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Blaneys on Business

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This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, the editor, or the head of our Corporate/Commercial Group:

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"The intention of the disclosure legislation is to have a broad definition of franchising; as a result, manufacturers or trademark owners may discover that their business dealings, unbeknownst to them, fall within the definition of a franchise."

SHE HAS BLONDE HAIR AND A BEAUTY MARK, BUT IS IT REALLY MARILYN? ALL TRADEMARK LICENSES ARE NOT FRANCHISES

H. Todd Greenbloom

There are significant consequences for a relationship being characterized as a franchise. One of the biggest consequences is the right of the "franchisee" to rescind the contract for 2 years if it was not given proper disclosure. Franchisors are aware of the obligations and act accordingly. Accidental franchisors, on the other hand, may not even be aware that franchise disclosure legislation applies to them. A person granting others the right to distribute the person's goods or services could find itself as an accidental franchisor.

The intention of the disclosure legislation is to have a broad definition of franchising; as a result, manufacturers or trademark owners may discover that their business dealings, unbeknownst to them, fall within the definition of a franchise. A franchise will exist if all of the following 3 elements are present:

1. a payment is made by the franchisee to the franchisor;
2. the franchisor grants the franchisee the rights to the franchisor's goods or services; and
3. where the distribution right:
   (a) is accompanied by a right to use the franchisor's trademarks, the franchisor exercises significant control over, or offers significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training; or
   (b) the franchisor provides location assistance (which includes securing retail outlets or accounts for the goods or services to be sold).

A manufacturer who provides sales leads to its customers might be seen as providing location assistance, and therefore meeting the criteria for being a franchisor. More troublesome may be a trademark holder who licenses others the rights to use its trademarks. In order to protect the image of the trademark, it is common that rules be imposed on how those trademarks are used. If those rules are viewed as the exercise of control over method of operation, then the trademark holder will be a franchisor.

A recent case may give comfort to trademark holders that they will not be franchisors. In *MGDC Management Group v. Marilyn Monroe Estate*, the Estate granted MGDC a license to use the Marilyn Monroe trademark to create and operate

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"The general rule is that where a surety has paid more than its rateable share of a debt, it has an equitable right to recover contribution from its co-sureties if the payment was made in a situation where such surety was legally obliged to pay."

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Marilyn Monroe-themed restaurants. The license agreement gave the Estate the right to veto designs and business methods that MGDC might employ in its use of the trademark, and MGDC were the ones responsible for developing and operating their restaurant business.

Although the case was determined on the basis of an exemption from the application of franchise disclosure legislation (i.e. an arrangement arising from an agreement between a licensor and a single licensee to license a specific trade-mark, **where such licence is the only one of its general nature and type** to be granted by the licensor with respect to that trade-mark) it was observed that trademark licenses are not franchise agreements.

The veto rights could have been interpreted as significant control over building design, but the judge did not see the veto rights given to the Estate as significant control or significant assistance by the Estate over MGDC's method of operating its business. The judge distinguished between control and protection of the trademark.

Reference was made to *Di Stefano v Energy Automated Systems Inc.* That case made it clear that "training" will not be the provision of significant assistance, if the training is about the product and **does not** relate to "method of operation."

In summary, not all veto rights on image and not all training is considered sufficient "assistance in, the franchisee's method of operation" to create a franchise relationship.

Grantors of trademark licenses or granters of distribution rights should consider how extensive their rights need to be to protect their intellectual property. Protecting their intellectual property and ensuring that their products are used properly will not create a franchise unless the rights reserved stray away from product knowledge, or restraints on how their image is portrayed. The bottom line is grantors of trademark licenses and distribution rights who do not want to be franchisors should not interfere with how the rights recipients carry on their businesses. ■

LAW OF GUARANTY: CAN-WIN LEASING, CONTRIBUTION AND THE RIGHTS BETWEEN CO-SURETIES

Kym Stasiuk with Dhanbir Jaswal

OK, here's the scenario:

You, and a partner, own a business 50 – 50. The business borrows money from a lender.

Both you and your partner guarantee the loan (thereby becoming co-sureties). You start to worry about the business's finances and decide to pay off the loan – absent any demand from the lender and without notifying your partner. You then ask your partner to contribute to the payment of the debt.

Is your partner obliged to pay you? Not necessarily.

The general rule is that where a surety has paid more than its rateable share of a debt, it has an equitable right to recover contribution from its co-sureties if the payment was made in a situation where such surety was legally obliged to pay.

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"It is important to remember that a guarantee is a secondary and contingent obligation - it is secondary to a primary obligation (i.e. that of the borrower) and it is contingent on the default of the borrower under the primary obligation."

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A demand by the lender can certainly trigger the obligation but this is not a prerequisite to the surety's right to pay the lender and seek contribution from the co-surety. So, absent a default by the borrower and demand by the lender, when, then, is a surety who pays the debt entitled to contribution from a co-surety?

Ontario's top court recently considered this issue in *Can-Win Leasing v. Moncayo*. This is a case where a co-surety is exempted from the general rule of contribution, the facts of which are briefly summarized below.

Clifford Irwin and Rafael Moncayo were 50-50 shareholders in Can-Win Truck Sales Inc. ("Can-Win Truck"), which bought and sold used trucks. Mr. Irwin was the sole shareholder of a second company, Can-Win Leasing (Toronto) Limited ("Can-Win Leasing"). Together, Mr. Irwin, Can-Win Leasing and Mr. Moncayo guaranteed a debt of Can-Win Truck to the Royal Bank of Canada ("RBC"). The guarantee was payable "on demand."

Can-Win Truck was losing money in 2007 and Mr. Irwin became concerned about the state of the business. Mr. Irwin was getting a lot of pressure from RBC, however, no formal demand was ever made by the bank.

In August 2008, Mr. Irwin commenced payments towards Can-Win Truck's outstanding debt through Can-Win Leasing. In March 2009, RBC assigned the Can-Win Truck debt to Can-Win Leasing. Both the payment and assignment of the debt took place without any notice to Mr. Moncayo. Consequently, Can-Win Leasing made a demand of contribution against Mr. Moncayo for his share. When Moncayo refused, he was subsequently sued in the Ontario Superior Court of Justice. After losing at trial, Can-Win Leasing appealed.

In dismissing the appeal, the court confirmed that the right to contribution arises when one co-surety has paid more than its fair share of the common obligation. A surety is typically notified by way of demand that there has been a default on the loan by the borrower. Where, as in this case, the guarantee is payable on demand, the demand is a condition precedent to the enforcement of the obligation by the lender.

But, the absence of a demand by the lender does not displace a surety's right of contribution as between co-sureties and a co-surety will nonetheless be entitled to indemnification by its fellow guarantors if default by the borrower is imminent or a demand can realistically be anticipated.

The court said it appreciates the policy rationale for permitting a co-surety to "stop the bleeding" when failure of the business is inevitable or where there has been a verbal demand on the surety. But it cautions, however, that there is great potential for abuse when this rationale is extended to circumstances where it is not established that default is imminent.

It is important to remember that a guarantee is a secondary and contingent obligation - it is secondary to a primary obligation (i.e. that of the borrower) and it is contingent on the default of the borrower under the primary obligation. By stepping in and paying the obligation, the surety exposes the debtor, and any co-surety, to a liability they may have been able to avoid.

"[T]he Extractive Sector Transparency Measures Act ... creates new reporting standards for payments made to foreign and domestic governments (including Aboriginal groups) by Canadian mineral, oil or gas development companies."

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The court, therefore, recommends that, if a surety is intending to pay off the debt, it should give notice of such intentions to its co-sureties and give them an opportunity to participate in the discharge of the obligation. The court says that this "promotes the efficient winding up of the business and the equitable allocation of its outstanding liabilities." Unilateral action, as occurred in this case, should be discouraged.

The result of this case ultimately turned on the facts. The majority of the court gave deference to the trial judge who found that the business was salvageable and that the threat of default was not imminent. The dissent, however, pointed to the fact that had Mr. Irwin stopped financing the company, then default was not only imminent but also inevitable.

To sum up, if the bank has demanded payment on either the principal debtor or a surety, or if there is evidence that the business is in imminent danger of default, then yes, the co-surety has an obligation. But, unless the evidence of imminent default is crystal clear, a surety may be better off keeping its money in its pocket until the lender comes knocking.

In any event, Ontario courts expect co-guarantors to consult and work together to satisfy the debt they have guaranteed and do not support unilateral settlement without notification. Moreover, in settling the debt on your own, you risk losing your right to contribution from a co-surety, a cost that could be dear. ■

NEW RULES FOR RESOURCES SECTOR FINANCIAL REPORTING AIM TO HELP REDUCE CORRUPTION

Ralph Cuervo-Lorens

The 2015 conference of the Prospectors and Developers Association of Canada (PDAC), one of the most influential annual resources sector meetings in the world, is scheduled for the Metro Toronto Convention Centre March 1 – 4. New federal law requiring all Canadian oil, gas, mineral and other resource companies to disclose publicly all payments to all governments is certain to be the subject of much discussion. In the following article, Blaney McMurtry partner Ralph Cuervo-Lorens highlights the key provisions of the new statute.

After considerable consultation and discussion, Parliament is debating the *Extractive Sector Transparency Measures Act*, which creates new reporting standards for payments made to foreign and domestic governments (including Aboriginal groups) by Canadian mineral, oil or gas development companies.

When the Act comes into force, it will apply to payments to governments immediately and to Aboriginal groups two years later. Despite the unknowns in the exact legislative timetable, a number of extractive sector enterprises are moving forward with development of their payment-reporting systems. The reporting standards are expected to be in place by June 2015, according to the federal government.

The Act is another piece in the world-wide drive to better deal with political and government corruption. As with the *Corruption of Foreign Public Officials Act*, it is intended to follow similar measures introduced by the United States and the

"The basic obligation under the statute is to report all payments to foreign and domestic governments ... made in relation to the commercial development of oil, gas or minerals that are in the prescribed amount."

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European Union. (Note that the U.S. measures are under challenge in the courts and, to the extent that they are ultimately changed, Canada's law may also have to be changed to maintain the desired alignment between the two jurisdictions.) The Act contains harmonization provisions allowing the Minister to deem another jurisdiction's standards a substitute acceptable to Canada.

Entities

Broadly speaking, the *Extractive Sector Transparency Measures Act* applies to any publicly-listed Canadian entity engaged directly or indirectly in the commercial development of oil, gas or minerals. "Commercial development" is defined to include exploration, extraction and the acquisition or holding of a permit, licence or lease, or any other authorization to carry out exploration or extraction of oil, gas or minerals.

For the Act to apply, the entity must (a) be listed on a stock exchange in Canada or (b) have a place of business in Canada, do business in Canada or have assets in Canada. In addition, the entity must further, and for least one of its two most recent financial years, have at least $20 million in assets, have generated at least $40 million in revenue or employed an average of at least 250 employees.

Payments to be Reported

The basic obligation under the statute is to report all payments to foreign and domestic governments (including any to Aboriginal groups, as noted) made in relation to the commercial development of oil, gas or minerals that are in the prescribed amount (for the various categories of payment). Where no amount is prescribed, all payments of $100,000 or more must be disclosed.

As drafted when it went to the House of Commons' Standing Committee on Natural Resources in late October, the Act requires disclosure of *all* payments, regardless of whether there are confidentiality clauses in contracts underpinning the resource development in question or confidentiality requirements in other statutes or regulations covering such development. This potentially creates a delicate problem for companies.

The types of payments in the Act are intended to cast a wide net:

(a) taxes, other than consumption taxes and personal income taxes;

(b) royalties;

(c) fees, including rental fees, entry fees and regulatory charges as well as fees or other consideration for licences, permits or concessions;

(d) production entitlements;

(e) bonuses (including signature, discover and production bonuses);

(f) dividends other than dividends paid to ordinary shareholders (such as dividends related to production or development milestones);

(g) infrastructure improvement payments; or

(h) any other prescribed category of payment.

Any such payments must be reported to the federal minister of natural resources no later than 150 days after the end of each of financial year and, perhaps just as important, must also be made public. The law, as it went to standing committee, did not specify how that will be done, or to what level of detail.

Sanction for Non-Compliance

Anyone who fails to comply with the reporting standards, or who knowingly makes false or misleading statements or who structures payments in such a way as to avoid the reporting requirements, is subject to a maximum fine of $250,000.

As in other regulatory-type legislation, the Act also stipulates that any officer, director or agent who directed, authorized, assented to, acquiesced or participated in the commission of the offence is also guilty of an offence and liable to sanction upon conviction. These offences will be subject to a defence of due diligence if the accused person can establish that all reasonable, prudent measures were taken to prevent the offence. ■

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