

Franchise Client Alert: COVID-19—Dealing with Disruption

The current COVID-19 pandemic has disrupted businesses across the globe, and franchises are no exception. As the coronavirus continues to affect the normal operations of business throughout the country, franchise companies may consider how to tackle the disruption and protect employees and customers while continuing to comply with their obligations to franchisees.

For those franchisors with questions surrounding information and guidance for their franchisees, we suggest that you consider the following:

1. To Close or Not to Close? For many franchisees, that is the question. Some closures may be mandated by the government. Franchisors need to be careful if they mandate that any franchisee remain open for business (or conversely, close). Putting aside the potential losses the franchisee may sustain, the franchisor also opens itself up to potential claims that the franchisee (or its employees) became sick with coronavirus because the franchisor prevented them from a voluntary self-quarantine or social distancing by requiring that the business remain open. Franchisors should also prepare for force majeure arguments by franchisees as a defense to performance under the franchise agreement.

In any case, we recommend that (in locations where closure has not been mandated by the government) franchisors leave the decision whether to close to the franchisee. Franchisees who are not required to close but are considering doing so should be encouraged to consult with local counsel before deciding to close.

2. Financial Relief: Franchisees will ask for financial relief. Whether you grant such relief (e.g., royalty waivers, reductions, or deferment) is ultimately a business decision that is entirely up to you. With that being said, we suggest that before deciding you first consider:
 - a. Will the company have the necessary financial resources to continue to support its franchisees if it provides some form of royalty relief?



- b. Has the franchisee closed its business? If so, is the closure mandated by a governmental authority? If not mandated, is closure necessary or important for other reasons (e.g., social distancing or other recommended precautions are not possible)?
 - c. If royalty relief will be given to some, but not all, franchisees, be careful of state franchise relationship laws containing anti-discrimination provisions that prohibit a franchisor from treating similarly situated franchisees differently.
 - d. If royalty relief is given, we suggest that it be memorialized in an amendment to the franchise agreement. Where possible, franchisors should obtain general releases from their franchisees in exchange for providing royalty relief.
3. Insurance: Your franchisees should have commercial liability insurance, as your franchise agreements will certainly require it. In many cases, franchisees may have purchased business interruption coverage as part of that policy or a separate policy. Encourage your franchisees to contact their insurance broker to determine whether coverage is available, and if so, the process to file claim(s). It is a good idea for each policyholder to talk to local counsel to understand possible exceptions to coverage as well as claim requirements. Although insurance companies may resist paying on claims under force majeure provisions, it is not clear those provisions will apply under all circumstances.
4. Leases: If your franchisees lease space, they may be asking you about what type of actions they should take under those leases. If a franchisee needs to close (either due to legal requirements or business realities), you should suggest that the franchisee contact the landlord to seek permission before doing so. Most leases have required hours of operation, and as such a closure without permission could be a breach of the lease. The force majeure provision in the lease may provide some relief, but if it doesn't, the tenant may need to work with the landlord to avoid possible legal consequences.

We are also hearing that while most landlords will not forego lease payments, many of them are willing to accommodate a tenant by deferring rents over the life of the lease or providing short-term rental reductions. Another possible short-term solution is a percentage lease arrangement (i.e., the tenant pays the landlord a percentage of revenues collected).



Many of your franchisees may also have equipment or other substantial leases or ongoing payment obligations. The same guidance above applies to these leases and other obligations.

Early communication with the lessor will enable your franchisees to begin the conversation and understand how their ongoing financial obligations will be impacted, and to begin the dialogue as to how to apply for deferments or other relief. In any case, you should suggest that your franchisees contact legal counsel to help them work through these issues.

5. Working Remotely: As always, it is important for you to avoid getting directly involved with franchisee employment matters. That said, providing general guidance to franchisees about employment matters in the face of this crisis—like suggesting that they encourage their employees to work remotely to the extent possible (depending upon your franchise system and its design and needs)—is likely prudent under these circumstances. Joint employer concerns, always present in franchising (and not yet resolved even considering recent NLRB guidance), suggest that you should avoid providing specific employment-related hiring, firing, layoff, furlough, or management guidance. ***As always, any guidance you provide to your franchisees about employment issues should be prefaced with a suggestion that they should consult with local employment counsel before they take any action relating to their employees.***

We are continuing to monitor this COVID-19 crisis, and we are standing by to assist our franchisors in every aspect of their response to the coronavirus. Please reach out to your Howard & Howard attorney, or any of the attorneys listed below for advice and counsel during this uniquely challenging time. We are open, and we are here to help.





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