

The impact of the coronavirus crisis on the franchise industry and what franchisors and franchisees can do to survive

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Economic predictions suggest that the coronavirus crisis will cause a significant global recession. Many restaurants and retail shops have already closed their doors. Will they be able to reopen when the crisis is over? Some commentators say that businesses that have been closed for more than three months may become irrelevant to the consumer and struggle to reopen after the crisis. This article seeks to provide some guidance on helping franchisors navigate these uncharted waters.

What does this mean for franchising?

Franchising will be impacted in a number of ways. Sales may decline particularly if you are in the hospitality industry or non-essential retail. Your supply chain may be impacted, particularly if you are sourcing products from countries that have closed their borders or that are amongst those most severely hit by the crisis such as China and Italy.

Some franchisees have requested to receive a royalty holiday to help their businesses. Others may try to rely on *force majeure* clauses in the franchise agreement to terminate the relationship. Consumer demand is shifting from leisure retail to grocery panic buying and food shopping. Supply chains are under stress and some delivery models are reportedly failing.

How can businesses in the franchise industry respond?

Know your legal position

There have been some encouraging reports of community spirit in parts of the industry with royalty holiday and stand still agreements being put in place but this is not a general phenomenon. Whilst one would hope that franchisors and franchisees could rely on collaborative solutions in this time of crisis, one must be realistic and prepared for the worst. You therefore need to know your legal rights and obligations.

Most franchise agreements will contain what is called a *force majeure* clause, which excuses performance of contractual obligations in circumstances where performance of the contract has become impossible. In most cases performance will be suspended pending the resolution of the *force majeure* event, but in some cases termination rights may arise if the emergency situation continues for an extended period of time, typically between 6 and 18 months. Some *force majeure* clauses require the parties to first take reasonable steps to keep their business open. In the context of the current COVID-19 pandemic, reasonable steps may include: adoption of mandated social distancing and quarantine directives, increased health and safety and sanitation protocols and modified staffing models. What is reasonable in any given circumstance, will be fact-specific and may vary from case to case and day to day as the *force majeure* event evolves. You may also need to provide evidence of efforts to mitigate the loss. This may be particularly applicable to those agreements where performance is only partially impossible, for example

restaurant franchises who have been ordered to close their doors to the public for dine-in services, but are permitted to continue offering pick-up and delivery services. In such circumstances, the franchisee's ability to perform its obligations have definitely been compromised, but they may not have been rendered impossible, thereby potentially removing the availability of a *force majeure* defence.

You should, therefore, carefully review any *force majeure* clauses in your franchise agreement to properly understand not only your rights, but any corresponding obligations that may exist in order to properly invoke or defeat the clause. For more information on *force majeure* provisions in franchise agreements please [click here](#).

Supply agreements and franchisors as suppliers

The supply chain is under pressure. This impacts not only the food industry but also others. Many franchisors around the world are reaching out to their suppliers to understand if deliveries will be delayed or cancelled. You also need to know if you have a legal right to cancel orders you may have placed for deliveries that are no longer required, for example because your business or that of your franchisees has been ordered to close, in whole or in part, because of a government mandated shutdown, curfew or other restriction. Legal rights and remedies will depend on the contract, however, little will be achieved by parties threatening or commencing legal action against one another in a climate where everyone is being forced to re-imagine and re-calibrate their business.

Franchisors who have established themselves as the main supplier of the franchise network may need to take action to secure alternate suppliers to support the network. You may wish to consider permitting local sourcing or alternative suppliers for an interim period whilst your supply chain is under pressure. Franchisors typically have stronger bargaining power than single franchisees when it comes to reaching standstill agreements or preferred customer status with their main or preferred suppliers. Quality standards should of course not be compromised by such measures.

Revisiting the core product range and menu offerings to prioritize recipes with locally sourced ingredients, products with longer shelf lives and perhaps moving to a cash on delivery (C.O.D.) payment model may be others ways to preserve the business.

Government help

Many governments around the world are passing legislation to assist small businesses. This ranges from tax relief to cancellation of VAT payments and property taxes. There are also proposals for temporary relief from the obligation to pay rent and various subsidised employment packages. For example in the UK the government is subsidising salaries of staff that are not laid off with up to £2500 per month to encourage employers not to make staff redundant. Similarly in Canada, the federal government has announced wage subsidies of up to 75% for employees of small and medium sized business and has engaged the banks to provide interest free loans for a period of time. For more information on global employment laws and government measures to help businesses please [click here](#).

Self-help

Industry self-help groups are forming everywhere. Franchisors should participate or at minimum be aware of which groups may benefit their systems and make those resources and information available to their franchisees.

Similarly, many landlords are negotiating standstill agreements and rent reductions with tenants and lenders. Where possible, franchisors should join or lead these discussions to support the future financial health of their systems and

use the opportunity to demonstrate leadership and support of their franchisees.

Franchisors are also reviewing and, where possible, renegotiating existing supply agreements, negotiating interim arrangements and opening up new supply and distribution channels. Franchisors who have perhaps proactively waived, postponed or decreased royalty and ad fund payments may be more dependent than ever on inventory revenue derived through supply chain product purchases and associated rebates from third party suppliers. Without revenue, franchisors will not be able to innovate the system and support franchisees. A balance needs to be found that allows franchisors and franchisees to survive this crisis.

Support franchisees, implement response measures

Nobody wants the termination of the franchise agreement but some franchisees may be driven to take such steps where they receive no support in the current crisis.

If franchisees invoke a *force majeure* clause or allege contractual frustration to support early termination and/or to obtain relief from payment obligations under the franchise agreement, franchisors need to be prepared on how to respond. Some franchisors may choose to accept the termination, however, most will seek to work with their franchisees to find a compromise or interim solution.

To mitigate their losses and support their systems, many franchisors are proactively devising solutions and reaching out to their franchisees with emergency and interim relief programs to ward off premature terminations and system collapse. Interim measures may include: negotiating standstill agreements with landlords across the system, introducing royalty relief, advertising fee relief, inventory subsidies, facilitating access to government subsidies and other measures to assist franchisees to stay open in some capacity or to be ready to re-open once permitted to do so.

In all circumstances, this is a time for leadership, definitive action and cooperation. How the parties respond and support each other in this unprecedented period of crisis will determine the future character and success of the parties' relationship, and potentially the sustainability of the system.

Take this opportunity to re-imagine your business and innovate the system

With every challenge comes an opportunity to not only do things differently, but perhaps better. We have seen encouraging examples of innovation and creativity amongst our franchise clients. Franchising is a win-win partnership between franchisor and franchisee when both parties cooperate and collaborate. Franchisors hold the power to innovate and adapt practices to respond to market conditions. Franchisees hold the power to adopt and execute these system changes to help the franchise system pivot in a direction that will allow the business to remain relevant, competitive and profitable. Neither party can accomplish this alone, each party is dependent on the other. Examples of franchise systems that have successfully shifted their models to respond not only to the current pandemic, but to consumer preferences and market trends include restaurant brands that have developed new or expanded delivery platforms by partnering with third party aggregators or developing in-house delivery solutions, satellite fractional franchise concepts to supplement existing businesses and add revenue streams, the conversion of fast food restaurants to mini-markets and improvements to the online retail offering of retail shops.

Conclusion

In summary, while the landscape of this global pandemic changes by the hour, essential to the survival of every business in this climate is leadership, strategic action and cooperation. To navigate these turbulent waters, a few key steps franchisors can execute immediately include the following:

- Understand your legal rights and obligations under the franchise agreement;
- Stay informed and up-to-date on all government regulations and supports available in the various jurisdictions your franchisees operate. For a summary of relevant updates by jurisdiction click [here](#);
- Review your supply chain arrangements and consider whether local or alternate sourcing should be permitted as an exemption;
- Consider what interim supports you can immediately provide, be it royalty relief, rent abatement, inventory subsidies or other relief;
- Pivot and/or innovate the system, as necessary, to respond to the crisis;
- Use your franchisee council or form a separate crisis response leadership group (that includes franchisee representatives) in order to maintain open lines of communication, remain informed of developments and their impact on the system as they arise and respond nimbly with strategic solutions for the benefit of the entire network; and
- Provide leadership and guidance and remain visible and accessible to your franchisees.

Dentons' free COVID hub contains a wealth of information that franchisors can use to understand the regulatory landscape. For specific questions regarding your business, please contact a member of the Dentons Global Franchise group.

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