We hope that you and your families are staying safe and healthy during these difficult times.

As the coronavirus disease 2019 (COVID-19) crisis has escalated, each of us is being inundated with communications about it.

Often, the most useful communications are those pinpointing specific matters of direct concern to the franchise community. Accordingly, we have selected some frequent questions and asked members of DLA Piper’s Franchising and Distribution group to provide succinct responses.

Some of the questions fall outside pure franchise law. We have called on our DLA Piper colleagues in those areas (Government Affairs, Labor and Employment, Insurance) to respond. Our firm has set up a Coronavirus Resource Center, and you can also subscribe to our mailing list to receive our daily digest as well as alerts, webinar invitations and other publications to help you navigate this challenging time.
1. **Even if the FDD has already been updated, what items in the FDD do franchisors need to amend to address the effects of COVID-19, given its substantial financial impact on franchise systems?**

   **When do franchisors need to make those updates?**

   Under the FTC Rule and most state franchise disclosure laws, franchisors are required to amend their FDDs to reflect any material changes to the information contained in the document. In light of unit closings, a reduction of demand, and other impacts of the crisis, many franchisors likely will need to consider mid-year amendments to their FDDs in a number of areas, a few of which we highlight here. First, if a franchisor’s financial condition materially changes from the financial condition reflected in the audited financial statements attached to the FDD, the franchisor will likely need to amend its FDD to include updated unaudited financial statements. Second, franchisors are obligated to notify a prospective franchisee of any material changes to a financial performance representation (FPR) contained in Item 19. For franchisors who include historical data as part of an FPR, even though the impact of the crisis in 2020 would not change the 2019 data, franchisors must ensure that the FPR has a “reasonable basis.” If a system experiences a significant revenue decline or otherwise has results in 2020 that differ materially from the 2019 results, the franchisor should consider amending its FDD to add a new FPR covering monthly performance in 2020 or to remove or otherwise revise the existing FPR. Though the FTC Rule does not require a franchisor to update Item 20 figures, under state disclosure laws, a franchisor may need to consider disclosing a material number of permanent unit closures in the system. Finally, if the franchisor files for bankruptcy, the FDD will of course need to be amended to reflect such filing.

2. **While normally franchisors strive to ensure uniformity among franchisees, what are the implications of treating franchisees — especially those more impacted by the COVID-19 threat — differently (eg, royalty reductions, delivery requirements)? How flexible should franchisors be in adapting the system to area-specific needs? Are there specific things franchisors should be doing to document their thought process (in providing preferential treatment)?**

   While a number of states have specific statutes that prohibit franchisors from “discriminating” against franchisees (with other legal theories also offering a basis for franchisee discrimination claims), generally, in order for the disparate treatment of franchisees to be unlawful, the franchisees must be similarly situated, and the franchisor must be rendering the differential treatment unfairly, arbitrarily, or capriciously. In the wake of the COVID-19 pandemic and its varying impact on communities nationwide, in crafting economic relief for franchisees and authorizing deviations from system standards, franchisors may consider the impact of the virus and attendant state and local policies and mandates in the geographic area in which the franchisee is operating. To mitigate the risk of any claim that the franchisor’s differential treatment of franchisees is “unfair,” however, franchisors are encouraged to consider establishing and implementing a written policy setting forth objective standards and business justifications for any economic relief offered and permitted deviations from system standards and making clear that such additional franchisor support, regardless of form, is within franchisor’s right to provide and for a limited period of time. Finally, franchisors are urged to document in writing any financial relief granted and deviations from system standards authorized. And, while at it, franchisors should also be considering other changes to their franchise agreements that reflect the lessons learned from the current health crisis.

3. **What steps can franchisors take to obtain designation as an “essential business” or provider for “essential products” or “essential services”? How should franchisors advise franchisees in obtaining the same? Do businesses need government certification to continue operating as an “essential” business or can businesses make that determination on their own? If businesses do not need government certification and mistakenly continue operating under the assumption that they are essential (but the government determines they are not), what are the consequences?**

   The Department of Homeland Security issued its [Guidance on the Essential Critical Infrastructure](https://www.dhs.gov/homepage) and provides guidance for determining which businesses can remain open during the COVID-19 pandemic. Businesses that have been determined to be essential will need to meet certain requirements, such as maintaining social distancing, sanitizing the workplace, and providing personal protective equipment to employees. Non-essential businesses will need to take steps to ensure they are in compliance with public health guidelines and work to prevent the spread of the virus. Franchisors should advise franchisees to consult with state and local officials to determine if they meet the criteria for essential businesses and to document any financial relief granted and deviations from system standards authorized. Franchisors may also consider establishing and implementing a written policy setting forth objective standards and business justifications for any economic relief offered and permitted deviations from system standards. The Department of Homeland Security has issued guidance on the Essential Critical Infrastructure and provides information on how to obtain designation as an “essential business” or provider for “essential products” or “essential services.”
Workforce: Ensuring Community and National Resilience in COVID-19 Response on March 19, 2020, setting forth the 16 critical infrastructure sectors and essential critical infrastructure workers that it recommends continue operations during the COVID-19 response. The Guidance is advisory in nature, and state and local governments have been inconsistent in adopting the recommendations set forth in the Guidance; in some cases, state and local governments have excluded sectors identified in the Guidance and in other cases, state and local governments have broadened the scope of permitted business operations in defining what constitutes an "essential business" or provider of essential products or services. Accordingly, whether a business qualifies as an "essential business" or provider of essential products or services should be reviewed under applicable law in the jurisdiction in which the business operates and in most cases is determined by self-assessment by the business.

Several states have implemented a process to be approved to be an "essential business." See Request for designation as an essential business for purposes of Executive Order 202.6 (New York), https://www.dlapiper.com (Maine), https://www.mass.gov/forms/essential-service-designation-request (Massachusetts) and https://www.wedc.org/essentialbusiness/ (Wisconsin); New Jersey businesses that consider their products or services "essential" may apply to the State Director of Emergency Management. Other states (e.g., Pennsylvania) define essential businesses, but then allow for submission of "waiver" requests for those businesses that believe that they were improperly categorized as "non-essential." Businesses that believe they are "essential" under applicable orders in their jurisdictions (or, absent any order, under the Guidance) are encouraged to make available to their employees a copy of the order on site to be used in communication with law enforcement or the applicable governmental authority charged with enforcing the order. Companies in jurisdictions that have issued orders directing "shelter-in-place," curfews, or other restrictions on operations are also encouraged to provide employees with a letter communicating the company's position regarding the employees' qualification as "essential critical infrastructure workforce" together with a copy of the Guidance. Franchisors that believe that their franchisees' businesses qualify as "critical essential workforce" are encouraged to provide a template communication that franchisees may use in connection with the continued operation of their franchised businesses, but franchisees may be reminded to conform the template communication to the then-current orders in effect in their respective jurisdictions. Penalties for non-compliance with orders issued by state and local governments vary by jurisdiction and may include written warnings and fines.

4. Can franchisors require franchisees to stay open if franchisees prefer to close (even if they are not required to do so under local law)? Can franchisors direct franchisees to close, if they are not required to do so under local law? If the franchisor does not require closure, does it risk incurring negligence liability to franchisee employees and customers?

Whether a franchisor may, or wants to, try to require a franchisee to stay open when the franchisee is not required to close under local law — or direct a franchisee to close when the franchisee is allowed to stay open under local law — likely depends on many factors, including franchise agreement terms, type of business, geography, and public perception. The franchise agreement might classify as a default of the franchisee's failure to remain open when it is not prohibited by law to operate; however, the agreement also might contain a force majeure provision permitting the franchisee's argument that its decision to close is justified (even without local law requiring closure). Conversely, the franchise agreement might give the franchisor the right to require closure where there is a risk to public safety or long-term brand damage. The franchisor is encouraged to take care though, because directing the franchisee to close when it is not required by law to do so could, in some circumstances, result in a constructive termination claim against the franchisor. Franchisors might also consider the potential negative public perception, and the accompanying brand damage, if they either default (and potentially terminate) a closed franchisee or direct the closure of a franchisee not otherwise required to close. If the franchisor's decision to not require closure follows the requirements of local law (i.e., not requiring closure when it is not required by local law), that may help mitigate the risk of liability.

5. What opportunities does this give franchisors to try to settle pending litigation, either through the threat of bankruptcy or reduced financial wherewithal (if the franchisor is the defendant), or by reducing the settlement demands now while the other side still has assets available for settlement
(if the franchisor is the plaintiff)?

Parties in litigation, or in pre-litigation disputes, who are in financial distress often threaten to file bankruptcy in order to obtain a more favorable settlement. A defendant’s credible threat of filing bankruptcy increases the likelihood of a settlement because of the inevitable delay caused by the mandatory stay of litigation once the bankruptcy is filed and the likelihood that, even if the claims have merit, the franchisee will obtain recovery on those claims only at the conclusion of the bankruptcy case (which could take a year or more) and even then recover only pennies on the dollar. The threat of a franchisor defendant filing bankruptcy may also motivate an existing franchisee plaintiff that intends to remain in the system to reduce its demands in order to preserve the viability of the system as a whole and thereby protect its individual investment. Even apart from the threat of bankruptcy, the cash-flow difficulties caused by the pandemic may facilitate settlements at a time when one or both parties cannot afford litigation costs, the courts are often only handling emergency civil matters, and money in hand today may be particularly valuable compared with an uncertain recovery down the road. For franchisor defendants facing claims of lost profits damages arising out of a franchisee termination, the pandemic may support the argument that a lost profits claim, premised on the continued viability of the franchisee’s business for the remaining franchise term, cannot meet the standard of reasonable certainty, particularly if other franchisees in the system go out of business as a result of the pandemic.

6. Should franchisors make recommendations or give directions concerning how to clean the stores to deal with COVID-19, to screen the customers and other people who visit the stores and come into contact with the employees, and to deal with situations where a customer or employee has tested positive? How should franchisees ensure that their employees are healthy and not transmitting the virus to takeout/delivery customers? Do franchisors need to be worried about joint-employment claims?

Franchisors are encouraged to provide franchisees with information from authoritative federal sources, such as the osha.gov and cdc.gov websites, and to remind franchisees as well about authoritative local sources, such as local county public health department websites. Where the osha.gov and cdc.gov guidance is clear for the franchise system, franchisors might offer help by accurately summarizing the guidance in mass communications to their franchisees, reminding franchisees to reference the full primary sources and to check for updated information and local requirements. Many franchise systems already might have cleaning and other practices as part of their brand standards that mirror some elements of federal, state, and local guidance, in which case the franchisor may emphasize the practices with which franchisees and their employees already are familiar. In communicating recommended guidance from government authorities, franchisors are encouraged to remain mindful of the desire to avoid creating a joint-employer relationship. If franchisors have company-owned locations in which they have implemented certain preventative employee-related practices, the franchisor might consider offering information about their own practices as a model. So too, though there is no specific guidance for franchisors from the applicable agencies, franchisors may opt simply to communicate accurate information from government sources, and remind franchisees to comply with applicable federal, state, and local requirements.

7. What assistance can franchisors provide to their franchisees to obtain financial and other forms of relief from landlords and other vendors?

Franchisees may be encouraged to review their leases for express language providing rent relief. These provisions are typically found toward the end of the lease agreement in provisions titled “force majeure,” “continuous operations,” or “business interruptions.” Without such express language in the lease agreement, it is unlikely that the franchisee will have a contractual right to stop making rent payments. Substantial case law supports the notion that a tenant must continue paying rent unless the value of the leasehold has been totally or substantially impaired, which is a very high bar. Nevertheless, franchisees may and still should consider asking their landlords for relief if their business operations have been impaired by COVID-19. There may be good economic reasons for landlords to offer rent deferrals that, if granted, would likely be just that – a deferral and not a forgiveness – especially if the alternative is a closed location with bleak prospects of economic recovery for the landlord. Franchisees may also be urged to review the business interruption coverage in their property insurance policies. Many of these policies have virus exclusions, which are obviously unhelpful. But these policies often provide coverage for losses caused by orders by civil authorities that prohibit or impair the insured’s operations. Because such insurance policies vary widely, their particular terms should be reviewed with care. In addition, various bills
pending in state legislatures could essentially overrule policy exclusions; it would therefore be worthwhile to consider giving notice of loss to the insurer now and see what happens. Finally, some cities and counties have issued moratoria on all no-fault evictions of commercial tenants who demonstrate COVID-19 related inabilities to pay rent. Where issued, these moratoria would allow franchisees to retain possession of their premises, though they will not excuse their obligation to pay rent. As a practical matter, where resources are available, franchisors may also extend assistance to their franchisees by curing lease defaults and/or engaging in relief negotiations with landlords on their behalf.

8. What financial assistance can franchisees obtain from current and proposed federal programs? What are the eligibility requirements for the SBA’s Economic Injury Disaster Loan Program and the Paycheck Protection Program? Are there other avenues for economic assistance franchisors can recommend to franchisees?

If you have suffered substantial economic injury and are one of the eligible businesses located in a declared disaster area (COVID-19 has been so declared in all 50 states and District of Colombia, Puerto Rico, USVI, American Samoa, Guam, and Northern Mariana Islands), you may be eligible for an SBA Economic Injury Disaster Loan (EIDL), which is available to (among others) small businesses. Substantial economic injury means the business is unable to meet its obligations and to pay its ordinary and necessary operating expenses. EIDLs provide the necessary working capital to help small businesses survive until normal operations resume after a disaster. The SBA can provide up to $2 million to help meet financial obligations and operating expenses that could have been met had the disaster not occurred. The loan amount will be based on a company’s actual economic injury and a company’s financial needs, regardless of whether the business suffered any property damage. The interest rate on EIDLs will not exceed 4 percent per year. The term of these loans will not exceed 30 years. The repayment term will be determined by the company’s ability to repay the loan. However, EIDL assistance is available only to small businesses when SBA determines they are unable to obtain credit elsewhere.

In addition, Congress has passed the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) that provides $349 billion in loan forgiveness grants to certain eligible small businesses and non-profits to maintain existing workforce and help pay for payroll, and other expenses like rent, mortgage, and utilities.

Eligibility for loans as a small business is generally limited to employers with not more than 500 employees. For some larger franchisees, it can be a complicated analysis to determine whether they are “small businesses.”

- Under the CARES Act, a franchisee (and its affiliated group) would be eligible to receive such loans if the group employs no more than 500 employees per physical location and is assigned a North American Industry Classification System (“NAICS”) code beginning with 72 (essentially, hotels and food services sector).
- The CARES Act would also waive the “affiliation rules” for: (a) a franchisee operating in a franchise system that is on SBA’s Franchise Directory; and (b) a franchisee that receives financing through the Small Business Investment Company (SBIC) program.

The maximum 7(a) loan amount is $10 million through December 31, 2020, and there is a formula by which the loan amount is tied to payroll costs and debt (mortgage or rent) incurred by the business. Allowable uses of the loan include payroll support, such as employee salaries, paid sick or medical leave, insurance premiums, and mortgage, rent, and utility payments. Collateral and personal guarantee requirements are waived under this program, and the maximum interest rate is 4 percent.

With the opening of the SBAs PPP portal, applicants will no longer be able to apply for both EIDL and PPP loans. An applicant may refinance an EIDL into a PPP loan, with a maximum limit of both loans of an aggregate $10 million.

Importantly, the new legislation establishes that eligible borrowers can receive loan forgiveness equal to the amount spent by the borrower during an 8-week period after the origination date of the loan on payroll costs, interest payment on any mortgage incurred prior to February 15, 2020, payment of rent on any lease in force prior to February 15, 2020, and payment on any utility for which service began before February 15, 2020. For more information on SBA’s loan programs, see https://www.sba.gov/page/coronavirus-covid-19-small-business-guidance-loan-resources.
Lastly, the CARES Act also fixes the 2017 tax bill’s “retail glitch” (a mistake in the tax law that hurt retailers by only allowing them to deduct 2.5 percent of their remodel costs in the year they are incurred, instead of 100 percent, making the value of the deduction 1/40 of what it should have been).

9. **What should franchisors say, if anything, in their FDDs about the COVID-19 pandemic?**

Nothing in the FTC’s Franchising Trade Regulation Rule, the NASAA Franchise Registration and Disclosure Guidelines, or the state franchise laws specifically requires a franchisor to disclose in its FDD COVID-19’s potential impact on the franchise system. However, franchisors might want to consider adding language at the end of Item 1 – tailored for their franchise system of course – stating that COVID-19 may or is likely to lead to certain levels of disruption in customer demand, supply chain, employee availability, and other aspects of operating a franchised business as well as an impact on operating costs. This disclosure might also advise prospective franchisees that their business operations could be affected by applicable laws, rules, and orders of any government authority concerning the outbreak, including shelter-at-home edicts. Because some businesses might not be materially impacted by COVID-19 given the industry in which they operate and the services or products they provide, a franchisor is encouraged to craft any disclosure very carefully.

10. **Some franchisors have several franchisees who have just stopped paying royalties. While franchisors understand the reason, and are hesitant to default and/or terminate under the circumstances, is there anything franchisors should be doing to protect their rights once this crisis ends?**

A franchisor looking to protect its ability to collect unpaid royalties and other amounts (and any rights that flow from non-payment) is encouraged to properly document the franchisee’s non-compliance. A formal notice of default is not necessary and, under the circumstances, probably is not advisable. A carefully crafted communication reminding the franchisee of the franchisor’s willingness to work with the franchisee during these challenging times and advising them that the issue of unpaid fees will be addressed again in a certain number of weeks or months may suffice to parry any claim that the franchisor waived its ability to pursue unpaid fees by failing to act sooner. If the applicable franchise agreement has a contractual limitations period that applies to non-payments, and that limitations period is close to running, more formal steps, such as the execution of a forbearance agreement, may be necessary.

11. **If the franchisor and its franchisees voluntarily close stores for a period of time are the employees entitled to unemployment insurance benefits?**

Generally speaking, if a franchise store voluntarily closes for a period of time, the store’s employees (whether furloughed for a specified period of time, or terminated) may be entitled to unemployment insurance benefits. In response to the COVID-19 virus crisis, the federal government is now allowing states to amend their laws to expand the circumstances under which an individual can apply for unemployment insurance benefits. Accordingly, many states are now offering benefits to individuals when an employer, such as a franchisee, temporarily ceases operations due to COVID-19. Further, the CARES Act also contains a series of provisions to strengthen and extend unemployment benefits for individuals now collecting such benefits in response to COVID-19. That said, because unemployment insurance law can vary from state-to-state, employers interested in information regarding their state’s unemployment insurance law are encouraged to visit their state’s unemployment insurance website, many of which have recently published COVID-19-specific information.

12. **What are the employment obligations to employees who are not laid off but who remain home (in a business where they cannot work at home) because they are in a vulnerable group (eg, over 60, underlying medical condition)?**

As a general rule, employers are not required to pay workers for time that they are not working. However, in response to the COVID-19 virus crisis, federal, state and local legislatures have passed several laws aimed at providing paid and protected leave to individuals affected by the COVID-19 virus, including those unable to work because they are members of a “vulnerable group.” For example, the federal Families First Coronavirus Response Act (“FFCRA”) requires employers with fewer than 500 employees to provide all employees, regardless of their tenure, with ten (10) days of paid sick leave, if an employee is “unable to work (or telework)” due to one of the
following COVID-19-related reasons:

- The employee is subject to a federal, state, or local quarantine or isolation order related to COVID-19 (added in the revised Act).
- The employee has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
- The employee is experiencing symptoms of COVID-19 and seeking a medical diagnosis.
- The employee is caring for an individual who (i) is subject to a federal, state, or local quarantine or isolation order related to COVID-19, or (ii) has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
- The employee is caring for a son or daughter of such employee if the school or place of care of the son or daughter has been closed, or the child care provider of such son or daughter is unavailable, due to COVID-19 precautions.
- The employee is experiencing any other substantially similar condition specified by the Secretary of Health and Human Services in consultation with the Secretary of the Treasury and the Secretary of Labor.

Several states, such as New York, have passed similar COVID-19 paid sick leave laws. Further, employees who fall into a “vulnerable group” may be entitled to leave from work as a reasonable accommodation under the Americans with Disabilities Act, or similar state or local law, which may entitle them to short-term disability, or other insurance, benefits. Finally, such employees may have access to paid, or partially paid, time off pursuant to their employment agreements, collective bargaining agreement and/or employer’s policies.

In any case, if an employee is unable to work because he or she is a member of a “vulnerable group,” the employer is encouraged to review the situation carefully prior to making any adjustment of the employee’s healthcare benefits. Generally speaking, if an employee is on a protected leave due to COVID-19-related illness, the employee may be entitled to the continuation of group health coverage during the leave on the same terms and conditions as if he or she continued to work.

13. What forms of financial relief are franchisors providing to franchisees? How should this be documented?

Financial relief from franchisors during this crisis may most appropriately consist of royalty payment deferrals or even waivers. Unlike monthly rent for the franchise premises and bank loan payments (fixed costs typically unaffected by volume of business), royalties typically are based on the franchised unit’s volume of business, so they self-adjust to reflect the downturn of business or even a business closure. Nevertheless, further relief— in the form of royalty deferrals and/or waivers — can be provided to assist with a franchisee’s temporary cashflow problems. How a franchisor chooses to document this relief depends on the terms of the franchise agreement; however, one party’s contractual obligations typically can be unilaterally waived by the other without formal amendments. In the case of a royalty payment deferral, the obligation to pay remains, but the timing of payment is deferred. Royalty payment waivers involve the franchisor’s foregoing the right to collect any royalties for a specific timeframe, ie, no repayment is expected. Given the need to move speedily in the current economic climate, a unilateral communication by the franchisor will likely suffice, whether for a deferral or a waiver. The communication is expected to be clear about the start and stop date and, in the case of a deferral, to describe how and when repayment is expected. Collections on the deferred due date are generally enforceable. Further deferrals – depending on the circumstances – may again be implemented unilaterally. However, any change of heart by the franchisor during the deferral/waiver period likely would not be enforceable due to the franchisee’s reliance on the deferral/waiver communication. The deferral/waiver process can apply to any payments due from the franchisee to the franchisor or its affiliates.

14. What are the insurance issues with respect to franchisees who close their stores? Are pandemics generally covered by business interruption clauses? Is insurance coverage dependent upon whether the closure is the result of a state order, a requirement of the franchisor, or merely the decision of the franchisee?

Did the store suffer physical injury or property damage (ie, is there any evidence that the store itself was contaminated by the virus)? If so, the franchisee may have coverage not only for the cost to clean the store (eg,
for the physical loss or damage) but also for the store’s business interruption losses (ie, loss of business income) caused by the virus. Even without physical injury or property damage, and despite common exclusions for losses caused by a “virus,” “pathogen,” or “contaminant,” an argument could be made for the business interruption coverage if the store’s closing resulted from an order by a civil authority that prohibited people from patronizing the store or at least interfered with their ability to do so. Such coverage for losses resulting from the actions of a civil authority often does not require proof of physical injury or property damage. Franchisees are encouraged to read the policy.

The franchisee might also benefit from insurance coverage that may be available to its landlord. The franchisee’s lease will often contain a force majeure or interruption of service clause that the franchisee may potentially argue entitles the franchisee to relief from its monthly rental payment, if the franchisee were not able to gain access to or to use the leased premises. Even in the absence of such a clause in the franchisee’s lease, the franchisee is encouraged to consider relying on the common law doctrine of impossibility of performance, which excuses contractual obligations where a change in circumstances has rendered performance of a contract impossible. Under either rationale, if the franchisee’s obligation to pay rent were legally excused, the franchisee’s landlord may have insurance coverage for its lost rent under the rent loss provisions in the landlord’s property insurance policy. Such coverage in the landlord’s insurance policy could include lost rent resulting from orders by a civil authority restricting access to or use of the leased premises. Since such civil orders are now commonplace, the lost rent resulting from such civil orders could be covered by the landlord’s property insurance. But one caveat. The franchisee’s landlord is urged to be careful not to act as a volunteer, that is, not to give its insurer an argument that the landlord’s rental losses were self-inflicted. The landlord and the franchisee are encouraged to be careful to document that whatever rent relief the landlord extends to the franchisee is required by the terms of the franchisee’s lease or by the common law.

With respect to application of the force majeure clause, consider Section 1102 of the CARES Act and its “Paycheck Protection Program.” This program permits the SBA to make loans, eligible for forgiveness, to small businesses up to $10 million per borrower (depending on the size of the borrower’s payroll), that can be used for various purposes such as the payment of eight weeks’ worth of employee salaries, rent, and franchise fees (although the portion of a loan used to fund payment of a franchise fee does not appear to be eligible for forgiveness). The availability of such loans arguably negates, or at least postpones, the franchisee’s rationale for relief from its rental obligations.

Finally, the franchisor and the franchisee may benefit from the contingent business interruption and contingent extra expense clauses in their respective property insurance policies. Such clauses commonly cover the insured’s loss resulting from loss or damage to property that directly or indirectly prevents a supplier from providing its goods or services to the insured, or that prevents customers of the insured from accepting the insured's goods or services. Such coverage potentially might be triggered if a franchisor or franchisee incurred losses because their respective suppliers or customers were unable to fulfill their contractual obligations because of property damage – the presence of the coronavirus at the supplier’s or the customer’s locations.

15. If there are supply chain disruptions, how should we address “approved supplier” provisions? Are other brands that can continue to operate being flexible in this regard by allowing “other suppliers” to source the system?

As a result of COVID-19, there may be serious disruptions to the franchise system’s supply chain from product availability, pricing, and other perspectives. To enhance the system’s flexibility and facilitate its uninterrupted operation, franchisors may consider expanding their approved-supplier network to permit additional local suppliers that can quickly and effectively source products to local franchisees. If franchisees request the right to source products from previously-unapproved suppliers, franchisors are encouraged to review franchisee requests and consider the competing interests of (i) permitting sourcing from suppliers that the franchisor has not had a chance to assess thoroughly (which may be a lesser concern when dealing with non-proprietary and/or non-regulated products) and (ii) promoting continued business operations that otherwise would be interrupted by supply-chain disruptions. Any concession to franchisees to source from previously-unapproved suppliers often are designated as temporary, preserve the franchisor’s right to reverse its decision upon appropriate notice, and confirm that the franchisor does not make any representations or warranties regarding the quality, suitability, or profitability of sourcing from the previously-unapproved suppliers. To the extent the franchise system has purchasing
cooperatives that have previously negotiated pricing and other supply-chain particulars (e.g., obtainability, fulfillment times), proactive communication is encouraged between the cooperative and its preferred vendors to achieve continued product availability and consistent non-premium pricing.

16. What risks do franchisors face by not providing contractually required services, whether in an effort to stop spread of the virus or to save cash flow? What can franchisors do to manage or mitigate this risk?

Failure to perform under a contract subjects a party to the risk of breach and claims for damages or injunctive relief. Parties are urged to review the specific terms of their franchise and other contracts to determine what events might excuse performance, such as force majeure and material adverse change clauses, and consider other doctrines such as commercial impracticability, impossibility of performance, and frustration of purpose. From a practical standpoint, being proactive and communicating with the other contracting parties before non-performance will help manage and mitigate the risk. Given that the pandemic is affecting everyone, reaching an agreement on how performance under a contract will be altered in the short-term is the most pragmatic approach.

17. What are a franchisor’s options when a franchisee has provided notice that coronavirus is a force majeure event and, as a result, the franchisee is not going to pay royalties while the WHO pandemic declaration is in effect?

Although it may be hard to argue that COVID-19 is anything but an unforeseeable event beyond the control of a franchisor and franchisee, whether a franchisee can successfully claim a force majeure defense for failure to pay royalties based on COVID-19 largely depends on the language and governing law of the franchise agreement, along with case law in the relevant jurisdiction. Force majeure clauses tend to be construed narrowly and will generally only excuse a party’s non-performance if the event that caused the party’s non-performance is specifically identified in the agreement and there is a direct causal link between the event and non-performance. Certain case law from some jurisdictions suggests that the inability to pay (for example, as a result of financial hardship) does not create an impossibility or impracticability which excuses a party’s performance of its contractual obligations.

Some franchise agreements also specify that a force majeure event will not excuse the obligation to pay royalties on sales that are realized. Before taking action against the franchisee, however, the franchisor is encouraged to consider long-term implications to the system, as well as any immediate consequences to the relationship with the franchisee. Where the relationship with the franchisee is otherwise positive and the franchisor expects the franchise agreement to run the full franchise term, the franchisor may want to be proactive and transparent by negotiating new or modified terms with the affected franchisee. In analyzing the appropriate strategic response to a force majeure notice, a franchisor might also consider whether there is insurance coverage.

Find out more about the issues covered in this Q&A by contacting any member of the Franchise group or your DLA Piper relationship attorney.

Please visit our Coronavirus Resource Center and subscribe to our mailing list to receive alerts, webinar invitations and other publications to help you navigate this challenging time.

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