

International Franchise Association
54th Annual Legal Symposium
May 4-6, 2021
Virtual

To Terminate or Not to Terminate, That is the Question: Enforcing System Standards in a Post-COVID World

Brian Forgas

Senior Counsel
Americas Development and Global Franchise Regulatory
Hilton Worldwide
McLean, Virginia

Erin Martin

Chief of Staff and General Counsel
Little Caesar Enterprises, Inc.
Detroit, Michigan

Frank J. Sciremammano

Partner
Lathrop GPM LLP
Washington, D.C.

TABLE OF CONTENTS

Introduction	1
I. Background on Franchise System Standards	1
A. System Standards	1
B. Enforcement	3
i. Investigating and discovering deviations from system standards	4
ii. Addressing deviations from system standards	5
II. The COVID-19 Pandemic	8
III. Addressing System Standards Issues In The COVID Era	11
A. Guiding Principles.....	12
i. The nature and locality of the system.....	12
ii. The lifecycle of the crisis	13
iii. Consistency versus triage response	13
iv. Legal risk.....	13
B. Waiving, Modifying, Changing, And Implementing New System Standards	14
i. Key considerations.....	14
ii. Implementing new system standards	16
C. Enforcing System Standards	19
i. Modified enforcement mechanisms.....	19
ii. Enhanced enforcement and termination considerations	19
D. Emerging From The Pandemic.....	21
IV. Addressing System Standards Issues In Future Times Of Uncertainty.....	22
Conclusion	23

Introduction

Since it first appeared in December 2019, the novel coronavirus, SARS-CoV-2, and the disease it causes, COVID-19, has changed the world. Infecting tens of millions of people around the world and driving large-scale lockdowns, COVID-19 wreaked havoc on modern society, including commercial institutions and businesses across all industries. But amidst the global crisis, there were reasons for optimism. Within the franchising sector, the pandemic gave new credence to the familiar catchphrase, “franchisees are in business for themselves, but not by themselves.” From the very beginning of the pandemic, many franchise systems took an all-hands-on-deck approach and leveraged their business relationships and collective knowledge to assist and support franchise system stakeholders, proving that in franchising, the whole is greater than the sum of the parts.

This paper will discuss the challenges franchise systems faced during the pandemic from a system standards perspective. System standards—which regulate everything in the franchised business from the location, design and appearance of the business, to the products and services sold, the methods of operation, the equipment used in the operations, and the marketing of the franchise brand—are the glue that holds a franchise system together. In ordinary times, strict enforcement is not only advisable but critical for a strong franchise system. However, when a crisis arises, how does that change? Should system standards be temporarily waived during a crisis? If so, which ones, and for how long? How do inspection and enforcement mechanisms change in a time of crisis? What are the best practices for implementing changes to system standards in such situations? How do you structure a post-crisis system to incorporate and integrate some of the more useful developments that you formulated to address the crisis? The COVID-19 pandemic provides a timely case study through which franchise practitioners can explore these important questions and distill valuable lessons to implement and strengthen franchise systems for the future.

I. Background on Franchise System Standards

A. System Standards

System or brand standards have been referred to as “the lifeblood of a franchise system.”¹ They are the minimum standards, procedures, rules, regulations, policies, and techniques that a franchisor requires its franchisees to meet. In other words, system standards “regulate everything in the franchise relationship from methods of operation, to the products sold by the franchisee, the equipment used in the franchise operations, and

¹ See David Beyer, Himanshu Patel, and John Dent, *Changes in System Standards – What is the Extent of the Franchisor’s Latitude?*, at 1, American Bar Association 35th Annual Forum on Franchising, October 2012.

even the look of the franchised outlet.”² As such, system standards are crucial to maintaining consistency and quality throughout a franchise system.

Perhaps the most important category of system standards is health and safety standards. Health and safety standards are used to help ensure franchised businesses are operated safely and in compliance with all safety-related laws and regulations. They vary significantly from industry to industry, but are always focused on the safety of customers of the brand, franchisees and their employees, and the surrounding community. For example, health and safety standards in a food service franchise system involve requirements related to food storage, handling, cooking, and packaging, as well as specific cleanliness and sanitization requirements such as timed hand washing and surface disinfection, to ensure the health and safety of restaurant staff and consumers. Health and safety standards in a fitness franchise system may focus on properly maintained equipment, cleaning and sanitizing requirements, and staff certification requirements to ensure the health and safety of the gym staff and attendees. In a hotel franchise system, health and safety standards may relate to the physical security of the premises and the personal safety of occupants, including fire and life safety systems, as well as rules for the operation of amenities like swimming pools along with all of the food-safety requirements that apply to commercial kitchens, bars, and restaurants.

An equally important category of system standards is that related to the use of the franchisor’s trademarks, trade dress, signage, and the look and feel of the unit and its products and services. The trademarks and trade dress are the unifying symbols connecting all franchisees in a franchise system. They allow consumers to quickly and reliably identify a business as part of a particular franchise system.

Operational system standards are another important category. These can include everything from hours of operation, the use of point-of-sale software, and reporting requirements, to how certain products are made and services are rendered. Operational system standards are what create a uniform product or service and the environment in which it is provided. These standards generally define the culture of the franchise and the customers’ experience with the brand. As a result, operational standards are also crucial to the brand identity.

While system standards are typically thought of as public-facing standards, there are many standards that affect the internal aspects of the business that help contribute to efficient and consistent operations. This includes financial reporting requirements. Typically, financial standards are focused on creating a consistent system that all franchisees can use to report sales, manage accounts and remittances, and collect and report on key metrics that help both the franchisor and franchisee understand how the business is performing.

Reinvestment requirements are another type of system standard. These standards ordinarily go beyond the requirement to simply maintain the premises in good

² *Id.*

condition and relate to upgrading the premises and replacing fixtures, furniture and equipment over time. This is why such requirements are generally referred to as franchisees' periodic refurbishment and renovation obligations. These standards often also include requirements related to a franchisee's periodic replacement of technology used in the business, such as updating a point-of-sale system with new hardware and software to improve customer convenience, enhance payment security, and remain current with the marketplace.

Finally, a brand may have standards related to suppliers or vendors. Franchisees are often required to purchase their products or supplies from certain pre-approved vendors or suppliers. These requirements help franchise systems provide a consistent product to consumers. For example, food service franchise systems often require franchisees buy certain ingredients from specific suppliers to ensure uniformity with respect to core menu offerings. That helps ensure that a franchisee's product is prepared the same way and that the food quality and taste remain consistent no matter where the business is located. Similarly, a hotel franchisor may require franchisees to purchase case goods (such as furniture and décor), soft goods (such as linens), and/or consumables (such as trademarked soap and shampoo) from certain pre-selected vendors to ensure a uniform and consistent guest experience throughout the franchise system.

B. Enforcement

Given the significance of system standards to a franchise system, enforcing system standards is obviously of critical importance to protecting the goodwill of the brand, preventing bad publicity, ensuring compliance with the franchise agreement, and preventing one franchisee's poor operations from impacting the entire franchise system.

Prior to the pandemic, franchisors generally viewed minor deviations from system standards as an early warning sign of a problem in the franchise relationship.³ Franchisors were generally advised to investigate such deviation(s) further, initiate communications with the franchisee regarding the deviation(s) and the franchised business more generally (if communications were not already ongoing), and, if the franchisee would not or could not remedy the deviation(s), decide whether to issue a

³ See Sarah Hill, Nicole Micklich, and Aaron-Michael Sapp, *Handling Franchise Defaults and Terminations*, 52nd Annual IFA Legal Symposium, May 2019; Alyssa Barnes and Michael Einbinder, *Franchise Defaults and Terminations – Best Practices*, 51st Annual IFA Legal Symposium, May 2018; Judy Marsh, Eunice Nakamura and Leslie Smith, *Franchise Defaults and Terminations – Best Practices*, 50th Annual IFA Legal Symposium, May 2017; Christine E. Connelly, Aron Friedman and Mark Inzetta, *Franchise Default and Termination – Best Practices to Enforce the Contract and Protect the System*, 49th Annual IFA Legal Symposium, May 2016; Harris J. Chernow, Stephen Hagedorn, and Leslie Smith, *Best Practices for Handling Defaults and Terminations*, 47th Annual IFA Legal Symposium, May 2014.

default or termination notice.⁴ In making that decision, franchisors were advised to review the franchise agreement for a contractual basis for a default and/or termination, review state relationship laws, review potential counterclaims and defenses by the franchisee, evaluate the benefits to avoiding termination, evaluate the impact on the system and other franchisees, and assess any viable alternatives to termination.⁵

i. Investigating and discovering deviations from system standards

At the outset, a franchisor could take one of many steps if it believed a franchisee was not complying with system standards. The most common first step was for an employee of the franchisor or an independent third-party retained by the franchisor to visit the franchised business and conduct an inspection or audit. Many franchisors have regularly occurring inspection programs to proactively monitor franchisees' compliance with system standards.⁶ The purpose of these programs is to improve operations and identify problem areas for additional assistance, training and correction.

There are generally four types of audits in the franchise relationship: (1) financial audits; (2) quality assurance audits; (3) customer experience audits; and (4) regulatory issue audits.⁷ These audits may be referred to by different names but tend to assess the same types of information. Financial audits generally involve a review of a franchisee's financial records and are done for the purpose of monitoring a franchisee's financial health and ability to meet its obligations (including future reinvestment obligations), coaching a franchisee on profitability improvement areas, and/or to detect the underreporting of sales, which has a deterrent effect on the rest of the franchise system and can uncover opportunities to grow sales and profitability.⁸

A quality assurance audit generally involves a review of a franchisee's adherence to system standards related to the quality of the product or service rendered. For example, in a franchise system involving food preparation, such an audit may review a franchisee's compliance with a brand's cleaning procedures, storage and handling procedures, hazardous critical control points, food safety, and food quality.⁹ In a hospitality or hotel franchise system, such an audit may review a franchisee's adherence

⁴ See, e.g., Hill, Micklich, and Sapp, *supra*, at 4-15.

⁵ *Id.*

⁶ See, e.g., Robert Zisk, Brian Balconi, Tabbassum Mumtaz, and Dennis Parker, *Protecting the Brand: Conducting Brand Compliance Audits*, 50th Annual IFA Convention, February 2010.

⁷ *Id.* at 4-7.

⁸ *Id.* at 4.

⁹ *Id.* at 5.

to guest service level requirements, the hotel's exterior and interior appearance, guest room and common area condition, maintenance and cleaning, use of approved furnishings in the hotel, and the hotel's foodservices and amenities. Such an audit is useful for ensuring a franchisee is following required procedures, has a clean and safe franchised business, is not using unapproved products, and is using correct uniforms.¹⁰ A quality assurance audit typically, pre-COVID, involved an employee of the franchisor or an independent third-party retained by the franchisor physically traveling to a franchisee's location to physically inspect the franchised business. Sometimes these in-person audits take multiple days to complete.

A customer experience audit may involve a review of different kinds of tools to help assess the customer experience at the business, such as gathering metrics on customer complaints and resolutions, reading customer reviews online, using direct customer surveys, and/or using "secret shoppers" (otherwise known as "mystery shoppers").¹¹ Secret shoppers are individuals who use the franchise business and report their experiences back to the franchisor. Secret shopper programs are useful to understand how an average customer is treated by the franchisee's employees and the quality of products and services they receive. Depending on the type of business there may be any number of other mechanisms for franchisors and franchisees to get a sense for how well the franchised business is operating from the customer point of view.

A regulatory issue audit involves a franchisor inspecting a franchisee for compliance with specific regulatory requirements, such as the Americans with Disabilities Act, fire and life safety systems, right to know / OSHA compliance, storage and handling of hazardous waste, and other discrete regulatory issues.¹² Like a quality assurance audit, a regulatory issue audit, pre-COVID, was generally performed by an employee of the franchisor or someone with technical expertise regarding the specific regulatory issue hired by the franchisor in-person at the franchisee's location.

ii. Addressing deviations from system standards

Nearly all franchise agreements give the franchisor the right to place a franchisee in default if they fail to comply with the system standards delineated in the franchise agreement and/or operations manual. Depending on the significance of the deviation, a franchisor may be entitled to terminate the agreement without an opportunity to cure, or a franchisor may be required to give the franchisee a certain number of days to cure the default before the franchisor can terminate the franchise agreement. A notice of default formally puts a non-compliant franchisee on notice that he/she/it must comply with system standards and should provide the franchisee with specific actions to take to cure the default. A notice of default / notice to cure is often the first step in a formal termination

¹⁰ *Id.*

¹¹ *Id.* at 5-6.

¹² *Id.* at 6.

scenario and should specifically and clearly include: (1) a description of the system standards deviation; (2) photos or other documentary proof of noncompliance; and (3) a due date for compliance.

However, default and termination is not the only way to address deviations from system standards. In recent years, some franchisors have opted to include enforcement mechanisms other than default and termination in their franchise agreements, such as non-compliance or enforcement fees. Such fees provide flexibility in addressing deviations. This type of provision gives the franchisor the right to charge certain levels of fees for different types of non-compliance as both an incentive for the franchisees to comply with system standards and for the franchisor to recoup some of the additional costs they incur as a result of the franchisee's failure to comply with standards. While generally the biggest cost of non-compliance for a franchisor is reputational damage, which is hard to quantify, other costs that may be recouped through non-compliance or enforcement fees include a franchisor's costs for investigating a default, preparing a notice of default, and performing follow-up inspections.

Additionally, there are a number of other interim remedies a franchisor can try to impose to address deviations from system standards short of termination. One such example is a performance plan, whereby a franchisee agrees to take certain actions, sometimes with the help of the franchisor and sometimes not, which will bring the franchisee into full compliance with system standards by a given date. Interim remedies can also include enhanced inspections / quality assurance evaluations, either in frequency or substance, to ensure a franchisee is improving. Under such a performance plan, a franchisee may be required to meet certain milestones to stay on track.

Of course, occasionally, the only way to protect the brand from a franchisee that cannot or will not comply with system standards is to terminate the franchise relationship. A non-compliant franchisee can cost the franchisor substantial time and money in policing the franchisee, in providing additional assistance, and in customer recovery efforts. In addition, continued operation of the business in a non-compliant manner can damage the reputation and goodwill of the brand, which negatively impacts the franchisor and all other franchisees in the system.

Terminating a franchise relationship can be a time consuming, frustrating, and expensive process for everyone involved. In an attempt to avoid that, franchisors and franchisees will sometimes try to settle their disputes over alleged deviations from system standards by agreeing that the franchisee may cure any existing defaults by selling the franchised business to a new or existing franchisee that the franchisor approves (who will complete the cure). This can be a good remedy for a franchisor seeking a new operator and a franchisee seeking to recoup its investment in the franchised business while avoiding the financial risk and embarrassment of a termination. Often, such settlements are structured such that the franchisee has a set period of time to sell the franchised business, and if it is not sold in that period of time, the franchisee will either sell it to the franchisor at a pre-negotiated price or the franchise agreement will terminate by agreement of the parties. The buyer of the franchised business usually has to be

approved by the franchisor and has to meet the franchisor's then-current criteria for new franchisees, including any training requirements.

So how does a franchisor choose which enforcement path to take? The traditional theoretical framework involves an analysis of the legal merits of the termination, the benefits to avoiding termination, the impact on the system and other franchisees, and to assess viable alternatives to termination. Some benefits to avoiding termination include maintaining the flow of royalties, advertising fees, and other payments from the franchisee.¹³ If a franchisee is terminated, the franchisor will lose that stream of cash flow.¹⁴ In addition, a franchisor will incur legal fees when terminating a franchisee, and even routine terminations based on obvious violations can quickly become very expensive.¹⁵

The traditional framework also involves consideration of the impact of termination of the franchise system as a whole. The customers of the terminated unit may never return to the franchise system (either returning to the business if it is re-opened by a different franchisee or seeking out another franchised location).¹⁶ Customers may also identify the terminated, closed unit, with the franchisor's brand and trademarks, which could be detrimental on the brand as a whole.¹⁷

Termination may also have a tangible effect on other franchisees in the system.¹⁸ This is particularly true in relatively small systems or systems that have endured a substantial number of recent terminations.¹⁹ Franchisee sentiment could suffer in both situations.²⁰ Terminations can also negatively affect prospective franchisees.²¹ Franchisors are required to disclose the number of franchisees who have left the system

¹³ See Hill, Micklich, and Sapp, *supra*, at 13-14.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

in Item 20 of its Franchise Disclosure Document (“FDD”), as well as certain litigation—which may occur as a result of terminations—in Item 3 of its FDD.²²

II. The COVID-19 Pandemic

COVID-19 first appeared in December 2019 and has since spread throughout the world. In that short time, the virus “thrust humankind into an unprecedented global public health crisis.”²³ “Experts consider [the COVID-19] outbreak the worst public health epidemic since the influenza outbreak of 1918.”²⁴ The virus is “extremely easy to transmit, can be transmitted by infected people who show no symptoms,” has no cure, and until winter 2020, there was no vaccine for it.²⁵ According to the Center for Disease Control, the virus is believed to spread mainly through close person-to-person contact via respiratory droplets.²⁶ Although guidance from the CDC evolved over time, the CDC generally recommended that to avoid exposure and transmission, individuals should maintain a physical distance of at least six feet from others, wear cloth face covers, frequently wash their hands or use hand sanitizer, and disinfect frequently touched surfaces.²⁷

The first known COVID-19 case in the United States was discovered on January 20, 2020.²⁸ The World Health Organization declared COVID-19 to be a Public Health Emergency of International Concern on January 30, 2020, and a pandemic on March 11, 2020.²⁹ On March 13, 2020, the former president declared a national emergency in the

²² *Id.*

²³ *Gayle v. Meade*, 2020 WL 2086482, at *1 (S.D. Fla. Apr. 30, 2020), *order clarified*, 2020 WL 2203576 (S.D. Fla. May 2, 2020).

²⁴ *Altman v. Cnty. of Santa Clara*, 2020 WL 2850291, at *1 (N.D. Cal. June 2, 2020).

²⁵ *Id.*

²⁶ *Ibarra-Perez v. Howard*, 2020 WL 3440298, at *4 (D. Ariz. June 23, 2020).

²⁷ *Things to Know about the COVID-19 Pandemic*, Center for Disease Control and Prevention, updated Jan. 5, 2021, (<https://www.cdc.gov/coronavirus/2019-ncov/your-health/need-to-know.html>).

²⁸ See Michelle L. Holshue, Chas DeBolt, Scott Lindquist, et. al, *First Case of 2019 Novel Coronavirus in the United States*, *New England Journal of Medicine*, Mar. 5, 2020 (available at <https://www.nejm.org/doi/full/10.1056/NEJMoa2001191>).

²⁹ See *Rolling updates on coronavirus disease, (COVID-19)*, World Health Organization, updated July 30, 2020 (<https://www.who.int/emergencies/diseases/novel-coronavirus-2019/events-as-they-happen>).

United States due to the COVID-19 outbreak.³⁰ The COVID-19 crises' rapid spread across the country (and world) resulted in an unprecedented public health crisis and crippled the country's economy. To control the spread of the disease, governments at all levels (federal, state and local) have issued various orders and regulations, and/or taken other actions to curtail (or halt entirely) all but the most essential of activities in the country.

For example, on March 19, 2020, the Governor of California issued an Executive Order requiring all individuals living in the State of California to stay at home or at their place of residence until further notice.³¹ On March 20, 2020, the Governor of Illinois ordered all Illinois residents to "shelter in place" through at least April 30, 2020.³² On the same day, the Governor of New York issued the "New York State on Pause" Executive Order, a 10-point policy, which, among other social distancing and travel restrictions, requires everyone to maintain a 6-foot distance in public and limits individuals to using public transportation only when absolutely necessary.³³ On March 21, 2020, the Governor of New Jersey issued Executive Order No. 107 requiring all New Jersey residents to remain at their home or place of residence unless they were obtaining essential goods or services.³⁴ In the same Executive Order, the governor ordered that all gatherings of individuals be cancelled and violators of the stay at home order face penalties of up to 6 months in jail and/or a \$1000 fine.³⁵ On March 31, 2020, the Governor of Texas issued an Executive Order directing all Texans to minimize non-essential gatherings and in-person contact with people not in the same household at least through

³⁰ See Cecelia Smith-Schoenwalder, *Trump Declares National Emergency Amid Coronavirus Pandemic*, US News, Mar. 13, 2020 (<https://www.cnn.com/2020/03/13/politics/donald-trump-emergency/index.html>).

³¹ *Governor Gavin Newsom Issues Stay at Home Order*, Gov.CA.gov, Mar. 19, 2020 (available at <https://www.gov.ca.gov/2020/03/19/governor-gavin-newsom-issues-stay-at-home-order>).

³² See Elliot Davis, *Illinois Governor Orders Residents to Shelter in Place*, US News, Mar. 20, 2020, <https://www.usnews.com/news/health-news/articles/2020-03-20/illinois-governor-orders-residents-to-shelter-in-place>.

³³ *Governor Cuomo Signs the 'New York State on PAUSE' Executive Order*, Governor, NY.gov, Mar. 20, 2020 (<https://www.governor.ny.gov/news/governor-cuomo-signs-new-york-state-pause-executive-order>).

³⁴ *Governor Murphy Announces Statewide Stay at Home Order, Closure of All Non-Essential Retail Businesses*, NJ.gov, Mar. 21, 2020 (<https://www.nj.gov/governor/news/news/562020/20200320j.shtml>).

³⁵ See Zachary Shevin and Allan Shen, *N.J. residents must stay at home, Gov. Phil Murphy announces*, The Daily Princeton, Mar. 21, 2020 (<https://www.dailyprincetonian.com/article/2020/03/gov-phil-murphy-signs-stay-at-home-order>).

April 30, 2020.³⁶ The foregoing are just a sample of the government orders, regulations and/or actions that impacted businesses by making it unlawful for customers and employees to go to certain businesses and for certain businesses to stay open for regular operations.

Within the first six months after the COVID outbreak, an estimated 32,700 franchised businesses closed.³⁷ Approximately two thirds of those closures were temporary, while the other third (approximately 10,875 franchised businesses) were closed permanently.³⁸ Only 25% of franchises regained their normal level of operations or were minimally affected by the pandemic as of September 5, 2020.³⁹ In other words, 75% of franchises had *not* regained their normal level of operations by September 2020. Further, franchised businesses, on a per unit basis, experienced on average a 19.3% decline in revenue.⁴⁰ As of August 31, 2020, the franchised businesses experienced an estimated total loss of 1.4 million jobs due to COVID-19, of which 40.2% were permanent.⁴¹ Franchised businesses in the hospitality and restaurant industries were some of the hardest hit, followed by franchised businesses in the personnel services and retail spaces.⁴²

Chapter 11 bankruptcy filings were up 20% in 2020 as a result of the pandemic, with restaurant and retailer bankruptcy filings up approximately 50%.⁴³ Franchisors and franchisees were among those filing for bankruptcy. For example, Sizzler USA, franchisor of the Sizzler steak, seafood, and salad bar restaurant concept, declared bankruptcy with

³⁶ *Governor Abbott Issues Executive Order, Implements Statewide Essential Services And Activities Protocols*, Gov.TX.gov, Mar. 31, 2020 (<https://gov.texas.gov/news/post/governor-abbott-issues-executive-order-implements-statewide-essential-services-and-activities-protocols>).

³⁷ See *Six-Month COVID-19 Impact Analysis on Franchising Market*, at 3, FRANdata, Sept. 2020 (available at <https://www.franchise.org/sites/default/files/2020-09/Six-Month%20COVID%20Impact%20on%20Franchising.pdf>).

³⁸ *Id.*

³⁹ *Id.* at 7.

⁴⁰ *Id.*

⁴¹ *Id.* at 3.

⁴² *Id.* at 3-4.

⁴³ See Jonathan O'Connell, *The wave of covid bankruptcies has begun*, MSN.com, Feb. 26, 2021 (<https://www.msn.com/en-us/money/companies/the-wave-of-covid-bankruptcies-has-begun/ar-BB1e2NdQ>).

respect to its 14 company-owned Sizzler units.⁴⁴ NPC International, the largest franchisee in the Pizza Hut system with over 1,200 Pizza Hut restaurants, declared bankruptcy and reached an agreement with Pizza Hut to permanently close 300 of its restaurants.⁴⁵ CFRA International, a 49-store IHOP franchisee declared bankruptcy in May 2020 citing the “safer at home” orders in North Carolina, South Carolina, Tennessee, and Virginia as the reason for the filing.⁴⁶ Similarly, the largest franchisee of Golden Corral declared bankruptcy,⁴⁷ and a 25-unit Applebees franchisee declared bankruptcy.⁴⁸

III. Addressing System Standards Issues In The COVID Era

In times of crisis, how should franchisors handle the enforcement of system standards? Should they be temporarily suspended or waived? Should a flexible approach be taken on a franchisee-by-franchisee basis, or is consistent, strict enforcement important? On one hand, a crisis should not give franchisees free reign to ignore contractual obligations. Unless a specific system standard is something that is truly affected by the crisis, it can be difficult to understand why the crisis would intervene and interfere with system standards obligations. On the other hand, a waiver or relaxation of at least *some* system standards in a crisis may not only be advisable, but *necessary* to ensure the survival of the system and the goodwill associated with the brand.

Additionally, in terms of enforcement, when, if ever, is it appropriate to terminate a franchisee for non-compliance with system standards during times of crisis? On one hand, termination is the most severe form of enforcement and many franchisors were reluctant to use it during the COVID era. On the other hand, the pandemic could have been viewed as an opportunity to separate weaker franchisees from stronger franchisees and to cull already struggling franchisees from a franchise system.

⁴⁴ 16 Restaurant Chains that Filed Bankruptcy Due to COVID-19, QSR Magazine, Sept. 2020 (<https://www.qsrmagazine.com/content/16-restaurant-chains-filed-bankruptcy-due-covid-19>).

⁴⁵ See Ben Coley, *Bankrupt Pizza Hut Operator NPC to Close up to 300 Stores*, QSR Magazine, Aug 2020 (<https://www.qsrmagazine.com/finance/bankrupt-pizza-hut-operator-npc-close-300-stores>).

⁴⁶ *Id.*

⁴⁷ See Peter Romeo, *Golden Corral's Largest Franchise Operator Files For Ch. 11 Bankruptcy*, Restaurant Business, Oct. 5, 2020 (<https://www.restaurantbusinessonline.com/financing/golden-corrals-largest-franchise-operator-files-ch-11-bankruptcy>).

⁴⁸ See Peter Romeo, *Applebee's Franchisee Files For Chapter 11 Bankruptcy*, Restaurant Business, Oct. 20, 2020 (<https://www.restaurantbusinessonline.com/financing/applebees-franchisee-files-chapter-11-bankruptcy>).

This section discusses several nonexclusive guiding principles for addressing system standards issues in the COVID era, considerations associated with waiving, modifying, and enforcing brand standards in the COVID era, and how these issues may evolve as we emerge from the pandemic.

A. Guiding Principles

i. The nature and locality of the system

The primary consideration in addressing system standards issues in the COVID era is the nature of the franchise system and the actual and specific causal affect the pandemic had on it. Not all franchise systems were affected equally during the pandemic. As discussed above, restaurant, hospitality, and retail industries were severely affected by the pandemic. Massage and fitness concepts were also severely affected. However, other industries and concepts, such as automotive concepts,⁴⁹ and QSR food concepts that were already optimized for delivery and/or take out, were not as severely affected. And some franchise systems, such as those in shipping and logistics, thrived during the pandemic. Indeed, it has been noted that some QSR franchise systems even experienced record sales during the pandemic.⁵⁰

A related consideration is the geographic footprint or locality of the franchise system. The pandemic spread across the world on a country-by-country basis, and across the United States like a wave, spiking first in the northeast and west coast, then in the southeast, southwest, and midwest. For large franchise systems, a region-by-region approach was necessary, as what may have worked for one group of franchisees did not work for others. In many cases a franchisee's specific location played a significant role in how severely that franchisee was affected by the pandemic.

⁴⁹ See *Thriving through Covid: Franchising in 2021*, FranNet, Nov. 19, 2020 (<https://frannet.com/resources/articles/thriving-through-covid-franchising-in-2021/>); Why Drive-Through Franchises Are Thriving During Covid-19, International Franchise Association, visited Mar. 7, 2021 (<https://www.franchise.org/blog/why-drive-through-franchises-are-thriving-during-covid-19>).

⁵⁰ See, e.g., Julie Creswell, *Pizza Was The Restaurant Hero of 2020*, New York Times, Feb. 12, 2021 (<https://www.nytimes.com/2021/02/12/business/pizza-delivery-covid.html?>) ("For large pizza chains like Domino's, Pizza Hut, Papa John's and the privately held Little Caesars, the pandemic proved to be a sales boon."); Ben Coley, *Little Caesars' COVID Success Could Lead To Growth Boom*, QSR Magazine, Dec. 11, 2020 (<https://www.qsrmagazine.com/exclusives/little-caesars-covid-success-could-lead-growth-boom>); John Ballard, *Domino's Pizza Reports Sales Increase Amid COVID-19 Pandemic*, The Motley Fool, Mar. 31, 2020 (<https://www.fool.com/investing/2020/03/31/dominos-pizza-reports-sales-increase-sales-amid-co.aspx>).

ii. The lifecycle of the crisis

Another consideration in addressing system standards issues is the specific stage of the pandemic in which the issue arose. Approaches to the enforcement of system standards necessarily varied depending on the stage of the pandemic. There is a significant difference in how a franchisor should act with respect to its system standards in response to an immediate crisis, versus in a prolonged recovery phase. Often a more flexible approach is necessary in the crisis response phase, such as what we witnessed at the onset of the pandemic in the spring of 2020, whereas, a less flexible approach may be appropriate in the recovery phase, such as in the spring and summer of 2021. As the marketplace has been transitioning from the crisis response to the recovery phase of the COVID pandemic, franchisors' focus has generally shifted from immediate all-hands-on-deck mitigation of imminent threats, to coaching, sharing best practices, and counseling franchisees in addressing prolonged issues and trends in their franchised businesses through the recovery.

iii. Consistency versus triage response

In responding to systems standards issues in the COVID era, there is an inherent tug-of-war between a consistent system-wide response and a franchisee-by-franchisee response. On one hand, there must be consistency in how a franchise system approaches system standards enforcement, and the perils of inconsistent enforcement are well established.⁵¹ Inconsistent enforcement can provide a franchisee with additional legal arguments and defenses in a dispute with a franchisor regarding non-compliance with system standards, including waiver, modification, estoppel, and/or breach of the duty of good faith and fair dealing.⁵² Inconsistent enforcement may also undermine a franchisor's justification for a covenant not to compete or a franchisor's allegation of irreparable harm.⁵³

On the other hand, differently situated franchisees are, in fact, in different situations, and that reality is compelling. For example, how should a franchisor address a franchisee, struggling with system standards issues, who was also struggling before the pandemic? How should the franchisor's approach change with respect to an otherwise compliant franchisee?

iv. Legal risk

There are a number of legal risks that must be considered in responding to system standards issues in the COVID era. One such risk is co-employment or joint employer

⁵¹ See Jess A. Dance, Robert M. Einhorn, Heather Carson Perkins, *Enforcing System Standards – A Franchisor's Prerogative?*, American Bar Association 41st Annual Forum on Franchising, at 5-16 (October 2018).

⁵² *Id.* at 5-12.

⁵³ *Id.* at 12-16.

risk. Normally, a franchisor should be at least one step removed from the management of a franchisee's employees to reduce the risk that the franchisor is found to be a co-employer or joint employer. However, if a franchisor mandates that franchisees implement a COVID-19 policy that applies to the franchisee's employees, for example, one could argue that the franchisor is taking a more active hand in the management of such employees.⁵⁴

However, that risk has to be weighed with the health and safety implications of not implementing a COVID-19 policy that applies to a franchisee's employees. Some franchisors formed the view that the evolving and critical nature of the pandemic required decisive actions to mitigate risks to public health and to franchisors' and franchisees' respective businesses. In that context, the risk of a co-employment or joint employer finding should be appropriately weighed against the risk of not issuing a COVID-19 policy.⁵⁵ Additionally, any such policy could be drafted in a way that is attentive to employment-related sensitivities and designed to mitigate risk in this area.⁵⁶

Additionally, there are a number of legal issues that might arise if an individual franchisee wants to implement adaptations and enhancements to the franchise system in the COVID era. Where novel adaptations or enhancements are implemented by franchisees, franchisors have to analyze how they accord with existing franchise agreements and applicable laws. For example, if a franchisee wants to implement a rewards program or a blast text message list to more easily and directly communicate with its customers, careful consideration has to be given to privacy laws to ensure the adaptation complies therewith. Clear communication of the terms and conditions upon which franchisees are free to explore their own adaptations and enhancements to the business format and franchised business operations is critically important.⁵⁷

B. Waiving, Modifying, Changing, And Implementing New System Standards

i. Key considerations

In evaluating whether to waive certain system standards in the COVID era, there are several key considerations franchise systems should examine.

⁵⁴ See Christine Jackson, Tom Peters, and Andraya Frith, *Implementing a COVID-19 Health and Safety Policy – Considerations for Franchisors*, Mar. 25, 2020 (available at <https://www.osler.com/en/resources/transactions/2020/implementing-a-covid-19-health-and-safety-policy-considerations-for-franchisors>).

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ See Andrae J. Marrocco, *The Franchisors Covid19 Legal Toolkit*, at 2, McMillan LLP (April 22, 2020).

First, a franchisor should ask itself what system standards are essential to the franchise system. Standards related to the look of a franchised business, the trademarks and trade dress associated with the franchise system, and the system's products and services are likely essential to the franchised business. In contrast, financial standards may not be as essential to the franchised business in the context of a temporary crisis period and may be the easiest for a franchisor to temporarily waive, relax, or defer. Franchisors should be hesitant to waive system standards that are essential to the franchised business.

Second, minimum standards related to the health and safety of employees and customers should never be waived, and depending on the nature of the crisis, it may be necessary to enhance health and safety standards. The safe operation of the franchised business should be the top priority at all times. Waiving health and safety standards not only exposes a franchisor to significant liability but can also expose a franchisor to significant and lasting damage to the brand and the goodwill associated with the brand. With that in mind, most franchise systems took the pandemic as an opportunity to strengthen and enhance their health and safety standards. But even then, some franchise systems faced litigation regarding the imposition of enhanced health and safety standards (or the lack thereof). For example, McDonald's was sued early in the pandemic in a class action by employees of various McDonald's franchisees accusing McDonald's of not doing enough to protect them from COVID-19.⁵⁸

Third, local laws and ordinances must be complied with. Since so many COVID restrictions were local, each franchised business unit was potentially subject to different local rules and requirements. Some franchisors simply reiterated to their franchise community that they must follow local laws and ordinances, and that such laws and ordinances trumped any conflicting system standards (such as minimum hours of operation or staffing requirements). Other franchisors decided to implement system wide standards that were tied to the most conservative local requirements in their system.

Fourth, reputational risk is a factor that should be considered in deciding whether to waive system standards during the COVID era. Waiving a health or safety standard or a standard that is essential to the franchised business could give rise to significant reputational risk from both a franchisee-facing perspective (including franchisee employees) and a public-facing perspective. But beyond that, franchisors should consider how waiving a certain standard may change expectations in a negative way. Will the public deem the brand less reliable or consistent? Will franchisees expect the same waiver next time there is an external event that affects their business even when it is less severe than this pandemic? Maintaining credibility with both franchisees and the public is essential for a franchisor.

Fifth, the legal risk associated with waiving a system standard should be carefully evaluated and proper legal procedures should be strictly observed. The legal doctrine of

⁵⁸ *Taynarvis v. McDonalds Corp., et al.*, Cook County, Illinois, Case No. 2020-CH-04247.

waiver “is the voluntary abandonment of a known right which, but for the waiver, would have been enforceable.”⁵⁹ If the temporary waiver of a system standard during a crisis is not properly documented, a franchisor could face an argument after the crisis is over that it waived such standards indefinitely going forward.

Finally, as discussed above, the specific nature of the pandemic affected franchise systems differently. Some systems’ operations were minimally affected, while others were entirely shut down. Franchise systems that were severely impacted by the pandemic necessitated far more waivers and modifications to system standards than those that were not.

ii. Implementing new system standards

Nearly every franchise system has been forced to adopt at least some new system standards in the COVID era. Health and safety standards have had a new light thrust on them in particular. Franchise systems have had to reimagine and reinvigorate health and safety standards to address the pandemic to ensure the safety of customers and employees. Responses include masking requirements, installation of physical barriers such as Plexiglas at points of customer contact, occupancy restrictions, moving some or all work to an online environment, and other innovative ideas. Operational standards have also had to also be reimaged in some instances. In the restaurant context, some examples include changes in food preparation steps, changes to/elimination of salad bars, breakfast bars, and similar things.

New system standards may derive from best practices developed by the franchisor. Some franchisors started by implementing new standards at corporate units, and then shared those out as recommendations to the franchisee community. Others vetted best practices from franchisees and introduced the best to the system as a whole.

At the outset of the pandemic franchisors were well advised to review the legal rights and mechanisms available in franchise agreements for both implementing and monitoring system changes.⁶⁰ Fortunately, most franchise agreements provide franchisors with the ability to protect their brand by modifying their brand standards and specifications to adapt to crises and/or changing times.⁶¹ Moreover, franchisors have latitude under the Lanham Act to act swiftly and decisively to protect their brands, goodwill

⁵⁹ *LaGuardia Assocs. v. Holiday Hosp. Franchising, Inc.*, 92 F. Supp. 2d 119, 130 (E.D.N.Y. 2000) (citing *Nassau Trust Co. v. Montrose Concrete Products Corp.*, 436 N.E.2d 1265, 1269–70 (1982)).

⁶⁰ See John Moore, *COVID Considerations for Restaurant Franchise Systems*, QSR Magazine, Mar. 2020 (<https://www.qsrmagazine.com/outside-insights/covid-19-considerations-restaurant-franchise-systems>).

⁶¹ *Id.*

and trademarks.⁶² The Lanham Act requires franchisors to guarantee the quality of the services and products sold under their trademarks.⁶³

One illustration of implementing new system standards in response to the pandemic is franchisor Hilton's implementation of its CleanStay program. In April 2020 Hilton announced the launch of 'Hilton CleanStay with Lysol Protection' ("CleanStay"), which was a rigorous system of enhanced cleaning and disinfection practices across Hilton's family of 17 hotel brands globally.⁶⁴ This program was put together in collaboration with RB, the maker of Lysol and Dettol, and in consultation with the Mayo Clinic's Infection Prevention and Control team.⁶⁵ The program involved: (1) contactless check-in services; (2) extra deep-cleaning and disinfection of 10 high-touch areas in each hotel room; (3) removing certain high-touch paper amenities; (3) improved guidelines for disinfecting hotel fitness centers; (4) increased frequency of cleaning public areas; (5) providing stations for guest-accessible disinfecting wipes in convenient locations throughout the hotels (for instance, allowing guests to wipe elevator buttons before pressing them); and (6) placing a room seal on guest room doors to indicate to guests that their room has not been entered since it was cleaned and disinfected.⁶⁶ The CleanStay program was designed to complement other hotel efforts, such as only providing in-room housekeeping services upon request, and temporarily replacing

⁶² Kerry L. Bundy, Lucie Guyot, Heather Carson Perkins, et. al, *Franchisor Best Practices for COVID-19*, Lexology, Mar. 19, 2020 (<https://www.lexology.com/library/detail.aspx?g=c85ca984-612e-4b10-b987-57d06be57a5a>).

⁶³ *Id.*

⁶⁴ See, Hilton Defining a New Standard of Hotel Cleanliness, Working With RB/Lysol and Mayo Clinic to Elevate Hygiene Practices From Check-In to Check-Out 'Hilton CleanStay with Lysol Protection' Expected to Launch June 2020 (April 28, 2020) (<https://newsroom.hilton.com/corporate/news/hilton-defining-new-cleanliness-standard>). The CleanStay program utilized different naming conventions in international markets where it was appropriate to do so.

⁶⁵ *Id.*

⁶⁶ *Id.*

breakfast bars with packaged meals, etc. The program build-out lasted from late April to mid-May 2020, and the program launched on June 15, 2020.⁶⁷

Implementing CleanStay required many elements to come together in short period of time, both business and legal. Key among them, Hilton had to make agreements with RB and the Mayo Clinic to establish the relationship of the parties and delineate the scopes of services, marketing and publicity parameters, and other elements. Hilton's operational teams had to assess the system standards for all 17 brands (which have different brand standards) to determine what requirements should be waived, reduced, modified, and/or added in order to respond to the pandemic and properly implement CleanStay. Hilton's leadership, operations, owner relations, legal, and communications teams had to coordinate and obtain buy-in from the appropriate stakeholders and begin communicating the program to the franchise estate and other relevant groups, including the preparation of media statements. Marketing was important to this effort. To achieve its goals, it was critical for Hilton to begin advertising CleanStay to the public as soon as possible to help give customers confidence in the brands. This required creating and executing the plan rapidly, which included instructing franchisees on how they could advertise CleanStay and distributing "tool kits" to the hotels which included on-property messaging and materials. As one can imagine, many business and legal issues had to be addressed at each step of this project; and determining whether and how to change the system standards was an essential step of the process. Franchisors are well advised to record proposed waivers, modifications, changed, and new system standards with robust legal documentation that addresses all legal concerns associated with the system change and monitoring.⁶⁸ The legal terms should allow for flexibility to, among other things, permit further updates, and should adequately cater to the ever-changing legal environment.⁶⁹ When resuming the enforcement of a standard that was waived, modified, or changed during a crisis, the franchisor should use a "new day" letter, or a communication advising franchisees that a standard that was waived, changed, modified, or just previously unenforced, will be enforced in the future.⁷⁰

⁶⁷ See, About Hilton CleanStay (May 7, 2020) (<https://www.fsae.org/assets/docs/HiltonCleanStay-FactSheet.pdf>); and Q&A: Phil Cordell on Hilton's New CleanStay Program and the Future of Hotel Cleanliness (June 12, 2020) (<https://newsroom.hilton.com/corporate/news/hilton-executive-on-new-cleanstay-program>).

⁶⁸ See J. Marrocco, *supra*, at 2.

⁶⁹ *Id.*

⁷⁰ See Leonard MacPhee, Scott McIntosh, and Janaki Parmar, *So You Want to Terminate for System Standards Violations*, at 10, American Bar Association 42nd Annual Forum on Franchising, October 2019.

C. Enforcing System Standards

As discussed above, prior to the COVID era, franchisors generally viewed minor deviations from system standards as an early warning sign of a problem in the franchise relationship, and franchisors were generally advised to investigate such deviation(s) further and decide whether to pursue termination based on the strength of the legal basis for termination and an evaluation of the benefits to avoiding termination, impacts on the system and other franchisees, and viable alternatives.⁷¹ During the COVID era, several key steps in that process were impacted. Those most impacted included the physical mechanisms for investigating and discovering deviations from system standards, and additional considerations in deciding whether termination is appropriate. In some respects, enforcement of system standards—especially those adopted to address the impacts from the pandemic—has become more important than ever to prevent adverse impacts on the brand related to non-compliant franchisees.

i. Modified enforcement mechanisms

Mechanisms for investigating and discovering deviations from system standards changed during the course of the pandemic. At the beginning of the pandemic many franchisors stopped all in-person inspections other than in cases where a physical inspection was critically needed.

In lieu of physical inspections, some franchisors utilized online video sessions to conduct virtual inspections. Others required photos of various aspects of the franchised business by franchisees as part of a modified inspection protocol. Some franchisors also made use of online checklists while physical inspections were temporarily suspended.⁷² Franchisors generally discovered that there is often a lot of information a franchisor can glean from a franchisee's compliance with brand standards outside of a physical visit. For example, an inspection as to whether the franchisee is submitting the required financial reports, and what information is contained in the financial reports, can yield significant information.

Many franchisors have resumed or are resuming physical inspections in a phased approach, utilizing virtual inspections where that is practical, and utilizing in-person/regular pre-COVID inspection schedules where that is now practical again.

ii. Enhanced enforcement and termination considerations

The number of issues that a franchisor had to consider before terminating a franchise relationship expanded and evolved during the course of the pandemic. Most significantly, the pandemic gave franchisees additional potential legal defenses excusing

⁷¹ *Id.*

⁷² See Bill Edwards, *Coping with Covid - What Global Brands Are Doing To Survive*, Multi-Unit Franchisee Magazine, Issue 3 2020, July 31, 2020.

a failure to meet certain brand standards. These defenses may include force majeure, material adverse event, hardship, impossibility of performance or frustration of purpose.⁷³

For example, in *E2W LLC v. KidZania Operations S.a.r.l.*, a franchisee of the KidZania franchise system sought a temporary restraining order against the franchisor after the franchisor tried to terminate the franchise agreement for failure to pay certain royalties.⁷⁴ The franchisee argued the termination was invalid for a number of reasons, including that: (1) COVID-19 and the ensuing governmental orders / regulations triggered the force majeure clause in the franchise agreement; (2) the doctrine of impossibility precluded termination of the franchise agreement; and (3) the franchisor waived any right to terminate the franchise agreement and was equitable estopped from doing so.⁷⁵

The court granted the franchisee's temporary restraining order and enjoined the franchisor and its agents, employees, and affiliated companies from terminating the franchise agreement and taking any actions that would interfere with the continued operations of the franchisee, and to otherwise maintain the status quo pending a decision on the merits of the termination.⁷⁶

While *E2W LLC* was not a decision on the merits, it highlights the types of arguments a franchisee may make in response to default or termination during the COVID era. There is very little case law in the franchise context for how these legal defenses are being interpreted in light of the pandemic as it evolves, but decisions in the commercial litigation context show these defenses may be successful.⁷⁷ Of course, as we get further

⁷³ James R. Ferguson, *Litigating Contract Disputes After COVID-19: A Practical Guide*, (available at <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/05/litigating-contract-disputes-after-covid19-a-practical-guide.pdf>)

⁷⁴ *E2W LLC v. KidZania Operations S.a.r.l.*, S.D.N.Y. Case No. 1:20-cv-02866-JPC, Doc. 1, Complaint.

⁷⁵ *Id.* at Doc. 31-7, Plaintiff's Memorandum of Law in Support of its Application for a Temporary Restraining Order and Preliminary Injunction.

⁷⁶ *Id.* at Doc. 54.

⁷⁷ See, e.g., *Eason v. US Well Services, Inc.*, No. H-20-2995, 2021 WL 520712, at *7 (S.D. Tex. Feb. 10, 2021) (holding that COVID-19 qualifies as a disaster under the Worker Adjustment and Retraining Notification Act); *In re Hitz Restaurant Group*, 616 B.R. 374, 377 (N.D. Ill. Bk. 2020) (holding rent payments becoming due after executive order closing indoor dining due to pandemic were partially excused by force majeure clause); *JN Contemporary Art LLC v. Phillips Auctioneers LLC*, No. 20-CV-4370, 2020 WL 7405262, at *7 n.7 (S.D.N.Y. Dec. 16, 2020) (holding the pandemic qualified as a force majeure event under a force majeure clause in an insurance policy); *AB Stable VIII LLC v. Maps Hotels & Resorts One LL*, No. 20-CV-0310, 2020 WL 7024929, at *58 (Del. Ch. Nov. 30, 2020 ("The COVID-19 pandemic arguably fits this definition [of natural disaster]"))

and further removed from the pandemic, and especially the initial triage phase of the pandemic, it becomes less of a reasonable excuse for noncompliance with brand standards.

In addition to the existing case law, the decision whether to terminate or not to terminate during the COVID era was impacted by other unique considerations including reputational concerns and cash flow concerns. Terminating a franchisee during a crisis such as COVID could be demoralizing to a franchise system and may infer that the franchisor is merely cutting ties with struggling franchisees rather than helping them. Additionally, exercising a right to terminate can be costly, both in terms of preparing the notice and potentially dealing with follow-on litigation, and in terms of the loss of cash flow from the franchised unit. Business cash-flow considerations were particularly important early in the COVID pandemic when most companies prioritized maintaining cash.

D. Emerging From The Pandemic

While it is impossible to predict the future, there are several trends impacting compliance with and enforcement of brand standards that merit consideration as franchise systems move beyond the pandemic. First, many franchisors are anticipating additional franchisee departures from franchise systems, both from franchisees that sell/close their business, and franchisees that are terminated as a result of defaults occurring before and/or during the pandemic. The pandemic and resulting economic crisis may root out already struggling units. Some of those units may be put up for sale and consolidated with an experienced, successful multi-unit operator. Consolidation may be viewed positively from a brand standards perspective assuming the experienced and successful multi-unit operator is more likely to uphold strict brand standards.

Additionally, there are business opportunities resulting from the pandemic. For example, in the hospitality and hotel space, there are likely to be fewer new builds but

under a purchase and sale agreement); *Pa. Democratic Party v. Boockvar*, 238 A.3d 345, 370 (Pa. 2020) (“We have no hesitation in concluding that the ongoing COVID-19 pandemic equates to a natural disaster” under a Pennsylvania statute). *But see In re CEC Entertainment, Inc.*, No. 20-BR-33163, 2020 WL 7356380, at *5 (S.D. Tex. Dec. 14, 2020) (holding that force majeure clause did not excuse the failure to pay rent because monetary obligations were specifically carved out from force majeure clause); *Future Street Limited v. Big Belly Solar, LLC*, No. 20-cv-11020-DJC, at *6 (D. Mass. July 31, 2020) (holding that licensee was no likely to succeed on a declaratory judgment claim that its non-performance under contract was excused by *force majeure* occurrence, because certain obligations preceded the pandemic and the licensee partially fulfilled its obligations even after the pandemic began).

more conversions of independent hotels into franchised brands.⁷⁸ In the QSR space, many franchisors are reviewing potential opportunities in real estate as other systems and business units close.

As we emerge from the pandemic and franchise systems regain levels of normalcy, fewer and fewer deviations from system standards will be attributable to the pandemic.

IV. Addressing System Standards Issues In Future Times Of Uncertainty

There are a number of important lessons that the franchise legal community can learn from the pandemic.

First, the pandemic taught many franchise systems how important their in-person relationship is with their franchisees. Prior to the pandemic, many franchise systems had, at some regular interval, in-person meetings or “conventions” with all of their franchisees. Franchise systems used those meetings to solicit and deliver important information to and from franchisors, franchisees, and suppliers. Those meetings did not occur during the pandemic, and while franchise systems tried to replicate them by engaging their franchise communities in a variety of formats and across a variety of platforms, most franchise systems agree that nothing beats the in-person relationship in a franchise system.

Second, the pandemic showed the value of building resilient franchise systems. Franchise systems with strong leadership, good communications, and agile operations were well-equipped to address the challenges of the COVID era. Building a resilient franchise system is done in the months and years leading up to a crisis event, not during a crisis event. Franchise systems that regularly focus on resiliency will be well-positioned to address the next crisis.

Third, the pandemic showed the value of strong crisis response planning. Crisis response planning focuses on anticipating and planning for the possibility of an unplanned event. The more prepared a franchise system is to manage disturbances, the less likely the franchise system will fall victim to the serious harm a disturbance like a crisis has the potential to inflict. Franchise systems would be well-advised to engage in crisis response planning going forward if they do not already.

Each of these lessons is applicable to decisions involving the enforcement of system standards and terminations in future times of uncertainty. Perhaps a franchisor will refrain from terminating a franchisee for systems standards violations until it can hold an in-person meeting with the franchisee to discuss the issues. When faced with a system standards issue in a crisis, franchisors need to assess how the various mechanisms and options for enforcement affect the resiliency of the franchise system—would a termination

⁷⁸ See e.g., Stephanie Ricca, *Business Demand, Conversions Bright Spots For Hilton Execs Point to First Signs of Business Demand Rebound*, Hotel News Now, Feb. 17, 2021 (<https://www.costar.com/article/862286504/business-demand-conversions-bright-spots-for-hilton>) (noting that conversion deals grew more than 30% in 2020 versus 2019, which represented about 20% of Hilton’s net unit growth for the year).

demoralize the franchisee community in general? Would it strengthen the brand and thus enhance the franchisee community? Franchisors should also ensure that systems standards issues, including enhanced considerations applicable in times of crises, are outlined in their crisis response plans going forward.

Conclusion

Franchise systems faced a multitude of challenges during the COVID-19 pandemic from a system standards perspective. Careful study of those challenges and the solutions franchise systems developed reveals a multitude of important lessons for addressing system standards issues, and the decision of whether or not to terminate a franchisee, in future times of uncertainty.