

FRANCHISING

In the face of the COVID-19 outbreak, franchisors and franchisees may have questions about their existing franchise agreements and obligations. This briefing note is intended to provide a general outline of some of the legal principles that apply to franchisors and franchisee in these circumstances.

CONTINUOUS OPERATION

Most franchise agreement will contain an obligation on a franchisee to continuously operate their businesses. Typically, franchisees will only be permitted to close for business for a certain number of consecutive days, although there may be exceptions for events beyond the franchisee's control. Franchisees should review their franchise agreements to determine whether there is a risk that they will be in breach of their continuous occupation covenants. Franchisors should consider whether it is sensible or even possible to enforce these obligations, bearing in mind that franchisees may have been mandated to close by governmental authorities.

PAYMENT OF FRANCHISE FEES

Franchisees may be wondering about how they will pay their franchise fees to the franchisor, while franchisors may be worried about their franchisees ability to pay such fees.

Franchisees should review the default provisions in their franchise agreements to see when a default is triggered for lack of payment of franchise fees. The level of concern of a franchisee may depend on whether the franchise fees are a set amount that must be paid periodically regardless of the revenues earned by the franchisee, or whether they are royalty payments calculated as a percentage of gross revenues.

Conversely, franchisors should consider whether they will be able to collect fees from their franchisees if those franchisees are required to close for business. Franchisors should consider whether they are going to enforce the default provisions of their franchise agreements, bearing in mind that there may be significant costs associated with terminating a franchisee and that there may be lack of demand when trying to find replacement franchisees.

FORCE MAJEURE

Franchisors and franchisees should review their franchise agreements to determine whether they contain a *force majeure* clause. A *force majeure* clause may allow a party to be released from its obligations under a contract due to unforeseen events. The clause will often use language that defines what will or will not constitute a *force majeure* event, and may also set out which obligations are released and which obligations remain in force. For example, a *force majeure* clause may relieve a franchisee from certain obligations under their franchise agreement, but might not relieve a franchisee from its obligation to pay royalty fees or advertising fees to the franchisor.

For more information about *Force Majeure* please refer to the *Force Majeure, Frustration, Cancellation, Material Adverse Change* article here: <https://www.pitblado.com/force-majeure-frustration-cancellation-material-adverse-change>.

PRACTICAL IMPLICATIONS

Franchisors and franchisee are encouraged to have discussions about the impact of COVID-19 on their businesses, to see how they might both be able to weather the storm. Franchisors should keep in mind that their franchisees may be required to drastically reduce, or suspend, their business operations. Franchisees should keep in mind that, like them, franchisors need to find a way to cover their own expenses and may be experiencing similar issues of having to lay off their employees. Franchisors and franchisees should try to work cooperatively to try to navigate these challenges.

Please do not hesitate to contact your relationship partner or lawyer if you have any questions or if we can be of assistance in guiding you through these new challenges.

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This article represents general information and is not legal advice. Please contact us if you would like legal advice that is tailored to your particular circumstances. We would be happy to help.