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Covid-19 Pandemic Impacts and Operational Adaptions: Exploring the New Normal and Relevant Legal Issues in Getting There

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The COVID-19 pandemic has impacted all areas of how we live our day-to-day lives, including how we consume products and services and how we provide business services. The pandemic's impact on the operations of franchise systems and businesses has been no less widespread. Undoubtedly, the health and safety restrictions affecting franchise systems in the restaurant, hospitality, and personal services industries have created disruptions for franchisors and franchisees. In this paper, we will address how U.S. franchisors and franchisees across these industries have reacted to the pandemic, operationally, and the associated legal issues with such operational suspensions, adaptations, and re-openings. Specifically, we will address the operational modifications related to health and safety and emerging court decisions and current resources and authority related to this dynamic issue. Additionally, we will analyze U.S. franchise operations during the pandemic and in re-opening, along with related legal issues arising with third-party contracts, focusing on suppliers and landlords. Lastly, in assessing the operational impacts of the pandemic, we will address emerging trends and lasting impacts related to operational adaptations and the implementation of such adaptations on operational standards and franchise systems.

I. INTRODUCTION

The abrupt onset of the pandemic forced franchisors to quickly gather (or create) their crisis teams and endeavor to become health and safety leaders. After honing systems and standards over years or decades, the onset of the pandemic forced franchisors into making operational changes and business decisions quickly and within the context of constantly changing information. Franchisors and franchisees also had to contend with ample uncertainty and no uniform national-level response. Franchisors were asked to create short-term business plans for themselves and their franchisees and adapting to each geographical area's government-related limitations. As the initial crisis and shut-down revealed itself to be a longer-term issue, franchisors began to not only look at short-term solutions but also considered operational adaptations that were advantageous during the pandemic.

As the proverb goes – necessity became the mother of invention – and some adaptations were so successful that operational standards and protocols may be permanently changed. As such, after more than one-year since the initial impact of the pandemic, franchisors are evaluating how to best sustain successful adaptations and other changes to their operations, systems and standards. Additionally, franchisors are faced with the delicate balance of assessing strategies and risk in returning to standards and obligations that may have been tolled or stayed during the pandemic.

This paper profiles three industries important to franchising – restaurants, hospitality and personal services - by first addressing each sector's Covid-19 pandemic-related challenges, then detailing franchisor reactions and health and safety concerns, and finally highlighting certain adaptations that are anticipated to remain post-pandemic.

A. Restaurants – Challenges and Adaptations

Government shut down orders slammed bars and restaurants across the country. Quick serve restaurants have held up better than many full-service and casual-dining chains that lacked robust drive-through and takeout operations.¹ Also, though there have been challenges, restaurants that are part of a franchise network may have benefitted from the protection of franchisor support, whether in the form of royalty holidays, supplies of personal protective equipment (“PPE”), and centralized, quick development of COVID-19-adaptive strategies such as online payment, ordering, pickup, and delivery, as well as marketing and promotional activity for those strategies. Compared to their non-franchised peers, franchised restaurants also would have benefitted from concessions they could negotiate directly with the franchisor – for example, rent concessions where the franchisor is the landlord, a tolling of a development schedule, and a freeze on contributions to the brand fund.

The highest profile change to the restaurant industry that accelerated during the pandemic is the skyrocketing use of third-party delivery apps. Under lockdown, these apps served as a lifeline to both restaurants trying to stay afloat, and consumers stuck at home and tired of eating sourdough bread. Sales on third-party food-delivery services are more than double what they were prior to the pandemic, with levels of demand staying high.² However, these apps are not without their problems, as detailed below. The authors anticipate disruption in the food delivery space as the apps attempt to solve their own problems, as competitor apps emerge, and as restaurants develop their own inhouse off-premises programs.

B. Hospitality – Challenges and Adaptations

Hospitality has been the industry hardest hit by the pandemic – after all, there is no “contactless delivery” option available for hotels and resorts. After declaring that 2020 was the worst year for tourism on record, with *one billion* fewer international arrivals, the United Nations World Tourism Organization says prospects for a 2021 rebound have worsened.³ About one million travel-related jobs have been lost since February 2020, according to the United States Department of Labor, including more than 600,000 hotel

¹ Heather Haddon, “McDonald’s Owners, Company Spar Over Assistance,” WALL ST. J., Apr. 14, 2020, https://www.wsj.com/articles/mcdonald-s-owners-company-spar-over-assistance-11586892394?mod=article_inline.

² Heather Haddon and Preetika Rana, “Restaurants and Startups Try to Outrun Uber Eats and DoorDash,” WALL ST. J., Feb. 21, 2021, https://www.wsj.com/articles/restaurants-and-startups-try-to-outrun-uber-eats-and-door-dash-11613903401?mod=trending_now_news_pos5.

³ Mike Cherney and Eric Sylvers, “Travel’s Covid-19 Blues Are Likely Here to Stay – ‘People Will Go Out of Business,’” WALL ST. J., Feb. 21, 2021, https://www.wsj.com/articles/travels-covid-19-blues-are-likely-here-to-stay-people-will-go-out-of-business-11613912401?mod=trending_now_news_3.

positions.⁴ Adaptations in the hospitality industry largely have consisted of covid protocols (i.e., increased sanitation, social distancing, and mask requirements) and discounts – neither of which have been cause for optimism for an industry that some have projected to not recover until 2023.⁵

C. Personal Services – Challenges and Adaptations

Personal services franchises, such as salons, massage centers, tutoring and teaching programs, and fitness studios all are centered around close contact and human interaction that largely experienced complete operational shutdowns during at least some period during the pandemic. After the initial lockdown, many personal services franchises were able to reopen as long as they observed social distancing, masking, and cleaning protocols, although certain types of personal services, such as fitness studios, faced tougher barriers to reopening than hair salons, for example. For some, the pandemic accelerated trends that already were in the works. For example, the recent pre-pandemic Peloton craze led some premier fitness concepts to stretch their reach into the home fitness market by developing at-home workouts available through mobile apps. Unfortunately, like many restaurants, some personal services franchises also were forced into bankruptcy after the pandemic shut down businesses across all industries.⁶ By way of example, Flywheel filed a Chapter 7 liquidation bankruptcy permanently closing 42 locations nationwide and largely abandoning the studios and equipment with no means to attempt to reorganize (estimating its assets as merely \$50,000), as opposed to Gold's Gym, 24 Hour Fitness and Yoga Works as systems filing Chapter 11 reorganization bankruptcies.⁷

II. FRANCHISOR RESPONSES TO THE COVID-19 PANDEMIC

At the onset of the COVID-19 pandemic, franchisors were faced with having to delicately balance the ongoing need to ensure the health and safety of their customers and franchisees, while also maintaining market share. In the United States, franchisees were faced with mandatory shut down orders, which varied from location to location.

⁴ Doug Cameron and Eric Morath, "Covid-19's Blow to Business Travel Is Expected to Last for Years," WALL ST. J., Jan. 17, 2021, https://www.wsj.com/articles/covid-19-pandemics-impact-on-business-travel-hitting-local-economies-11610879401?mod=article_inline.

⁵ Konrad Putzier, "Hotel Owners Continue to Reel from the Pandemic," WALL ST. J., Jan. 2, 2021, <https://www.wsj.com/articles/hotel-owners-continue-to-reel-from-the-pandemic-11609563815>.

⁶ Josh Saul, "Gold's Gym to Be Bought Out of Bankruptcy by German McFit Owner," BLOOMBERG, Jul. 14, 2020, <https://www.bloomberg.com/news/articles/2020-07-14/gold-s-gym-to-be-bought-out-of-bankruptcy-by-german-mcfit-owner#:~:text=The%20company%20tapped%20a%20%2420,to%20the%20RSG%20news%20release>.

⁷ *In re Flywheel Sports Parent, Inc. et al.*, filed Sept. 14, 2020, Bankr. S.D.N.Y., Case No. 20-12157 (Jointly administered).

Franchisors scrambled to figure out how to keep their system strong while accommodating franchisee needs in the wake of quickly changing (and sometimes controversial) health and safety recommendations and a fractured U.S. government response. As a result, many franchisors modified their system standards and requirements to provide temporary relief for franchisees facing short-term financial crises resulting from mandated closures. These modifications included royalty and advertising contribution abatements, extensions of development and remodeling deadlines, assisting with negotiating lease modifications, and providing franchisees with information related to government assistance programs, such as government-backed loans with forgiveness eligibility.

And at the same time, as government restrictions were modified to accommodate different levels of service availability, such as reopening restaurants for takeout and delivery, some franchisors instituted new standards and programs to accommodate the changes necessary to the crisis. This section will discuss franchisor responses to the pandemic.

A. Franchisors Provided Direct Relief for Franchisees

In March 2020, as government responses to the pandemic began to shut down many franchisee operations in the United States, many franchisors leapt into action to protect their systems by ensuring that franchisees could weather the precipitous drop in demand and the resulting financial impact.

Some select example of reported franchisor relief programs are as follows:

- Freddy's Frozen Custard & Steakburger offered a 1.5% royalty abatement for the first month of the pandemic, and directed 0.5% of the royalty contributions to national marketing efforts to assist franchisee's when operations could return to normal⁸;
- Barberitos fully removed royalty and marketing contribution fund fees for franchisees during the pandemic⁹;
- Bodybar Pilates abated royalties for March, April and May¹⁰, and
- Marriott temporarily deferred most brand standards, including delaying

⁸ Cherryh Cansler, "8 Franchisors Waiving Royalty Fees," FAST CASUAL, Mar. 30, 2020, <https://www.fastcasual.com/articles/8-franchisors-waiving-royalty-fees/>, (hereinafter "Cansler").

⁹ *Id.*

¹⁰ "Stories from the Covid-19 Front Lines: Bodybar Pilates Works It Out," Franchising.com, Aug. 18, 2020, https://www.franchising.com/articles/stories_from_the_covid19_front_lines_bodybar_pilates_works_it_out.html, (hereinafter "Bodybar").

renovations due in 2020 by one year, deferred required furniture, fixtures, and equipment updates, and suspended brand standard audits.¹¹

By reducing required contributions and delaying deadlines for large scale expenditures, such as remodeling, franchisors hoped to increase cash flow for franchisees to put into their franchised businesses during the short term to avoid unnecessary closures. These delays, however, can come at a cost to franchisors. The obvious impact of royalty waivers, deferrals or forgiveness is a decrease in the franchisor's revenue. Additionally, for franchisors who were in the middle of making important changes to the system, including modernizing their technology or branding, the delayed implementation threatened to have a compounded economic impact. In those cases, some franchisors offered short-term, interest-free loans to franchisees to cover the costs of the most important upgrades, while still tolling or delaying the franchisee's obligation to implement other less critical system changes.

B. Franchisors Assisted Franchisees with Third Party Negotiations and Applications

Some franchisors, recognizing that real estate is one of the largest expenses for many franchisees, assisted franchisees with negotiating COVID-19-related rent relief from landlords. Further, other franchisors who serve as landlords, provided their own rent relief. For example:

- Dunkin Brands provided rent abatement for franchisees who leased space owned by the franchisor¹²;
- Tropical Smoothie Café used its negotiating power to achieve \$1.8 million rental abatements or forgiveness for franchisees¹³;
- Restaurant Brands International, the parent company of some 3,700 Tim Hortons and Burger King locations, deferred rent for restaurants for 45 days and then converted rent payments from fixed plus variable rent based on

¹¹ "Marriott International Provides Business Update Amidst the Rapidly Evolving Coronavirus Situation," MARRIOTT INT'L NEWS CTR., Mar. 18, 2020, <https://news.marriott.com/news/2020/03/18/marriott-international-provides-business-update-amidst-the-rapidly-evolving-coronavirus-situation>.

¹² Jeff Gelski, "Dunkin' Scales Down in Response to COVID-19," FOOD BUSINESS NEWS, May 1, 2020, <https://www.foodbusinessnews.net/articles/15950-dunkin-scales-down-in-response-to-covid-19>.

¹³ "How Tropical Smoothie Pulled Off Record-Breaking Year During COVID-19," FAST CASUAL, Jan. 13, 2021 <https://www.fastcasual.com/articles/tropical-smoothie-cafe-posts-9-consecutive-quarters-of-sss-growth/>, (hereinafter "Fast Casual").

sales, to 100% variable rent based on sales¹⁴; and,

- UKW Franchising Company LLC, the franchisor of Uni K Wax Studios, a waxing studio franchise, provided franchisees with tenant representatives to help them negotiate rent relief agreements with landlords¹⁵.

In still other cases, franchisors assisted and continue to assist franchisees by providing information about government assistance programs, such as Payment Protection Program (“PPP”) loans in the U.S.¹⁶ Established by the U.S. Congress pursuant to the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), PPP loans have been offered in two waves by the U.S. Small Business Administration (“SBA”) to provide forgivable loans to cover costs such as payroll expenses, rent, and utilities for businesses with less than 500 employees.¹⁷ Of particular interest to franchisors and franchisees, is that the CARES Act exempted franchised businesses from the affiliation test, which counts employees of closely affiliated businesses together for purposes of determining their eligibility for the PPP.¹⁸ However, franchises are exempt from that rule, as long as the franchise has been assigned a franchise identifier code by the SBA. The SBA assigns a franchise identifier code only to franchises listed on the SBA Franchise Directory. Hence, the franchise must be on the SBA Franchise Directory as a prerequisite for a franchisee to receive a loan under the Paycheck Protection Program.¹⁹

Franchisors, therefore, were faced with first ensuring that they were on the SBA Franchise Directory in order for their franchisees to qualify for PPP loans. Many franchisors acted quickly to provide information about the availability and the application requirements for the PPP loans, but, unfortunately, in the first round of PPP loans, many smaller businesses and small franchisees were cut out of the process as well-capitalized businesses and large-scale franchisees with the capacity to quickly apply for loans through their financial institutions took up the majority of funding.²⁰ Thus, for some

¹⁴ Erika Morphy, “Fast-food Chains Give Franchisees Rent Deferrals, Other Assistance,” GLOBEST.COM, Mar. 31, 2020, <https://www.globest.com/2020/03/31/fast-food-chains-give-franchisees-rent-deferrals-other-assistance/>.

¹⁵ Ozzie Grupenmager and Holly Guarino, “Uni K Wax Franchise Experiences Growth Amid Pandemic Adversity,” CISION PRWEB, Apr. 14, 2021, https://www.prweb.com/releases/uni_k_wax_franchise_experiences_growth_amid_pandemic_adversity/prweb17704759.htm.

¹⁶ See Cansler.

¹⁷ CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY ACT, PL 116-136, March 27, 2020, 134 Stat 281.

¹⁸ Jan S. Gilbert, “CARES Act Paycheck Protection Program: What Franchisors and Franchisees Need to Know,” NATIONAL LAW REVIEW, Vol. X, No. 94, Apr. 3, 2020, <https://www.natlawreview.com/print/article/cares-act-paycheck-protection-program-what-franchisors-and-franchisees-need-to-know>.

¹⁹ *Id.*

²⁰ Alex Lockie, “PPP Loans Round 2 Now Open: How to Apply,” 1851 FRANCHISE, Jan.

franchise systems, large franchisees were able to weather the storm, while smaller franchisees (i.e., those with only one or two units) did not have the safety net that the PPP loans were meant to provide.

The adverse impact on smaller franchisees, who may have had to close, left open the opportunity for better capitalized franchisees to take over some of these units and gain greater control of the system. For some franchisors, this shift in the balance of power among franchisees may have been unwelcomed, as some franchisors resist having franchisees own a certain percentage of the system. Yet, for some large, well-capitalized franchisees, the impacts of the pandemic and available funding were advantageous.

An additional issue that franchisors may face in the coming months is with franchisees who received the PPP loans, but for a variety of reasons may not be eligible for loan forgiveness. Loan forgiveness could be limited or denied because the borrower does not have the required documentation to prove its prescribed use of the funds, the borrower's failure to actually use the loan proceeds for forgivable purposes, or even a simple failure to apply for forgiveness as required. As of February 25, 2021, the SBA reported that borrowers who secured more than half of the \$500 billion in PPP loan proceeds had not yet applied for loan forgiveness.²¹ Additionally, as to those borrowers who had submitted forgiveness applications, loans with nearly half a billion dollars in proceeds had been rejected.²² If franchisees are among those having their applications for forgiveness rejected and the pandemic continues to prevent business in the U.S. from returning to normal, it is likely that franchisors may begin to see a second round of franchisee closures and defaults as the financial strain that was delayed by the initial round of PPP loans comes back to haunt those franchisees who may have unexpected payments come due.

Further, despite the availability of these programs, some franchised businesses were still forced to close in the midst of the pandemic. For example, COVID-19 was the final death nail for many malls and shopping centers. Pre-pandemic, malls had already been hit hard by increases in online sales.²³ Recognizing the seemingly insurmountable difficulties caused by the COVID-19 pandemic, some franchisors are offering options to mutually terminate franchise agreements early and waive rights to liquidated damages,

13, 2021, <https://1851franchise.com/ppp-loans-round-2-now-open-how-to-apply-2714698>.

²¹ "PPP Data", U.S. Small Bus. Ass'n, (Mar. 2, 2021, 10:01 AM), <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program/ppp-data>.

²² *Id.*

²³ Charisse Jones and Kelly Tyke, "Shopping Malls Were Struggling Before COVID-19 and Now Have More Empty Stores: What's Next After the Pandemic?," USA TODAY, Dec. 28, 2020, <https://www.usatoday.com/story/money/shopping/2020/12/29/shopping-mall-closures-after-coronavirus/3862931001/>.

where franchisees cannot bounce back from the impacts of the pandemic.

Recently, the SBA opened a second round of PPP loans for those smaller franchisees who missed out in the first round of lending but were still able to weather the storm.²⁴ As additional government aid becomes available in the U.S., franchise systems may be better able to battle the long-term effects of the pandemic. For example, the Bipartisan-Bicameral Omnibus COVID Relief Deal, passed by the U.S. Congress on December 22, 2020, offered a second draw on PPP loans for eligible borrowers and expanded the permitted uses of PPP funds. In addition to labor and rent costs, the second round of PPP loans can be used for additional expenses, including:

- Any software or computing service that: “facilitates business operations, product service or delivery, the processing, payment or tracking of payroll expenses, human resources, sales and billing functions, or accounting or tracking of supplies, inventory, records and expenses;”
- Any property damage caused by vandalism or looting “due to public disturbances in 2020” not covered by insurance;
- Supply chain expenses for goods that are essential to the operations where the contracts already in effect as of the covered loan period, or with respect to perishable goods, in effect during the covered loan period; and
- Costs to implement COVID-19 health and safety operational or capital expenditures necessary to protect customer employee safety measures.²⁵

Additionally, early borrowers of PPP loans may be eligible to increase the amount of their loans if they would have qualified for higher amounts under the updated rules.²⁶

Other forms of relief for small business owners, such as franchisees, came in the form of the American Rescue Plan Act (“ARPA”) which was signed into law in March 2021 in the U.S.²⁷ The new act, for example, requires employers to fully subsidize the costs of Continuation of Health Coverage (“COBRA”) insurance coverage for eligible employees in the U.S. from April 1 to September 30, 2021, but offsets the costs to businesses by providing advanceable and refundable tax credits to cover those

²⁴ *Id.*

²⁵ John Gotaskie, “What Franchising Needs to Know about the New COVID-19 Relief Law,” JD SUPRA, Dec. 29, 2020, <https://www.jdsupra.com/legalnews/what-franchising-needs-to-know-about-72978/>

²⁶ *Id.*

²⁷ Sean Ludwig, “Everything You Need to Know about Coronavirus Federal Small Business Stimulus Aid Programs,” US CHAMBER OF COMMERCE (Mar. 19, 2021), available at: <https://www.uschamber.com/co/start/strategy/federal-small-business-stimulus-aid-programs-guide>

subsidies.²⁸ The ARPA also created the Restaurant Revitalization Fund, which is a \$28.6 billion grant program to provide grants for restaurants based on their amount of pandemic-related revenue loss.²⁹ Food-service businesses that own or operate fewer than 20 establishments are eligible to receive grants to cover costs including: payroll, rent, utilities, maintenance, protective equipment and supplies, food and beverage inventory, certain supplier costs, operational expenses, and paid sick leave.³⁰ Grants cannot be more than \$10 million for an owner, and not more than \$5 million for each individual location.³¹

Other industries in the franchising space are still lobbying for their own targeted federal relief as well. For example, the fitness industry is backing the proposed GYMS Act, which has been introduced in Congress.³² The GYMS Act would provide similar grants to gyms and fitness clubs as the Restaurant Revitalization Fund does for restaurants.³³ Currently, the GYMS Act is in the Small Business Committee of the U.S. House of Representatives.³⁴ As these types of relief programs are implemented and put into place, the hope of franchisors and franchisees alike is to see franchised locations survive the ongoing financial hardships caused by the COVID-19 pandemic.

C. Franchisors Added New Programs to Increase Sales During COVID-19 Pandemic

Other franchisors assisted franchisees by implementing new programs and technology to increase customer comfort and awareness during the pandemic. For example:

- Minuteman Press launched the “Bounce Back USA” program, where it launched a two-fold campaign to help franchisees continue to build relationships with local businesses by providing free COVID-19 awareness posters to local businesses and free printing for local advertisements to help local businesses bounce back³⁵;

²⁸ *Id.*

²⁹ *Id.*; see also NAT’L RESTAURANT ASS’N, “Policy Brief: Restaurant Revitalization Fund,” at 1, available at: <https://restaurantsact.com/wp-content/uploads/2021/03/UnderstandingRRF.pdf>, (hereinafter “RRF”).

³⁰ RRF at 2.

³¹ *Id.* at 1.

³² See “GYMS Act,” INTERNATIONAL HEALTH, RACQUET & SPORTSCLUB ASS’N (“IHRSA”), (Apr. 15, 2021, 10:46 A.M.), <https://www.ihrsa.org/federal/the-gym-mitigation-and-survival-act/>.

³³ *Id.*

³⁴ Legislative History of the GYMS Act, H.R. 190, 117th Cong. (2021), (Apr. 15, 2021, 10:53 A.M.), <https://www.congress.gov/bill/117th-congress/house-bill/890/actions?r=15&s=1>.

³⁵ “We Can Handle This. Together We Can Bounce Back,” Bounce Back USA, (Apr. 14,

- Bodybar Pilates launched a virtual training platform allowing clients to continue training online from their home within 1 week of the COVID-19 shutdown³⁶;
- Marriott International began offering certain COVID-19 health protocols to meeting planners, including COVID-19 testing (both on-site and self-administered prior to arrival), health screening questions for attendees, and daily temperature checks for attendees before they enter ³⁷;
- CaliBurger recently began testing a voice-ordering platform, which operates like Siri or Alexa and integrates with the restaurant system's existing point-of-sale system and ordering systems³⁸; and
- McDonald's has begun installing walk-up take out windows at some of its locations to respond to the need for contactless service³⁹.

As franchisors test these new delivery methods and technologies under pandemic conditions, many will find that they will want to implement them in the long-term. In doing so, franchisors will end up having to make system-wide operational changes and accommodations, and in some cases require franchisees to expend additional funds to meet the changing needs. To make the conversions easier, franchisors should consider (i) consulting their franchisees and any franchise advisory councils on when and how to implement certain changes and (ii) providing franchisees with data about the long-term economic benefits of such changes.

III. CUSTOMER AND EMPLOYEE COVID-19 HEALTH CONCERNS: NAVIGATING OPERATIONAL CHANGES

In addition to measures franchisors are taking to assist franchisees in weathering the economic storm caused by the COVID-19 pandemic, franchisors are also faced with how to address the need to increase health and safety precautions for customers and

2021, 3:55 PM), <https://bouncebackusa.minuteman.com/>.

³⁶ Bodybar.

³⁷ "Marriott International Announces Covid-19 Testing Availability and Optional Health Protocols for Groups in Expansion of Connect with Confidence Initiative," MARRIOTT INT'L NEWS CTR., Dec. 17, 2020, <https://news.marriott.com/news/2020/12/17/marriott-international-announces-covid-19-testing-availability-and-optional-health-protocols-for-groups-in-expansion-of-connect-with-confidence-initiative>.

³⁸ Blaire Briody, "A Digital Revolution is Coming to Franchising. These Franchises are Best-Prepared for What's Next," ENTREPRENEUR, Feb. 4, 2021, <https://www.entrepreneur.com/article/363391>.

³⁹ Josh Kosman, "Store Operators Outraged at Subway's COVID-19 Demands," N.Y. POST, Sep. 22, 2020, <https://nypost.com/2020/09/22/store-operators-outraged-at-subways-covid-19-demands/>.

employees. For franchisors with locations throughout the U.S., an added hurdle in creating system wide operational modifications is that states have differing levels of permitted operations and opening/closure status.⁴⁰

Of course, operational changes, whether related to health and safety or otherwise, can result in additional stress on the franchisor-franchisee relationship since operational changes often increase the cost of doing business. In the case of the pandemic, many franchisors are requiring franchisees to purchase new equipment and supplies, such as face coverings, gloves and plexiglass barriers, and recommending that franchises adopt safety protocols such as health screening for employees.

Recommendations and requirements related to health and safety operations also present potential complications for franchisors, as franchisors are placed in a highly-charged environment with quickly shifting standards. Clear, uniform communication as to safety standards, operational modifications and implementation dates is critical.⁴¹ Moreover, franchisors must balance wanting to communicate best practices for protecting the health and safety of franchisees and their employees while being mindful of the risk of being deemed a joint employer.

Franchisors will want to consider the impact of the virus and attendant state and local policies and mandates in each geographic area to determine the appropriate level of and length of relief is offered to particular franchisees. For example, Dunkin Brands has made the following public statement:

To provide our franchisees in the hardest hit areas with added flexibility, we have offered the option to temporarily close, reduce hours of operation to provide relief to restaurant employees and allow extra time for deep cleaning in the evening, migrate to a drive-thru only model.⁴²

Similarly, franchisors may want or need to accommodate franchisees that are at high-risk for complications associated with COVID-19 virus by modifying certain requirements related to the level of direct participation in the business. To mitigate the risk of discrimination claims based on a franchisor's differential treatment of franchisees, franchisors should consider establishing a written policy setting forth the objective standards and business justifications for any variations or deviations in their existing

⁴⁰ See Fifty State Summary of Current Business Limitations, ICEMILLER LEGAL COUNSEL, (Apr. 14, 2021, 4:01 PM), https://www.icemiller.com/MediaLibraries/icemiller.com/IceMiller/PDFs/State_by_state_business_reopenings.pdf.

⁴¹ A sample franchisor communication modifying and implementing system wide safety standards is attached hereto as Exhibit A.

⁴² Josh Kosman, "Store Operators Outraged at Subway's COVID-19 Demands," N.Y. POST, Sep. 22, 2020, <https://nypost.com/2020/09/22/store-operators-outraged-at-subways-covid-19-demands/>.

policies.

A. Face Masks and Distancing

Despite the highly-charged social and political environment related to masks, a valuable resource for the rationale and recommended use of masks begins with the guidance provided by the U.S. Centers for Disease Control and Prevention (“CDC”).⁴³ At this stage of the pandemic, franchisors may be well served by acknowledging the shifting guidance on the use of masks, while emphasizing the growing consensus that masking is effective in containing the spread of the COVID-19 virus. Polling consistently shows that the overwhelming majority of Americans are regularly wearing masks in public settings.⁴⁴ Even with loosening government mandates, some companies and franchises are staying firm in their masking policies despite criticism:

- A southeastern grocery store chain, Food City, implemented a policy to encourage customers to put on a mask as they entered stores, and reported backlash from customers including harassment and foul language⁴⁵;
- On February 14, 2021, a group entered a Trader Joe’s store protesting the store’s mask mandate, refused to leave, and then posted a video of the conflict on You Tube⁴⁶; and
- Starbucks has reported that it will continue its mask mandate for franchisees, employees, and customers beyond March 2021, despite the availability of a vaccine and many states and localities lifting their mask mandates⁴⁷.

In short, succumbing to the objections of employees or customers who oppose mask use may cause more harm to your business—and workplace environment—than

⁴³ “Guidance for Wearing Masks,” Ctr. for Disease Control, (Apr. 14, 2021, 4:05 PM), <https://www.cdc.gov/coronavirus/2019-ncov/prevent-getting-sick/cloth-face-cover-guidance.html>.

⁴⁴ See Megan Brenan, “More Mask Use, Worry About Lack of Social Distancing in U.S.,” GALLUP, Jul. 6, 2020, <https://news.gallup.com/poll/313463/mask-worry-lack-social-distancing.aspx>.

⁴⁵ Jaewon Kang and Micha Maidenberg, “Grocers Wrestle with Mask Mandates as Pandemic Wears On,” WALL ST. J., Feb. 20, 2021, <https://www.wsj.com/articles/grocers-wrestle-with-mask-mandates-as-pandemic-wears-on-11613817000?page=1>.

⁴⁶ Tom Ryan, “What’s Next for Mask Mandates?,” RETAILWIRE, Feb. 25, 2021, <https://www.retailwire.com/discussion/whats-next-for-mask-mandates/>.

⁴⁷ Carolyn Crist, “You Still Need a Mask at Kroger, Starbucks, Target,” WEBMD, Mar. 4, 2021, <https://www.webmd.com/lung/news/20210304/you-still-need-a-mask-at-kroger-starbucks-target>.

holding firm against the complaints of a few. Regardless of whether a franchisor decides to implement mask mandates for franchisees on a system-wide basis or merely encourages the franchisees to do so on their own, expect there to be some system discord. While litigation based on operational changes and system safety procedures is substantial and growing, the court decisions are limited at this time. The recent state court rulings in Vermont and Illinois involving UPS and McDonald's provide some insight as to the parties' respective ultimate exposure and the role of the state in enforcement.

B. Litigation Related to System Wide Safety Protocols

COVID-19 liability lawsuits sprung up nearly as soon as businesses opened with or without safety protocols. And many franchise systems have already faced litigation related to operational safety protocols and mask mandates. There is also abundant litigation related to the scope of insurance for such COVID-19 liability actions. A pair of related McDonald's cases heard in the federal courts in Illinois provide an instructive example of employee claims and the interplay with insurance.⁴⁸

McDonald's and its franchisees faced allegations by their respective employees related to an alleged failure to implement a mask mandate. In a pair of related cases, federal judges in Illinois heard claims from McDonald's employees and their family members regarding safety protocols in effect at three McDonald's restaurants in Illinois, and then claims in a separate lawsuit by McDonald's Corporation and the franchisees relating to whether insurance policies covered exposure to the virus in addition to contraction of COVID-19.

In *Massey v. McDonald's Corp.*, five employees and four family members of cohabitants sued several McDonald's Chicago-area franchisees, along with McDonald's Corporation and McDonald's USA, for injunctive relief based on public nuisance and negligence.⁴⁹ The employees worked at a franchised location or a corporate location.⁵⁰ The workers alleged that McDonald's failed to provide workers with adequate safety in several areas.⁵¹ First, the employees alleged that they were not provided adequate face coverings, gloves, and hand sanitizer.⁵² Second, the employees alleged that McDonald's failed to implement policies requiring employees and customers to wear face coverings.⁵³

⁴⁸ *Massey v. McDonald's Corp.*, Cir. Ct., Cook County, Ill., County Dept., Ch. Div., Case No. 20 CH 4247, Jun. 24, 2020, <https://images.law.com/contrib/content/uploads/documents/292/69750/McDonald's-ruling-6.24.20.pdf>; *McDonald's Corp. v. Austin Mut. Ins. Co.*, D. Ct. N.D. Ill., Case No. 20 C 5057, Feb. 22, 2021, https://www.wilsonelser.com/writable/files/Insights/McDonald's_v._austinndill_case_210311.pdf.

⁴⁹ *Massey*, Case No. 20 CH 4247, at *2.

⁵⁰ *Id.*

⁵¹ *Id.* at *3.

⁵² *Id.*

⁵³ *Id.*

Third, the employees alleged that McDonald's failed to monitor infections among workers or inform workers of potential exposure, and failed to provide employees with accurate COVID-19 information and risk exposure.⁵⁴ While the court found that McDonald's provided employees with sufficient masks, gloves, and hand sanitizer, the court found that McDonald's policy of permitting employees to stand within six feet of one another, without a mask, for 10 minutes or less and McDonald's failure to enforce its mask-wearing policy properly conflicted with the Illinois' governor's executive order on social distancing.⁵⁵ Based upon the court's finding that McDonald's practices did not fully conform to the restrictions in the executive order, the court ultimately granted injunctive relief sought by the employees, finding a likelihood of success on the merits of the plaintiffs' public nuisance claim, and ordering McDonald's to enforce its own policies and bring them into alignment with the Illinois' governor's orders, as well as the CDC.⁵⁶ Notably, in granting the employees request for preliminary injunction, the court found that the hardship McDonald's would suffer by strictly enforcing its mask policy and retraining employees on proper social distancing procedures to be slight; and, as such, the balance of equities tipped in favor of the injunction.⁵⁷

After its insurer failed to defend McDonald's and its franchisees in the *Massey* case, McDonald's and the other franchisees then sued Austin Mutual Insurance Company, setting forth a novel question of whether costs incurred to comply with the injunction issued in the *Massey* case constituted "damages" because of "bodily injury."⁵⁸ The policies at issue provide that the insurer will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury," caused by an occurrence that takes place in the coverage territory.⁵⁹ Bodily injury is defined as bodily injury, sickness, disease or mental anguish sustained by a person, including death resulting from any of these at any time.⁶⁰ The insurance carrier filed a motion to dismiss, arguing that the *Massey* suit did not seek damages because of bodily injury and the nature of McDonald's expenditure was to remedy bodily injury to third persons.⁶¹

In denying the insurance carrier's motion to dismiss, the court found that McDonald's and its franchisees sufficiently established that they may be liable for damages in the *Massey* lawsuit because of their employees contracting the COVID-19 virus—a plausible interpretation of the policies that created a potential for coverage.⁶²

⁵⁴ *Id.* at *9.

⁵⁵ *Id.* at *10-14.

⁵⁶ *Id.* at *34-35.

⁵⁷ *Id.* at *33-34.

⁵⁸ *McDonald's Corp. v. Austin Mut. Ins. Co.*, D. Ct. N.D. Ill., Case No. 20 C 5057, Feb. 22, 2021, https://www.wilsonelser.com/writable/files/Insights/McDonald's_v._austinn_dill_case_210311.pdf.

⁵⁹ *Id.* at 2.

⁶⁰ *Id.*

⁶¹ *Id.* at 3.

⁶² *Id.* at 5-6.

The court found that “damages” does not just mean money, but can also include the cost to comply with an injunction.⁶³ The court found that the mandatory injunction sought by the *Massey* plaintiffs was a damage because it would require the McDonald’s plaintiffs to expend money to remediate the continuous and ongoing exposure to the virus.⁶⁴ The court also found that three of the *Massey* plaintiffs contracted COVID-19 or had COVID-like symptoms, which was indisputably bodily injury and that, but-for the sickness, McDonald’s would not have to spend money to comply with the injunction.⁶⁵

More recently, in mid-March 2021, a Vermont Superior Court heard a case against a former UPS franchisee who refused to comply with a state-wide mask mandate in the operation of his franchised UPS store.⁶⁶ The franchisee operated the store and interfaced with customers and refused to wear a mask. The franchisee went as far as to posting a sign on the door to his UPS store noting that he would not comply with the state mandate. This case is noteworthy because UPS terminated the franchise agreement based upon the franchisee’s intentional failure to conform to the safety measures. In addition to breaching UPS’s standards, the franchisee refused to comply with the statewide mask mandate.⁶⁷ UPS noted that its decision to terminate was not only motivated by the former franchisee’s failure to comply with Vermont law, but also that mask use was a current part of the required uniform for employees and the failure to wear a mask was in violation of the system standards.⁶⁸

In this case, both the franchisor and franchisee received a call from the state Attorney General, advising that compliance with the mask rule was a requirement of the law. On that same day, UPS contacted the franchisee by phone, as well, and the franchisee explicitly stated that he would wear a mask and he would not make his employee at the store wear a mask. UPS also terminated the franchise agreement that same day.

The state then brought an action attempting to enjoin the former franchisee and its owner from continued violations of the mask mandate and for civil fines as a result of those claims.⁶⁹ The state argued that although the former franchisee was no longer operating as a UPS store, no evidence existed to show a business would not continue to operate

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.* at 8-10.

⁶⁶ *State v. HNR Desautels LLC, et. al.*, Super. Ct., Orleans Unit, Vermont, Civ. Div., Case No. 21-CV-332 (Mar. 12, 2021).

⁶⁷ NBC5, “UPS Ends Relationship With Vermont Franchise Owner Who Refused to Enforce Mask Mandate,” Feb. 19, 2021, <https://www.mynbc5.com/article/ups-ends-relationship-with-vermont-franchise-owner-who-refused-to-enforce-mask-mandate/35553388>.

⁶⁸ *Id.*

⁶⁹ *Desaultes*, Case No. 21-CV-332 at 1.

from the location.⁷⁰ Overruling the former franchisee’s arguments that the mask mandate was unconstitutional and its enforcement as arbitrary and capricious, the court granted injunctive relief prohibiting the former franchisee from continuing business operations for so long as he fails to comply with the mask mandate.⁷¹ In issuing the injunction the court heard the former franchisee’s constitutional defenses and heard testimony of expert witnesses and made findings as to the contagious nature of the disease to address the constitutional concerns.

This UPS case is instructive for the purpose of exposing the potential liability franchisors may have as a result of their own safety protocols and the role of local enforcement. Here, it appears that the state Attorney General was in close contact with both the franchisee and UPS in reporting the infractions and escalating enforcement actions by the state. Franchisors may have direct exposure to suit and liability in instances where the franchisor knows (or should know) that a franchisee intentionally and continuously violates local mandates.

C. Considerations for Employee Policies

Cloth face coverings and disposable (non-medical grade) masks, which are intended to prevent the *wearer* from spreading the virus to others, are not considered mandatory PPE under U.S. Occupational Safety and Health Administration (“OSHA”) standards (though current OSHA guidance strongly encourages their use in the workplace). Medical grade PPE (e.g., respirators or medical-grade surgical masks) are required as PPE for certain classes of employees, such as health care workers or construction workers, in order to protect against a variety of hazards including, but not necessarily limited to, COVID-19.⁷²

The U.S. Equal Employment Opportunity Commission (“EEOC”) has stated that employers may require employees to wear masks and gloves to help prevent COVID-19 infection. U.S. employees with disabilities or religious beliefs that conflict with masking requirements may be entitled to a reasonable accommodation under the Americans with Disabilities Act (“ADA”) (disability) or Title VII of the Civil Rights Act of 1964 (“Title VII”) (religion). The EEOC notes that, “the employer should discuss the request and provide the modification or an alternative if feasible and not an undue hardship on the operation of the employer’s business under the ADA or Title VII.”⁷³ For example, a potential

⁷⁰ *Id.* at 15.

⁷¹ *Id.*

⁷² Additional informal guidance is available from: “COVID-19: Frequently Asked Questions,” U.S. DEPT. OF LABOR, OCCUPATIONAL SAFETY AND HEALTH ADMIN. (Apr. 14, 2021, 4:18 PM), <https://www.osha.gov/SLTC/covid-19/covid-19-faq.html>.

⁷³ See Question G.2, “What you Should Know About COVID-19 and the ADA, the Rehabilitation Act, and Other EEO Laws,” U.S. EQUAL EMPLOYMENT OPPORTUNITY COMM’N, (Apr. 14, 2021, 4:21 PM), <https://www.eeoc.gov/wysk/what-you-should-know-about-covid-19-and-ada-rehabilitation-act-and-other-eeo-laws>, (hereinafter,

accommodation might be allowing the employee to wear a face shield instead or temporarily reassigning the employee to a work area where the employee will not be in close contact with coworkers or customers.

D. Customers

The U.S. Department of Justice (“DOJ”) has recently commented on the existence of fraudulent cards and other materials bearing the DOJ’s seal that purport to exempt carriers from facemask requirements pursuant to the ADA. In addition to disavowing such fraudulent documents, the DOJ noted that, “[t]he ADA does not provide a blanket exemption to people with disabilities from complying with legitimate safety requirements necessary for safe operations.”⁷⁴ That said, as in the employment context, the ADA may require a business to provide a customer with a reasonable accommodation in relation to the masking mandate. Such a request should be considered on a case-by-case basis. And, again, businesses should be aware of state and local requirements that may supplement or conflict with federal law.

In addition to considering federal law, it is important for employers to consult with counsel about the impact of state and local law regarding the application of masking policies and/or mandates. It is possible that state or local law may contain provisions that are more restrictive than federal law—or even provisions that conflict with federal accommodation requirements.

E. Vaccines

In large part, re-opening and a return to the new normal is made possible by the availability of a vaccine for the COVID-19 virus. And while the vaccine is being hailed by many as a saving grace to businesses by enabling reopening, the true story is much more complicated as franchise systems attempt to navigate whether franchisees and their employees can and will actually get the vaccine.

1. Franchisor incentives for employees and customers

In an attempt to increase vaccination rates among franchisees, employees and customers while avoiding joint employer or vicarious liability exposure, many franchisors are rolling out national programs to encourage vaccinations. For example:

- Krispy Kreme began offering free donuts to individuals who showed their vaccination cards through the end of 2021;

“EEOC FAQ”).

⁷⁴ See Press Release, U.S. Dep’t of Justice, The Department of Justice Warns of Inaccurate Flyers and Postings Regarding the Use of Face Masks and the Americans with Disabilities Act (Jun. 30, 2020) (<https://www.justice.gov/opa/pr/departments-justice-warns-inaccurate-flyers-and-postings-regarding-use-face-masks-and>).

- Retro Fitness, a gym franchise, began offering \$0 down and no commitment membership to vaccinated individuals beginning on April 1, 2021;
- Beef O’Brady’s is offering employees of its corporate locations \$100 in cash for getting the vaccine, and is encouraging franchisees to offer similar incentives to their employees;
- BrightStar Care, a home health care franchise system, made a video for franchisees and their employees educating them about the vaccine and even assisted 1,000 nurses employed by its franchisees in getting signed up for an early trial of the vaccine⁷⁵; and
- Focus Brands, the parent company of Auntie Anne’s, Carvel, Cinnabon, Jamba, McAlister’s Deli, Moe’s Southwest Grill, and Schlotzsky’s, is offering all employees at company-owned store locations two hours of paid time off for each COVID-19 shot they receive and told franchisees of their policy leaving it up to the franchisees whether to implement any similar policies encouraging vaccination.⁷⁶

2. Recent EEOC Guidance

Vaccine mandates are a shifting landscape, especially in light of the Emergency Use Authorization (“EUA”) status of the vaccines in the U.S. While not exhaustive, the EEOC has provided updated guidance on employee vaccination which addresses employer vaccination policies under the ADA, Title VII, and the Genetic Information Nondiscrimination Act (“GINA”).⁷⁷

The ADA generally prohibits an employer from requiring medical examinations or making disability-related inquiries unless "job-related and consistent with business necessity." The EEOC has provided clarification on when the ADA is triggered with respect to COVID-19 vaccinations. The vaccination itself is not a "medical examination" for purposes of the ADA. The pre-vaccination medical screening questions are "disability-related" for purposes of the ADA, but the ADA is not triggered in the following instances:

⁷⁵ Beth Ewen, “Vaccine Rollout Poses Latest COVID Challenge for Franchises,” FRANCHISE TIMES, Feb. 24, 2021, https://www.franchisetimes.com/franchise_operations/hr/vaccine-rollout-poses-latest-covid-challenge-for-franchises/article_c6654386-716a-11eb-8ccf-f31b4fa5c994.html.

⁷⁶ Callie Evergreen, “COVID-19 Vaccine Incentives to Consider from Franchisors and Franchisees,” FRANCHISE TIMES, Mar. 26, 2021, https://www.franchisetimes.com/franchise_news/covid-19-vaccine-incentives-to-consider-from-franchisors-and-franchisees/article_cb5f1c06-8e5a-11eb-b95a-bb6b0373cfd9.html.

⁷⁷ See EEOC FAQ at Section K.

- Employers may offer the vaccination to employees on a voluntary basis (so long as no retaliation for non-participation);
- Employers may require the vaccine from a third party who is not under contract with the employer, in which case the provider makes disability-related inquiries; and
- Asking an employee for proof of a COVID-19 vaccination is not a disability-related inquiry. Employers should be careful about asking for additional information though.

GINA restricts employers from collecting or using genetic information in employment decisions. Per the EEOC guidance, administering the vaccine to employees or requiring it does not implicate GINA because it does not involve the request or collection of genetic information. However, similar to the analysis under the ADA, if the pre-screening vaccination questions seek any genetic information (including family medical history), then the employer's inquiry would not be permitted under GINA, if part of the employer's mandatory vaccination policy.

If an employer will require vaccinations when they are available, the ADA and Title VII require that the employer provide reasonable accommodation, absent undue hardship, to employees who indicate they are unable to receive a COVID-19 vaccination due to a disability or sincerely held religious belief.⁷⁸ As a reminder, the ADA requires employers to keep any employee medical information obtained in the course of the vaccination program confidential.

3. Joint Employer Risk

And while the EEOC guidance allows employers to mandate vaccination among their employees, franchisors are not the employers for most of their customer-facing representatives. To ensure customers that they can safely reenter franchised businesses, franchisors may want to communicate the efforts they are making to ensure the vaccination of employees. On the other hand, franchisors want to avoid the risk of being deemed a joint employer of the franchisees' employees. The franchise relationship therefore presents additional complications in navigating the vaccination process. Franchisors both want to communicate best practices for protecting the health and safety of employees, while also avoiding the risk of being deemed a joint employer by requiring certain employment practices or procedures.

⁷⁸ *Id.* at Question K.4 – K7 (The EEOC makes a passing reference to the EUA of COVID-19 vaccines. Under those guidelines, health care providers must notify patients that they have the option to accept or refuse the vaccine. This EUA requirement raises a question about whether claims can be brought against an employer who terminates the employment of an individual for refusing the vaccine).

Under the joint employment doctrine, “an employee formally employed by one employer (the primary employer) may be deemed constructively employed by another employer (the secondary employer) if that secondary employer exercises sufficient control over the employee's terms and conditions of employment.”⁷⁹ To avoid exercising such control, franchisors can use resources to educate franchisees and their employees and share best practices or model policies instead.⁸⁰ For example, if franchisors have company-owned locations in which they have implemented certain preventative employee-related practices, vaccination incentives, or even vaccination mandates, the franchisor might consider offering information about their own practices as a model.⁸¹

Franchisors should also consider that inaction comes with risk. If a franchisor fails to implement COVID-19 safety measures, they may face public scrutiny for failure to take action to prevent the spread of COVID-19. Moreover, there is a legitimate litigation and liability risk based upon potential claims from employees or franchisees for failure to protect the employees, franchisees, and the brand as a whole by setting out system-wide standards or recommendations.⁸² In order to balance these risks, it is important for franchisors to institute their own safety protocols as models and make recommendations to franchisees while being mindful of the risk to the extent such requirements extend to control franchisees’ employees.

IV. RE-OPENING AND BEYOND: POST-PANDEMIC ONGOING OPERATIONAL CONSIDERATIONS

As local mandates and restrictions loosen, and the world looks towards a return to “normal,” there are likely operational changes and adaptations that are here to stay. Some franchisors and franchisees have bounced back from the initial impacts of the pandemic returning to pre-pandemic sales.⁸³ And as a result, some franchisors have started to roll back the temporary measures they put in place to assist franchisees in the early days of the pandemic.⁸⁴ In determining whether to roll back franchisee assistance and operational

⁷⁹ Joint Employment: Overview, Practical Law Practice Note Overview 9-523-4928.

⁸⁰ Beth Ewen, “Vaccine Rollout Poses Latest COVID Challenge for Franchises,” FRANCHISE TIMES, Feb. 24, 2021, https://www.franchisetimes.com/franchise_operations/hr/vaccine-rollout-poses-latest-covid-challenge-for-franchises/article_c6654386-716a-11eb-8ccf-f31b4fa5c994.html.

⁸¹ *Id.*

⁸² See, e.g., Eric Schwartzel, “No Shoes, No Mask, No Service? Businesses Now Write the Rules on Face Coverings,” WALL ST. J., Mar. 12, 2021, <https://www.wsj.com/articles/no-shoes-no-mask-no-service-businesses-now-write-the-rules-on-face-coverings-11615564810> (“[B]usiness owners have a responsibility, enforced at the federal level, to maintain a safe working environment for their employees.”).

⁸³ See, e.g., Fast Casual (“[Tropical Smoothie] posted its ninth consecutive year of positive same-store sales, with 2020 same-store sales up 7.5%.”).

⁸⁴ *Id.*; see also Josh Kosman, “Store Operators Outraged at Subway’s COVID-19 Demands,” N.Y. POST, Sep. 22, 2020, <https://nypost.com/2020/09/22/store->

modifications, franchisors have to consider both the practical and legal consequences to their decisions.

To determine whether or how to roll back pandemic relief efforts or possibly re-implement them in the wake of surges in virus counts, franchisors should examine their quarterly sales data to determine if sales are bouncing back over time, as well as consult with franchisees on their on-the-ground experiences. Franchise systems with franchise advisory councils can consult them directly to assist in making the determination on which relief efforts to roll back and when to do so to avoid franchisee rancor or further franchisee failures.

Franchise systems may also seek to leverage favorable operational changes that arose or accelerated during the pandemic. Offsite delivery and iterations and the use of virtual technology are pre-pandemic trends that have only gained velocity over the last fourteen months. While we may seek a return to “normal,” re-opening and system standards will undoubtedly look different. The pandemic has also presented unanticipated challenges, including a growing concern over a labor shortage.

A. Labor Issues

One of the biggest challenges to reopening is labor. As states prepare to reopen in part or in whole, there are repeated reports that there simply not enough workers willing to return. Effective masking, PPE and vaccine incentives will help to alleviate some fears, but many are looking to more creative ways to entice workers back from unemployment, such as boosting benefits to employees.⁸⁵ Competition will be fierce so no options should be left on the table to encourage workers back to the workplace and to your brand.

B. Leveraging Technology Training and Operations

One undeniable lasting impact from the pandemic is the use, ease of incorporation and lasting impact of virtual interactions. Within franchisor companies, remote work and virtual meetings have become the norm with major projected impacts on corporate workplace environments.

The use of technology and virtual meetings have also extended to franchisor and franchisee interactions in two main areas: system-wide conventions and training. Many

operators-outraged-at-subways-covid-19-demands/ (“Subway this month told its roughly 23,000 US restaurants to resume operating 84 hours a week, or an average of 12 hours a day, as they did before the pandemic, sources said. It has also demanded franchisees begin repaying royalties fees that the company graciously deferred in the early days of the health crisis after it shuttered the restaurant industry.”).

⁸⁵ Lisa Fickenscher, “Taco Bell Boosts Benefits as Labor Shortage Hampers Recovery Efforts,” N.Y. POST, Apr. 6, 2021, <https://nypost.com/2021/04/06/taco-bell-boosts-benefits-as-labor-shortage-hampers-rebound-efforts/>.

franchisors hold annual or semi-annual system-wide franchise meetings in a convection-type environment. The pandemic eliminated the physical gathering aspect of annual system-wide meetings, but franchise systems continued to stay in touch – and in many instances, increased communication with franchisees, through virtual meetings. In fact, many systems have experienced greater franchisee satisfaction and participation in on-line and virtual meetings. Considering the efficiencies with virtual meetings – both from a time and cost perspective, it seems virtual meetings are here to stay, and systems will continue to use virtual platforms in a post-pandemic world. Systems will certainly grapple to find the right balance of engaging and maintaining some face-to-face contact and in-person gatherings, but the ease and access of virtual meetings are here to stay.

Virtual training programs for franchisees will also, undoubtedly, continue post-pandemic. Certain franchisors have remodeled their entire training platform to accommodate virtual training for new franchisees during the pandemic. Adaptive learning management and training systems have been and will be incorporated into the system standards as a result of the pandemic. Additionally, many franchisors have also used technology to enhance web access and intranet portals for franchisees such that operational updates can largely be delivered electronically and in real-time, resulting in streamlined system updates to training, operations, and communications.

C. Ghost Kitchens and Off-Site Delivery Apps

Ghost kitchens continue to expand into commercial kitchens, hotels,⁸⁶ existing restaurants,⁸⁷ and even mobile kitchens⁸⁸ offering existing and virtual and proprietary brands a lower-cost platform to prepare food for delivery to customers by a third-party delivery service. Because there is no consumer-facing space (such as seating or restrooms), labor and other costs are lower, and the kitchen can focus solely on cooking as efficiently as possible.

While post-pandemic times certainly will see continued volatility in the delivery app space, franchise systems can and should evaluate the delivery landscape for the model that is right-sized for their network. Large franchise systems likely either already have or would most benefit from arrangements with one or more of The Big Three (Uber Eats, GrubHub, and Door Dash – down from “The Big Four” after Uber Eats acquired Postmates in December 2020⁸⁹) for several key reasons. Larger systems are better positioned to

⁸⁶ Debra Kamin, “Ghost Kitchens Find a Home in Empty Hotel,” N.Y. TIMES, Jan. 28, 2021, <https://www.nytimes.com/2021/01/26/business/ghost-kitchens-hotels-coronavirus.html?searchResultPosition=3>.

⁸⁷ Florence Fabricant, “As Food Deliveries Boom, So Do Ghost Kitchens,” N.Y. TIMES, Sep. 1, 2020, <https://www.nytimes.com/2020/09/01/dining/ghost-kitchens-delivery-pandemic.html?searchResultPosition=1>.

⁸⁸ *Id.*

⁸⁹ Paris Marx, “Uber Buys Postmates in Deal Where Restaurants, Delivery People, and Customers All Lose,” Jul. 8, 2020, <https://www.nbcnews.com/think/opinion/uber-buys->

negotiate commissions for their franchisees and offer select menu items that will yield the greatest margin. Additionally, larger systems are typically better suited to control costs and manage ingredient inventory and supply chain issues. Lastly, the synergy that comes from large scale marketing and promotions is most likely to benefit a large franchise network.

Medium-sized and smaller franchise systems could investigate delivery apps designed for smaller restaurants (such as Square, Fare, and Spread), consider inhouse deliveries or pickup, engage in social media promotions, and leverage a ghost kitchen arrangement.

No matter the size of franchise system, franchisors and franchisees alike should beware that delivery providers consider order and sales data generated through their sales platform to be the property of the delivery provider. At this point, restaurants across the country are just trying to make it through the pandemic, but it will be over one day, and restaurants are going to need data. Forward-thinking restaurant franchises would do well to design off-premises programs around the goal of having ultimate control over their data.

The legal issues associated with off-premises services so far have been the highly visible classification issues of whether drivers for third party delivery apps are employees or independent contractors of the technology platforms that arrange their deliveries.⁹⁰ Naturally, litigation is winding its way through California's courts, and it will be some time

postmates-deal-where-restaurants-delivery-people-customers-all-ncna1233189.

⁹⁰ The answer to this question has played out differently in different jurisdictions. For example, in California, the previously hotly debated Assembly Bill 5 became California Labor Code Section 2750.3 on January 1, 2020, clarifying that a worker is an independent contractor only if three elements are met: (i) the person is free from the control and direction of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact; (ii) the person performs work that is outside the usual course of the hiring entity's business; and (iii) the person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed. Shortly thereafter, in early 2020, Assembly Bill 2257 was proposed as a clarification of the former AB 5, and, after ongoing confusion and debate over exceptions to and exemptions from the applicability of AB 5, AB 2257 was signed into law on September 4, 2020. Notably, AB 2257 left unresolved the question of whether the law covers the relationship between franchisors and franchisees. It also left unresolved the fate of gig economy workers. Later in November 2020, California voters passed Proposition 22, available at: <https://voterguide.sos.ca.gov/propositions/22>

before there is resolution on the multiple challenges to AB 5⁹¹, AB 2257, and Proposition 22⁹².

To the extent that franchise systems decide to participate in ghost kitchen arrangements, franchisors need to take care to protect franchisees' exclusive territories and avoid working through a ghost kitchen that is in a franchisee's backyard, but even a ghost kitchen arrangement can maintain or enhance brand recognition and create goodwill for the entire franchise network.

With the rise of ghost kitchens, there is healthy debate related to whether ghost kitchens constitute franchises, and therefore must prepare and register a franchise disclosure document ("FDD") and disclose prospective franchisees in accordance with federal and state franchise laws. Early ghost kitchen concepts seem to have taken a "belt and suspenders" approach to this question. Early adopters of this model claim not to be franchises, while also claiming exemptions from franchise laws. Prudent franchisors engaging in the ghost kitchen channel have either sought discretionary exemptions from state regulators or disclosed the relationship in their FDDs. In time, and as the ghost kitchen model gains popularity and staying power, franchise laws may require amendment to reflect the nuance of the ghost kitchen model.

D. Roll Backs and Enforcing System Standards: Relevant Legal Considerations

Franchisors need to be sure that when they roll back pandemic relief efforts and seek to enforce system changes or reinforce their regular system obligations that they do not run afoul of common legal considerations, including the equitable defenses of waiver and estoppel.

Typically, to successfully prevail on the equitable defense of waiver, the party asserting the waiver defense must demonstrate an ongoing and consistent counter-contractual practice between the parties that indicates the counterparty would not insist on adherence to the agreement.⁹³ For example, in *LaGuardia Associates v. Holiday Hospitality Franchising, Inc.*, the court found that the franchisor waived its right to issue a payment default as a basis for terminating the franchise agreement when there was an

⁹¹ Erin Mulvaney, "California Classification Law Blocked for Truck Drivers (2)," BLOOMBERG LAW, Jun. 16, 2020, <https://news.bloomberglaw.com/daily-labor-report/california-classification-law-blocked-for-truck-drivers>

⁹² Verified Petition for Writ of Mandate, *Castellanos, et.al. v. State of Cali., et. al.*, Cali. Super. Ct., Alameda County, (Feb. 11, 2021), available at: <https://aboutblaw.com/VA8>.

⁹³ See, e.g., *Dunkin' Donuts Inc. v. Panagakos*, 5 F. Supp. 2d 57 (D. Mass. 1998); see also *Burger King Corp. v. E-Z Eating*, 41 Corp., 572 F.3d 1306, 1315 (11th Cir. 2009) (defining waiver as "the voluntary and intentional relinquishment of a known right or conduct which implies the voluntary and intentional relinquishment of a known right").

established practice of providing a grace period for remittal of such payments.⁹⁴ The court characterized the grace period practice between the parties as so entrenched in the franchise relationship that the “[franchisee] came to rely on this pattern of waiver and to build it into their own financial planning.”⁹⁵ In enjoining the franchisor from termination of the franchise agreement based upon prior payment defaults, the court determined that the franchisor could not “abruptly compel [franchisee] to comply with the strict payment terms in the Agreement without first providing sufficient notice of the withdrawal and a reasonable time for plaintiffs to alter their conduct.”⁹⁶

Similarly, in *Hatchett Firm, P.C. v. Atlanta Life Financial Group, Inc.*,⁹⁷ a prolonged course of conduct between the parties without any communication as to the deficiency or default until the time of enforcement resulted in a court ruling that the contract could have been modified by the parties’ conduct. The *Hatchett* case involved a non-performing subtenant who defeated the sublandlord’s motion summary judgment as to the issue of whether all rent owed under the sublease had been paid. Specifically, the court found that a sublandlord’s sixteen month silence as to the subtenants failure to remit the full rental payment resulted in a genuine issue of material fact for a jury to determine as to whether a sublandlord waived the terms of a sublease where the subtenant did not pay the full amount of rent for ten months and then failed to pay any rent for six months.⁹⁸ The court noted that “[a] mutual departure from the terms of an agreement results in a quasi-new agreement until one party has given the other reasonable notice of its intent to rely on the original terms.”⁹⁹

With respect to estoppel, to successfully assert this equitable defense, a party must establish that the other party’s conduct “was intended to induce a course of conduct on his part and that he did reasonably rely on that conduct to his detriment.”¹⁰⁰ Generally, while silence may be sufficient for establishing a waiver defense, silence is not sufficient to prevail on an estoppel defense.¹⁰¹

To avoid arguments that franchisors have waived certain franchisee obligations

⁹⁴ *LaGuardia Assoc. v. Holiday Hospitality Franchising, Inc.*, 92 F. Supp. 2d 119 (E.D.N.Y. 2000).

⁹⁵ *Id.* at 130.

⁹⁶ *Id.*

⁹⁷ *Hatchett Firm, P.C. v. Atlanta Life Fin. Group, Inc.*, 2021 WL 774596 (Ga. Ct. App. Mar. 1, 2021).

⁹⁸ *Id.*

⁹⁹ *Id.* (also rejecting the sublandlord’s attempt to rely on an anti-waiver provision in the sublease, finding that the sublandlord’s acceptance of the irregular payments raised a jury question as to whether the anti-waiver provision in the sublease was waived).

¹⁰⁰ See e.g., *Dunkin’ Donuts Inc. v. Panagakos*, 5 F. Supp. 2d 57, 61 (D. Mass. 1998).

¹⁰¹ *Id.* at 62 (explaining that while estoppel can be based on silence, the court found that that was true only where there is a duty to speak, and the ensuing silence is “wrongful and misleading”).

under a franchise agreement, the best practice is for franchisors to have consistent communication related to the contractual obligation and the franchisor's intent to reserve all of its rights. Additionally, it can be advisable for a franchisor to issue a "New Day letter" when the practice within the franchise system generally deviates from the obligations under the franchise agreement.¹⁰² A New Day letter puts franchisees on notice of the franchisor's intent to begin reinforcing the obligations that were previously unenforced or deferred.¹⁰³ After issuing the New Day letter, franchisors can then begin enforcing their rights systemwide while mitigating the risk of waiver arguments.¹⁰⁴

In addition to legal issues related to potential waiver and estoppel arguments that franchisors need to avoid, franchisors also need to be sure that they are applying their pandemic-relief measures in a way to avoid franchise discrimination claims.¹⁰⁵ Some states have specific statutes that explicitly prohibit franchisors from "discriminating" against franchisees.¹⁰⁶ Generally, however, in order for the disparate treatment of franchisees to be unlawful, the franchisees must be similarly situated, and the franchisor

¹⁰² Leon F. Hirzel, "An Analysis of Franchise Agreement Terminations and Nonrenewals for Failure to Meet Minimum Performance Standards", 37 *FRANCHISE L.J.* 123, 141–42 (2017) ("In situations where a minimum performance standard has not been routinely enforced against a group of franchisees, the franchisor should consider issuing a 'new day' letter to its franchisees communicating its intention of strictly enforcing the franchise agreement in the future.") (hereinafter "Hirzel"). A sample new day letter is included at Exhibit B.

¹⁰³ Hirzel at 141-42.

¹⁰⁴ 13,229 *Brown Dog, Inc. v. The Quizno's Franchise Company LLC*, *BUS. FRANCHISE GUIDE (CCH) P 13229* (holding that the franchisor's decision to begin enforcing the terms of its development agreements and holding master franchisors to their development quotas and communication of that decision was sufficient to defeat the master franchisee's argument of waiver.).

¹⁰⁵ Hirzel at 142.

¹⁰⁶ See, e.g., *Haw. Rev. Stat. Ann. § 482E-6* (making it unlawful for franchisors to: "[d]iscriminate between franchisees in the charges offered or made for royalties, goods, services, equipment, rentals, advertising services, or in any other business dealing, unless and to the extent that any classification of or discrimination between franchisees is: (i) Based on franchises granted at materially different times, and such discrimination is reasonably related to such differences in time; (ii) Is related to one or more programs for making franchises available to persons with insufficient capital, training, business experience, education or lacking other qualifications; (iii) Is related to local or regional experimentation with or variations in product or service lines or business formats or designs; (iv) Is related to efforts by one or more franchisees to cure deficiencies in the operation of franchise businesses or defaults in franchise agreements; or (v) Is based on other reasonable distinctions considering the purposes of this chapter and is not arbitrary.").

must be rendering the differential treatment unfairly, arbitrarily, or capriciously.¹⁰⁷

E. FDD Pandemic Considerations

System changes may give rise to disclosure of COVID-19 impacts on a system. The first guidance addressing how FDDs may need to be amended came on June 17, 2020, when the North American Securities Administrators Association, Inc. (“NASAA”) Franchise Project Group issued guidance entitled “Disclosing Financial Performance Representations in the Time of COVID-19” (“COVID-19 FPR Guidance”). Under federal and state franchise disclosure laws, Franchisors must ensure that they have a “reasonable basis” for making a historical financial performance representation (“FPR”) and written substantiation for the FPR.¹⁰⁸ According to the COVID-19 FPR Guidance, franchisors may not be able to continue to use historical FPRs showing only 2019 results if the franchise business was significantly impacted by the COVID-19 pandemic. Those franchisors may have had to file amended FDDs to update the Item 19 FPRs to include monthly performance in 2020 or to remove or otherwise revise the existing FPR.¹⁰⁹ Now, with 2020 numbers available, franchisors will be better able to address the 2021 FDD Item 19 FPR considerations as they will have data available showing the full impact of the COVID-19 pandemic.

Other disclosure issues have arisen as a result of changes franchisors have implemented to deal with the pandemic. In their FDDs, Franchisors will need to disclose changes to operations and training or new programs, such as virtual services or third-party delivery services, and the related costs. Regardless of the impacts of COVID-19, in the wake of the pandemic, franchisors must ensure that they are fully and adequately disclosing both the short and long-term changes to the system as required under the various franchise disclosure laws and regulations.

V. THIRD-PARTY OPERATIONAL IMPACTS OF COVID-19

The pandemic has impacted players throughout the economic ecosystem. In addition to businesses and hospitals, the global supply chain, lenders and landlords felt the secondhand effects of COVID-19. Third-party contractual litigation is widespread and has revived equitable concepts and defenses – force majeure, impossibility and impracticability, and frustration of purpose. We examine these legal principles related to

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 2.

¹⁰⁹ *Id.*

contractual non-performance, with decisions in the landlord-tenant context predominating.

A. Supply Chain

Many consumers have experienced delays and shortages - not only of toilet paper, but of fruits and vegetables, consumer goods, and appliances.¹¹⁰ During the pandemic, links in supply chains have broken due to COVID-19 infections, where either a sufficient number of individual workers have been out sick to cause delays, or where there were outbreaks at meat packing plants, loading docks, or other facilities involved in preparing, packing, and transporting goods.

In addition, changes in consumer lifestyles as a result of the quarantine shifted traditional demand dynamics creating shortages in some consumer supplies and overages in other areas. For example:

- Early in the pandemic, as people started staying home more the demand for toilet paper increased for consumers by more than 784% early in the pandemic, however the demand for commercially sized and packaged toilet paper rolls dropped dramatically as office buildings and retail spaces remained closed¹¹¹;
- The shift to consumers staying at home and closing restaurants also affected food suppliers that were focused on providing food to restaurants rather than direct to consumers, leaving them with an excess of supply that was not easily redirected based on the size of the packaging and even the processing used;¹¹²
- With the inability to exercise in gyms and travel indoors, home exercise and outdoor recreational equipment was in high-demand resulting in huge

¹¹⁰ Alina Selyuky, “Why It’s So Hard to Buy a New Refrigerator These Days,” NATIONAL PUBLIC RADIO (Sep. 22, 2020), <https://www.npr.org/2020/09/22/915240713/shortage-of-new-refrigerators-leaves-appliance-shoppers-out-in-the-cold>.

¹¹¹ Jen Wieczner, “The Case of the Missing Toilet Paper: How the Coronavirus Exposed U.S. Supply Chain Flaws,” FORBES (May 18, 2020), <https://fortune.com/2020/05/18/toilet-paper-sales-surge-shortage-coronavirus-pandemic-supply-chain-cpg-panic-buying/>.

¹¹² Ignacio Felix, et. al., “US Food Supply Chain: Disruptions and Implications from COVID-19,” MCKINSEY AND COMPANY (Jul. 2, 2020), <https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/us-food-supply-chain-disruptions-and-implications-from-covid-19>.

supply chain shortages for items like tents and exercise bikes¹¹³;

- Vitamin manufacturers are also having trouble keeping up with the demand for immune-boosting, natural vitamin solutions, such as Vitamins C and D.¹¹⁴

The shift in demand toward higher demand for individual consumer items and lower demand for commercial supplies, impacted both the suppliers and the businesses to who supplies were provided as ongoing contracts for those supplies shifted and suppliers looked to fulfill the new consumer demands, rather than addressing the much lower commercial demands. Also, during the pandemic parties negotiating supply and distribution agreements were confronted with questions of how to treat forward-looking performance. For example, because of actual or projected instability further up the supply chain, distributors could not commit to performance metrics such as order fill rates, delivery times, or even quantities or the quality of goods. Likewise, buyers were hesitant to commit to minimum purchase quantities, and took care to review and analyze provisions related to shortages, allocation, inspection, acceptance of goods, returns, warranties, and insurance.

Given their roles in the preparation, packaging, and transportation of goods and services, there have been efforts to bump farm workers, truckers, dock workers, delivery drivers, and other logistics and supply chain workers closer to the front of the line for vaccinations.¹¹⁵ Minimizing disruptions in the supply chain would benefit businesses, consumers, and the national economic recovery effort.

B. Commercial Lease Modifications

The shutdown of many stores, shops, restaurants, and gyms has resulted in unprecedented concessions by landlords. Since the onset of the pandemic, some commercial landlords have offered rental abatements, rent deferrals, percentage rent in lieu fixed rent, modifications to lease terms, waivers of operational covenants and kick-out rights. Alternatively, some commercial landlords have, at least from the tenant's

¹¹³ John Meyer, "Why You May Soon Have a Hard Time Buying Outdoor Gear Like Bikes, Tents and Backpacks," DENVER POST (Apr. 19, 2021) <https://theknow.denverpost.com/2021/04/19/outdoor-gear-inventory-shortage-bicycles-tents/256707/>.

¹¹⁴ Robbie Gardner, "COVID's Ongoing Impact On Immune-Health Vitamins," NUTRITIONAL OUTLOOK (Apr. 19, 2021), <https://www.nutritionaloutlook.com/view/covid-s-ongoing-impact-on-immune-health-vitamins>.

¹¹⁵ Jennifer Smith, "Trucking, Freight Industry Seek Faster Route to Covid-19 Vaccinations," WALL ST. J., Feb. 19, 2021, https://www.wsj.com/articles/trucking-freight-industry-seek-faster-route-to-covid-19-vaccinations-11613770683?mod=djem_logistics_h.

perspective, provided inadequate accommodations resulting in litigation between the landlord and tenant. The operational impacts resulting from COVID-19 on a tenant's operations at brick and mortar locations have resulted in an onslaught of landlord and tenant litigation with recent court rulings providing guidance in assessing the application and viability of contractual and equitable defenses.

C. Contractual and Equitable Defenses

For the past year, suppliers, purchasers, lenders, landlords and tenants have learned the limits of their existing force majeure clauses, many of which did not provide parties a clear path to handling performance failures during a pandemic. We overview the most common contractual and equitable defenses that may apply to COVID-19 contract litigation. We have categorized the claims and defenses with relevant decisions below. Although these rulings have been predominantly between landlord and tenant, the cases and rationale are instructive to franchise parties as a barometer to assess potential claims and defenses in any contractual dispute where there is non-performance.

1. Force Majeure

Force majeure provisions often are limited to a few sentences, where more comprehensive provisions specify that timely payment is not excusable by force majeure and allow the parties to reevaluate the relationship if the force majeure continues for a certain period of time.¹¹⁶ Cases involving the application of force majeure clauses are generally fact-intensive and are determined by the specific language of the force majeure clause at issue. In the context of a party seeking to excuse its obligation to pay rent or other financial obligations under a contract, several courts have analyzed force majeure provisions containing language that the clause shall not apply to a party's inability to pay money due to lack of money or financial inability with differing results. For example, in *In re: CEC Entertainment, Inc.*, the casino debtor argued that force majeure clauses in its leases excused its obligation to pay rent during the COVID-19 pandemic, but the Court found otherwise.¹¹⁷

Yet, another bankruptcy court came to a different conclusion in *In re Hitz*

¹¹⁶ Comparative sample force majeure clauses are attached hereto as Exhibit C.

¹¹⁷ See *In re: CEC Entertainment, Inc.*, 625 B.R. 344, 353-354 (Bankr. S.D. Tex. Dec. 14, 2020) (In rejecting this argument, the court focused on the language in the force majeure clause that it "shall not apply to the inability to pay any sum of money due hereunder or the failure to perform any other obligation due to the lack of money or inability to raise capital or borrow for any purpose." Based on this language, the court found that the force majeure clause did not apply to the debtor's inability to pay rent. The court further found that it was irrelevant whether the pandemic itself or government regulations that prohibited the debtor's operation of its gaming establishment were force majeure events under the lease because the clause did not apply to the debtor's obligation to pay rent.).

Restaurant Group.¹¹⁸ In that case, the debtor argued that it was excused from paying post-petition rent based on the lease's force majeure clause, which provided:

Landlord and Tenant shall each be excused from performing its obligations or undertakings provided in this Lease, in the event, but only so long as the performance of any of its obligations are prevented or delayed, retarded or hindered by . . . laws, governmental action or inaction, orders of government.... Lack of money shall not be grounds for Force Majeure.¹¹⁹

The court found that the force majeure clause excused the debtor from paying rent after March 16, 2020, when the Illinois Governor's executive order suspending all on-premises offering of food or beverages became effective.¹²⁰ Unlike the court in *CEC Enterprises*, the court expressly rejected the landlord's argument that the force majeure clause was inapplicable because the tenant's inability to pay was due to a lack of money, finding that the tenant had not argued that it could not pay because of lack of money, but rather that the government orders were the proximate cause of its inability to generate revenue to pay rent.¹²¹

Because there are a variety of holdings from various courts, a party is well-served by tailoring its arguments and analysis to the exact language of the force majeure provisions and considering the evidentiary lessons in recent rulings as well.¹²²

2. Impossibility and Impracticability

So far, it appears that courts are generally rejecting litigants' arguments that their contractual performance became impossible due to the COVID-19 pandemic, particularly when the contractual obligation involves payment. For example, in *Lantino v. Clay LLC*,

¹¹⁸ *In re Hitz Restaurant Group*, 616 B.R. 374, 377 (Bankr. N.D. Ill. 2020).

¹¹⁹ *Id.* at 376-77.

¹²⁰ *Id.* at 377.

¹²¹ *Id.* (finding that the debtor's duty to pay rent was not entirely excused by the executive order as the debtor was still permitted to perform carry-out, curbside pick-up, and delivery services. Thus, the court found that the debtor's obligation to pay rent was reduced in proportion to its reduced ability to generate revenue due to the executive order).

¹²² See, e.g., *Palm Springs Mile Assocs., Ltd. v. Kirkland Stores, Inc.*, No. 20-21724, 202 WL 5411353 at *3 (discussing how a retail tenant attempted to invoke the lease's force majeure provision to excuse its non-payment of rent during the pandemic, arguing that county regulations governing the shutdown of non-essential activities and business operations suspended the tenant's obligation to pay rent. In rejecting this argument, the court found that the tenant failed to explain how the governmental regulations resulted in the tenant's inability to pay rent.).

a party to a settlement agreement argued that the doctrine of impossibility excused its obligation to make a payment under the agreement based on the COVID-19 pandemic.¹²³ In rejecting this argument, the court found that while the party showed that it encountered financial difficulties arising out of the COVID-19 pandemic that adversely affected their ability to make the payments under the settlement agreement, this did not rise to the level of impossibility. Similarly, in *Martorella v. Rapp*, the court rejected a prospective buyer's impossibility defense where the buyer argued he was unable to secure financing after his wife contracted COVID-19 based on the fact that the purchase agreement did not contain a financing contingency clause or evidence that the agreement was contingent upon the health of the buyer's wife.¹²⁴

Likewise, the court also rejected an impossibility defense in a landlord/tenant case, *Backal Hospitality Group LLC v. 627 West 42nd Retail LLC*,¹²⁵ where the tenant argued that its obligation to pay rent under a lease became impossible, permitting the tenant to terminate its lease, because of a government order prohibiting large gatherings due to the COVID-19 pandemic. In rejecting the tenant's argument, the court found that the government order was foreseeable based on the parties' inclusion of a clause in the lease that obligated the tenant to take such actions as may be legally permissible to enable the landlord to collect the maximum rent due in the face of a government order or regulation affecting the collection of rent.¹²⁶

Yet, while not in the landlord context, other courts have given credence to a party's impracticability defense where government regulation made performance impracticable. For example, in *Daversa-Evdyriadis v. Norwegian Air Shuttle ASA*, the court dismissed a plaintiff's class action lawsuit against two airline carriers over the carriers' failure to refund the plaintiff for a flight canceled due to the COVID-19 pandemic.¹²⁷ The plaintiff alleged in her complaint that the flights were cancelled due to the travel ban imposed between the United States and Europe. Based on this, the court found that the carriers' contractual obligation to provide carriage for the plaintiff was discharged because performance was rendered impossible by the travel ban. "Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged."¹²⁸ Here, because performance was made impracticable by the carriers' compliance with a government regulation or order—an

¹²³ *Lantino v. Clay LLC*, No. 1:18-cv-12247, 2020 WL 2239957 (S.D.N.Y. May 8, 2020).

¹²⁴ *Martorella v. Rapp*, No. 20 MISC 000153, 2020 WL 2844693 (Mass. Land Ct. Jun. 1, 2020).

¹²⁵ *Backal Hospitality Group LLC v. 627 West 42nd Retail LLC*, No. 154141/2002, 2020 WL 4464323 (N.Y. Sup. Ct. Aug. 3, 2020).

¹²⁶ *Id.*

¹²⁷ *Daversa-Evdyriadis v. Norwegian Air Shuttle ASA*, No. EDCV 20-727-JGB, 2020 WL 5625740 at *1 (C.D. Cal. Sept. 17, 2020).

¹²⁸ *Id.* at *5.

event the nonoccurrence of which was a basic assumption when the contract was made.¹²⁹

Within the leasing context, the same governmental shutdown factor resulted in a ruling in favor of the tenant. In *Simon Property Group, L.P. v. Pacific Sunwear Stores LLC*, an Indiana court gave preliminary credence to a commercial tenant's impossibility defense in response to a landlord's proceeding to evict the tenant and for outstanding rent owed.¹³⁰ The tenant, Pacific Sunwear, argued that both government-mandated shutdowns and the landlord's own decision to close its malls prevented the tenant from being able to operate its retail store, which is its primary obligation under the lease with the landlord.¹³¹ In finding that the tenant had a likelihood of success on the merits of its claim (in adjudicating the tenant's motion for injunctive relief), the court found that the tenant's impossibility defense satisfied the likelihood of success factor by providing a prima facie case where performance of the lease was impossible when the mall was closed, discharging the tenant from the obligation of paying rent during the relevant time period.¹³²

3. Frustration of Purpose

Parties have also been seeking relief from courts from performing their obligations under contracts due to the COVID-19 pandemic under the doctrine of frustration of purpose.¹³³ This doctrine applies where an unforeseen event occurs that is neither party's fault but that makes the performance of the contract impossible or radically changes the nature of the contract from what the parties intended when they entered into it.¹³⁴

¹²⁹ *Id.*

¹³⁰ See, e.g., *Simon Property Group, L.P. v. Pacific Sunwear Stores LLC*, No. 49D01-2006-PL-020195 at ¶ 21 (Ind. Comm. Ct. June 26, 2020) ("The Court thereby finds that PacSun can proceed seeking injunctive relief under its Motion for TRO").

¹³¹ *Id.* at ¶ 48.

¹³² *Id.* at ¶ 55.

¹³³ See, e.g., *Westchester Fitness, LLC v. Retrofitness, LLC*, No. 20-CV-699 (PKC) (LB), 2021 WL 688296, at *2 (E.D.N.Y. Feb. 23, 2021) (Plaintiff argues that "[a]s a result of its total inability to operate its business by government order, Westchester Fitness's performance under the Lease was excused by, *inter alia*, the doctrines of frustration of purpose and impossibility of performance." (internal citations omitted.)); *UMNV 205-207 Newbury, LLC v. Caffé Nero Americas Inc.*, Superior Court, Commonwealth of Massachusetts, 2084CV01493-BLS2 at *12 (Mass. Super. Ct. Feb. 8, 2021) (holding "Defendant's obligation to pay rent under the parties' Lease was discharged under the doctrine of frustration of purpose from March 24 to June 22, 2020, and during any other period when Defendant was barred by government order concerning the COVID-19 pandemic not to allow any consumption of food or beverage within the lease premises".)

¹³⁴ RESTATEMENT (SECOND) OF CONTRACTS § 265 (1981).

Generally, thus far, courts have found that frustration of purpose will discharge a party's obligation where a government order or regulation bars certain conduct or economic activity, and the non-occurrence of such an order or regulation was a basic assumption underlying the contract.

While frustration of purpose is related to the doctrine of impossibility of performance, the two doctrines apply in different contexts. Under impossibility, "performance is excused where the contracting parties assumed that something would continue to exist, neither party guaranteed that thing would continue to exist, and performance becomes impossible because that thing was destroyed through no fault of either party."¹³⁵ Under frustration of purpose, in contrast, "performance is excused even through it is possible for the party to perform its contractual obligations, but the expected value of that performance has been destroyed by an unforeseeable event."¹³⁶ But the key question under both doctrines is whether an unanticipated event occurs, making performance vitally different from what the parties reasonably expected, and the risk of that event should not be borne by the promisor.¹³⁷

The recent landlord tenant case of *UMNV 205-207 Newbury, LLC v. Caffé Nero Americas Inc.* is particularly insightful. In this case, Caffé Nero entered into a lease for retail space and agreed to only use the leased premises to operate a Caffé Nero themed café, and not for any other purpose.¹³⁸ In March 2020, the Massachusetts Governor barred restaurants from allowing on-premises consumption of food or beverages, indoors or outside.¹³⁹ As a result, Caffé Nero shut down its café and stopped paying rent.¹⁴⁰ The landlord then terminated the lease and brought suit to recover unpaid rent for the months that Caffé Nero continued to occupy the premises, and sought liquidated damages for the remainder of the 15-year term of the lease.¹⁴¹ Caffé Nero vacated the space in late October 2020.¹⁴²

The court granted summary judgment to the tenant, Caffé Nero, finding that Caffé Nero's "obligation to pay rent was discharged while it was barred from letting customers drink and eat inside the leased premises, at least from March 24 to June 22, 2020," while the Governor's order remained in place.¹⁴³ Based on this, the court found that the landlord's notice of default premised on Caffé Nero's failure to pay rent during this time

¹³⁵ *Caffé Nero Americas Inc.*, 2084CV01493-BLS2 at *4.

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.* at *2.

¹³⁹ *Id.* at *3.

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at *4-5.

¹⁴² *Id.*

¹⁴³ *Id.* at *12.

was in error and not effective, and the landlord then improperly terminated the lease for non-payment of rent in April.¹⁴⁴

In applying the frustration of purpose doctrine, the court found that the entire purpose of the lease was for Caffé Nero to provide coffee and other food and drinks to its customers who could sit and consume them on the premises.¹⁴⁵ The court found that the Governor's order, prohibiting on-premises consumption of food and beverages from March 24 to June 22, 2020, frustrated this purpose, thus discharging Caffé Nero's obligation to pay rent was during this time.¹⁴⁶ Influencing this decision was the fact that the lease limited Caffé Nero's permitted use to a single purpose, and that nothing in the lease allocated the risk of COVID-19 to Caffé Nero.¹⁴⁷

Interestingly, the lease contained a force majeure provision, which addressed impossibility but not frustration of purpose.¹⁴⁸ The court found that the force majeure provision did not apply, but also that it did not bar Caffé Nero's frustration of purpose defense.¹⁴⁹

Several factors that seemed to tip the scale in favor of the tenant, including that there was no other evidence in the record that the landlord sent any other notice giving Caffé Nero time to remedy any later rent deficiency.¹⁵⁰ Additionally, the court's opinion refers to attempts by Caffé Nero to pay rent, although not full rent, and also details the landlord's refusal to make any exceptions to Caffé Nero's obligation to pay rent under the lease, despite Caffé Nero's inability to operate from March through June 2020.¹⁵¹ Reading between the lines, it appears that the landlord's inflexible and unaccommodating approach factored into the court's decision to find in Caffé Nero's favor. After all, the case was before the court on the landlord's motion for summary judgment, which the court not only denied, but then *sua sponte* granted summary judgment to Caffé Nero on the frustration of purpose defense. This, combined with the landlord's decision to immediately terminate the lease based on Caffé Nero's failure to pay April rent, seemed to ultimately cut against the landlord's position.

In contrast, a New York court rejected a tenant's frustration of purpose defense regarding a commercial lease.¹⁵² In *35 East 75th Street Corporation v. Christian Louboutin L.L.C.*, a commercial landlord sued its tenant based on the tenant's failure to

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at *7.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at *8.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.* at *7-8.

¹⁵¹ *Id.* at *7.

¹⁵² *35 E. 75th St. Corp. v. Christian Louboutin L.L.C.*, No. 154883/2020 at *6 (Sup. Ct. N.Y. Dec. 11, 2020).

pay rent since March 2020.¹⁵³ Similarly, in *BKNY1, Inc. v. 132 Capulet Holdings, LLC*, the court rejected a commercial tenant’s frustration of purpose defense to a landlord’s suit seeking rent that the tenant failed to pay during the pandemic, finding that given the nine-year term of the lease, “a temporary closure of plaintiff’s business for two months (April and May 2020) in the penultimate year of its initial term could not have frustrated its overall purpose.”¹⁵⁴ The court also rejected the tenant’s impossibility defense, finding that “[n]othing in the lease at issue permits termination or suspension of plaintiff’s obligations to pay rent in the event of the issuance of a governmental order restricting the use of the leased premises.”¹⁵⁵ To the contrary, the lease provided that the tenant’s obligation to pay rent “shall in no wise be affected, impaired or excused because Owner is unable to fulfill any of its obligations under this lease ... by reason of ... government preemption or restrictions.”¹⁵⁶

VI. CONCLUSION: PANDEMIC OPERATIONAL ADAPTATIONS HAVE BECOME A WAY OF LIFE

Behaviors that may have been trends pre-pandemic have become channels of trade in their own right as lockdowns and COVID-19 outbreaks forced changes in consumer behavior. Whether considering the so-called “retail apocalypse,” which slashed foot traffic in shopping malls, a general increased facility among the public for ordering goods and services on smartphones, or the increased appetite for on-demand experiences (food, movies, and fitness classes), many of these lifestyle changes had been in the works before the pandemic hit. In many instances, the pandemic simply accelerated the trends.

From the earliest rush of ordering toilet paper and hand sanitizer from Amazon to placing orders from the grocery store to the massive increase in restaurant delivery, consumers have come to expect online ordering and payment options, as well as “no contact” pickup and delivery services. More than half of all consumers intend to continue using curbside pickup and grocery-delivery services after the pandemic is over. Nearly 70% of consumers surveyed intend to continue buying online for store pickup.¹⁵⁷

Adaptive restaurant franchise systems will implement new or enhance existing online ordering and payment capabilities, whether through their websites, mobile experiences, apps, or third-party delivery providers. They should also consider adapting

¹⁵³ *Id.* at *1.

¹⁵⁴ *BKNY1, Inc. v. 132 Capulet Holdings, LLC*, 2020 WL 5745631 at *2 (N.Y. Sup. Sept. 23, 2020).

¹⁵⁵ *Id.* at *4.

¹⁵⁶ *Id.*

¹⁵⁷ Josh Mitchell, “Your Covid-19 Shopping Habits Are Changing What Jobs Are Available,” *WALL ST. J.*, Dec. 4, 2020, https://www.wsj.com/articles/your-covid-19-shopping-habits-are-changing-what-jobs-are-available-11607105471?mod=article_inline

brick and mortar stores to accommodate customers' new on-site and delivery preferences. These accommodations could include drive-thrus, designated parking areas for pickup orders, and creating a formal delivery program, whether in-house or with a third-party service. Of all the post-pandemic adaptations, food delivery apps are most primed for disruption. For years before the pandemic, restaurants complained about apps' steep commissions, which can be 30%.¹⁵⁸ Pre-pandemic, restaurants were exploring multiple avenues around delivery apps, which included inhouse delivery, designing delivery app menus for profitability, and ghost kitchens.

Hotel franchises may have a longer row to hoe. While virtual meeting technologies may have been the previously unknown salvation of schoolchildren and employers alike at the beginning of the pandemic, by now everyone has personally experienced Zoom fatigue. Virtual meetings began as a pandemic trend and have become a way of life. Whereas electronic meeting technologies provided a connection during lockdown, hotels dread the potential loss of business travelers post-pandemic. As people become accustomed to virtual meetings, future business travel may become obsolete. Also, as companies recover from pandemic's economic effects, they may cut travel budgets to compensate for years of lower revenue.¹⁵⁹ For example, rather than send four or five staff to visit a customer, a company may send one in-person ambassador and have their colleagues join the meeting remotely. As the pandemic forced an acceleration of technology in general, likewise it also forced a reckoning that remote work is possible (and even more productive than going to the office)¹⁶⁰. While the unquestionable pent-up demand for leisure travel will help hotels bounce back as vaccines become available, a permanent loss of business travel could force further changes to the hotel industry.

Like hotels, personal services generally will not be served by an off-premises option (virtual haircuts simply are not a good idea). Tutoring, training and fitness concepts have had some success with online classes, however. Although many consumers miss the in-studio workout, others appreciate the convenience of an on-demand, at-home work out. Post-pandemic, many fitness concepts may decide to continue their off-premises offerings for those times when their customers just cannot make it to the gym. Off-premises fitness offerings would bridge the gap for customers who are not quite ready to come back into public workout settings while providing continuous revenue for the

¹⁵⁸ Greg Bensinger, "Apps Are Helping to Gut the Restaurant Industry," N.Y. TIMES, Dec. 8, 2020, <https://www.nytimes.com/2020/12/08/opinion/delivery-apps-restaurants-fees.html>.

¹⁵⁹ Doug Cameron and Eric Morath, "Covid-19's Blow to Business Travel Is Expected to Last for Years," WALL ST. J., Jan. 17, 2020, https://www.wsj.com/articles/covid-19-pandemics-impact-on-business-travel-hitting-local-economies-11610879401?mod=article_inline.

¹⁶⁰ Julian Birkinshaw, et. al, "Research: Knowledge Workers Are More Productive from Home," HARV. BUS. REV., Aug. 31, 2020, <https://hbr.org/2020/08/research-knowledge-workers-are-more-productive-from-home>.

business.

Re-opening operations in any sector is on the forefront and ongoing health and safety protocols continue to be adaptive depending on the geographical area, rate of infection, and local government restrictions. Additionally, the growing population with immunity – whether from previously having the virus or electing to be vaccinated – will greatly impact how business and franchises reopen in a post-pandemic (or a “COVID-lite”) world. As with any disruption, the market reshuffles and there are winners and losers. The franchise system is unique in that it presents a partnership between franchisor and franchisee to mutually benefit from adaptations to refine a service delivery or business for success.

Addendum Inserts

Exhibit A - Sample Franchisor Safety and Operational Change Communication

Exhibit B - Sample New Day Letter Template

Exhibit C - Force Majeure Provisions

EXHIBIT A

SAMPLE FRANCHISOR COMMUNICATION FOR HEALTH AND SAFETY OPERATIONAL CHANGES AND STANDARD

Dear Franchisee:

As more jurisdictions have begun to allow groups to gather, and we move toward resuming in-person training, the health and safety of all training staff and course participants remains our highest priority. The last thing we want is for someone who is infected to come into the classroom and potentially infect other participants or training staff, so to ensure we are taking reasonable precautions to keep everyone safe during in-person training, we have developed some minimum standards in accordance with the recommendations for group gatherings by the World Health Organization and the Centers for Disease Control and Prevention.

All training staff are required to wear a mask or face covering that covers his or her mouth and nose and to use his or her best efforts to practice social distancing in conducting the course. This will be required of training staff whether the training occurs at the franchise location or a client location.

- For courses that are conducted at the franchise location, all course participants are also required to wear a mask or face covering and strongly encouraged to practice social distancing. Franchises should inform all clients and participants about the mask and social distancing requirements in sufficient time for them to comply with such requirements and should also have a supply of masks available if participants need one.
- If the training is conducted at a client location, the franchise should request that the client ask all participants to wear masks or face coverings and practice social distancing for the safety of the training staff and participants.

Below you will find links that will lead you to our new Training Room and Office Health and Wellness standards that are required for all offices and training rooms globally. We should consider these our minimum standards that can be supported and marketed throughout our brand. Local guidelines should always be followed. These are critical to follow as the credibility of our brand depends on our clients and staff feeling safe in our training room and offices when in-person training returns.

Links to:

Letter to Clients (for you to email)

Link to Global Standards

Editable Signage

Editable Brochure (customize to your local office and local guidelines, holding to minimum standards)

Images you can use for social media

EXHIBIT B

NEW DAY LETTER

[Date]

**VIA FEDERAL EXPRESS TRACKING
NO. [INSERT TRACKING NO.]**

[Franchisee Business Name]

Attn.: [insert individual name]

[Street]

[City, State, Zip]

**VIA FEDERAL EXPRESS TRACKING
NO. [INSERT TRACKING NO.]**

Insert any additional recipients, including
any **guarantors** here.

Via Email ([insert email address(s)])

**RE: Franchisee Defaults Related to Failures to Meet Development
Milestones**

Dear Franchisee:

[Franchisor] hereby notifies you of its intent to begin strictly enforcing the development milestones in all of its current and future franchise agreements. A number of franchisees are well beyond the deadlines set forth in their franchise agreements to both select a site for and open their [location]. The value of our brand and franchise system depends on franchisees following through with their development obligations. When franchisees sign a franchise agreement with rights to develop in a designated territory, but never open, the entire franchise system loses valuable growth opportunities and market share. While [Franchisor] has been lenient in enforcing development milestones in the past, that will be changing going forward.

If you have missed a deadline to select a site or open your [location], you will be receiving a notice of default and will need to cure the default by the deadline set forth therein. If you fail to cure the default by that deadline, [Franchisor] will terminate your franchise agreement. Further, if you recently signed a franchise agreement and are still within the period of time to select a site and open, please know that [Franchisor] is enforcing development milestones and expects for you to open on time.

As always, we wish to be supportive franchise partners. Therefore, if you anticipate that you may not meet your deadline for site selection and opening on time, please let us know right away. We remain willing to provide reasonable, limited extensions for franchisees who can demonstrate that are working in earnest towards development. But we are not able to allow franchisees to occupy territories indefinitely without developing. Honoring and enforcing development milestones is critical to the value and strength of our brand and brand awareness. As a result, it serves our collective interest for franchisees to meet their development milestones.

If you have any questions, please contact . . .

EXHIBIT C

FORCE MAJEURE PROVISIONS

Sparse Force Majeure Provision

No party will breach this Agreement if its performance is prevented or delayed because of war, acts of terrorism, civil disturbances, strike, labor dispute, shortage in supply, fire, act of God, action of a government, or other cause beyond the reasonable control of the party. If a force majeure event prevents us from supplying all of our customers' Product needs, we will allocate available product among our customers in a manner we determine. No force majeure event will excuse your payment obligations under this Agreement.

Better Force Majeure Provision

Neither party shall be liable for loss or damage or deemed to be in breach of this Agreement if its failure to perform its obligations results from: compliance with any laws; acts of God; pandemic or epidemic; unavailability of any essential equipment, materials, or service, including interruptions in telephone or internet service; lockout, other industrial disturbance or labor difficulty; war, civil unrest, act of public enemy, terrorist act, blockade, revolution, riot, insurgency or insurrection; lightning, storm, flood, fire, earthquake, other natural disaster; explosion; embargo; or unavoidable accident, which are not the fault of the non-performing party. Any delay resulting from any of said causes shall extend performance accordingly or excuse performance, in whole or in part, as may be reasonable, except that said causes shall not excuse payment of amounts owed at the time of such occurrence or any and all other payments which may become due thereafter. In the event that such causes or occurrences continue for a period of six (6) months or more and prevent the performance of a party's obligations under this Agreement, the party whose performance has not been impacted may terminate this Agreement, effective upon delivery of notice to the non-performing party.