

# COVID-19 and the franchise landscape

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## Introduction

The COVID-19 pandemic has profoundly destabilised the economy in Quebec and the rest of Canada. The pandemic's effects on franchised businesses across the country are severe. Governments have taken sweeping steps to order the reduction of business activities in many sectors, particularly commercial fields. While some franchised businesses have transitioned to working remotely and have ramped up their e-commerce business models, allowing them to mitigate their losses to a certain extent, the vast majority of traditional franchised businesses are in a precarious state due to a drastic reduction in revenues and uncertain economic conditions for the foreseeable future.

For example, the North American Association of Subway Franchisees, representing approximately 23,500 Subway franchisees, recently requested relief from Subway's weekly fees which amount to 12.5% of sales.**(1)** Subway has since introduced plans to collect part of these fees on a deferred basis.**(2)**

As franchisees across different industry sectors in Canada experience diminished sales and the threat of insolvency, it is likely that they will make similar demands of their franchisors. As such, franchisors and franchisees may struggle to continue conducting business in accordance with the terms of their existing franchise agreements due to the disruption and instability caused by the COVID-19 pandemic. The industry may well be facing a turning point where franchisors and franchisees must learn to support each other in new ways and find solutions to this unprecedented crisis together to ensure their collective viability.

## ***Force majeure***

As a first resort, parties may consider whether their obligations may be reduced or otherwise affected by the pandemic, given that it could constitute a *force majeure* event. The question of whether COVID-19 constitutes *force majeure* – either in and of itself or based on closures, restrictions and other measures resulting from orders issued by governmental bodies in connection with public health concerns – should be considered by those concerned, together with their counsel. However, it is not uncommon for payment obligations and other

obligations not strictly related to operations to escape the application of contractual provisions and legal principles that excuse performance on account of *force majeure* events. Reliance on *force majeure* to justify contractual non-performance may therefore prove difficult in practice.

### **Practical tips and considerations for navigating COVID-19**

Given the major upheaval of commercial operations and consumer behaviours in various industries with a large presence of participants from the franchise sector, it is important to consider how best to approach the circumstances with a view to limiting the lasting effects of the current crisis.

The importance of proactive communication between franchisors and franchisees must be emphasised, particularly as concerns any temporary relief or the reconsideration of any provisions of the franchise agreement. Since the interests of franchisors and franchisees are aligned when it comes to ensuring the survival of franchised businesses, it is critical to consider the issues that will achieve mutually acceptable solutions for navigating the current crisis and for ensuring the long-term viability of the business model in the context of rebuilding the economy once the COVID-19 crisis is resolved.

For example, franchisors and franchisees alike may review their franchise agreements in order to assess:

- how the model or business may be adapted for e-commerce or delivery;
- whether online outreach tools may be of assistance in that regard; and
- who will bear the responsibility for initiating and implementing any such changes.

As concerns interim crisis measures more specifically, franchisors may consider collecting royalties on a deferred basis once franchisees' economic circumstances have recovered. They may also consider investing advertising funds in online publicity geared towards driving traffic to online sales, takeaway and delivery services and other digital business models that are compatible with social distancing requirements.

In addition, franchisors and franchisees should investigate any available financial relief, such as:

- government wage subsidies, tax remittance deferrals and other financial assistance;
- incentives and relief measures offered by financial institutions; and
- other resources that may alleviate cash flow and other pressures both during and after the crisis.

In Canada, federal and provincial governments, as well as leading institutional lenders, are making various measures available, albeit with rapidly evolving eligibility criteria, which should be readily and repeatedly investigated.

Franchisors may also consider supporting efforts of the Canadian Franchise Association, which has announced that it is lobbying the federal and provincial governments for additional measures supporting franchised businesses, including:

- increased wage subsidies;
- workers' compensation premium subsidies;
- sales tax remittance deferrals;
- commercial rent relief;
- the foregoing of municipal property tax payments;
- utility bill relief;
- loan payment deferrals;
- requirements on rating agencies to freeze credit scores;
- incentives and subsidies for new hires after the crisis; and

- enhancements to the Canadian Small Business Finance Programme, such as:
  - improving access to capital;
  - increasing maximum loan amounts; and
  - allowing working capital to be financed.

In addition, franchisors should consider revisiting system-wide workplace health and safety policies, as well as cleaning and sanitisation procedures for physical locations. In turn, franchisees may wish to receive training and guidance from franchisors with respect to post-pandemic measures relating to employee illness, such as:

- requirements to self-report symptoms;
- penalties for failing to do so;
- strict hand-washing and physical distancing requirements; and
- other health-related concerns.

Such considerations will likely be key to enticing and retaining employees going forward and could prove to be a driving factor in ensuring customer flow and fostering market share and brand loyalty following the pandemic.

Franchisors which are lessees under the head lease for franchised premises may consider reviewing their lease agreements in order to determine whether any relief or deferral measures may be negotiated with commercial lessors and pass them along to struggling franchisees where available.

Finally, from an internal perspective, franchisors may wish to revise their business development and growth strategies given the economic landscape and anticipated difficulties in soliciting investments going forward. On the other hand, where struggling franchisees are showing signs that they are ready to exit a system, franchisors should make efforts to accommodate these requests in a timely manner where possible, either by directly repurchasing units or connecting franchisees with interested buyers.

## **Comment**

The COVID-19 pandemic is having an unprecedented effect on social and economic realities that will leave lasting damage. It is therefore incumbent upon franchisors and franchisees to collaborate and seek creative and responsive solutions to the issues as they arise and to generally ensure their continued relevance in the commercial marketplace going forward.

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## **Endnotes**

- (1) Kosman, J (17 March 2020). "Subway franchisees seeking relief amid coronavirus pandemic".
- (2) Kosman, J (31 March 2020). "Subway franchisees fret as corporation says it won't offer new break on fees".

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