

A background graphic featuring a network diagram with nodes and connecting lines in blue and red. Overlaid on this are the words 'CORONAVIRUS' in large, white, bold letters and '[COVID-19]' in smaller, red, bold letters.

The Franchisor's COVID-19 Legal Toolkit

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Overview

Franchisors are currently responding to a myriad of challenges confronting their franchise systems. However, as the implications of COVID-19 continue to unfold, franchisors must continue to assess and pivot to successfully navigate through these uncertain times.

This article explores some of the high-level issues, strategies and recommendations arising from the experiences of various franchisors that may assist other franchisors as they continue to respond to the COVID-19 pandemic.

1. Health and Safety is Paramount

The health and safety of all individuals associated with a franchise system is a primary and continuing concern for franchisors. Reconsidering protocols, processes and persons involved at all levels of a franchise system – from the franchisor's employees and service providers to the ultimate customers serviced by franchisees – and focusing on protecting health and safety are more important than ever.

The following are recommendations for creating, implementing and monitoring enhanced health and safety policies:

- Carefully assess where health and safety protocols require enhancement, and this assessment will likely need to be done more than once as the pandemic continues.
- Review the legal rights and mechanisms available (in franchise agreements and operations manuals) for both implementing and monitoring system changes.
- Communicate with franchisees regarding the rationale and legal framework for proposed changes.
- Consider consultation with franchisees for input and feedback (before and after implementation).
- Record proposed changes with robust legal documentation that addresses all legal concerns associated with the system change and monitoring. The legal terms should allow for flexibility to, among other things, permit further updates, and should adequately cater to the ever-changing legal environment (for example, mandated closures of non-essential services businesses).

Franchise systems are facing unprecedented upheaval in the wake of the COVID-19 pandemic.

- Observe applicable franchise laws, such as the obligation to act in good faith toward franchisees, to minimize the risk of later claims. Some of the items in this bullet list can assist franchisors in satisfying their obligation to act in good faith.
- Create implementation and monitoring protocols that include informing franchisees of proposed measures and the process for adopting them.
- Protect against the potential liability created by implementing system changes, including the risk of franchisors being deemed to be taking an active role in franchisees' businesses.

2. Remain Current and Informed

Undoubtedly, one of the conundrums faced by franchisors is that franchisees are looking to franchisors for guidance in circumstances where there is no blueprint or manual. It is essential for franchisors to remain informed about developments (across all relevant jurisdictions) including with respect to: (i) changing health and economic conditions as they relate to COVID-19; (ii) regulatory policies and orders from all levels of government, and how such regulations are being interpreted; and (iii) the relief and stimulus packages available. In each case, franchisors should understand how these developments impact and apply to the franchise system (and particularly the franchisees). Franchisees are relying on their franchisors' wisdom and judgment in these matters.

McMillan has a number of resources to assist franchisors in staying current on all regulatory notices and changes taking place across Canada. These resources can be found on our website at <https://mcmillan.ca/COVID-19-Resource-Centre>. We also have dedicated lawyers who are assisting clients with responding to government orders, such as the closures of non-essential services businesses (and, in certain cases, preparing letters of proof of essential services business), as well as providing assistance in determining which government benefits apply to our clients and their business arrangements. McMillan's public affairs arm, McMillan Vantage, can assist clients seeking clarification on the application of or exemptions from evolving government restrictions on businesses that are being put in place in response to COVID-19.

In addition to establishing consistent and multi-faceted methods of communication to keep franchisees informed of the above matters, prudent franchisors are also: (i) synthesizing the relevant information so that it makes sense to their franchisees (in their respective jurisdictions); (ii) monitoring and assessing what other businesses and franchise systems are doing in the circumstances; and (iii) sharing the franchisor's plans and responses to daily changes and challenges with franchisees. Importantly, the latter type of communication must be undertaken with care to ensure that, among other things, franchisors are acting within their rights and not making promises that they are not able to deliver on (which may result in misrepresentation or good faith claims down the road).

3. Communicate Continually

The determination by many franchisors to communicate more frequently with their franchisees during the challenges caused by the pandemic demonstrates their commitment to their franchisees. In most cases, these frequent communications extend beyond information updates and system changes. They are part of an intentional strategy to ensure that franchisees receive the support they require, whether it be technical and business-related, or more general and personal.

There are several practical and empirical points to glean from franchisors in this regard. First, franchisors are being creative in utilizing as many platforms as possible – social media, video-conferencing tools, online content, intranet portals, etc. – in maintaining communications with their franchisees. Second, franchisors are also using these platforms to give franchisees an opportunity to voice their concerns, provide feedback on proposed and implemented changes (and the results from same), and share their stories and experiences. Moreover, franchisors are sharing best practices gleaned from their franchisees across jurisdictions as well as "success stories" of what some franchisees are doing to overcome business challenges creatively.

The importance of communication cannot be overstated. However, franchisors must take caution to ensure that all communications with their franchisees are reviewed by appropriate senior management, made by authorized representatives and monitored to avoid inconsistencies and ambiguity, which carry with them increased risk of liability. Such precautions depend on both the content and the form of the communication.

4. Crisis and Continuity Planning

Whether it be an outline of damage control measures or a set of creative solutions to address challenges (or likely both), it is critical that a franchisor chart its franchise system's course through the pandemic with a plan. Understandably, such a plan is typically a "working document" with sufficient flexibility and nimbleness to deal with current uncertainties and ever-changing conditions. Undoubtedly, the underlying assumptions and proposed strategies will require tweaking and fine-tuning throughout 2020.

Many franchisors are undertaking comprehensive "stress tests" of their entire systems and infrastructure, including business formats, policies, procedures, manuals, supply chains and franchisees, etc. This level of analysis facilitates more robust "modelling" and assessment of various eventualities (both during the course of the pandemic and beyond it). Ultimately, all of this provides franchisors with the insight and tools required for contingency planning, understanding and mitigating the impact of COVID-19 on their system, and for adopting many of the suggested strategies reflected in this article.

The planning process should also identify and address legal issues associated with the strategies to be implemented, and the potential liability arising from both good and bad activities/outcomes, as well as any contemplated present and future system changes. Furthermore, franchisors should seek advice on changes to the judicial process (in all regions in which they operate) as many jurisdictions have limited access to their courts and suspended limitation periods under various laws (although there is ambiguity as to whether such suspension applies to rescission claims).

5. Adaptations and Enhancements

Franchisors acknowledge that addressing the threats caused by COVID-19 has in some cases provided the opportunity to innovate, to develop adaptations and enhancements to their systems, many of which will continue beyond the pandemic. There have been numerous innovative "pivots" by franchise systems, some of the common ones being mobile ordering, delivery and take-out for food businesses, and transition to online formats for service brands such as fitness and child activity concepts. Some have stretched the pivot further by introducing new COVID-19 specific services, for example, brands that utilize vehicles are repurposing them to provide grocery shopping/delivery and home sanitization services.

Others have converted their infrastructure to produce new products/equipment to specifically support COVID-19 relief measures, for example, sanitization products and medical supplies. Many of these innovations will enhance franchise system offerings following COVID-19. Online formats are a good example. The demand for online fitness solutions existed prior to the pandemic and the format has met with major success during COVID-19. Significant investment in further research and development has begun, and the demand (as well as the offerings) are set to increase post-pandemic.

These turbulent times have also been helpful for testing and improving franchisors' business interruption and crisis management policies. In addition, there has been a significant increase in the adoption of remote working and virtual activities. New virtual training courses, increased continuing training activities through free webinars, and virtual discussion sessions where franchisees share their feedback and suggestions have all been beneficial.

There are number of legal matters to address with respect to adaptations and enhancements. First, franchisors must communicate clearly (and in writing) the terms and conditions upon which franchisees are free to explore their own adaptations and enhancements to the business format and franchised business operations. Second, franchisors must determine how adaptations and enhancements will be monitored, assessed, and (as applicable) rolled out across the franchise system. Further, where novel online formats are being offered, franchisors must ask how they accord with existing franchise agreements, as well as applicable laws (such as privacy laws) and how these formats will be integrated into the system offerings going forward. Many of the other legal considerations set out in the first paragraph of this article apply to these types of system changes.

6. Franchisees

Franchisors are able to bring significantly more resources and infrastructure to bear in addressing the challenges created by COVID-19. This gives credence to the familiar franchise refrain, "franchisees are in business for themselves, but not by themselves." Franchisors are providing assistance and support to franchisees in a number of ways, some of which are detailed below.

Assessment and Monitoring

The focus of many franchisors is on assessing the viability of franchisees and their franchised business. Early intervention in identifying and diagnosing the more vulnerable franchisees and franchised businesses, and those requiring more assistance, has been key. Franchisors must continue to make these assessments on an ongoing basis, as the vulnerabilities and the need for assistance may develop as issues stemming from the pandemic become more severe.

Franchisors should review and confirm the rights they have to obtain more regular, quick and informal financial reports and updates from franchisees. Analysing terms/ renewal periods may also be important at this time. This will enable franchisors and franchisees to make informed decisions, even if that involves hard decisions around bankruptcies, permanent closures, or franchisor buy-outs (which will require a careful review of the relevant rights and obligations of the franchisor under the franchise arrangement).

Relief and Concessions

Despite the urgency, prudent franchisors have been deliberate about developing systematic and flexible frameworks for franchise relief and concessions, while still moving with a degree of haste. More than other strategies, providing franchisees with any form of assistance by way of relief or concession can create a landmine of legal issues if not done properly. Importantly, the framework within which a franchisor offers such relief or concessions must include, among other things, a time frame/term, regular review periods, conditions, a statement of no-waiver and termination events. Furthermore, franchisors must build flexibility into these frameworks to accommodate changes that will likely be necessary to address new developments over time.

Any kind of relief, concession, or other deal made with franchisees must be documented in detail with robust terms, and not with a “back of the napkin” type approach (including emails). This is particularly so where such deals involve changes to royalty fees, advertising contributions, minimum inventory purchases, development and opening deadlines, marketing activities and brand standards, etc. Clearly, the best practice is to document these deals beforehand, but executing agreements after the fact is better than not at all. In certain cases, franchisors are providing outright financial assistance by way of loans to their franchisees.

These types of arrangements must be treated as separate financing transactions with the typical loan and security legal documentation.

Some franchisors have decided not to provide any form of relief or concession with respect to financial obligations, but are assisting franchisees in other ways. Even where franchisors offer other forms of assistance, it is crucial that such assistance be provided through clear written communication with the appropriate provisos and disclaimers. Even the best of intentions and cooperation at the outset of the crisis can end in disagreement and acrimony (particularly if things become increasingly dire as the crisis continues).

Further Assistance

Franchisees are also calling on franchisors to assist with various franchised business-level issues. There are a few elements to the rationale behind these requests. First, in many cases the issues are system-wide (faced by many franchisees) and second, the franchisor has the appropriate resources and infrastructure to more competently deal with them. Franchisors who decide to provide any form of assistance must do so in an organized and systematic manner, exercising caution so as not to increase their risk of liability, including being held vicariously liable for franchised business-level activities (i.e., being held to be taking an active role in the operations of franchised business). There are legal protections that franchisors can adopt to mitigate and manage risks in this regard. The following are select issues and suggested approaches that franchisors have taken during the COVID-19 pandemic.

- **Suppliers.** Franchisors have been addressing supply chain issues faced by franchisees. In some cases, this has involved identifying alternative arrangements (whether temporary or permanent), including permitting franchisees to source their own supplies. Structuring and documenting supply chain modifications can be both complex and pressing.
- **Financing.** Particularly where established financing programs are in place, some franchisors have been involved with system-wide negotiations for relief/ concessions under loan arrangements between their franchisees and financial institutions. The best practice recommendation here is for the franchisor to keep in mind the clear distinction between its relationship with the financial institution and its franchisees’ financing arrangements with the financial institution.

- **Leases.** Franchisors are being called upon to assist with lease negotiations, including considering whether government subsidies apply to certain lease arrangements. While this kind of assistance may be critical to a franchisees survival, if not undertaken prudently and documented carefully, it can also create potential liability for the franchisor.
- **Contracts.** Franchisees are facing contractual issues with various counterparties in a number of contexts, including invoking force majeure clauses. A franchisor is best advised to avoid giving guidance/advice on contracts to which it is not a party, and instead assist franchisees in securing independent legal advice.
- **Insurance.** Franchisors should avoid providing guidance on insurance policies held by franchisees, including business interruption insurance, as liability issues and conflicts of interest are prevalent in this context (e.g., where policies require holding off on closing businesses and franchisors are mandating closure to comply with government orders).
- **Employees.** While it is critical that franchisors do not involve themselves in the affairs of franchisees as they relate to their employees, there may be scope for franchisors to include general guidance in operation manuals (subject to legal review) and to identify a list of resources, including professionals, from which franchisees are able to seek advice.
- **Customers.** Franchisees are under significant pressure to maintain/increase customer engagement in these times. Franchisors may wish to provide high-level guidance on such matters, but must avoid the risk of becoming actively involved in franchised business operations.

7. Franchise Development

Some franchisors have put franchise development entirely on hold, while others are determined to continue. Those who have decided to continue with franchise development have devised workarounds to partially advance development and onboarding, despite the interruption caused by the COVID-19 pandemic. Virtual discovery days and remote training are a few of the tools utilized by franchisors moving forward with development activities. Clearly, other processes such as on-site training, site development and location openings cannot continue, but franchisors are positioning themselves for a strong recovery in anticipation of post-pandemic times.

Irrespective of the approach to franchise development, at some point franchisors will likely face circumstances where they are required to issue a franchise disclosure document to a franchisee or prospective franchisee; whether as a result of a renewal, resale, or a new franchisee looking to get ahead of the curve. In certain cases, franchisors have provided franchise disclosure documents to prospective franchisees, but no agreements have been signed, nor any money paid. Accordingly, these franchisors are considering whether to re-disclose or issue a statement of material change. Finally, some franchisors have decided to make further disclosure to franchisees in the onboarding phase, even though they may not be legally required to do so.

Preparing a franchise disclosure document (or other form of disclosure) in each of the scenarios depicted above involves careful consideration and analysis of how COVID-19 has affected the franchise system, and how it will continue to affect the franchise system. However, this is much easier said than done. Largely, the issues, strategies, recommendations set out in this article (as applicable to the relevant franchise system) provide meaningful guidance on the kinds of information that may need to be reflected in any further disclosure.

This white paper was first published on www.franchise.org (International Franchise Association).

