# International Commercial Transactions, Franchising, and Distribution

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This article reviews 2016 legal developments to the field of international commercial transactions, franchising, and distribution in Canada and the United Kingdom.

## I. Franchising in Canada

### A. ONTARIO COURT DECISION SAYS FRANCHISE GRANT CAN BE "PREMATURE"

It is not uncommon in the Ontario franchise industry to conduct the site selection process after the issuance of a disclosure document and the execution of a franchise agreement. Where franchisors or their affiliates act as head leaseholders for the purpose of sub-leasing the premises to the franchisees, franchisors are reluctant to spend time and money for securing a site unless a franchisee commits to the franchise by signing a franchise agreement or paying a deposit. A recent decision of the Ontario Superior Court of Justice startled the franchising industry in the Province and the Ontario franchise bar, when it held in *Raibex Canada Ltd. v. ASWR Franchising Corp.*[1] that this well-established practice may result in grounds for rescission of the franchise agreement. The practical implications of this decision could be quite disruptive for franchisors whose common practice is to provide disclosure and enter into a franchise agreement for an undetermined location.

The plaintiff, Raibex Canada Ltd. ("Raibex"), an intended franchisee with ASWR Franchising Corp. ("ASWR"), entered into a franchise agreement to obtain an AllStar Wings and Ribs franchise in November 2012.[2] The Franchise Disclosure Document ("FDD") provided to Raibex did not contain head lease details as the franchisor had not yet found a location for the new restaurant.[3] After ASWR issued Raibex a C$120,000 invoice for the

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1. *See* Raibex Canada Ltd. v. ASWR Franchising Corp., 2016 O.N.S.C. 5575 (Can.) [hereinafter Raibex].

2. *Id.* ¶ 23.

3. *See id.* ¶ 25.

prepaid rent and security deposit under the head lease in July 2014, Raibex rescinded the franchise agreement and took ASWR to court claiming damages in excess of C$1 million.[4]

Ontario franchise law requires a franchisor to disclose to a prospective franchisee all material facts about the franchise at least fourteen days before the signing of a franchise agreement.[5] "Material facts" include information that would reasonably be expected to have a significant effect on the value or price of the franchise or the decision to acquire the franchise.[6] If the franchisor failed to provide timely and complete disclosure, the franchisee may rescind the franchise agreement within sixty days after receiving the FDD; if there was no disclosure at all, then the franchisee is entitled to rescind the agreement within two years after signing it.[7]

The judge in *Raibex* held that not only was the FDD delivered by ASWR incomplete due to the lack of head lease provisions and associated costs, but also that the omission of this information was so detrimental to the franchisee as to amount to no disclosure at all.[8] As a result, the judge ordered rescission of the franchise agreement, dismissing ASWR's argument that disclosure was impossible because no lease existed at the time.[9] The court's concern was that premature grants of franchises based on deficient disclosure documents can be a way for franchisors to simply avoid disclosing important information to their franchisees.[10] If the franchisor does not know all material facts, the franchise grant is "premature" and the franchisor must wait until all material facts are known.[11]

This proposition creates a lot of uncertainty about timing of disclosure obligations. Ontario franchise laws do not require disclosure to be made at a certain time. What if a franchisee is supposed to find and lease premises directly from a landlord, rather than sublease them from the franchisor—in this context, should the terms of the lease be known at the time of disclosure? Is there ever a time when the franchisor is certain that he or she knows all material facts? The Ontario court did not close the door on the possibility that proper disclosure could be made even if no location is found at the time of disclosure.[12] But there is no guidance regarding the circumstances in which such disclosure would be considered sufficient by the courts. Franchisors should keep the *Raibex* holding in mind when entering into franchise agreements in Ontario.

4. *Id.* ¶¶ 29, 32, 34.

5. *See* Arthur Wishart Act (Franchise Disclosure), S.O. 2000, cl. 3, § 5(1) (Can.), *available at* https://www.ontario.ca/laws/statute/00a03.

6. *Id.* § 1(1).

7. *Id.* §§ 6(1), 6(2).

8. *See* Raibex, *supra* note 1, ¶114.

9. *See id.* ¶¶72, 73.

10. *Id.* ¶76.

11. *Id.* ¶¶76, 78.

12. *Id.* ¶ 77.

*Raibex* is already being followed by Ontario courts.[13] In *2122994 Ontario Inc. v. Lettieri*,[14] the court rescinded a franchise agreement because the FDD did not contain audited financial statements for the most recent financial year, as required by the franchise disclosure regulations. Although the franchisor provided audited financial statements for the previous year, the court held that the franchisor should have waited until the audited financial statements for the most recent year became available. Citing *Raibex* with approval, the court in *Lettieri* pronounced that the franchisor must refrain from delivering an FDD prematurely,[15] until all material facts are determined and can be properly disclosed to the franchisee.

While *Raibex* is being appealed, it remains to be seen whether other Canadian provinces with similar franchise regulations will follow suit.

## B. Ontario Catches Up on Electronic Disclosure

Since July 1, 2016, franchisors in Ontario are permitted to deliver FDDs electronically.[16] Before the amendment, electronic delivery of franchise disclosure was explicitly permitted only in Manitoba, New Brunswick, and Prince Edward Island.[17] New British Columbia franchise law and regulations, coming into force in February 2017, will also permit electronic delivery.[18] As such, Alberta remains the only province with franchise regulation that does not explicitly permit this practice, although electronic delivery is widely used there.

Ontario, as well as Manitoba, Prince Edward Island, and British Columbia require franchisors to obtain a written acknowledgment of receipt of the electronic FDD.[19] By virtue of provincial Electronic Commerce Acts,[20] such written acknowledgment can be signed and delivered electronically, for

13. *See* 2122994 Ontario Inc. v. Lettieri, 2016 O.N.S.C. 6209 (Can.).

14. *Id.*

15. *Id.* ¶ 21.

16. General, O. Reg. 581/00, as amended by O. Reg. 164/16 (Can.), *available at* https://www.ontario.ca/laws/regulation/000581.

17. *See* Franchises Regulation, Manitoba Regulation 29/2012, § 5(1)(b) (Can.), *available at* http://web2.gov.mb.ca/laws/regs/current/_pdf-regs.php?reg=29/2012 [hereinafter Man. Reg.]; Franchises Act, New Brunswick Regulation 2010-92, § 3(1)(b) (Can.), *available at* http://www.gnb.ca/0062/acts/BBR-2010/2010-92.pdf [hereinafter NB Reg.]; Franchises Act Regulations, P.E.I. Regulation EC232/06, § 2(b) (Can.), *available at* https://www.canlii.org/en/pe/laws/regu/pei-reg-ec232-06/latest/pei-reg-ec232-06.html [hereinafter P.E.I. Reg.].

18. *See* Franchises Act, Bill 38 – 2015, § 5(2) (Can.), *available at* https://www.leg.bc.ca/parliamentary-business/legislation-debates-proceedings/40th-parliament/4th-session/bills/third-reading/gov38-3; Franchises Regulation, B.C. Reg. 238/2016 [hereinafter B.C. Reg.], § 8(1)(b) (Can.), *available at* http://www2.gov.bc.ca/assets/gov/employment-business-and-economic-development/business-management/small-business/.franchises_regulation.pdf.

19. *See* General, O. Reg. 581/00, *supra* note 16, § 12(1)(d); Man. Reg., *supra* note 17, § 5(1)(b)(ii); P.E.I. Reg., *supra* note 17, § 2(b)(iii); B.C. Reg., *supra* note 18, § 8(1)(b)(iii).

20. *See* Electronic Commerce Act, S.O. 2000, c. 17 (Can.); Electronic Commerce and Information Act, C.C.S.M. c. E55 (Can.); Electronic Commerce Act, R.S.P.E.I. 1988, c. E-4.1 (Can.); Electronic Transactions Act, S.B.C. 2001, c. 10 (Can.).

example, by using electronic signatures and document management software.

## II. Commercial Transactions in the United Kingdom

### A. Modern Slavery Act

Although the Modern Slavery Act (the "Act")[21] came into force in 2015 and the reporting requirement for applicable organizations to prepare an annual slavery and human trafficking statement contained in Section 54(9) came into force on October 29, 2015,[22] the effect of the reporting requirement is only now being seen. This is due to the lead-in time provided under the Act, which waived the 2016 reporting requirement for organizations whose financial year ended on or before March 30, 2016;[23] although eligible organizations whose financial year ended after March, 31 2016, must still publish the statement for 2016.

The Modern Slavery Act 2015 consolidated previous offences of slavery and trafficking and addresses the role of businesses in preventing modern slavery in their supply chains and organizations. Under the Act, all commercial organizations with a global turnover of £36 million or more that carry on any business in the UK must publish a "slavery and human trafficking statement" for each financial year.[24] The statement must set out the actions they have taken to ensure their supply chains and all aspects of their business are free from slavery and human trafficking, increasing transparency for the public, consumers, employees, and investors.[25]

The statement must be approved by the board of directors and signed by a director.[26] It must then be published each financial year on the organization's website, and include a link to the slavery and human trafficking statement in a prominent place on that website's homepage so it is easily accessible.[27] For organizations without a website, the statement must be made available to anyone who asks within thirty days.[28]

If foreign subsidiaries are part of the parent company's supply chain or own business, the parent's statement should cover any action taken in relation to that subsidiary.[29] A non-UK subsidiary may also produce its own

21. Modern Slavery Act 2015, *available at* http://www.legislation.gov.uk/ukpga/2015/30/contents/enacted (UK) [hereinafter Modern Slavery Act].

22. *See* Modern Slavery Act 2015 (Commencement No.3 and Transitional Provision) Regulations 2015, S.I. 2015/1816 (c. 113) (UK), *available at* http://www.legislation.gov.uk/uksi/2015/1816/pdfs/uksi_20151816_en.pdf.

23. *Id.*

24. Modern Slavery Act, *supra* note 21, §54(1).

25. *See id.* §§ 54(4), 54(7).

26. *Id.* § 54(6).

27. *Id.* § 54(7).

28. *Id.* § 54(8).

29. *Id.* § 54(5).

statement, which is highly recommended in cases where the non-UK subsidiary is in a high risk industry or location.

Government guidance issued on October 29, 2015[30] recommends that the statement includes the following:

- details of the organizational structure and supply chains, including countries used to source goods especially high risk countries where modern forms of slavery are prevalent;
- minimum labor standards;
- process for contracting with suppliers;
- due diligence processes in respect of the supply chains;
- policies to support whistle-blowing; and
- adoption of risk assessment policies and procedures and training available to employees.[31]

The Act has not introduced any formal penalties for non-compliance. But failure to comply or the production of a statement reporting that an organization has taken no steps, may damage the reputation of the business, and consumers and investors may apply pressure where they believe a business has not taken sufficient steps.

The Secretary of State (in the UK, called the "Home Secretary") can separately impose penalties through an injunction requiring the organization to comply,[32] although it is unlikely to do so without prior warnings.

## B. Interpretation of Contractual Drafting

In a recent case,[33] the Court of Appeal considered whether a ship owner could terminate a charterparty for a failure to pay. Although the facts of the case involved charterparties, the decision in this case has a wide impact as the Court reviewed more generally the principles of conditions and warranties, time is of the essence clauses, anticipatory repudiatory breach, and the drafting of termination clauses.[34]

### 1. *Contractual Interpretation*

The Court of Appeal in this case reviewed the principles of contractual construction in determining whether a clause requiring punctual payment of hire by charterers was a condition of the contract.[35] As a matter of common law and for the purposes of termination rights, a contract term can be

30. Home Office, *Transparency in Supply Chains etc. A Practical Guide* (Oct. 29, 2015) (UK), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/471996/Transparency_in_Supply_Chains_etc__A_practical_guide__final_.pdf.

31. *Id.*

32. Modern Slavery Act, *supra* note 21, §54(11).

33. Grand China Logistics Holding (Group) Co. Ltd. v. Spar Shipping AS, [2016] EWCA (Civ) 982 (Gr. Brit.).

34. *See id.*

35. *See id.* ¶¶ 41-56.

classified as a condition, a warranty, or an innominate term.[36] Any breach of a condition justifies termination, but no breach of a warranty (however serious) can justify termination; while breach of an innominate term will justify termination only if it deprives the aggrieved party of substantially all the benefit of the contract.[37] Based on general U.K. common law principles, the wording "time is of the essence" will make a deadline for performance a condition; breach of which would justify termination.[38] This approach was followed by the Court of Appeal (upholding the High Court decision). In reaching these conclusions, the Court of Appeal referred to and followed certain authorities to the effect that, in the absence of a clear indication to the contrary, courts lean against the interpretation of a contractual term as a condition.[39] It also held that there is no general presumption in a mercantile contract that a stipulated time for payment is a contractual condition without further wording expressly stating this (e.g., time is of the essence).[40]

The conclusion from the judgment of the Court of Appeal is that as the classification of contractual terms as conditions, warranties, or innominate terms depends on contractual interpretation, in the absence of express wording, drafters should clearly state the intention behind a contractual term. Because conditions and warranties can have extreme effects if breached, the tendency is to find contractual terms to be innominate terms unless otherwise stated. Therefore, if a contracting party wishes to ensure that it can rely on a breach of a term to terminate the contract, it should be expressed as a condition of the contract.

### 2. *Renunciation (Anticipatory Repudiatory Breach)*

It is clear from the Court of Appeal's judgment that the classification of the contractual term is also important in relation to the calculation of damages that may be available to the aggrieved party.

When a contracting party refuses to perform a contract the aggrieved party may accept the renunciation and end the contract even before the time for performance.[41] This would also be the case if there is a threatened breach of a condition or other threatened repudiatory breach.[42]

The innocent party can claim damages for loss caused by breach of contract.[43] If, however, a contract is terminated for breach of a condition or a repudiatory breach, then these damages can include compensation for loss for the remainder of the contract term.[44] This would not necessarily be the case if the innocent party terminated the contract on some other ground

36. *See id.* ¶ 52.
37. *See id.* ¶ 20.
38. *See id.* ¶ 104.
39. *See id.* ¶¶ 35, 65.
40. *See id.* ¶ 65.
41. *Id.* ¶ 21.
42. *Id.*
43. *See id.* ¶ 17.
44. *See id.* ¶¶ 16, 17, 26.

(e.g., a contractual right to terminate under a termination clause for a breach of a term that is not a condition or where it is not a repudiatory breach).

## C. Brexit

It remains to be seen how Brexit will affect international commercial, franchising, and distribution arrangements, but it is expected that there will be an increasing attempt to impose trigger mechanisms in contracts to force contractual review or even exit rights in the event that tariffs or other less favorable trading conditions are imposed on the UK as a result of Brexit.