

CV-09-378780-00CP

Court File No.

**ONTARIO
SUPERIOR COURT OF JUSTICE**

BETWEEN:

578115 ONTARIO INC. O/A MCKEE'S CARPET ZONE

Plaintiff

and

SEARS CANADA INC., SEARS, ROEBUCK AND CO. and HOME
COVERINGS BUYING GROUP INC.

Defendants

Proceeding under the *Class Proceedings Act*, 1992, S.O. 1992, c.6. as amended

STATEMENT OF CLAIM

TO THE DEFENDANT(S)

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 May 15, 2009

Issued by 

Local Registrar

Address of court office:
393 University Avenue
10th Floor
Toronto, Ontario
M5G 1E6

(M. Brenton)

TO **SEARS CANADA INC.**
Department 610
222 Jarvis Street
Toronto, Ontario
M5B 2B8

AND **SEARS, ROEBUCK and CO.**
TO c/o Sears Canada Inc.
Department 766
222 Jarvis Street
Toronto, Ontario
M5B 2B8

ATTENTION: THE SECRETARY

AND **HOME COVERINGS BUYING GROUP INC.**
TO 1510 Drew Road
Unit #10
Mississauga, Ontario
L5S 1W7

DEFINITIONS

The following definitions apply for the purpose of this Statement of Claim:

- a) **“McKee’s”** means 578115 Ontario Inc. operating as McKee’s Carpet Zone;
- b) **“Class”** or **“Class Members”** means all individuals or entities in Canada who/which entered into a license agreement with **Sears** for operation of a “Sears Floor Covering Centre”, since 1998;
- c) **“Sears”** means together the defendants Sears Canada Inc. and Sears, Roebuck and Co.;
- d) **“HCBG”** means the defendant, Home Coverings Buying Group Inc.

CLAIM FOR RELIEF

1. The plaintiff claims:
 - a) an order certifying this action as a class proceeding and appointing it as representative plaintiff;
 - b) general damages for breach of contract in the amount of FIFTEEN MILLION DOLLARS (\$15,000,000.00), or such other sum as this Honourable Court may find appropriate in the circumstances;
 - c) in addition, or in the alternative, general damages for breach of duty of good faith in the amount of FIFTEEN MILLION DOLLARS (\$15,000,000.00);

- d) in addition, or in the alternative, general damages for unjust enrichment in the amount of FIFTEEN MILLION DOLLARS (\$15,000,000.00);
- e) an order granting a constructive trust in favour of Class Members as against the defendants in the amount of FIFTEEN MILLION DOLLARS (\$15,000,000.00);
- f) aggravated, exemplary and punitive damages in the amount of ONE MILLION DOLLARS (\$1,000,000.00);
- g) prejudgment interest in accordance with section 128 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;
- h) postjudgment interest in accordance with section 129 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;
- i) the costs of this proceeding on a full indemnity basis, plus a premium/multiplier, as well as the costs of notice and of administering the plan of distribution of recovery in this action, plus disbursements and applicable taxes; and,
- j) such further and other relief as this Honourable Court may deem just and appropriate in the circumstances.

THE NATURE OF THIS ACTION

2. Class Members owned and operated floor covering retail businesses under the name "Sears Floor Covering Centre".

3. License agreements were entered into between Class Members and Sears after January 1, 1998 up to and including approximately 2006. These license agreements governed the relationship.
4. At its peak, there were approximately sixty "Sears Floor Covering Centre" retail businesses operating across Canada pursuant to license agreements entered into between Class Members and Sears.
5. Class Members, as licensees, were obligated to purchase all retail products from approved suppliers on behalf of and as agent of Sears. Pursuant to the terms of the license agreements, Sears was entitled to receive from each Class Member a royalty equal to 4% of net sales of floor covering products and services.
6. Contrary to the terms of the licence agreements and duties and obligations owed at law, Sears and/or HCBG received undisclosed rebates from Sears' approved suppliers arising from the sale of flooring products to Class Members. These undisclosed rebates amount to secret commissions, contrary to section 426(1) of the *Criminal Code of Canada*.

THE PARTIES

7. The plaintiff, McKee's, is a corporation incorporated pursuant to the laws of Ontario, with its head office in Newmarket, Ontario.
8. The defendant, Sears Canada Inc., is a corporation incorporated pursuant to the laws of Canada, with its head office in Toronto, Ontario.

9. The defendant, Sears, Roebuck and Co., is a corporation incorporated pursuant to the laws of the State of New York, United States of America, with its head office in Chicago, Illinois.
10. The defendant, HCBG, is a corporation incorporated pursuant to the laws of Ontario, with its head office in Mississauga, Ontario.

BACKGROUND INFORMATION

11. In 1998, Sears entered into a "Management Services Agreement" with HCBG, whereby HCBG was appointed to act as Sears' "Manager" as defined under license agreements entered into with Class Members. On December 22, 2003, Sears and HCBG entered into an Amended and Restated Management Services Agreement.
12. In 2005, Sears acquired Cantrex Group Inc. ("Cantrex"). At that time, Cantrex was Canada's largest buying group acting on behalf of independent merchants throughout Canada.
13. Sears terminated its relationship with HCBG effective December 31, 2006. Sears then appointed Cantrex as its "Manager" as defined under the license agreements entered into with Class Members.
14. After Sears terminated its relationship with HCBG, Class Members received information that caused them to suspect that undisclosed rebates had been paid to HCBG and/or Sears by approved suppliers. The undisclosed rebates had

been paid to HCBG and/or Sears, contrary to section 426(1) of the *Criminal Code of Canada*.

STATED FACTS OF THE REPRESENTATIVE PLAINTIFF

15. Sears and McKee's entered into a license agreement in August, 1998 (the "License Agreement"). McKee's was the fourth "Sears Floor Covering Centre" in Canada.
16. Under the License Agreement, McKee's is the "licensee" and HCBG was, at all material times, the "Manager".
17. The License Agreement provided McKee's with the exclusive right to operate a Sears Floor Covering Business in a "Designated Market", being the trading area of Newmarket with the use of the Sears trademark.
18. Under the License Agreement, the licensee paid Sears a royalty payment equal to four percent of net sales, payable monthly. Similarly, the licensee was entitled to an annual rebate of four percent of the Total Annual Purchases made by the licensee each year at approved suppliers.
19. The License Agreement included the following terms:
 - (a) Use of Trademark: Sections 3.1 and 5.2 permit the licensee to use the name "Sears Floor Covering Centre" in association with a retail floor covering business;

- (b) Sears Operations Manual: Section 3.2 requires the licensee to comply with the Sears Operations Manual, which is incorporated by reference into the License Agreement;
- (c) Royalty Payment: Section 7.1 requires the licensee to pay Sears a royalty "equal to the aggregate of four percent of Net Sales payable monthly";
- (d) Marketing Levy: Section 18.3 and Schedule "D" require the licensee to pay Sears a Marketing Levy of "one percent of annual Net Sales per month";
- (e) Annual Rebate to licensee: Section 10.1 provides that the licensee is entitled to "an annual rebate of four percent of the Total Annual Purchases made by the licensee in each year";
- (f) Total Annual Purchases: Section 10.1 defines "Total Annual Purchases" as the "total of all amounts paid by licensee to approved suppliers for Floor Covering Products in each year, exclusive of (i) sales taxes, Goods and Service Tax, *ad valorem* taxes and any other taxes, and (ii) any amount for shipping or handling or any other services whatsoever";
- (g) Purchases from Approved Suppliers: Section 14.1 requires the licensee to purchase "only from suppliers approved by Sears and shall offer for sale in the Business only approved products and services approved by Sears" as set-out in Schedule "B". Failure to comply with this requirement is grounds for immediate termination of the License Agreement by Sears under Section 23.2(i);

(h) Agency: Section 14.2 permits the licensee to act as Sears' agent to "effect purchases and make payments in respect of approved products from suppliers designated by Sears, with whom Sears or the Manager has confirmed acceptance of volume rebate programs, provided the licensee is at the time of such purchase or payment in compliance with this Agreement";

(i) Purchases by and from Sears: Section 14.4 specifies that the licensee will place all orders "on behalf of and as agent of Sears so that Sears is the purchaser and invoices for the products purchased will be issued in the name of Sears". Sears is "deemed to have resold the approved products to the licensee upon delivery by the supplier to the licensee";

(j) Manager: The "Manager" is defined in Section 1.1 as "such person, corporation, partnership or otherwise as Sears may designate from time to time by written notice to the licensee". The Manager, as implied in Section 14.2, has responsibility for control and management of supply arrangements, although the duties and role of the Manager is not expressly stated; and,

20. McKee's was always in good standing under the License Agreement.

21. Under the License Agreement, McKee's made purchases of approved products totalling approximately \$3,400,000.00 for the period 1998-2008.

22. The License Agreement required that McKee's purchase products only from suppliers approved by Sears. The intended effect of this provision is that

McKee's would be able to purchase products at a discounted price in comparison to the price it would pay if it were not an agent for Sears.

SITUATION OF CLASS MEMBERS

23. Class Members entered into license agreements with Sears at various times after January 1, 1998, in form identical to or substantially similar to the McKee's License Agreement.
24. The license agreements entered into between Class Members and Sears contain identical or substantially similar terms as referenced above in paragraph 19.
25. Class Members were in good standing under the license agreements.
26. Under the license agreements, Class Members made purchases of approved products totalling tens of millions of dollars, full particulars of which are known to the defendants.
27. All license agreements between Class Members and Sears required that Class Members as licensees purchase products only from suppliers approved by Sears.

BREACH OF CONTRACT

28. In or around June 2007, McKee's and certain Class Members received information that caused them to suspect that undisclosed rebates were being paid to HCBG and/or Sears by approved suppliers.

29. It was an implied term of the license agreements entered into between Sears and Class Members that Sears and HCBG would disclose to Class Members all commissions, rebates and other beneficial payments received or to be received by them.
30. Based on purchases made by Class Members and without the knowledge or consent of Class Members, Sears received rebates from HCBG. The undisclosed rebates amount to secret commissions.
31. As agent for and of Sears, HCBG is liable for all actions and/or commissions of Sears under the license agreements.
32. Undisclosed rebates were received separate from the royalty payments owed to Sears under the license agreements with Class Members.
33. Class Members estimate that Sears received annual payments from approved suppliers of twelve percent of Total Annual Purchases by Class Members. Precise amounts and particulars are known to the defendants.
34. Sears has failed and/or refused to provide information relating to undisclosed rebates and has to this point denied receiving rebates from approved suppliers.

BREACH OF DUTY

35. Class Members and Sears had a franchise relationship. The license agreements signed did not alter the nature of the relationship. The relationship remained a franchise arrangement.

36. Sears and its agent HCBG owed Class Members a general duty of fair dealing.
37. By accepting, receiving and not disclosing payment of rebates, Sears and its agent breached their duty of fair dealing and good faith to all Class Members.
38. Class Members plead and rely upon the provisions of the *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c.3, and equivalent/similar legislation in provinces outside Ontario if and where applicable.
39. Class Members state that section 3 of the above-referenced legislation prescribes a duty of fair dealing and a right of action for breach of that duty.
40. Class Members furthermore state that the legislation requires full disclosure of all financial arrangements including payments in the nature of rebates, commissions or any other beneficial payments.
41. Class Members state that Sears and its agent are in breach of these duties.

DUTY OF GOOD FAITH

42. Sears and its agent HCBG had an obligation of good faith in dealings with Class Members and, in receiving undisclosed rebates, breached the duty to Class Members.

UNJUST ENRICHMENT

43. Sears and/or its agent, HCBG, through the receipt of undisclosed rebates, received a financial benefit equal to approximately twelve percent of the Total Annual Purchases by Class Members.

44. Class Members were deprived monies owed to them under the license agreements. They were deprived of monies because there were undisclosed rebates taken by Sears and/or HCBG from the Total Annual Purchases paid by the licensees.
45. Sears and HCBG have been unjustly enriched to the detriment of Class Members. Class Members have been correspondingly deprived. The license agreements do not permit the defendants to receive undisclosed rebates. There is no other juristic reason to allow the undisclosed rebates.
46. Sears and/or its agent, HCBG, were bound by cumulative duties of fair dealing, utmost good faith and full disclosure in favour of Class Members.

DAMAGES

47. As a result of the conduct of Sears and HCBG described above, Class Members have suffered damage and loss. These duties negate any legal rights or entitlement to receipt of undisclosed rebates without disclosure to Class Members. The Class Members paid more for Sears' approved products from Sears' approved suppliers which purchases were pursuant to the terms of their license agreements. Accordingly, each Class Member is entitled to the amount of undisclosed rebates or secret commissions Sears and/or HCBG received from the Total Annual Purchases made.

AGGRAVATED AND PUNITIVE DAMAGES

48. The conduct of Sears and HCBG was entirely without care, deliberate, callous, willful and with intentional disregard of the rights and circumstances of Class Members and indifferent to the consequences.
49. The conduct of Sears and HCBG lacked the requisite honesty, candour and forthrightness required in the circumstances.
50. The conduct of Sears and HCBG was disingenuous and in bad faith.
51. The conduct of Sears and HCBG, as aforesaid was high-handed, over-reaching and deserving of an award of not only compensatory damages, but also aggravated and punitive damages.
52. The conduct of Sears and/or its agent, HCBG is contrary to the *Criminal Code of Canada*. Punitive damages ought to be awarded.

LEGISLATION

53. The plaintiff pleads and relies upon the *Class Proceedings Act*, R.S.O. 1992, c.6 the *Courts of Justice Act*, R.S.O. 1990, c.C.43., the *Criminal Code of Canada*, and the *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c.3.

SERVICE OUTSIDE ONTARIO

54. The plaintiff anticipates that it might be necessary to serve the Statement of Claim on one or more of the defendants outside the Province of Ontario, and in

that regard pleads and relies upon the provisions of Rule 17.02 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 as amended and in particular:

- (a) Rule 17.02 (f) – a contract made in Ontario and/or breached in Ontario;
- (b) Rule 17.02(h) – damages sustained in Ontario;
- (c) Rule 17.02(o) – against the person outside Ontario who is a necessary or proper party to a proceeding properly brought against another person served in Ontario.

PLACE OF TRIAL

55. The plaintiff proposes that this action be tried in the City of Toronto, in the Province of Ontario.

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May 15, 2009

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578115 ONTARIO INC. O/A MCKEE'S CARPET ZONE
Plaintiff

-and-

SEARS CANADA INC. et al.
Defendants

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TORONTO

STATEMENT OF CLAIM

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