

Court File No.

**ONTARIO
SUPERIOR COURT OF JUSTICE**

B E T W E E N:

1291079 ONTARIO LIMITED

Plaintiff

- and -

SEARS CANADA INC. and SEARS, ROEBUCK AND CO.

Defendants

Proceeding under the *Class Proceedings Act, 1992*

STATEMENT OF CLAIM

TO THE DEFENDANTS:

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiff. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a statement of defence in Form 18A prescribed by the Rules of Civil Procedure, serve it on the plaintiff's lawyer or, where the plaintiff does not have a lawyer, serve it on the plaintiff, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this statement of claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your statement of defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a statement of defence, you may serve and file a notice of intent to defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your statement of defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES,

LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

Date July 5 , 2013

Issued by

Local Registrar

Address of
court office

Milton Courthouse
491 Steeles Avenue East
Milton, ON L9T 1Y7

TO: **SEARS CANADA INC.**
290 Yonge Street, Suite 700
Toronto, Ontario
M5B 2C3

AND TO: **SEARS, ROEBUCK AND CO.**
3333 Beverly Road
Hoffman Estates, IL 60179
United States of America

CLAIM

1. The plaintiff claims:

(a) damages not exceeding \$100,000,000 for:

- (i) breach of contract, negligent misrepresentation, or either of them;
- (ii) breach of sections 3 and 7 of the *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c. 3 (“**Wishart Act**”);
- (iii) breach of sections 7 and 9 of the *Franchises Act*, S.A. 1995, c. F-17 (“**Alberta Act**”), sections 3 and 7 of *The Franchises Act*, C.C.S.M., c. F156 (“**Manitoba Act**”), sections 3 and 7 of the *Franchises Act*, S.N.B. 2007, c. F-23.5 (“**NB Act**”), and sections 3 and 7 of the *Franchises Act*, R.S.P.E.I. 1988, c. F-14.1 (“**PEI Act**”), in respect of class members carrying on business in Alberta, Manitoba, New Brunswick and Prince Edward Island, respectively;
- (iv) breach of articles 6, 7 and 1375 of the *Civil Code of Quebec*, S.Q. 1991, c. 64 (“**Civil Code**”) in respect of class members carrying on business in Quebec;

or, alternatively, an order directing individual hearings in respect of such damages;

(b) further, and in the alternative, compensation and restitution for unjust enrichment in the amount of \$100,000,000;

(c) an accounting of all products sold by either of the defendants through direct channels (as defined herein) and delivered directly to customers within each class member's defined market area since the inception of each class member's Dealer Agreement (as defined herein) and judgment in an amount equal to Retail Commissions (as defined herein) on all such sales;

(d) a mandatory order directing the defendants to pay to the class members Retail Commissions in respect of all products sold by either of the defendants through direct channels and delivered directly to customers within each class member's defined market area;

(e) an accounting of all commissions paid to each class member in accordance with section D of Schedule "A" to the Dealer Agreement since the inception of each class member's Dealer Agreement, and judgment for any shortfall arising therefrom;

(f) a declaration that the defendants, or either of them, are "franchisors" or "franchisor's associates" within the meaning of the Wishart Act, Alberta Act, Manitoba Act, NB Act and PEI Act (collectively, the "**Franchise Acts**");

(g) a declaration that each class member is entitled to the benefit of the Wishart Act pursuant to the choice of law provision in the Dealer Agreement, and further that each class member carrying on business in Ontario, Alberta, Manitoba, New Brunswick and Prince Edward Island is entitled to the protection of the Franchise Act applicable in its province;

(h) pre-judgment and post-judgment interest pursuant to the *Courts of Justice Act*, R.S.O. 1990, c. C.43;

- (i) costs of this action on a substantial-indemnity scale, plus applicable goods and services and harmonized sales taxes; and
- (j) such further and other relief as this Honourable Court deems just, including all further necessary or appropriate accounts, inquiries and directions.

Summary of Claim

2. The class members comprise a network of approximately 260 “Sears Hometown” stores operating in every province and territory of Canada pursuant to a standard dealer agreement (“**Dealer Agreement**”) with the Sears defendants. The Dealer Agreement is a franchise agreement within the meaning of the Franchise Acts, although Sears does not comply with any applicable franchise legislation.

3. Sears uses its discretionary powers under the Dealer Agreement to make it virtually impossible for a dealer to realize a profit unless it achieves exceptionally high, and generally unattainable, revenues. The Hometown store program dooms dealers to financial ruin while Sears reaps the rewards of the dealers’ hard work and investment. The principal of the average class member labours 50-60 hours per week in its store for the equivalent of minimum wage and receives no return on its investment. Many dealers cannot afford to pay their principal any wage at all. Sears is well aware that the Hometown store program is not economically viable for the dealers.

4. On the other hand, the Hometown store program is a very profitable distribution channel for Sears. Sears realizes high profit margins on sales made through the Hometown stores while downloading the high retail and handling costs onto the dealers who operate on a subsistence compensation model. Even though Sears maintains unilateral, discretionary power under the

Dealer Agreement to adjust the dealers' financial compensation in order to make the Hometown store model a successful one for the dealers and Sears alike, Sears has ignored repeated pleas from the dealer body to exercise its discretion to increase compensation to a sustainable level. Instead, Sears squeezes ever more profit from the Hometown store program and leaves dealers to languish and then fail. After a dealer finally exhausts its resources and gives up its store, Sears reacquires and resells the store to a new dealer by misrepresenting the truth about the system.

5. Sears perpetuates this predatory scheme through a number of means. First, it conceals the economic reality about the Hometown store program from prospective dealers. It does so by disregarding provincial franchise disclosure laws designed, among other things, to provide full disclosure of all material facts related to the franchise system. Instead of disclosing the truth about the economics of the network, it provides a common information package to prospective dealers which touts the Hometown store system as "brilliant," "better than a franchise," and a "smart business model."

6. Once the dealer has signed the Dealer Agreement, often tying itself into a long-term lease, the exploitation of the dealer continues:

- (a) Sears maintains a compensation structure that results in the vast majority of dealer-principals being unable to make a living wage from the business, let alone realize a return on its investment and efforts.
- (b) Sears poaches sales in the dealer's market area by selling goods directly to customers over the internet and telephone and ships those goods directly to the customer, bypassing the dealer and avoiding paying compensation to the dealer for sales in the dealer's 'Market Area' as defined under the Dealer Agreement.

- (c) Sears charges and retains for itself an unauthorized “handling fee” on all goods purchased online or by telephone and shipped to the dealer’s store.
- (d) Sears has introduced new programs superficially designed to be revenue neutral, but that in fact claw back for many dealers what little economic benefits the program delivers to the dealers.

7. Contrary to its duty of good faith and statutory duty of fair dealing, Sears carries out these acts solely to maximize its own profits, and in complete disregard of the dealers’ economic well-being, reasonable commercial interests and contractual expectations.

8. Through these systemic actions, Sears has destroyed the right of dealers to enjoy the fruits of the Dealer Agreement and has deprived the dealers of the opportunity to fairly participate in revenues and profits generated by the Hometown store program.

Parties

9. The plaintiff, 1291079 Ontario Limited, is incorporated under the laws of Ontario and carries on business in the Town of Woodstock, Ontario, as a retailer under the “Sears Hometown” store program.

10. The defendant, Sears Canada Inc. (“**Sears Canada**”), is incorporated under the federal laws of Canada and has its head office in the City of Toronto, Province of Ontario. Sears is one of Canada’s largest retailers of home appliances, furnishings, mattresses, electronics and apparel, among other things.

11. The defendant, Sears, Roebuck and Co. (“**Sears Roebuck**”), is incorporated under the laws of the state of New York and has its head office in Hoffman Estates in the State of Illinois.

Sears Roebuck owns the trade-marks associated with the “Sears” brand and is an affiliated company to Sears Canada. Sears Roebuck is party to the Dealer Agreement together with Sears Canada.

12. Sears Canada and Sears Roebuck are referred to herein as “Sears” unless the context requires differentiation.

13. In addition to Hometown stores, Sears owns and operates its own retail outlets, including full-line department stores and other smaller, specialty retail outlets. Sears also sells products to customers through catalogue ordering, telephone ordering through its 1-800 telephone number, and online through www.sears.ca and www.sears.com (collectively, the “**direct channels**”). Sears distributes catalogues across Canada where customers can order goods from the catalogues, which are then either delivered directly to the customer or picked up at a Sears retail outlet. Similarly, customers can order products directly from Sears online from Sears’ website or through Sears’ 1-800 telephone number for direct delivery or pickup at a Sears outlet.

14. At the end of 2012, there were approximately 260 Hometown stores, 118 full-line department stores, as well as other Sears retail stores.

15. The proposed class consists of all persons carrying on business as a Hometown store under a Dealer Agreement with Sears at any time on or after January 1, 2011 (“**dealers**” or “**class members**”).

The Sears Hometown Store Program

16. Hometown stores typically offer for sale major appliances, furniture, home electronics, and outdoor power equipment among other things, and include a catalogue merchandise pick-up location. Most Hometown stores are located in small towns and more rural areas that lack the

market size to support a full-line department store, which are generally located in large urban and suburban shopping centres.

17. Dealers do not pay any upfront fees to Sears to be part of the Hometown stores program, but must pay for the fixturing and design of their stores. Dealers are also responsible for securing a lease for the premises for the Hometown store and the costs of leasehold improvements. While Sears provides some of the equipment used in the operation of the Hometown store (such as the POS system so Sears can track sales), a dealer purchases all the other equipment and fixtures not provided by Sears. Typically, a dealer is required to spend between \$50,000 - \$100,000 to get its Hometown store up and running in addition to its lease commitments.

18. Under the Dealer Agreement, with the exception of purchasing most inventory, a dealer is responsible for all expenses in running its Hometown store. The dealer is responsible for securing the premises, paying staff, utilities, and all other business expenses that are required to operate the Hometown store.

19. With respect to most inventory, according to the Dealer Agreement, the dealer acts as bailee for Sears, which places the inventory with the dealer on consignment. When an item is sold at the Hometown store, according to the Dealer Agreement, title to the inventory transfers directly from Sears to the customer and all payments for merchandise by the customer are the property of Sears. All credit card payments are directed to Sears. All cash payments are deposited into Sears' bank account.

20. Sears controls what merchandise is offered for sale at each Hometown store and at what price. A dealer has little input on what merchandise is sold at its Hometown store. Sears also controls what inventory is on display and the general layout of the Hometown store.

Dealer's Revenue Streams

21. A dealer does not earn revenue directly from the customers that shop at the Hometown store (except from the sale of parts and accessories, as to which see paragraph 73 below). Rather, Sears pays the dealer a commission for merchandise sold at the Hometown store. Each category of items offered (for example, major appliances) has a set commission rate. On average, the commission paid by Sears is about 10% of the retail price of the merchandise (the “**Retail Commissions**”). Therefore, if a dealer sells \$1,000,000 of merchandise at its Hometown store, Sears will pay the dealer approximately \$100,000 in Retail Commissions.

22. In addition to Retail Commissions, a dealer earns 4.5% of the retail price of goods ordered through the direct channels that are picked-up at the dealer's Hometown store (“**Direct Channel Commissions**”).

23. A dealer also earns a 3% commission of the retail price of goods if a catalogue order is made from the dealer's Hometown store (“**Catalogue Commissions**”).

24. A dealer also earns \$25 for an item that is purchased at another Sears' retail location (including other Hometown stores) and picked up at the dealer's Hometown store, and an additional \$10 for each additional item in a multi-piece order (“**Retail Handling Commissions**”).

25. Retail Commissions, Direct Channel Commissions, Catalogue Commissions and Retail Handling Commissions are hereinafter collectively referred to as “**commissions**” or “**compensation**”.

26. The majority of a dealer's revenue comes from Retail Commissions.

27. If a customer cancels or returns an item purchased from the dealer's Hometown store, the dealer's commission is reduced by the commission originally paid on the sale of the good without compensation for handling. The dealer is also responsible to pay Sears for unpaid goods in certain cases where a customer does not make proper payment.

Hometown Store Program Is Not Viable for Dealers

28. Hometown stores are a very profitable business segment for Sears. On the sale of a typical good at a Hometown store, Sears realizes a gross margin of approximately 36%. Out of that 36%, Sears pays the dealer approximately 10% for the Retail Commissions and keeps the remaining 26% for itself, despite the fact that virtually all of the costs of selling the good are borne by the dealer. Out of the dealer's 10% Retail Commissions, it must pay rent, employees, utilities and all other expenses needed to keep the Hometown store operating.

29. The effect of the Sears Hometown Program is that the vast majority of dealers barely earn enough commissions to cover their expenses and pay their principals minimum wage. Many dealers are unable to pay their principals more than a token amount for their 50-60 hour work week. Very few dealers generate enough income to pay their principals a living salary and earn a return on their investment. Many dealers hang on out of fear that by closing their store, they will be forced into bankruptcy due to lease obligations and employee obligations.

30. Sears, on the other hand, profits handsomely from the Hometown store program. By realizing an approximately 36% gross margin from the sale of goods (and even after covering its own expenses for distribution and maintaining the Hometown Sears program), the Hometown store program has been a huge boon to Sears' profitability while the dealers struggle to stay in business and not lose their initial investment and be exposed to claims from landlords, employees and the like.

31. Sears knows that the Hometown store program is unsustainable for the dealers. After a dealer eventually runs out of money, Sears simply appoints a new dealer operator to run the Hometown store.

32. The commissions under the Dealer Agreement, which directly impact the viability of the dealer network, can be changed by Sears in its sole discretion on 90 days' notice to the dealers. Because of this unilateral discretion to change the commissions, Sears has a duty of good faith and a statutory duty of fair dealing under section 3 of the Wishart Act to exercise its discretion in a manner which is fair and commercially reasonable taking into account the interests of both Sears and the dealership network at large. Sears has instead breached such unilateral and discretionary powers by perpetuating a predatory system of under-compensation which forces dealer-principals to labour 50-60 hours per week in return for subsistence compensation which Sears knows is insufficient to meet their basic financial needs, and which provides no return on the dealers' financial investment and efforts.

33. Sears is fully aware of that the commissions structure of the Dealer Agreement is unsustainable and that Retail Commissions need to be increased to at least 15% of sales on average in order for the dealership network to be viable. However, instead of increasing commissions pursuant to its unilateral and discretionary powers, Sears has:

- (a) *lowered* dealers' commission rates;
- (b) unlawfully competed for sales by selling and shipping directly to customers within the dealers' market area through the direct channels without compensation to the dealers and offered lower prices through the direct channels while prohibiting dealers from price matching;

- (c) implemented a handling fee on catalogue sales for its sole benefit and without sharing of such fee with the dealers who do the actual handling; and
- (d) removed local store advertising subsidies and converted such advertising to national advertising.

34. Further particulars of these actions are provided in the following paragraphs.

(a) Lowering of dealers' commissions

35. In August 2012, Sears reduced the average Retail Commission rates paid to dealers.

36. Under the Dealer Agreement, Sears reserves the right to modify the Retail Commissions paid to dealers by providing no less than 90 days' written notice to the dealers. In light of the vulnerability of the dealers, whose only compensation are the commissions set by Sears, modifications to the Retail Commissions must be carried out fairly, in good faith and in accordance with reasonable commercial standards. Such modifications must also be made with proper motive and taking into account the dealers' reasonable expectations of profit.

37. At the same time, in order to offset the reduction in Retail Commissions, Sears introduced a 1% bonus commission if the customer purchases the item using a Sears-branded credit card (the "**Cardshare Program**"). Under the Cardshare Program, if a customer purchases an item at the Hometown store using its Sears' credit card, Sears pays the dealer a 1% bonus commission, in addition to the Retail Commission regularly paid on the sale of the item.

38. When Sears introduced the Cardshare Program, Sears represented to the dealers that the reduction in Retail Commissions would not have a negative effect on a dealer's commissions, and would result in an increase in revenue for the dealers. Sears sent to every dealer a

customized report summarizing the net effects on total commission under the Cardshare Program.

39. Through the Cardshare Program, Sears encourages dealers to push customers to buy their products using the Sears' credit card. Sears does this because it has an agreement with the underwriter for the Sears credit card that pays Sears a substantial undisclosed rebate on goods bought using the Sears' credit card ("**Credit Card Rebates**"). Sears then uses a small part of the Credit Card Rebates to pay the dealer the 1% bonus under the Cardshare Program. A dealer has little control over whether a good is purchased using a Sears credit card other than to try to promote and encourage the use of the card. The change in Retail Commission has had a net negative effect on many dealers' revenue to the benefit of Sears.

40. Section 16.07 of the Dealer Agreement states: "[t]he Dealer **shall not be required to pay additional costs** for Sears established credit plans or approved third party credit plans" (Emphasis added).

41. The Credit Card Rebates is money that is properly payable to the dealers as the dealers are the merchants who transact with the customers. To the extent that such amounts would otherwise have been payable to the dealers but, through negotiation, Sears has directed the third party credit provider to pay such amounts to itself, then such amounts are "additional costs" and are in breach of section 16.07 of the Dealer Agreement.

42. Further, the lowering of Retail Commissions in August 2012 was an additional cost to the dealer for approved third-party credit plans in breach of section 16.07 of the Dealer Agreement.

43. The lowering of the Retail Commissions in August 2012 and the receipt of Credit Card Rebates by Sears, individually and together, in circumstances where Sears is aware that the

Hometown dealer program is unsustainable for the dealers, have been carried out in complete disregard of the interests of the dealers and in a purely self-preferential manner by Sears. Such conduct is a breach of the duty of good faith and the statutory duty of fair dealing under the Wishart Act.

44. The Credit Card Rebates are not disclosed to a prospective dealer before it enters into the Dealer Agreement in a disclosure document or otherwise, contrary to section 5(4) of the Wishart Act and section 6(8) and the general regulation thereto, O. Reg. 581/00. The dealers claim damages in respect of such non-disclosure under section 7 of the Wishart Act.

45. Further, and in the alternative, Sears has been unjustly enriched through the receipt of the Credit Card Rebates and the lowering of the Retail Commissions in August 2012.

46. Further, because the dealers are the merchants who transact with the customers directly as independent businesses, the Credit Card Rebates are ordinarily payable to them, but have been redirected through negotiation between Sears and the third-party credit card underwriters to be paid entirely to Sears. Accordingly, the Credit Card Rebates are indirect payments by the dealer to Sears or its associate within the definition of “franchise” under section 1(1) of the Wishart Act as discussed more fully below under the heading “Sears is a Franchisor under the Franchise Acts.”

(b) Sears directly competes within dealers’ market area

47. Sears undercuts the dealers’ revenues by competing with Hometown stores through the direct channels and shipping directly to customers in the dealer’s market area. Hometown stores are generally located in small towns or rural areas. Under section 4.01 of the Dealer Agreement, Sears reserves the right to “acquire, own, license, operate or authorize others to operate and

advertise other Sears stores **physically located** within the [dealer's] Market Area," but only if, "in Sears [sic] sole discretion, acting reasonably, the Market Area can support such expansion" (emphasis added). "Market Area" is defined in the plaintiff's Dealer Agreement as Woodstock, Ontario.

48. Unlike with respect to the placement of physical stores, Sears did not reserve to itself the right to compete with the dealers' stores through the direct channels and direct-to-customer shipping. The Dealer Agreement does not permit Sears to compete in the dealer's Market Area using direct shipping through the direct channels. Despite this, Sears actively competes in the dealer's Market Area by selling through the direct channels and shipping directly to customers residing in the dealers' Market Area. Sears also sends promotional emails and flyers to customers in the dealer's Market Area encouraging them to order products through the direct channels. Sears does not pay commissions to the dealers in respect of direct channel sales shipped directly to a customer in the dealer's Market Area.

49. The effect of Sears competing through its direct channels has been a material decrease in dealers' revenues, as customers are increasingly purchasing products through the direct channels and Sears is actively encouraging them to do so.

50. In addition to unlawfully encroaching upon the dealers' Market Area, Sears undercuts the dealers through its online business by incentivizing the customer to buy the item online through such things as "free shipment" promotions, "daily deals" and other online promotions. This results in greater profits to Sears than if the customer bought from a dealer's store as it results either in lower commissions to be paid to the dealer (if the online customer picks up the product from the dealer's store), or bypasses the dealer completely if the product is shipped directly to

the customer. If the customer returns to a dealer store a good purchased online that was shipped directly, the dealer store receives no compensation for handling.

51. Both Sears Canada and Sears Roebuck sell online directly into the dealers' Market Area. Sears Canada competes through www.sears.ca; Sears Roebuck competes, directly or indirectly through its subsidiaries and/or affiliates, through www.sears.com.

52. The sale of products by Sears through direct channels shipped directly to customers in the dealers' Market Areas is a breach of the Dealer Agreement.

53. Alternatively, if Sears is permitted to compete in the dealer's Market Area through the direct channels by shipping directly to customers (which is strictly denied), then, by analogy to section 4.01 of the Dealer Agreement, Sears can only compete in the dealers' Market Area in such manner if it can reasonably establish that the Market Area can support such competition. Because the Hometown store program is, to Sears' knowledge, unsustainable for the dealers, Sears is not permitted to compete with the Hometown stores through its direct channels unless it pays full Retail Commissions to the dealers for all direct channel sales within the dealer's Market Area.

54. Further and in the alternative, by engaging in such competition, Sears has failed to take the dealers' reasonable commercial interests into account or comply with the duties of good faith and fair dealing, and has been unjustly enriched by not paying Retail Commissions to the dealer in respect of direct channel sales into its Market Area.

55. Accordingly, the dealers request a mandatory order requiring Sears and Sears Roebuck to pay Retail Commissions to the dealers in respect of direct channel sales into its Market Area and

an accounting of all direct channel sales into their Market Area since the inception of their respective Dealer Agreement.

(c) Sears imposes unlawful “handling fee” on catalogue sales

56. Sears charges a \$3.95 flat “handling fee” for Hometown store customers that purchase items through a direct channel and choose to ship to a Hometown store for pick-up. Customers generally purchase items through a direct channel because the specific item is not offered for sale at the Hometown store.

57. Although it is the dealer which handles the item when the customer picks it up from the Hometown store, Sears keeps the entire handling fee for itself and does not share the fee with the dealer.

58. The effect of the handling fee is to discourage customers from having items purchased through a direct channel shipped to a Hometown store for pickup and to encourage customers to have the item shipped directly.

59. The handling fee is not permitted by the Dealer Agreement. Indeed, Sears highlights on its website page devoted to “Business Opportunities” for “Dealer Store Owners” that one of the benefits of the Hometown stores program is that there is “no merchandise shipping or handling fee.” The imposition of the handling fee is a breach of the Dealer Agreement. Alternatively, the imposition of the handling fee in circumstances where Sears is aware that the dealer compensation is systemically inadequate constitutes a breach of the duties of good faith and fair dealing and/or unjust enrichment on the part of Sears.

60. Further, because the dealers handle the merchandise and transact directly with the customer, any handling fee is earned by the dealers, not by Sears. Because Sears directs the

customer to pay the entire handling fee to Sears, the handling fees are indirect payments by the dealer to Sears or its associate within the definition of “franchise” under section 1(1) of the Wishart Act as discussed more fully below under the heading “Sears is a Franchisor under the Franchise Acts.”

(d) Removal of local store advertising subsidies

61. Pursuant to section 19.01 of the Dealer Agreement, Sears is required to share advertising costs undertaken by a dealer. Until August 2012, after a dealer performed local advertising, which included distributing flyers, placing radio ads or other forms of local advertising, the dealer would submit the invoice to Sears who would reimburse the dealer for 50% of the cost pursuant to section 19.01 and Part H of Schedule “A” of the Dealer Agreement.

62. As part of this local advertising, Sears would create, at its own cost, advertising templates for flyers that dealers could distribute. A dealer would only be required to pay for the distribution costs of the flyer (usually through the local newspaper) and Sears would reimburse 50% of the distribution costs.

63. Beginning in August 2012, Sears implemented fundamental changes to the local advertising reimbursement program. The changes included three components:

- (a) With respect to flyers, Sears agreed to pay 100% of the production and distribution costs of a flyer. However, Sears maintained the discretion whether to distribute the flyer in a particular dealer’s market area. If Sears did not distribute the flyer in the dealer’s market area, the dealer would be responsible for 100% of the distribution costs;

- (b) With respect to radio and newspaper ads, Sears agreed to pay 100% of producing radio scripts and the production of the newspaper advertisement. The dealer would then be responsible for 100% of the costs of running the radio or newspaper advertisements; and
- (c) Periodically, Sears agreed to pre-approve various subsidies with respect to other local advertising, which a dealer was permitted to take advantage of. Otherwise, the dealer was required to request pre-approval from Sears for other local advertising, for which Sears would then decide whether to offer any reimbursement.

64. The net result of these changes is that dealers are now paying more for local advertising. Further, all of the flyers or advertising templates created by Sears for use by dealers are for national advertising and often include items that are not even offered for sale at the dealer's Hometown store. Such flyers also encourage customers to order through a direct channel and thereby completely bypass the dealers if products are shipped direct-to-customer. As such, in addition to the increase in direct costs placed on dealers through the changes to the advertising programs, Sears now charges dealers for what amounts to the right to advertise for Sears' other distribution channels. It is a detriment to the dealers to advertise products which are unavailable at their stores.

65. The changes initiated in August 2012 are a breach of section 19.01 and Part H of Schedule "A" of the Dealer Agreement. Alternatively, in circumstances where Sears is aware that the dealer compensation is systemically inadequate, such changes constitute a breach of the duties of good faith and fair dealing and/or unjust enrichment on the part of Sears.

66. Further, to the extent that dealers are or were at any time under their current Dealer Agreements required to pay for:

- (a) part or all of the advertising of items not generally offered for sale at Hometown stores, or
- (b) advertising which, in whole or in part, constitutes national advertising,

such payments are or were indirect payments by the dealer to Sears or its associate within the definition of “franchise” under section 1(1) of the Wishart Act as discussed more fully below under the heading “Sears is a Franchisor under the Franchise Acts.”

Sears is a Franchisor under the Franchise Acts

67. Throughout this statement of claim, any reference to a section in the Wishart Act shall mean and include such equivalent section in the other Franchise Acts, as applicable, in accordance with the following table:

Wishart Act section	Manitoba Act, NB Act and PEI Act sections	Alberta Act section
1(1)	1(1)	1(1)
3	3	7
5	5	4
7	7	9
11	11	17

68. The Sears Hometown dealer program meets the criteria of a “franchise” under section 1(1) of the Wishart Act, namely: (i) the sale of goods associated with the franchisor’s name; (ii) the exercise of significant control by the franchisor over the business of the franchisee, and (iii) direct or indirect payments by the franchisee to the franchisor or its associate. Each of these criteria is discussed in the following subparagraphs:

- (a) **Sale of goods associated with the Sears name:** The Dealer Agreement grants the dealer the right to sell, offer for sale or distribute goods or services that are substantially

associated with Sears' trade-mark, service mark, trade name, logo or advertising or other commercial symbols.

(b) **Significant control:** Sears exercises significant control over a dealer's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training. To take but a few examples, the dealer must carry only Sears products (s. 6.01); must sell products at the selling price determined by Sears (s. 6.09); must comply with Sears' operations manual (s. 5.08); and, may only advertise using approved advertising materials (s. 19.0); and

(c) **Payments to Sears or its associates:** The dealer is required by contract or otherwise to make direct or indirect payments to Sears or its associate in the course of operating the business or as a condition of acquiring the franchise or commencing operations. The types of payments which the dealer is required to make are set out in the following paragraphs.

(i) *Consignment sale is indirect payment by dealer to Sears*

69. Sears has structured the Dealer Agreement so that the payments required to be made by the dealer for inventory are ostensibly made by the retail customer directly to Sears. Using the artifice of a consignment contract, payment for inventory purchased from a dealer is deemed by the Dealer Agreement to be a payment made by the customer directly to Sears. Such payment, however, is for all intents and purposes an indirect form of payment of inventory by the dealer to Sears via the customer. Such payments qualify as indirect payments to Sears by the dealer in the course of operating the business and therefore satisfy the "payments" requirement under the definition of "franchise."

70. Although the Dealer Agreement states that title to the inventory does not pass to the dealer but passes directly from Sears to the retail customer, Section 26 of the Dealer Agreement reveals that transactions between the dealer and its customer are made by the dealer as principal and not as a mere agent or bailee of Sears. Section 26 provides, among other things:

- a. “The Dealer agrees that all purchases and contracts, made by it in connection with the operation of the Dealer Store and this Agreement shall be made solely in the name of the Dealer...”
- b. “The Dealer further agrees not to do any act or make any statement that may imply that the Dealer or the Dealer Store is a branch of Sears or, that Sears in any manner owns, controls or operates the Dealer Store or, that any relationship exists between Sears and the Dealer other than that of the Dealer being an independent contractor of Sears.”
- c. “Nothing in this Agreement shall be construed to create a partnership, joint venture or agency relationship between Sears, Sears Roebuck, the Dealer, the Guarantor or any agent, employee or affiliate of the Dealer. The parties agree that the Dealer is an independent contractor.”
- d. “the Dealer must clearly display on or near the principal entrance of to the Dealer Store a decal provided by Sears, which states ‘SEARS AUTHORIZED RETAIL DEALER independently owned and operated by [dealer name]’”.

71. Pursuant to sections 16.10 and 16.11 of the Dealer Agreement, the dealer is responsible to pay Sears for unpaid goods in certain cases where a customer does not make proper payment.

72. Such provisions indicate that the dealer transacts the sale of goods with its customer in its own name, as principal and not as agent. The consignment provisions in the Dealer Agreement

are a transparent attempt to avoid the application of the Wishart Act. The plaintiff pleads and relies on section 11 of the Wishart Act to the extent that such provisions would otherwise have the effect of depriving the class members of their rights under the Wishart Act.

(ii) Purchase of products by dealer from Sears are direct payments

73. In addition to taking inventory ostensibly on consignment, dealers are required to purchase certain inventory, primarily parts and accessories, directly from Sears. The dealer must purchase such parts and accessories only from Sears pursuant to section 6.01 of the Dealer Agreement (unless Sears authorizes a dealer to purchase from a person other than Sears). Such purchases constitute direct payments by the dealer to Sears within the meaning of section 1(1) of the Wishart Act.

(iii) Credit Card Rebates are indirect payments by the dealer to Sears

74. As stated in paragraph 46 above, Credit Card Rebates are indirect payments by the dealer to Sears or its associate.

(iv) Handling fees are indirect payments by the dealer to Sears

75. As stated in paragraph 60 above, handling fees are indirect payments by the dealer to Sears.

(v) Advertising payments are indirect payments by the dealer to Sears

76. As stated in paragraph 66 above, to the extent that the dealers pay for advertising which is, for all intents and purposes, national advertising, such payments are indirect payments by the dealer to Sears or its associate.

77. Accordingly, the Dealer Agreement is a “franchise agreement” within the meaning of the Wishart Act.

78. All class members are entitled to the protection of the Wishart Act pursuant to the choice of law in section 33.01 of the Dealer Agreement.

79. Alternatively, all class members carrying on business in Ontario, Alberta, Manitoba, New Brunswick and Prince Edward Island are entitled to the protection of their province’s respective Franchise Act.

Breach of Duties of Good Faith and Fair Dealing

80. Sears and Sears Roebuck are “franchisors” or “franchisor’s associates” within the meaning of the Wishart Act.

81. Sears owes the class members a duty of fair dealing in the performance and enforcement of the Dealer Agreement under section 3 of the Wishart Act.

82. Further and in the alternative, Sears owes a duty of utmost good faith in the performance and enforcement of the Dealer Agreement particularly in the exercise of all discretionary rights affecting dealer compensation. Further, Sears owes dealers in the Province of Quebec a duty of good faith in the performance of its obligations under the Dealer Agreement pursuant to articles 6, 7 and 1375 of the Civil Code.

83. The Dealer Agreement grants Sears the discretion to modify the commissions under the Hometown store program. Such discretionary rights must be exercised not solely for Sears’ goal of profit maximization, as it has done, but in order to maintain a dealership network that fairly compensates both Sears and the dealers for their respective investments of labour and capital.

84. Sears' contractual rights and obligations must be considered and applied in light of the vulnerability and the dependence of dealers, who, by virtue of the Dealer Agreement, sell only the products that Sears provides them at prices set by Sears, and whose compensation is set by Sears.

85. Sears' contractual rights to set and modify dealer compensation imposes an obligation on it to set and maintain commission rates that afford the dealers a reasonable opportunity to pay their expenses including a reasonable salary for their dealer-principals and realize a reasonable return on their investment. By refusing to do so, Sears has breached the Dealer Agreement including the duty to perform its obligations thereunder in good faith and has breached the statutory duty of fair dealing under the Wishart Act.

86. Sears has a continuing duty to act reasonably, and to adjust dealer compensation, including Retail Commissions, to reflect the economic realities in which the dealers operate. Sears cannot use its unilateral and discretionary powers to condemn the dealers to a compensation structure which Sears itself has acknowledged is "broken" and unsustainable for the dealers while Sears itself realizes significant profits from the Hometown stores system.

87. In carrying out its discretionary powers in respect of dealer compensation, Sears has acted with improper motive and without taking the dealers' reasonable commercial interests and contractual expectations into account by:

- (a) maintaining a compensation structure that results in the vast majority of dealers working for subsistence compensation and not realizing any return on their investment and sweat equity;

- (b) introducing new programs such as the Cardshare Program superficially designed to be revenue neutral to the dealers, but that, in fact, further claw back what little economic benefits the program delivers to the dealers;
- (c) unlawfully competing in the dealers' Market Areas through direct channel sales shipped directly to the customer as pleaded above;
- (d) receiving the Credit Card Rebates as pleaded above;
- (e) charging an unauthorized "handling fee" on all direct channel sales shipped to the dealer's store as pleaded above; and
- (f) clawing back payments for local advertising as pleaded above.

88. In so doing, Sears has breached the Dealer Agreement including the duty to perform its obligations thereunder in good faith, has breached the statutory duty of fair dealing under the Wishart Act, and has acted contrary to the duties contained in articles 6, 7 and 1375 of the Civil Code.

Breach of Statutory Disclosure Obligations and Negligent Misrepresentation

89. Sears is required under the Wishart Act to deliver to prospective dealers a statutorily prescribed disclosure document at least 14 days before a dealer signs any agreement or pays any money related to a Hometown store dealership.

90. The disclosure obligations under the Wishart Act apply to all class members pursuant to the choice of law provision in section 33.01 of the Dealer Agreement.

91. Alternatively, the disclosure obligations under the Franchise Acts apply to all class members carrying on business in the province in which the respective Franchise Act applies.

92. The disclosure document required under each of the Franchise Acts must contain complete and truthful information about the franchise system, supported by a certificate signed by two of Sears' officers or directors. The purpose of the disclosure document is to ensure that a franchisee can decide whether to enter into the proposed franchise agreement with full and complete information.

93. Sears has failed to provide a disclosure document to any dealer. Had it done so, it would have had to disclose all "material facts" regarding its franchise system, as defined in the Franchise Acts and their corresponding regulations. In addition to the prescribed material facts set out in the Franchise Acts and their corresponding regulations, Sears would have had to disclose such material facts as:

- (a) over 70% of dealers are not profitable because of the inadequate compensation structure;
- (b) many dealers exhaust their resources and cease operating within a few years of opening;
- (c) revenues of Hometown stores have been steadily declining;
- (d) Sears competes directly with the dealers by selling into their Market Area through direct channel sales shipped directly to the customer in respect of which Sears pays no commissions to the dealers;
- (e) Contrary to the statement on Sears website devoted to "Business Opportunities" for "Dealer Store Owners" that there is "no merchandise shipping or handling fee," Sears charges and keeps for itself a "handling fee" of \$3.95 for items purchased through a direct channel for shipment to a Hometown store, even though the dealer handles the item when the customer picks it up from the Hometown store; and

- (f) Sears does not share the costs of local advertising undertaken by the dealer contrary to section 19.01 and Part H of Schedule A of the Dealer Agreement.

94. Sears did not provide a disclosure document to any class member.

95. By failing to provide a disclosure document, Sears has breached section 5 of the Wishart Act entitling the dealers to damages under section 7 thereof.

96. Further, each of the omissions pleaded at paragraph 93 above constitutes a misrepresentation within the meaning of sections 1(1) of the Wishart Act entitling the dealers to damages under section 7 thereof.

Negligent Misrepresentation

97. Further, and in the event that the Dealer Agreement is found not to be a franchise agreement under the Franchise Acts, Sears owed a duty of care to ensure that it did not mislead the class members by misrepresenting the truth or by failing to disclose material facts about the Hometown stores to them before they signed their Dealer Agreement. Sears breached such duty by failing to disclose any of the material facts set out in paragraph 93.

98. Sears further breached such duty of care by providing prospective dealers with a franchise brochure (the “**Brochure**”) that made the following misrepresentations about the Hometown store system:

- (a) “[t]his business model is brilliant. You partner with Sears and own one of our prestigious community stores”;
- (b) “... we have created an opportunity to move up the escalator of business ownership and have concentrated on the elements that are critical to success”;

- (c) “Sears wants you, our partner, to succeed. In fact, we take a personal and financial interest in your success”;
- (d) “Better than a Franchise”
- (e) “A Smart Business Model;” and
- (f) “as a Sears Hometown Store owner, you will have a competitive advantage not normally associated with small businesses.”

99. Each of these representations contained in the Brochure was false and misleading. Sears was negligent, reckless or careless in making such representations and in failing to disclose any of the material facts set out in paragraph 93 above to prospective Hometown dealers.

100. Sears knew and intended at all material times that the information contained in the Brochure would be used to induce members of the public to become Hometown dealers.

101. Sears knew and intended at all material times that prospective dealers would rely reasonably to their detriment upon the Brochure in making their decision to become a Hometown dealer.

102. Prospective Hometown dealers were entitled to, and did, reasonably rely on the Brochure and the lack of disclosure of the material facts set out in paragraph 93 in making a decision to become Hometown dealers.

103. The plaintiff pleads and relies on article 1375 of the Civil Code.

Harm to Dealers

104. As a direct result of the aforementioned acts and omissions, Sears has realized significant revenues and profits on the Hometown stores program while the dealers’ revenues

and profits have declined. Sears has deliberately kept commission rates low even though it was aware that commission rates were insufficient to cover the basic costs of running a Hometown store and that the dealers must use their dwindling revenues to pay for significantly increased costs of operation. By virtue of its acts and omissions pleaded above, Sears has destroyed the right of dealers to enjoy the fruits of the Dealer Agreement and has deprived the dealers of the opportunity to fairly participate in the revenues and profits generated by the Hometown store program.

105. As a direct and foreseeable consequence of the acts and omissions pleaded above, dealers are entitled to substantial damages for:

- (a) breach of contract, including breach of the duty of good faith;
- (b) breach of the statutory duty of fair dealing under section 3 of the Wishart Act (or, in the event that the Wishart Act does not apply to class members carrying on business outside of Ontario, under the corresponding section of the Franchise Acts and articles 6, 7 and 1375 of the Civil Code in respect of each class member carrying on business in a province in which a Franchise Act applies or in Quebec as the case may be);
- (c) statutory misrepresentation under section 7 of the Wishart Act (or, in the event that section 7 of the Wishart Act does not apply to class members carrying on business outside of Ontario, under the corresponding section of the Franchise Acts and article 1375 of the Civil Code in respect of each class member carrying on business in a province in which a Franchise Act applies or in Quebec as the case may be);
and
- (d) negligent misrepresentation.

106. Further and in the alternative, Sears must account for and disgorge all profits unreasonably retained as a result of its acts and omission described above. Sears has retained these profits unjustly, to the detriment of dealers and without juristic reason.

Accounting of Catalogue Sales Commissions

107. Section D of Schedule “A” to the Dealer Agreement provides that the dealer “will be provided with a statement each month which outlines how the Compensation was calculated”. In breach of this section, Sears provides the dealers with a lump sum amount on their monthly statements showing commissions paid but no accounting of how the commissions were calculated. Dealers are unable to verify the amounts or the basis for such calculations. Despite requests from the dealers or their representatives, Sears has failed to properly account to the class members for commissions.

108. Sears has breached the Dealer Agreements by failing to account. Accordingly, the dealers request a complete account of all commissions since the inception of their Dealer Agreements and judgment for any shortfall arising therefrom.

Service *Ex Juris*

109. The plaintiff is entitled to serve Sears Roebuck outside Ontario without a court order pursuant to the following rules of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 because:

- (a) Rule 17.02 (f)(i) – the claim relates to a contract made in Ontario;
- (b) Rule 17.02 (f)(iv) – the claim relates to a breach of a contract committed in Ontario;
- (c) Rule 17.02 (h) – the claim relates to damage sustained in Ontario arising from a tort and breach of contract; and

- (d) Rule 17.02 (o) – the defendant residing outside of Ontario is a necessary and proper party to this proceeding.

July 5, 2013

SOTOS LLP

Barristers and Solicitors
180 Dundas Street West, Suite 1200
Toronto, Ontario M5G 1Z8

David Sterns (LSUC # 36274J)
Andy Seretis (LSUC # 57259D)

Tel: (416) 977-0007
Fax: (416) 977-0717

Lawyers for the plaintiff