THE FINE PRINT

JANUARY 2008

Wishing You all the Best for the New Year

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Debi Sutin hands Joe Donnell of Donnell Insurance Brokers Ltd. 1 of the 39 coats that the firm collected and provided to Donnell Insurance as part of its "Cookies for Coats" program. The coats were collected by Donnell Insurance and donated to the Salvation Army which will distribute them to those in need this winter season.

In This Issue...

- Is Your Promissory Note Enforceable?
- Franchise Expansion Goes Global
- FDH News & Legal Tidbits
- InProfile - Pioneer Petroleums

Feltmate Delibato Heagle
LAWYERS

Is Your Promissory Note Enforceable?

By Paul Lawson

For a matter that many of us have been confronted with at some point, private lending has an astoundingly spotty success rate. Private loans, free from the seemingly tedious strings attached to institutional lending, often appear as a simpler and less complicated solution. While many private loans certainly work out as intended, the conflicts brought about when things go wrong are both plentiful and painful, with drastic effects on the relationships that made such loans possible.

A recent decision of the Ontario Court of Appeal has many re-visiting their outstanding demand promissory notes and wondering if demand for payment can still be enforced. This concern arises, in part, following the coming into force on January 1, 2004 of the *Limitations Act, 2002* (the "new Act"), which reduced the general limitation period for enforcement of claims from 6 years to 2 years. In *Hare v. Hare*, the Court barred a mother from enforcing repayment of a loan made to her son many years before.

In upholding the dismissal of the action, the Court re-confirmed that the limitation period under a demand promissory note begins on the date that the note is issued, or on the last date that any payment of interest or part payment of principal is made being (an acknowledgement of the debt which re-starts the limitation period), not the date of default under the Note. In its decision, the Court examined the governing principles of private lending in case of default and the implications of the reduced limitation period under the new Act.

In 1997, Mary Hare loaned her son Brian $150,000, which was evidenced by an interest-bearing demand promissory note. One payment of interest was made, in October 1998, and a formal demand for payment was made in November 2004. When Brian refused to repay the loan, Mary commenced her action for payment in February, 2005.

In rendering its decision, the Court first had to decide which limitation period applied, that under the former *Limitations Act* (the "former Act"), being 6 years from the date a cause of action arose, or the 2 year period following discoverability under the new Act. The majority of the Court held that the concept of "discoverability" under the new Act did not change existing law, that there was nothing in the case before them to be discovered because "the law is well settled that a lender has the right to immediate repayment of such loans…As there is no repayment period specified, the lender is entitled to require immediate repayment." That is, the relevant date continues to be the date of issue of the promissory note. Under the transitional provisions of the new Act, it was the former Act and the 6-year limitation period that the Court was therefore required to apply. Mary's claim expired in October, 2004, 6 years following the last interest payment made by Brian but more than 6 months prior to the issuing by Mary of her claim. As a result, Mary's claim was statute-barred and she had no legal right to enforce repayment of the monies loaned to her son.

As a result, promissory notes made prior to January 1, 2004 will be governed by the former Act with the 6 year limitation period commencing on the later of the date of issuance of the note or the date of the last payment on the note. Demand loans made after January 1, 2004 will be subject to the 2 year limitation period under the new Act, again commencing on the later of the date of issuance of the note or the date that the debt was acknowledged through part payment of principal or a payment of interest.

In addition to reviewing the status of outstanding demand promissory notes, lenders and their counsel should ensure that their promissory notes are now drafted to take into account the reduced limitation period, by providing for default only following demand for payment. Non-payment will be discovered only once the time period provided for payment following demand has expired, which then starts the limitation period for commencement of an action.

Without careful consideration of this decision and the need to seek counsel when lending money, lenders may be unwittingly making a gift instead of the loan that was intended.

FEEDBACK:

We are always interested in hearing what you think about our Newsletter. If you have any comments or suggestions, or a topic that you would like to see covered, please contact our Editor, Debi Sutin at 905-631-3643.

Franchise Expansion Goes Global

*By Debi M. Sutin**

As franchise systems have begun to saturate their home markets, there has been significant interest in expanding beyond one's home jurisdiction to meet the demands of emerging markets and to increase profits and market share.

Prior to entering a new market, whether it is to another province, across the border to the US or to the other side of the world, a franchisor must determine the structure of the relationship that is most appropriate, both for the franchise system and for the target market. The many factors to consider when seeking to expand globally will be discussed in a future article in this Newsletter. In this issue, the various means of expansion, and their varying constituent elements, will be discussed.

The following methods are used by franchisors to expand other than by direct or unit franchising: joint venture franchising, area representation, area development and master franchising.

Joint Venture Franchising

The joint venture is an agreement between two partners, the franchisor and a party from the prospective new market. It is the least risky approach to expansion, representing shared risk but also shared control. In this arrangement, the franchisor takes on a partnership role or an equity position in the franchisee entity, the franchisor bringing to the venture its proprietary franchise system and knowledge and, possibly as well, a contribution of capital. The local joint venture partner will generally make a significant capital contribution and will be the operator and manager of the franchise system in the territory.

Many initial foreign transactions have been structured as joint ventures, rather than true franchises, for a number of reasons. In certain countries, the joint venture is the only structure under law open to foreign investors and may be the only vehicle to allow access to government subsidies and favourable tax status.

Area Representation

In this arrangement, the franchisor grants another the right recruit franchisees in a designated (usually exclusive) territory. The area representative has no right to contract directly with the franchisees, who will enter into a franchise agreement directly with the franchisor. However, certain of the obligations of the franchisor under the unit franchise agreement, such as training, site location assistance and ongoing supervision and assistance are delegated to, and performed by, the area representative who is generally compensated through the sharing of initial fees and on-going royalties payable under the franchise agreement.

Area Development

In the area development scenario, the franchisor and a national of the target territory enter into a development agreement pursuant to which the local developer undertakes to establish and operate all of the outlets of the system in a defined territory. One of the principal advantages to the area development arrangement is that the franchisor contracts with and must train just one, likely sophisticated, franchisee. This individual is then responsible for substantially all obligations leading to the establishment and operation of the franchised outlets in the target market. This is cost-effective to the franchisor and does not require the use by the franchisor of its head office personnel who can continue to support the franchisor's home market. However, the development arrangement generally results in slower growth of the system, with reliance upon only one person for the expansion. Furthermore, each outlet will be managed rather than developer-operated, managers generally being less motivated and less entrepreneurial in the operation of the franchised outlet.

Master Franchising

Master franchising has become the structure of choice in international transactions. In this arrangement, the franchisor grants to a master franchisee the right, in a designated territory, to own and operate outlets as well as the right to grant -franchises to others to own and operate franchised outlets. A master franchisee essentially becomes the "franchisor" in the territory with responsibility for managing and controlling many aspects of the franchise system, including the training, site selection, sourcing and supply of products, as well as, if necessary, the right to modify the System to meet local market tastes and preferences.

In addition to payment of an initial fee, the franchisor will typically share in the initial fees and royalties payable to the master franchisee under the franchise agreements which it has granted.

Experience has shown that it is critical for franchisors to ensure that the split of revenue between the franchisor and the master franchisee allows the master franchisee sufficient funds to undertake the expansion and sustain the continued involvement and growth of the franchise system in the new market.

In both the area development and master franchise arrangements, the parties must also establish a realistic timetable for development. The development schedule is generally subject to much negotiation and the agreement between the parties must provide for appropriate remedies if the development fails to proceed as anticipated. For example, failure to meet the development schedule should entitle the franchisor, in lieu of termination, to reduce the developer's exclusive territory or to remove the exclusivity altogether in order to at least preserve the franchisor's presence in the market.

The decision to expand a franchised business outside of one's home market, whether provincially, nationally or internationally, cannot be taken lightly. It requires immense planning, investigation and resources. Consultation and advice from the franchisor's professional advisors, both at home and in the target market, are essential to the probability of success of the venture and to avoid having to

continued on page 4

FDH News & Legal Tidbits

- On November 3, 2007, **Brian Heagle** made a presentation to YMCA Ontario at its annual CEO/CPO Conference on the topic of "Developing and Monitoring a Board Work Plan". **Brian** will attend the North American YMCA Development Organization Annual Conference, to be held April 9-12 in Montreal, where he will be part of an international panel leading a discussion on "Annual Support Track: The Community Support Campaign"
- **Brian Heagle** was appointed Chair of the 2008 YMCA Strong Kids Campaign for the YMCA of Hamilton/Burlington. The Strong Kids Campaign is the YMCA's major annual campaign and this year hopes to raise more than $700,000.
- **Debi Sutin** has been selected again this year to be listed in *The 2008 Canadian Legal Lexpert® Directory* as a leading franchise practitioner
- **Paul Lawson** was profiled in the November 2, 2007 issue of The Hamilton Spectator. In an article by Scott Radley, Paul's experiences playing for the Dundas Real McCoys on the Ontario Senior 'A' circuit were contrasted with his days as a commercial lawyer. After playing hockey at Yale and then toiling in the minor pro leagues, Paul finished his schooling and joined **Feltmate Delibato Heagle** in 2006.
- **Debi Sutin** and **Lori Brown** attended the 7th Annual Dinner & Dance Fundraiser for Bereaved Families of Ontario–Hamilton/Burlington on November 9, 2007 at the Burlington Convention Centre
- On November 22, 2007 **Henry Krupa** was the Plenary Speaker at the Land Disposal Restrictions Conference and Workshop sponsored by the Waste Services Group of Conestoga-Rovers & Associates
- **Debi Sutin** has joined the Executive Committee of the Ontario Bar Association's Joint Subcommittee on Franchising
- **Henry Krupa** will be speaking on Legal Land Mines of the Clean Water Act and Source Water Protection and Process and Procedures of the Source Protection Committees at the Ontario Farm Environmental Coalition Conference to be held December 12 – 13, 2007 at the University of Guelph

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Franchise Expansion Goes Global continued from page 3

face head-on a myriad of "surprises" once rights have been granted. Global expansion is a long-term proposition and a short term return on investment cannot be expected.

There are numerous examples of franchised systems that have successfully expanded beyond their own borders, as witnessed by the proliferation of mostly U.S.-based fast food or quick service restaurants in Europe, Asia and the Middle East. However, there are also numerous examples of attempts that have gone awry, leading to a retreat by certain franchisors from global expansion and the potential loss of opportunity in various target markets.

Franchisors must proceed cautiously in expanding to any new market, carrying out a thorough analysis of the target destination from a legal and business perspective before settling upon a truly committed and well-suited "partner". A cautious, well-planned move abroad may protect a franchisor from a "venture gone bad" and preserve the value of the brand and the franchise system; goals that are certainly worth pursuing.

* This article is based upon a paper presented by Debi Sutin and Joseph Adler of Hoffer Adler LLP at the Ontario Bar Association's Annual Franchise Law Conference in November, 2007.

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