



# Legal Action Plan: Franchise System Contracts & Agreements

April 16, 2020

# Introduction

- The spread of Covid-19 has created arguably the biggest global health crisis since the Spanish flu pandemic in 1918.
- In the last few weeks, the virus has spread throughout the global economy and many businesses have been adversely affected.
- The COVID-19 pandemic has caused unprecedented disruption to many franchise systems.

# COVID-19's Impact on Franchise Systems



- Roadmap for today's webinar:
  - What is Force Majeure and frustration of contract?
  - How are franchise agreements impacted by COVID-19?
  - What should franchisors and franchisees look for in contracts with vendors, landlords, and suppliers and how might they negotiate extensions, amendments or terminations of these agreements?
  - What should franchisees or franchisors look for in their insurance contracts?

# Speakers



**Canadian  
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# COVID-19's Impact on Franchise System Contracts & Agreements

*Force Majeure & Doctrine of Frustration*

# *Force Majeure*

- A "*force majeure*" clause (French for "superior force") is a contract provision that relieves the parties from performing their contractual obligations when certain circumstances beyond their control arise, making performance inadvisable, commercially impracticable, or impossible.
- A "*force majeure* event" generally refers to the occurrence of an event which is outside the reasonable control of a party and which prevents that party from performing its obligations under a contract.

# *Force Majeure* is Specific to Your Contract



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- The ability to claim relief for a *force majeure* event depends upon the particular terms of the contract.
- *Force majeure* clauses can vary widely, so a careful reading of your specific force majeure provision is critical to understanding whether performance can be excused in the particular circumstance.

# Examples of *Force Majeure* Clauses



- There is a very wide range of *force majeure* clauses:
  - Some broadly state that the parties will not be liable for failure to perform their contractual obligations due to an event of “*force majeure*”, without any detail.
  - Some clauses provide a list of specific circumstances beyond the control of the parties that fall within the scope of the provision, such as acts of war, strikes, civil disorders or adverse weather conditions.
  - Some *force majeure* provisions include generic, catch-all language that extends the application of the *force majeure* provision to “other similar intervening events.”



# What Must be Shown?

Generally, a party seeking to rely on a *force majeure* clause must be able to show that:

- The *force majeure* event was the cause of their inability to perform or their delayed performance and was beyond their control.
- There were no reasonable steps that could have taken to avoid or mitigate the event or its consequences.

# Relying on *Force Majeure*



- The party seeking to rely on a *force majeure* clause must comply with any procedural requirements under the contract, such as (as applicable under the terms of the provision):
  - Notice of its intention to rely on the *force majeure* provision within a certain time frame.
  - Requirement to provide updates on performance delays.
  - Obligation to mitigate damages.
- Even if your contract does not include a notice requirement, it is often advisable to communicate with your customers or suppliers to let them know if you are unable to perform your obligations.

# Precise Language of *Force Majeure* Clause



- The precise language of the *force majeure* clause is paramount.
- COVID-19 could arguably be included within the scope of broader phrases such as “Act of God” or something “Beyond the Parties Control.”
- However, COVID-19 is more likely to qualify as a *force majeure* event when wording such as “pandemic”, “epidemic”, “quarantine”, “public health emergency”, “outbreak” or “disease” is included in the clause.

# Doctrine of Frustration

- If a contract is silent on *force majeure*, the parties may consider whether they can seek relief under the common law doctrine of frustration.
- The Supreme Court of Canada has described frustration as occurring “*when a situation has arisen for which the parties made no provision in the contract and performance of the contract becomes ‘a thing radically different from that which was undertaken by the contract’.*”

*Naylor Group Inc. v Ellis-Don Construction Ltd.*, 2001 SCC 58 at para 53.

# Application of Frustration



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- The Courts will generally rely on the following elements to determine if frustration applies:
- **No *Force Majeure* Clause:** The contract does not have a *force majeure* clause or similar provision that considers the parties obligations in unforeseen events. If a contract has a *force majeure*, the courts will likely rely on its interpretation since the provision contemplated how the parties would deal with these types of circumstances.
- **The Event:** Frustration occurs where the event is not the fault of either party and was not contemplated or reasonably foreseeable at the time of the contract. The event must also be directly linked to the frustration of the purpose of the contract.
- **Performance:** The frustrating event must render performance impossible or "radically different from that which was undertaken by the contract."

# *Force Majeure* vs Frustration

- The important distinction between *force majeure* provisions and the concept of frustration is their result.
- Under a *force majeure* provision, the result of a *force majeure* event is typically that a party is temporarily excused from the performance of their obligations during the period of the *force majeure* event. However, the contract remains in effect and is not terminated.
- Frustration of contract, on the other hand, leads to the termination of the contract on the basis that the contract's purpose cannot be fulfilled. The parties will no longer be bound by any future obligations.

# Practical Suggestions

- Review your contract carefully to determine whether the contract includes a *force majeure* provision and, if so:
  - Review the definition of *force majeure* to determine if there is an express event that would capture COVID-19 or if the general language is sufficient.
  - Ensure that your inability to perform is due to the consequences of COVID-19.
  - Consider the steps you can take to mitigate the possible effects of COVID-19.
  - Consider and comply with any applicable procedural obligations.



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# Franchise Agreement Provisions



- Whether an event is an event of Force Majeure will depend on the exact wording of the FA's Force majeure clause (if any).
- 3 Possible Events:
  - The Pandemic
  - The Government's Response
  - The Economic Downturn

# Force Majeure and the Franchisor



- Supplies.
- Training.
- Field Support.
- Advertising and Promotion?

# Force Majeure and the Franchisee



- Closure.
- Operating Hours and Shifts.
- Compliance with Operating Standards and Procedures.
- Advertising and Promotion?
- Payments?
  - Fees that vary with Gross Sales
  - Minimum/Fixed Royalties or Advertising Contributions

# What Should the Franchisor Do?



- Review/revise operating standards and procedures.
- Offer financial relief.
- Consider carefully how to deal with historically under-performing franchisees.
- Add/delete/amend Force Majeure provision, going forward?



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Supply Chain



# Supply Chain Disruption



- As a result of COVID-19, the franchise system's supply chain has been disrupted with respect to product availability, pricing, delivery delays and order cancellations.
- Businesses all over the globe are reaching out to their suppliers to understand any disruption and if their orders will be delayed or cancelled.
- Businesses are facing hard choices in crisis management amid the supply chain disruptions.
- Understanding your options is critical to mitigate your risks.

# Supplier Contracts – Review Your Problem Contracts



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- Review the relevant distribution or supply contract to determine the parties rights and obligations under them.
- Carry out risk assessment and mitigation by categorizing them based on required action:
  - Cancel – Termination rights, force majeure and frustration
  - Suspend – Minimum volume commitments
  - Modify – Extension to timelines and term

# Modifying Supplier Terms



- Franchisors and suppliers may need to consider relaxing any exclusive obligations.
- Franchisors and suppliers may consider waiving performance targets or waiving a breach to their contractual obligations.
- While such actions may allow for flexibility and generate goodwill in the relationship, such modifications need to be documented properly.



# Adding New Suppliers During COVID



- Franchisors may need to diversify their supply chain to ensure a continuous flow of products and services.
- What do you do if a supplier can't meet your needs?
  - Relationship considerations
  - Legal considerations
  - Practical considerations

# Practical Suggestions

- Engage with your suppliers to understand their supply chain.
- Understand your network's expectations should supply of stock/products be prioritized between customers.
- Ask your suppliers to provide you with regular updates on supply issues and work with them to see if any modifications can be made to ease their burden.
- Prepare a list of alternative suppliers in the event your supplier cannot meet your requirements.
- Review your contracts to determine the obligations, rights, and remedies available.



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# Concluding Remarks

- Parties should review their contractual rights and obligations carefully.
- Legal rights and remedies will depend on the specifics of your contract but strict enforcement of those legal rights may not be the most appropriate course in these circumstances.
- Parties should try to work together cooperatively to try to navigate these challenges.
- Most businesses are looking to build successful long-term relationships and are not looking to take advantage of the current circumstances.

# THANK YOU



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