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DISCLOSURE RULES APPLICABLE PRIOR TO THE SALE OF ADDITIONAL WARRANTIES

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The reform of the Consumer Protection Act (hereinafter "CPA") that started in 2006 is still progressing in 2010 with the coming into force on June 30, 2010 of Bill 60, *An Act to Amend the Consumer Protection Act and Other Legislative Provisions*.

With the explosion of the use of cellular telephones, it is no surprise that much has been written on the new provisions in this Bill. This is not the first time the legislator decides to regulate the form and substance of a contract commonly used in a particular field. But with Bill 60, the legislator also enacted numerous other new provisions, some of which directly affect the merchants' business process and marketing strategy and, for instance, impose a number of oral and written disclosure rules that shall henceforth be under the responsibility of the merchants and that shall have a direct impact on the sales process and conclusion of contracts of additional warranty.

A "contract of additional warranty" is a "contract under which a merchant binds himself toward a consumer to assume directly or indirectly all or part of the costs of repairing or replacing goods or a part thereof in the event that they are defective or malfunction, otherwise than under a basic conventional warranty given gratuitously to every consumer who purchases the goods or has them repaired.[1]" This type of contract is commonly offered as an accessory contract at the time of sale of electronic devices, electric household appliances, and even certain tools, or at the time of sale or lease of cars or motorcycles.

With the coming into force of Bill 60, merchants who sell additional warranties to consumers for valuable consideration will have to comply with the new Section 228.1 *CPA*:

> 228.1. Before proposing to a consumer to purchase a contract that includes an additional warranty on goods, the merchant must inform the consumer orally and in writing, in the manner prescribed by regulation, of the existence and nature of the warranty provided for in Sections 37 and 38.

> In such a case, the merchant must also inform the consumer orally of the existence and duration of any manufacturer's warranty that comes with the goods. At the request of the consumer, the merchant must also explain to the consumer orally how to examine all of the other elements of the warranty.

Thus, before proposing to a consumer to purchase a contract of additional warranty, the merchant must, from now on, give the consumer a notice informing him of the existence and nature of the warranty prescribed in Sections 37 and 38 of the *CPA*, which covers all goods protected under a consumer contract, whether it is a sale or a lease. The contents of this mandatory written notice are prescribed by regulation and the notice also advises of the merchant's obligation to make an oral disclosure:

[1] Section 1 of the *Consumer Protection Act* (hereinafter "*CPA*").

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"NOTICE CONCERNING THE LEGAL WARRANTY

The Consumer Protection Act gives a warranty on all goods you purchase or lease from a merchant: they must be usable for normal use for a reasonable length of time.

(Merchants are required to read to you the above text.)

The Consumer Protection Act gives a warranty on all goods you purchase or lease from a merchant.

The goods must be usable

- for the purposes for which they are ordinarily used (Section 37 of the Act) and
- in normal use for a reasonable length of time, which may vary according to the price paid, the terms of the contract and the conditions of use (Section 38 of the Act).

For more information on this legal warranty, go to the website of the Office de la protection du consommateur at www.opc.gouv.qc.ca."

The coming into force of these new provisions has raised numerous questions and presented various challenges for merchants. First, the merchant's representatives will have to avoid exceeding the requirements set forth in the *CPA* and avoid giving consumers a "law course" on legal warranties while still meeting their obligations prescribed in Section 228.1 *CPA*. This could make the merchant liable in the event of erroneous disclosure. The merchant's representatives do not have the expertise required to properly disclose this type of information. In addition, consumers are likely to have a number of questions on the information disclosed by the merchant. The notice in the regulation invites people to refer to the Office de la protection du consommateur website; but is that sufficient? Will the lack of answers to particular questions have an impact on the sale of products?

Another challenge: with these new provisions, the legislator's goal is to ensure the consumer is as fully informed as possible of his rights under the terms of the legal warranty prior to concluding a contract of additional warranty. However, the majority of additional warranty products go much further than the simple replacement of a good in the event of defect or malfunction, which are the only areas covered by the legal warranty described in Sections 37 and 38 of the *CPA*. Many of these products or programs will apply in case of a breakdown or an accident. This is more than just a simple warranty.

Furthermore, manufacturers or distributors cannot honour the rights under a legal or conventional warranty unless a specific process is followed, which can take some time. An additional warranty program frequently allows for the waiver of these terms in favour of the consumer as well as the immediate replacement of the good, simply upon the consumer's request, with no other formality.

Merchants must also determine at what time during the sales process they must meet their new obligations. New Section 228.1 *CPA* states: "*Before proposing* [to a consumer] *to purchase a contract.*" Legally, within the meaning of *Civil Code of Quebec*, a proposal to conclude is an offer, that is to say a proposal comprising all the essential elements of the proposed contract. This includes, of course, the price, the scope of coverage, the terms and conditions as well as the exclusions.

A good way of determining what elements are essential to a contract of additional warranty is to refer to Section 45 *CPA*, which states the minimum content required in a said contract, as follows: *(a)* the name and address of the person offering the warranty; *(b)* the description of the goods or services that are the object of the warranty; *(c)* the fact that the warranty may or may not be transferred; *(d)* (the nature and the extent) the obligations of the person granting the warranty in the case of a defect in the goods or of the improper carrying out of the services covered by the warranty; *(e)* the manner in which the consumer is to proceed to obtain execution of the warranty, and the persons authorized to execute it; and *(f)* the duration of the warranty. Thus, the obligations that are now incumbent upon the merchant in virtue of new Section 228.1 *CPA* must be met before all these essential elements are revealed to the consumer. If they are not, no proposal to conclude a contract has occurred.

This means that nothing prevents the merchant from proposing to consumers a summary of the additional warranties to "evaluate" their potential interest in the product so that later, once the product is more fully explained to consumers, the merchant can meet its obligations as defined in the new Section 228.1 *CPA*. It is important that the oral and written disclosure obligations be met prior to the proposal to conclude. Lastly, new Section 228.1 *CPA* does not prohibit advertisements which inform consumers of the existence of additional warranty programs.

Evidently, these new provisions have not yet been subjected to judicial interpretation. It is now up to the merchants to adapt to this new reality, which has a direct impact on the sales process and marketing strategy of a series of goods commonly offered in the retail industry.

It will be interesting to see how merchants will overcome these new challenges. These could represent a golden opportunity for those who wish to fine tune their commercial practices to acquire, once again, increased consumer trust and loyalty.

Merchants who fail to meet their obligations under the terms of the new provisions will be deemed as engaging in a prohibited practice under the *CPA*. This could lend to serious consequences, such as the new recourse in injunction stated at Section 316 *CPA*, which grants a deemed interest to a consumer advocacy body to institute such a recourse.

ATTORNMENT OF JURISDICTION CLAUSE SET ASIDE IN BANKRUPTCY PROCEEDINGS

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GROUPE MOUNT REAL VEST (SYNDIC DE), 2010 QCCS 1881[1]

On February 27, 2006, the *Groupe Mount Real Vest* (hereinafter "GMRV") declared bankruptcy. A decision rendered March 16, 2007:

- Empowered the Trustee to exercise all rights of Mount Real Capital Markets Ltd. (hereinafter "MCMR"), a subsidiary of Mount Real Corporation (hereinafter "MRC"), also in bankruptcy;
- Ordered the respondent *Thomas Weisel Partners Canada Inc.* (hereinafter "Weisel") to pay any amount that it may be required to pay to MCMR, for the benefit of the Trustee, and as property of the bankrupt.

Weisel is a full service brokerage firm with which MCMR, on behalf of multiple beneficiaries, entered into a share purchase agreement whereby such beneficiaries sold their interests in the Montreal Stock Exchange. When the Montreal Stock Exchange was converted into Bourse de Montréal Inc., prior to the sale, a rectification agreement was entered into (the "Rectification Agreement"). One of the clauses of the Rectification Agreement reads as follows:

> **8.8 Consent to Jurisdiction**
>
> (a) Each of the Parties irrevocably attorns and submits to the exclusive jurisdiction of any Ontario court sitting in Toronto in any action or proceeding arising out of or related to this Agreement and irrevocably agrees that all Claims in respect of any such action or proceeding shall be heard and determined in such Ontario court. Each of the Parties irrevocably waives, to the fullest extent it may effectively do so, the defence of an inconvenient forum to the maintenance of such action or proceeding.

The Rectification Agreement stated that Weisel was to transfer all proceeds of "Scheduled Accounts Receivable," to MCMR, which it did transfer for the most part. However, fearing a future notice of assessment, Weisel held back $2,980,622, including an amount of $565,983 which was the share owing to MCMR for said return of "Scheduled Accounts Receivable" which was the property of MCMR.

The Trustee relied on paragraphs d) and e) of Article 30 of the *Bankruptcy and Insolvency Act*[2] to claim the amount of $565,983 withheld by Weisel. The Trustee essentially argued that its request was related to the bankruptcy, as its main focus was to recover property of the bankrupt for eventual distribution to the creditors.

Weisel argued that the appropriate forum is the Superior Court of Ontario as a result of clause 8.3 (a) of the Rectification Agreement. It asserted that Trustee's claim was unrelated to the bankruptcy, which meant that the Trustee must, like all other beneficiaries of the Rectification Agreement, apply to the Superior Court of Ontario to resolve the dispute concerning a contract to which GMRV is not a party. The question which the Court had to answer is the following: "In the presence of a contractual clause conferring jurisdiction to the courts of Ontario, must the Superior Court of Quebec decline jurisdiction?"

DECISION

The Court concluded that the appeal lodged by the Trustee does not constitute a claim for damages as had been argued by Weisel's attorney, but rather "is intimately linked to its role and its duty under the BIA, which is to repatriate all assets of bankruptcy, to liquidate and distribute them to the creditors under the referral. [...] No doubt that the Trustee seeks to enhance the assets under his referral."[3]

The fact that a contract needs to be interpreted in order to determine whether or not amounts held back belong in the patrimony of the bankrupt is simply incidental to the bankruptcy proceedings.

In addition to the classification of the claim by the Trustee, the Court noted that the substance of the dispute involved tax issues and explained that it would not analyze nor apply foreign legal concepts or those of another province. The judge also highlighted that the bankruptcy court of a province has the jurisdiction to apply and interpret the law of another province. In this case, the Court decided that it was as equipped as an Ontario court to settle the dispute between the parties, especially with regards to Quebec taxation law provisions.

The existence of other beneficiaries contractually and legally bound by the choice of forum provision is not a factor to consider in determining whether to uphold an attornment to jurisdiction clause. Rather, it was held that the public interest in coming to an expedient settlement on the issue was paramount.

[1] Hereinafter "Mount Real".

[2] R.S.C. 1985, c. B-3, hereinafter "BIA".

[3] *Mount Real* at para. 33.

[4] *Sam Lévy & Associés Inc. v. Azco Mining Inc.*, [2001] 3 S.C.R. 978.

COMMENT

Ten years ago, the Supreme Court of Canada had recognized that on the initial date of bankruptcy, the court that declared the bankruptcy has jurisdiction for all disputes related thereto and that the choice of forum provisions that may exist in contracts signed with the bankrupt proceedings are not binding to the trustee.[4] However, in that case, Justice Binnie asserted that "[i]t is well established that the bankruptcy court does not have the general jurisdiction of a civil court to award damages in breach of the contract cases. It is restricted to the jurisdiction and remedies contemplated by the Act."[5]

The case under review, when coupled with Supreme Court case, is interesting because it seems to indicate that the analysis in order to determine whether a hold-back is justified under a contract can fall under bankruptcy proceeds, whereas the determination of whether or not damages are owing from a breach of contract cannot be adjudged in the context of a bankruptcy litigation but must proceed before separate civil courts.

[5] *Ibid.* at para. 50.

WHAT TO DO TO PROTECT YOURSELF WHEN YOUR LESSEE DECLARES BANKRUPTCY

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A commercial lease does not end solely based on the fact that the lessee declares bankruptcy; to the contrary, the *Bankruptcy and Insolvency Act* ("BIA") provides that the property of the bankrupt, including the lease, is vested in the trustee. In fact, the terms of the lease are what make it possible for the lessor to resiliate the lease should the lessee declare bankruptcy.

When a lease is resiliated, the lessor arrears for a period of three months of rent preceding the date of bankruptcy; however, if the lessor is entitled to accelerated rent under the lease, he will also be able to recover three months of accrued rent. The priority granted to the lessor only applies to the rent with the exception of any amount related to damages caused by the lessee for which the lessor can make an ordinary claim.

Although granting the lessor priority may seem like an efficient way to recover rent in the context of a bankruptcy, this is tempered by the fact that the lesson's priority can only be enforced against the equity value of the realization of property located in the premises under lease i.e. the value after the secured creditors who had rights on the goods have been paid. In addition, if the value of the goods is low, the priority granted to the lessor can be rendered irrelevant. Faced with this reality, can the lessor improve his position with guarantees or collateral security?

There are other means by which lessors can ensure the payment of rent such as movable hypothecs, security deposits, letters of credit, surety bonds, etc.

Without explaining the underlying reasoning at length, suffice to say that the movable hypothec the lessor has over the lessee's goods is ineffective in the context of the lessee's bankruptcy due to the primacy of the BIA, the federal law, over the provincial law. The same situation exists with regard to a security deposit since, as a security, the deposit is still considered the property of the lessee and therefore is vested in the trustee at the time of bankruptcy; however, this is different with regard to an advance deposit of rent seeing as it would be considered the property of the lessor and therefore cannot be claimed by the trustee.

The agreements entered into with third parties to ensure the payment of rent, that is to say the bond and the bank letter of credit, are by far the most efficient means to adequately compensate the lessor in the event that the lessee declares bankruptcy, since the bankruptcy is immaterial to the agreements of the third parties.

In conclusion, make sure that the lease binding you to your lessee expressly provides for (i) the resiliation of the lease should the lessee declare bankruptcy; (ii) the possibility of recovering three months in the form of an accelerated payment and not only the three months of rent prescribed in the BIA; and (iii) with reference to a deposit, the confirmation that it is the prepayment of rent and not just a security.