad Fund. Quiznos spent \$11,515,727 in Canada for advertising and marketing in that same year. The shortfall of almost \$6,000,000 was made up entirely by CFD.

13. The Ad Fund is used to generate greater brand awareness through television, radio and print advertisements which, in turn, increase franchisee returns. This is in sharp contrast to the plaintiffs' assertions that Quiznos has made exorbitant profits from sales of products to its franchisees.

14. Due to its volume purchasing power and efficient supply system, Quiznos' costs of supply are low and compare favourably to the food costs of other QSR

franchise systems. Indeed, Quiznos' pricing is based on its over 4000 restaurants in North America.

### **The Parties**

15. Contrary to paragraph 3 of the claim, 2038724 Ontario Ltd. ceased to be a Quiznos franchisee on or about September 10, 2007.

16. Contrary to paragraph 4 of the claim, on February 4, 2009, Quiznos terminated 2036250 Ontario Inc. as a franchisee as a result of numerous different violations of its franchise agreement including failure to offer delivery services, failure to follow promotions and under-portioning sandwiches over a two year period. This Honourable Court ordered 203 to cease operations when its owner refused to do so, despite having been terminated.<sup>4</sup>

17. With respect to paragraph 6 of the claim, Quiznos principal place of business is located at 355 King Street West in Toronto, Ontario, not Mississauga, Ontario.

18. Quiznos Canada Restaurant Corporation ("QCRC") is the Canadian franchisor of the Quiznos Sub™ Restaurants. QCRC commenced operations in 1996. There are now approximately 454 Quiznos franchises in Canada.

19. QCRC is owned by Quiz-Can LLC, a Delaware company. Quiz-Can LLC provides certain management services to QCRC relating to QCRC's day-to-day operations.

20. The Quiznos Master LLC is a Colorado company and owner of the trademark and trade name Quiznos. It is named as a third party beneficiary of the Franchise Agreements between QCRC and QCRC's franchisees, and has a contractual right to enforce those Agreements against the franchisees.

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<sup>4</sup> Leave to appeal the injunction Order to the Divisional Court was denied.

21. CFD is a Nova Scotia corporation which is an affiliate of Quiznos. In 2003, Quiznos appointed CFD as its agent to carry out the obligations to source, negotiate and contract with suppliers of food products and other restaurant supplies (the "Products").

22. Quiznos' distributor is the defendant, GFS, who is responsible for distributing the Products to each franchisee.

### **The Quiznos System**

23. Quiznos is a franchise chain. A franchisor creates a product and a brand through an act of innovation. The distribution of the brand innovation involves franchisees, who operate the business designed by the franchisor.

24. As franchisor, Quiznos enters into standard franchise agreements with its franchisees in Canada. The franchise agreements are identical in most respects, and require the franchisees to follow uniform business practices. Requiring franchisees to follow uniform business practices is necessary in the QSR franchise industry to ensure that customers receive consistent products. This is an accepted element of franchising.

25. By its franchise agreements, Quiznos determines what franchisees may sell to customers, what ingredients are to be used in making those products, how those products are to be prepared and the maximum prices at which those products can be sold to customers.

### **Quiznos' Revenue**

26. Quiznos generates revenue primarily from three sources: (i) initial franchise fees; (ii) royalties; and (iii) the supply of products. Obtaining revenue in these ways is typical of QSR franchise businesses.

#### ***(i) Product Supply and Distribution***

27. Like most major franchisors in the QSR industry, Quiznos has developed confidential product specifications and specific recipes for many of the menu items

sold at its restaurants. Use of specified products and adherence to the recipes by each franchisee accords with the requirement for uniform business practices. It is essential to ensuring customers receive the same menu item of similar quality when they patronize any Quiznos restaurant in Canada.

28. During the class period, Quiznos specified between 163 and 256 products for use in the preparation and sale of Quiznos menu items. Contrary to the plaintiffs' claims, most of these products are not "commodities". In fact, approximately 50% of these products are based on Quiznos unique specifications and are proprietary to Quiznos.

29. Franchisees are provided with the build requirements (recipes) on how to prepare the menu items that are sold in Quiznos restaurants. The franchisees are not provided with, nor are they entitled to, the confidential specifications for the ingredients in individual food products.

30. In January 2003, Quiznos assigned its food distribution rights to its affiliate, CFD. CFD assumed the role of sourcing, negotiating and contracting with companies to supply these specified products. Through CFD, Quiznos contracts with a single food-services distributor, GFS, to organize the delivery of products to franchisees across Canada.

31. CFD and GFS have entered into two successive Distribution Agreements. The first commenced in January, 2003 and the second commenced on October 1, 2006 (the "Distribution Agreement"). Pursuant to the Distribution Agreement, GFS is responsible for distribution of all products, as defined in the Agreement, to franchisees. GFS maintains an inventory of Quiznos' specified products.

32. A sole-source Canada-wide distribution system greatly increases efficiency for the franchise, and thus reduces costs for all franchisees. For example, volume purchasing and effective management of transportation routes yield considerable savings on a franchise-wide basis. Furthermore, a sole-source distribution service ensures a level of quality control and product specificity which otherwise may not be

possible. A single delivery source also reduces the time and labour component franchisees must expend to receive product. Quiznos also manages inventories and accepts most of the risk of loss on over-buys on all products.

33. Quiznos has divided Canada into five different regions in which distribution centres ("DC") owned by GFS or its affiliates are located. Quiznos' franchisees are supplied with products from these distribution centres, with the exception of its Newfoundland franchises, which are supplied by an independent entity, Atlantic Grocers. Atlantic has a distribution arrangement with GFS.

34. Contrary to the plaintiffs' allegations at paragraphs 55A-55G of the claim, Quiznos did not "inflate" the price of products. At all material times Quiznos adhered to their contractual obligations to the franchisees, including meeting their obligations to act in good faith.

**(ii) Product Purchases and Pricing**

35. A number of factors affect the price of particular products. Part of the price charged to Quiznos' franchisees includes a fee for the services rendered by Quiznos and its affiliates. These services include: establishing the confidential specifications of the products, negotiating with suppliers, inventory management, establishment of the brand and goodwill, and demand for the product. Quiznos is entitled to charge a sourcing fee for the products sold to franchisees. Nothing in the standard franchise agreement or disclosure document suggests otherwise.

36. The Distribution Agreement sets the maximum price that GFS can charge to deliver the products to franchisees. GFS is entitled to charge less for delivery if it wishes. This is a common practice in distribution agreements. It parallels the obligation which prevents franchisees from charging its customers more than the maximum pricing Quiznos sets for menu items from time to time.

37. The maximum delivery fee that GFS can charge is a flat fee for each product delivered to each franchisee. Franchisees are charged for delivery based on a "flat fee" model so that franchisees obtain similar products at more or less similar prices,

regardless of their location. In effect, franchisees with low delivery costs subsidize those with high delivery costs, i.e. franchisees that are close to distribution centres subsidize delivery charges to those franchisees that are remotely located. This system of averaging actual costs to achieve standard cost of supplies to franchisees is not only ubiquitous in the franchising world, it is essential.

38. The delivery charge for products is not the only factor in assessing the actual costs of those products. Actual food costs are solely within the control of each franchisee and reflect numerous store level variables. Actual costs are determined by calculating the value of the inventory (i.e. products) consumed or disposed of in a period (i.e. food and other supplies used) and taking that value as a percentage of total sales for the same period.

39. Some franchisees own multiple stores. For multi-unit owners, the food costs of each restaurant may be distorted because each store orders and pays for food that may ultimately be used by one of their other restaurants. The plaintiffs' owners both owned multiple restaurants. Therefore, any reliance on the food costs of the plaintiff companies is potentially misleading since those food costs are not entirely attributable to one store's operations.

#### **No Breach of the *Competition Act***

40. Contrary to the plaintiffs' allegations at paragraphs 32-34 and 49 of the claim, the Distribution Agreement is not a price maintenance agreement. The mere fact of a contractual obligation to use a preferred supplier or distributor and the setting of a price for the delivery of those goods is not illegal. The plaintiffs have not identified any provisions of the Distribution Agreement that they say fix and maintain prices.

41. At no time has Quiznos used agreements, threats, promises or other like means, directly or indirectly, to enhance, fix and maintain the prices which its franchisees pay for supplies.

42. The plaintiffs' suggestion that Quiznos "threatened" consultants in order to maintain prices is completely off base. As stated, like all QSRs, Quiznos considers



its confidential product specifications to be of extreme importance. No notice was provided by the alleged consultants to Quiznos prior to the overtures they made to the suppliers. No disclosure was made regarding the parties for whom they were acting. In the highly competitive QSR industry, it was entirely reasonable and understandable for Quiznos to protect its product information as it saw fit. Therefore, contrary to the allegations made by the plaintiffs in paragraphs 35-36 of the claim, Quiznos made no threats nor have they engaged in intimidation in an attempt to prevent lowering the price of supplies.

43. With respect to paragraphs 37-38 of the claim, the plaintiffs have failed to particularize their claims of promises made by Quiznos in furtherance of the alleged price maintenance. Quiznos expressly denies that any such promises were made.

44. Quiznos expressly denies the "other like means" as pleaded by the plaintiffs in paragraphs 39-42 of the claim.

45. Section 61 of the *Competition Act*, R.S.C., 1985, c. C-34, as amended, was repealed effective March 12, 2009. Quiznos pleads and relies on the repeal of section 61, to the extent that any claim by the plaintiffs or member of the putative class pursuant to section 61 is limited to the period ending March 12, 2009. Similarly, no new claims can arise in respect of an alleged violation of s. 61 following that date.

#### **No Loss or Damage Suffered by the Plaintiffs**

46. Quiznos denies the allegations at paragraphs 43 and 45 of the claim, that the plaintiffs could have obtained Quiznos products at lower prices. Fifty percent of the products are proprietary to Quiznos and cannot, therefore, be obtained elsewhere. For the remaining fifty percent, the plaintiffs have been unable, to date, to provide a single instance of a product that could have been obtained at a lower price from an alternative source or distributor. Due to its volume purchasing power and efficient supply system, Quiznos' costs of supply are low and compare favourably to the food costs of other QSR franchise systems.

47. The factual basis needed to support the plaintiffs' claim that "overcharging" occurred is proof that the delivered price for one or more of the products supplied by GFS to a franchisee at a particular point in time has been set at a level higher than the delivered price available to a franchisee for that same product from another source at the same point in time. Quiznos denies that this could ever be established and holds the plaintiffs to the strict proof thereof.

48. Contrary to the plaintiffs claims at paragraphs 44 and 46 of the claim of a "chronic lack of profitability", and "unsustainable losses", Quiznos franchisees continue to show increased profits and financial stability. As stated above, and demonstrated in the tables below, the metrics are contrary to the plaintiffs allegations:

<b>Year</b>	<b>Gross Profits</b>	<b>ROI</b>
2005	\$156,080	\$18,055
2006	\$169,829	\$29,592
2007	\$192,115	\$46,848
2008	\$183,522	\$37,930
2009	\$202,184 <sup>5</sup>	\$37,198 <sup>6</sup>
<b>Percentage Increase Since 2005</b>	<b>29.5%</b>	<b>106%</b>

#### **No Unlawful Conduct Means No Common Law Conspiracy**

49. Contrary to the plaintiffs' allegations at paragraphs 62 and 63A of the claim, Quiznos is not involved in a conspiracy to increase franchisees' product pricing. As

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<sup>5</sup> This value is based on actual numbers to November 15, 2009 and amortized for the 1.5 months remaining in 2009.

<sup>6</sup> See note 1.

mentioned above, there is no incentive for Quiznos to do so since higher prices would ultimately harm its franchisees and, by consequence, the Quiznos brand.

50. Proof of the common law conspiracy claim requires proof of "unlawful conduct". The plaintiffs allege that the "unlawful conduct" was the purported violation of the *Competition Act*. Since the plaintiffs cannot establish any breach of the *Competition Act*, they cannot establish a conspiracy at common law either.

51. Establishing proof of loss or damages is also an essential element of a claim in civil conspiracy. The plaintiffs are unable to demonstrate that they suffered any loss or damage, let alone as a result of Quiznos conduct.

### **No Breach of Contract**

52. Quiznos has not breached the terms of its franchise agreements with the plaintiffs in any respect related to food pricing.

53. Sections 9 and 10 of the standard franchise agreement provides each franchisee with the right to contact Quiznos for certain types of assistance and guidance. Contrary to the plaintiffs' allegations at paragraphs 47-55 of the claim, the plaintiffs did not contact Quiznos for such assistance or guidance and therefore did not trigger these provisions of the franchise agreement.

54. Section 13 of the standard franchise agreement provides that the franchisees must purchase products from Quiznos authorized distributors. It also provides that, a franchisee may propose to offer, conduct or utilize any services, products, materials, forms, items or supplies for use in their restaurant which Quiznos will then consider. The plaintiffs have made no such proposal to Quiznos with respect to alternate sources of supply.

55. Quiznos is also entitled to receive payments from franchisees and rebates, price concessions, allowances or advantages from its suppliers. Franchisees were provided with this information and were informed that those monies could be deposited into the Ad Fund:

### Section 13.4 of the Franchise Agreement

[...] QCC or Franchisor may receive payments from suppliers on account of such suppliers' dealings with Franchisee and other franchise owners and may use all amounts so received without restriction and for any purpose QCC or Franchisor deems appropriate. QCC may (but is not obligated to) collect for deposit into the Marketing and Promotion Fund any or some amounts paid by suppliers.

### Section 16 of the Disclosure Document

The Franchisor and its associates do, from time to time, receive rebates, price concessions, allowances or advantages from approved suppliers in connection with sales to a Franchisee. Franchisor and its associates may use all amounts so received, without restriction, for any purpose they deem appropriate. Franchisor may (but is not obligated to) collect for deposit into the Marketing and Promotion Fund any some amounts paid by suppliers. Franchisor and its associates do not cause rebates to be paid directly to Franchisees.

### **No Breach of Statutory or Common Law Duties of Good Faith**

56. At all material times, Quiznos has exercised its contractual rights in accordance with its duties of good faith and fair dealing. Quiznos has treated its franchisees fairly, honestly and reasonably. Contrary to the plaintiffs' allegation at paragraph 52 of their claim, Quiznos is not required to exercise its rights and obligations in the best interests of its franchisees. Quiznos does not owe a fiduciary duty to the plaintiffs.

57. Contrary to paragraph 55 of the claim, the prices charged by Quiznos for products were fair and commercially reasonable. In any event, Quiznos is entitled to charge a sourcing fee for its role in developing, sourcing and negotiating product prices with suppliers.

### **Releases from Putative Class Members**

58. Approximately 181 Quiznos franchisees have executed releases waiving any right to claims raised against Quiznos in the within action. Quiznos pleads and relies on those releases as a complete defence to any claims made by those franchisees in the within action.

## **Damages**

59. The plaintiffs have not suffered any damages as a result of any of their claims against Quiznos. Quiznos holds them to the strict proof thereof.

60. In the alternative, if the plaintiffs did suffer any damages, which Quiznos expressly denies, the amounts claimed are excessive and without merit. Furthermore, the plaintiffs have failed to mitigate their alleged damages.

## **Rate of Interest**

61. Quiznos denies any and all liability for the claims made against it. In the alternative, if any claims are successful, the proper pre- and post- judgment interest rates should be those that are posted, from time to time, in accordance with the *Courts of Justice Act*.

62. Quiznos asks that this action be dismissed with costs.

**December 7, 2009**

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**STATEMENT OF DEFENCE**

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