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Competition Bureau Grounds FlightHub's Misleading Advertising

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On February 24, 2021, the Competition Bureau announced that it had concluded its multi-year investigation into allegations of misleading advertising by FlightHub and reached a consent agreement to resolve its concerns, which includes monetary penalties for FlightHub and two of its directors.

Key Implications for Businesses

Even if the case has no precedential value since it was not a disputed matter, it still serves as a reminder that the Competition Bureau remains focused on conduct it believes to be deceptive, including drip pricing. It is also significant that the focus here is online advertising and the travel industry, where many consumer protection organizations internationally have focused particularly due to the COVID-19 pandemic.

Finally, there is an important warning for directors and officers that the Bureau may try to hold them personally liable in some cases.

Background

FlightHub was the subject of a large number of consumer complaints regarding its marketing practices both in Canada and in the U.S.

In 2017, the National Advertising Division of Council of Better Business Bureaus, found FlightHub to have made false or misleading claims and recommended such practices be discontinued. At the time, FlightHub agreed to comply with those recommendations.

In 2019, the City Attorney of San Francisco filed suit against FlightHub alleging unlawful and deceptive business practices. That lawsuit remains pending.

Early in 2019, the Bureau executed search warrants at FlightHub's Montreal headquarters. The execution of a search warrant in a case of alleged misleading advertising challenged under the *Competition Act*'s civil provisions is unusual, as we discussed in our prior bulletin. The Bureau typically relies on voluntary information requests or production orders as the primary means of obtaining information. However, the Bureau may use search warrants where it is concerned about document destruction or where the conduct raises potential criminal issues.

In October 2019, the Bureau also took the unusual step of entering into a "temporary consent agreement" with FlightHub, which required FlightHub to refrain from making any materially false or misleading representations regarding seat selection on flights and cancellation or rebooking rights while the Bureau continued its investigation. With FlightHub agreeing to temporarily halt some of the conduct at issue, the Bureau did not have to go to court to seek an interim injunction. FlightHub's agreement to the temporary consent agreement resulted from the Bureau's announced intention to seek an injunction. The Bureau had indicated that it intends to make greater use of injunction proceedings.

The Bureau had concerns with several marketing practices of FlightHub:

- **Drip Pricing**: Charging customers fees for selecting seats and for cancellation/rebooking after having made representations that conveyed the impression that such services would be at no cost.
- **Astroturfing**: Promoting positive online consumer reviews that gave the impression that they were made by independent and impartial customers, when the reviews were made by FlightHub.
- **Misleading Claims**: Representing that:
  - Customers booking a flight could reserve specific seats and FlightHub would secure those seats with the airline, when many customers' selected seats were not in fact secured, even though they were charged a fee for their selected seats;
  - Customers were offered more extensive cancellation and/or rebooking rights than was actually the case;
  - Customers could cancel flights and obtain credits that could be used for future flights, without disclosing important restrictions and costs on the use of such credits, including reductions in the value of the credits in some cases; and
  - Customers could purchase flights at particular prices, when it at times increased the cost of flights after customers selected their flights.

Penalties

FlightHub agreed to pay an administrative monetary penalty (AMP) of $5 million, and two of its directors agreed to pay an AMP of $400,000 each. The consent agreement also prohibits FlightHub and the two directors from making false or misleading claims for 10 years.

The fact that the consent agreement imposes penalties and obligations on FlightHub directors personally is notable. FlightHub is insolvent and under creditor protection. As the AMP is an unsecured claim, FlightHub may not have the means to pay the $5 million penalties following a restructuring proceeding. Recognizing FlightHub's limited ability to pay, the Bureau concluded that it is in the public interest to resolve this matter not only with an AMP for Flighthub, but also with specific obligations imposed on FlightHub's directors. In doing so, the Bureau relied on a rarely invoked provision of the *Competition Act*, subsection 52(1.2).

Key Takeaways

- Online price advertising, especially "drip pricing" conduct where sellers charge additional fees that are not disclosed "up front", continues to be an enforcement priority for the Competition Bureau.
- The Bureau also remains interested in "astroturfing", *i.e.* false consumer reviews.
- The Bureau has several investigative and procedural options, such as search warrants and temporary injunctions, to address misleading advertising.
- The Bureau may sometimes seek to hold company directors and officers personally liable if they directed the advertising at issue.

If you have any questions about these developments or would like assistance in addressing a Competition Bureau complaint, please contact us or your usual McMillan contact.

Toronto Law Journal

Treaty Shopping and the GAAR: Where From Here?

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On March 19, 2021, the Supreme Court of Canada heard the appeal in *Canada v. Alta Energy Luxembourg S.A.R.L.*, a case in which the Crown took the position that the taxpayer had engaged in abusive “treaty shopping”. The appeal was from the decision of the Federal Court of Appeal (FCA), which held that Canada’s general anti-avoidance rule (GAAR) did not apply where the taxpayer, a Luxembourg-resident company, relied on the tax convention between Canada and Luxembourg (the Can-Lux Treaty) to exempt a capital gain from Canadian income tax.

In this case, the shares of the taxpayer (a Luxembourg company) were held by a limited partnership, the members of which were generally not Luxembourg residents. The taxpayer held shares in a Canadian company (Canco), which it acquired through a restructuring. Canco, in turn, held a working interest in Canadian resource properties (oil and gas leases in Alberta), in which it carried on exploration and production activities. When the taxpayer sold the shares of Canco, it realized a capital gain of over $380 million and took the position that this gain was exempt from tax in Canada.

Article 13(4)(a) of the Can-Lux Treaty entitles Canada to tax a resident of Luxembourg on gains arising from the alienation of shares if the value of such shares is derived principally from immovable property situated in Canada. The term “immovable property” expressly excludes property in which the business of the corporation is carried on.

The Tax Court of Canada (TCC) found that the taxpayer was a resident of Luxembourg and that the Canco shares derived their value principally from immovable property in which its oil and gas exploration and production business was carried on. The TCC also concluded that the GAAR did not apply to deny the applicable treaty benefits. The Crown's appeal to the FCA related only to the GAAR.

On appeal, the FCA held that the object and purpose of the relevant provisions, including Article 13(4) of the Can-Lux Treaty, were fully reflected in the plain language of these provisions. The FCA also rejected the Crown’s position that Article 13(4) effectively requires the taxpayer to have strong economic or commercial ties to Luxembourg, since the sole criterion to be eligible for the exemption is residence in Luxembourg, which turns on liability to tax. Also, as the FCA observed, measures subsequently taken by the Department of Finance to curtail treaty shopping were not applicable to its decision and could affect future transactions.

On appeal to the Supreme Court, the Crown took the position that the FCA had erred in its application of the GAAR, having restricted its analysis to the text of the relevant provisions. The Crown argued that the policy or underlying rationale of the provisions was to allocate taxing rights based on “economic connections” to each contracting state. Although the Crown conceded that the taxpayer was a resident of Luxembourg for purposes of the Can-Lux Treaty, it nevertheless argued that the taxpayer had limited “economic or commercial ties” to Luxembourg and therefore had engaged in “treaty shopping”, contrary to the policy of the provisions on which it relied. Finally, the Crown argued that the FCA’s emphasis on the text “rendered the GAAR largely inapplicable to Canada's tax treaties.”

In response, the taxpayer argued that the underlying rationale of the relevant provisions was no broader than the text itself, and that a textual, contextual and purposive analysis of those provisions evidenced no intention to depart from the carefully defined criteria negotiated and agreed upon by the treaty partners. The taxpayer also argued that, in seeking to have the GAAR applied, the Crown was effectively adding an unexpressed condition to the test for residency under the Can-Lux Treaty.

As the Supreme Court reserved judgment, guidance from our highest court will be forthcoming on a fundamental issue of international taxation. It remains to be seen whether the Court will agree with the Crown that the taxpayer engaged in abusive tax avoidance or whether it concludes that the GAAR cannot be used to curtail treaty shopping.

Putting the Cart before the Horse – Proper Proof of Right to Sue is Fundamental to Successful Copyright Claims

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In the context of copyright infringement claims, plaintiffs may assert standing by virtue of their ownership of the copyright work alleged to be infringed, or because their license in respect of that work includes a right of action. Two recent decisions from the Federal Court — *Lickerish, Ltd. v. Airg Inc.*, 2020 FC 1128 and *Dunn's Famous International Holdings Inc. v. Devine*, 2021 FC 64 — provide instances where plaintiffs failed due to an inability to clearly establish their ownership or license and, thereby, their right to sue. The decisions highlight the importance of providing direct evidence of authorship and ownership of the works alleged to be infringed, so that, if the plaintiff's entitlement to sue is challenged by a defendant, an otherwise meritorious case is not vulnerable to dismissal.

Background

The *Copyright Act*, 1985 R.S.C. c. C-42, establishes that, in almost all instances, the author of a work is considered its first owner, including where a work is commissioned or "made for hire". Ownership can be assigned, which assignment must be in writing. Owners can also license their copyright, including by granting an exclusive license. Like assignments, exclusive licenses must be in writing.

Importantly, copyright arises upon creation of an original work, and need not be registered with the relevant government office to be valid (in Canada, registration is obtained through the Canadian Intellectual Property Office's Copyright Office). As a practical matter, however, there are many benefits to registering ownership or a grant of interest in copyright — including a presumption that the named owner indicated on the registration document is, in fact, the copyright owner. Without a registration, or other evidence to prove the plaintiff's ownership (for example, a copyright notice with the owner's name), the *Copyright Act* presumes the author to be the owner of copyright where the plaintiff's title to the work is put into issue in any civil proceeding.

Lickerish, Ltd. v. Airg Inc.

Lickerish involved a claim brought by a U.K. photographic syndication agency, Lickerish Ltd., alleging copyright infringement by a social networking software company, AirG Inc. The works at issue were two photographs of Meghan Markle that the defendant allegedly reproduced on its website. Lickerish conceded it was not the author of the photographs. It took the position that it had standing to sue based on an exclusive license to act as the agent for syndication of the photographs at issue. To support its claim, the Plaintiff filed an affidavit of its director, which included a copy of a purported U.S. copyright registration certificate for the photographs, which listed the photographer as the author, and Lickerish as having “rights and permissions” in the works.

The action was brought as a simplified procedure action. After reviewing this evidence, the Court dismissed the action outright on the basis that the Plaintiff lacked standing. The Prothonotary noted that the Plaintiff provided no direct evidence about the creation of the works, or that it either authored or owned the copyright in the two photographs, including by way of assignment or exclusive license. Moreover, she found the purported U.S. copyright registration inadmissible under the *Canada Evidence Act*. The certificate provided was a mere copy, not a certified copy; the Plaintiff further provided no authority to suggest that the “certified copies” exception in the *Canada Evidence Act* applied to foreign documents; and the Plaintiff failed to provide any authority to suggest that foreign registration certificates could benefit from s. 53 of the *Copyright Act* that provides that the Register of copyrights is evidence of the particulars entered in it. Moreover, the witness had no personal knowledge about the actual application for registration with the U.S. Copyright Office or the issuance of the registration certificate — in other words, there was no way for the Court to authenticate the document and its contents.

Dunn’s Famous International Holdings Inc. v. Devine

In *Dunn’s Famous*, Justice Southcott dismissed copyright infringement claims outright due to the Plaintiff’s failure to provide any evidence of authorship or ownership. The Plaintiff, Dunn’s Famous International Holdings (Dunn’s), operates a consumer retail food product development, marketing, licensing, and wholesale distribution business based out of Montreal, Quebec. The Defendants included a set of allegedly unauthorized franchisees of the Plaintiff, and their principals. Among other claims, including for trademark infringement, Dunn’s advanced claims for copyright infringement against a set of the Defendants for the unauthorized reproduction of portions of Dunn’s website, including its logo, the structure of the website, and specific content in the franchising section of the website. The evidence of copyright ownership proffered by Dunn’s consisted of an affidavit from its President and sole shareholder, in which the affiant referred to “our” website, design, and logos.

Justice Southcott found such evidence fell “significantly short” of what was required to establish copyright ownership. It did not show that the Plaintiff was the author (and thus, the first owner of the works at issue). Nor was it sufficient to show it was the owner by virtue of an assignment. As such, the copyright infringement claim was dismissed.

In contrast, the trademark-related claims succeeded. Dunn’s was awarded over $500,000 in damages, and pre-judgement and post judgement interest, and costs from the corporate Defendants as well as some of the individually named directors and officers. This outcome suggests that had the Plaintiff filed sufficient ownership evidence, its copyright claim may have succeeded as well.

Toronto Law Journal

Gross Loss for Franchisee's Claim of "Net Losses"

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Introduction

The decision of the Alberta Court of Queen's Bench in *1777543 Alberta Ltd v. Got Mold Disaster Recovery Services Inc.*, 2019 ABQB 259 ("***Got Mold***") provides guidance on how a franchisee is to calculate "net losses" after cancelling their franchise agreement.

Pursuant to Section 13(b) of the *Franchises Act*, R.S.A. 200, c. F-23 (the "***Act***"), a franchisee can cancel (in Ontario and other franchise law provinces this is referred to as "rescission") their franchise agreement within two years if the franchise failed to give the prospective franchisee a disclosure document (case law has also deemed that a deficient disclosure document will also constitute non-disclosure), in accordance with s. 4 of the *Act*. Section 14(2) of the *Act* requires the franchisor to compensate the franchisee for its "net loss" from the acquisition, set up, and operation of the franchise.

Background Facts

The parties 1777453 Alberta Ltd. ("**177**") and Got Mold Disaster Recovery Services Inc. ("**GMDRS**") entered into a franchisee agreement for a term of five years on October 21, 2013, which was subsequently rescinded by 177 on February 27, 2015. Upon rescission 177 claimed net losses in acquiring, setting up, and operating the franchise in the amount of $200,394.27, which GMDRS refused to pay. By the time the matter reached the Court, the sole issue that remained was whether there were actual losses and, if so, what the quantum of those losses were.

The Expert Evidence

Most importantly, the Court determined that it will rely on the expert evidence led by the parties in determining "net loss", where such determination is not a simple matter.

The Court focused on analyzing the evidence of the two different expert witnesses, who each explained how they calculated the net losses 177 suffered for the acquisition, set up, and operation of the franchise. The losses claimed by the experts differed by approximately $200,000.00. While both experts agreed that a determination of net loss requires an off-setting of the expenses against the revenue of a business, GMDRS's expert engaged in additional rationalizing and normalizing of the expenses 177 claimed.

177's expert determined the franchisee's losses by calculating the difference between 177's expenses versus revenues; however, this is where his analysis more or less ended. 177's expert relied solely upon the financial statements provided by 177 and nothing more. The result was a relatively basic analysis to come to the conclusion that 177 suffered a net loss in the amount of $199,637.00. 177's expert did not review 177's general ledgers, invoices issued for the expenses claimed or cheques issued as payment for invoices.

On the other hand, GMDSR's expert, analyzed numerous pieces of evidence including affidavits and undertakings from the directors of 177, financial statements, and even 177's expert's report. Through this analysis GMDSR's expert identified a number of problematic claimed expenses from 177.

Included in 177's ledgers were expenses for things such as management or accounting fees, where the owners provided services to 177 at abnormal and above-market rates. GMDSR'S expert reasoned that these expenses should be reduced in calculating losses because the owners charging above market rates for services was really just a different way of distributing profits or providing dividends to the owners. For instance, if an owner charged $100,000.00 for marketing services, yet commercial practices in the area indicated the exact same service would only cost $50,000.00 from outside hires, then in reality the "expense" was only $50,000.00. Essentially, GMDSR's expert's methodology involved rationalizing the expenses to determine whether their values were commercially reasonable and normal.

GMDSR's expert also included one other important caveat in his analysis of net losses for 177. He argued that the calculation of profits versus losses for 177 didn't stop when the franchise agreement terminated, as 177 had actually continued in the mold business after terminating the Agreement. GMDSR's expert argued that 177's current profits were relevant to the calculation of net losses as the knowledge, knowhow, and acquisition costs associated with operating a mold business, which 177 obtained from the franchise agreement, were now being used to contribute to the profits in their new business.

<u>The Final Decision</u>

The first issue determined by the Court was the time frame to use in calculating any losses and profits, *i.e.*, whether the calculation of "net losses" should include or exclude the profits 177 had obtained since opening their new mold business, being subsequent to the cancellation of the franchise agreement. The Court agreed with GDSMR's expert and stated that the *Act* is not meant to give franchisees a windfall by allowing them to obtain resources from a franchisor and then use those resources to start their own business in the same field. As a result, 177's profits in their new mold business were to be included in the calculation of "net loss".

The second issue determined by the Court was whether or not to "normalize" and "rationalize" 177's expenses based on regular commercial practice. Here, the Court again accepted the evidence of GMSDR's expert and concluded that it only made sense to properly normalize and rationalize expenses, as to not do so may allow for parties to claim windfalls by allowing directors or shareholders to receive payments disguised as expenses and then claim those expenses as losses.

Ultimately, based on the overstated expenses from 177 and the profits they received from operating their new business, the Court determined that 177 did not in fact suffer any net losses and they did not receive any damages.

Practice Takeaways

The takeaway from the Got Mold case is twofold, that (at least in Alberta) calculating net losses requires:

1) normalizing a franchisee's balance sheet to accurately reflect the true expenses; and

2) that the franchisee account for their profits following the cancellation of the franchise agreement, if their future profits are connected to the resources acquired through the franchise agreement. The analysis for net losses does not end simply on the date the agreement ended, the timeline is not as clear as that and may involve analyzing profits post-agreement too.

Before commencing claims lawyers (at least in Alberta) need to therefore assess these two issues.

Note however must be taken that in Ontario, and perhaps some other provinces with franchise legislation, the *Arthur Wishart Act (Franchise Disclosure) 2000,* S.O. 2000, c. 3 (the "***Wishart Act***") does not expressly provide for the netting out of losses the profits received by the franchisee from the operation of the franchised business, either before or after, the rescission of the franchise agreement. Firstly, following the decision of *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*, the Court of Appeal for Ontario held that a franchisee can be compensated for damages under subsections 6(6)(a), (b) and (c) regardless of whether or not the franchisee suffered any losses. Further in *2122994 Ontario Inc. v. Lettieri*, the Ontario Court of Appeal for Ontario also affirmed that a franchisee does not have to take into account its profits since the *Wishart Act* is not a net loss regime.