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Lessons Learned by Franchise Systems in Crisis Events

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IFA 56TH ANNUAL LEGAL SYMPOSIUM

LESSONS LEARNED BY FRANCHISE SYSTEMS IN TIMES OF CRISIS

Introduction

At the onset of a global health event, international or domestic political unrest, or economic uncertainty or worse, franchise systems and franchise agreements are put to the test. When faced with challenging circumstances, however, franchise systems can adapt to and plan for crisis events in various ways. This Paper will focus on the impact to franchise systems as a result of two recent global events, namely the COVID-19 pandemic and war in Ukraine and related sanctions impacting Russia, and use these events to discuss these and other types of crises. It will discuss the contractual mechanisms that may help in planning for future crises, contracting around supply chain disruptions, and the enforcement of intellectual property rights.

This Paper will proceed in four parts. Part 1 provides a survey of the crises-laden landscape in which franchise businesses seek to operate. It will survey the global crises that have emerged in recent years and have impacted global and domestic franchise businesses and will highlight specific ways in which franchise businesses have adapted. Next, Part 2 considers the key contract considerations that emerge in light of global health, political, and economic crises. It will discuss innovations in contracting, the *force majeure* clause, and contracting to ensure a reliable supply chain is in place. Part 2 concludes with a case study that highlights the key considerations for franchise businesses that emerged at the onset of the Russian invasion of Ukraine. Part 3 outlines the various steps franchisors can take to mitigate losses when confronted with unforeseen circumstances when establishing franchise relationships going forward. Finally, Part 4 highlights additional contract-based solutions franchisors may consider when establishing future contractual relationships with franchisees or third parties.

1. Discussion of Crisis Events and Impact on Franchised Businesses

(a) Global Health Crisis: COVID-19 Pandemic

In March 2020, the global outbreak of the novel coronavirus, SARS-CoV-2 or COVID-19, created an extreme shift in daily life. The emergence of a highly contagious and often fatal illness caused lawmakers worldwide to respond quickly to try and contain the virus. Relying on emergency laws, lawmakers and politicians declared states of emergency across regions worldwide, placing “lockdown measures” in effect which included “stay-at-home” orders, mandating quarantines on exposure or infection with the virus, and prohibiting any form of social congregation whether for work or pleasure. The economic and social impact of these measures was far reaching. From a strictly business and economic perspective, the pandemic’s policies effectively shut down economies and global industries including manufacturing, travel, hospitality and tourism, service, and the arts.

As a result, COVID-19 had a significant impact on business generally, including franchised businesses.¹ In a survey conducted by the International Franchise Association, COVID-19 in the United States resulted in the loss of “1.4 million franchise jobs ... of which 40.2% were permanent, and over 32,000 franchised businesses closed, of which 10,875 were permanent.”² Franchise

¹ Constantine T. Fournaris & Robert S. Burstein, “The Potential Impact of COVID-19 on Franchise Lost Profits Claims” (2022) 41 Franchise LJ 309

² Constantine T. Fournaris & Robert S. Burstein, “The Potential Impact of COVID-19 on Franchise Lost Profits Claims” (2022) 41 Franchise LJ 309

businesses felt the impact of COVID-19 from at least two key perspectives. First, uniform “stay at home” orders meant there was a decrease in in-person shopping and dining, key industries where franchise businesses operate.³ Focus brands, for example, which has notable brands such as Auntie Annie’s and Cinnabon within its portfolio, had a heavy presence in malls and airports and felt the impacts of COVID-related measures disproportionately.⁴

Second, supply chain delays caused by COVID-related measures impacted business and franchises. Franchisors faced issues in arranging for the timely supply of their franchisees, especially when contracting internationally and navigating various international pandemic rules and regulations. Conversely, franchisees may have ceased to operate for a variety of reasons, including where supply chain requirements could not be met by their usual suppliers, including the franchisor, or when employees refused to show up for work, making it impossible for the franchisee to deliver products or services to its customers.⁵ Moreover, perhaps unique to franchised businesses, is the impact COVID-19-related supply chain and other disruptions had on one of the key foundational elements of a franchise system, namely the distinctiveness of the licensed intellectual property (IP). However, a lack of contractual preparedness for supply chain delays may not be captured in a franchise agreement.⁶ Disruptions in supply of component parts may limit a franchisee’s ability to validly sell goods under the franchisor’s IP without the appropriate components.⁷

(b) International Political Unrest

In February 2022, almost two years since the outbreak of COVID-19, Russia mobilized a “full-scale invasion” on its neighboring country Ukraine.⁸ As an act of political aggression in Europe, the ongoing conflict is considered the “largest mobilization of forces Europe has seen since 1945” and has had devastating humanitarian impacts in Ukraine.⁹ Intense political backlash coupled with swift economic sanctions from several NATO and other countries has impacted global economies and American business, especially as it relates to global franchises based in the United States with outlets in Russia and surrounding countries.

The war in Ukraine prompted several American businesses, many of which are franchises, to pull out of operating in Russia. Notable restaurant brands impacted in this way (not all franchised) include McDonalds, Starbucks, Subway, KFC, and Pizza Hut.¹⁰ Certainly the most iconic

³ “Coronavirus: How the pandemic has changed the world economy” (24 January 2021), online: *BBC* < <https://www.bbc.com/news/business-51706225>>.

⁴ Alicia Kelso, “Focus brands’ pandemic-inspired adjustments create development optimism” (20 November 2022), online: *Nation’s Restaurant News* <<https://www.nrn.com/quick-service/focus-brands-pandemic-inspired-adjustments-create-development-optimism>>.

⁵ Robert W Emerson & Zachary R. Hunt, “Franchisees, Consumers, and Employees: Choice and Arbitration” (2022) 13 *Wm & Mary Bus L Rev* 487 at 560.

⁶ Foley & Lardner LLP, “Supply Chain Disruption Survival Guide” (2022) at 31, online: < <https://www.foley.com/en/general/supply-chain-disruption>>.

⁷ Foley & Lardner LLP, “Supply Chain Disruption Survival Guide” (2022) at 30, online: < <https://www.foley.com/en/general/supply-chain-disruption>>.

⁸ Ban Bilefsky, Richard Perez-Pena & Eric Nagourney, “The Roots of the Ukraine War: How the Crisis Developed” (12 October 2022), online: *New York Times* < <https://www.nytimes.com/article/russia-ukraine-nato-europe.html>>.

⁹ Ban Bilefsky, Richard Perez-Pena & Eric Nagourney, “The Roots of the Ukraine War: How the Crisis Developed” (12 October 2022), online: *New York Times* < <https://www.nytimes.com/article/russia-ukraine-nato-europe.html>>.

¹⁰ Clint Rainey, “How McDonald’s Won Russia—and Then Lost it All” (4 January 2023), online: *Bloomberg* < https://www.bloomberg.com/news/features/2023-01-04/mcdonald-s-won-big-in-russia-until-the-ukraine-invasion?utm_campaign=news&utm_medium=bd&utm_source=applenews&leadSource=verify%20wall>

American brand to join this movement is McDonalds, which initially made headlines when it entered the Russian market 33 years ago bringing a high profile symbol of American success into previously unwelcomed territory.¹¹ However, despite their commercial success in Russia marketing a highly Americanized fast-food culture, Russia's invasion of Ukraine sparked intense backlash in the U.S. Shareholders began pressuring McDonalds to pull out of the country for good.¹² Ultimately, what was perhaps still good for business for McDonalds Russia was certainly perceived as being bad for business in the U.S. In response, McDonald's Corp. sold its Russian business to an existing licensee, releasing a statement that this unprecedented move meant allowing McDonalds to "do the right thing" one of the corporation's key values.¹³ Where their contractual arrangements permitted, other American franchise brands such as Pizza Hut, owned by Yum Brands Inc., was also able to effect a similar exit from Russia in a relatively quick fashion.¹⁴

Other franchised businesses who faced similar pressure and negative media attention, however, were not able to exit Russian markets as easily or at all. Franchise brands facing these difficulties include the fast-food businesses such as Burger King, Subway, the Yum Food Brands, KFC, and hotel chains Accor and Marriot.¹⁵ Without looking at the specific business dealings of each of these companies, the nature of certain long-standing franchise agreements generally are such that it would be impossible for certain franchisors to unilaterally cease Russian operations due to complicated licensing agreements. In a statement to the press, Subway acknowledged that it had "limited insight into [Russian franchisee's] day-to-day operations."¹⁶ Despite having little legal authority to unilaterally terminate certain franchise agreements, these franchisors have other, less absolute, tools at their disposal to limit operations in unwanted jurisdictions. For instance, Burger King's owner, Restaurant Brands International, has halted corporate support for all 800+ Russian-franchisee locations.¹⁷ It is also in the process of unwinding its ownership stake in its Russian

¹¹ Clint Rainey, "How McDonald's Won Russia—and Then Lost it All" (4 January 2023), online: *Bloomberg* <https://www.bloomberg.com/news/features/2023-01-04/mcdonald-s-won-big-in-russia-until-the-ukraine-invasion?utm_campaign=news&utm_medium=bd&utm_source=applenews&leadSource=verify%20wall>

¹² Clint Rainey, "How McDonald's Won Russia—and Then Lost it All" (4 January 2023), online: *Bloomberg* <https://www.bloomberg.com/news/features/2023-01-04/mcdonald-s-won-big-in-russia-until-the-ukraine-invasion?utm_campaign=news&utm_medium=bd&utm_source=applenews&leadSource=verify%20wall>

¹³ Catherine Larkin, "McDonald's Golden Arches to Disappear From Russia After Sale to Licensee" (19, May 2022), online *Bloomberg* <<https://www.bloomberg.com/news/articles/2022-05-19/mcdonald-s-agrees-to-sell-russian-business-to-current-licensee?leadSource=verify%20wall>>. Clint Rainey, "How McDonald's Won Russia—and Then Lost it All" (4 January 2023), online: *Bloomberg* <

https://www.bloomberg.com/news/features/2023-01-04/mcdonald-s-won-big-in-russia-until-the-ukraine-invasion?utm_campaign=news&utm_medium=bd&utm_source=applenews&leadSource=verify%20wall>

¹⁴ Heather Haddon, "Starbucks to Exit From Russia" (23 May, 2022), online: *Wall Street Journal* <<https://www.wsj.com/articles/starbucks-to-exit-from-russia-11653312015>>. Yum Brands Inc, "Update on Yum! Brands Plan to Exit Russia" (5 July 2022), News Release, online: <<https://www.yum.com/wps/portal/yumbrands/Yumbrands/news/company-stories/Update+on+Yum+Brands+Plan+to+Exit+Russia>>.

¹⁵ Karen Gilchrist, "Over 400 companies have withdrawn from Russia. But some Western brands are locked in" (18 March 2022) online: *CNBC* <<https://www.cnbc.com/2022/03/18/burger-king-subway-ms-western-brands-in-russian-franchise-deals.html>>. Julia Creswell, "Fast-food chains and food producers stay open in Russia, and mostly quiet about Ukraine" (5 March 2022), online: *New York Times* <<https://www.nytimes.com/2022/03/05/world/europe/russia-food-ukraine.html>>.

¹⁶ Karen Gilchrist, "Over 400 companies have withdrawn from Russia. But some Western brands are locked in" (18 March 2022) online: *CNBC* <<https://www.cnbc.com/2022/03/18/burger-king-subway-ms-western-brands-in-russian-franchise-deals.html>>.

¹⁷ Karen Gilchrist, "Over 400 companies have withdrawn from Russia. But some Western brands are locked in" (18 March 2022) online: *CNBC* <<https://www.cnbc.com/2022/03/18/burger-king-subway-ms-western-brands-in-russian-franchise-deals.html>>.

business.¹⁸ Accor and Marriott have both halted plans to open new hotels.¹⁹ These alternatives are certainly less ideal and, as media and business repercussions mount, highlight one of the fragilities of franchising as a method of doing business.

(c) Domestic Political Unrest

The past five years have seen immense civil unrest and turmoil within the United States. COVID-19-related protests and convoy blockades protesting COVID vaccination and masking mandates, a national uprising against police brutality, the creation of a structured Black Lives Matter movement in a response to incidents of police brutality, and an attempted insurrection of the United States Capital are the key dark moments which have punctuated the past half-decade.

From the perspective of businesses and franchises, there has been a growing trend for corporate partisanship where corporations and their executives emerge to take a stance on these important but divisive issues. Research now demonstrates that consumers expect executives of large corporations to speak out and engage with major social issues.²⁰ McDonald's exit from Russia is perhaps an example of this where executives released a statement that provided "continued ownership of [a] business in Russia was no longer tenable nor consistent with [the] values" of the company.²¹ However, where an executive takes a divisive stance, they risk damaging both their personal reputation in the media and the reputation and perhaps viability of their business.²²

(d) Economic Uncertainty

Not completely unrelated to economic pressures associated with the COVID-19 pandemic and the Russian invasion of Ukraine, inflation reached a record-breaking high in the recent year in Canada and the United States.²³ Statistics Canada, a Federal government agency, has reported that consumer inflation increased 5.1% in January 2022 which represents a 30-year high.²⁴ Similarly, the consumer-price index, which measures the price consumers pay for goods, and the employer cost index rose substantially in the past year.²⁵ Moreover, the cost of living has increased substantially with consumers noticing drastic increases in costs associated with food

¹⁸ Heather Haddon, "Starbucks to Exit From Russia" (23 May, 2022), online: *Wall Street Journal* <<https://www.wsj.com/articles/starbucks-to-exit-from-russia-11653312015>>.

¹⁹ Karen Gilchrist, "Over 400 companies have withdrawn from Russia. But some Western brands are locked in" (18 March 2022) online: *CNBC* <<https://www.cnbc.com/2022/03/18/burger-king-subway-ms-western-brands-in-russian-franchise-deals.html>>.

²⁰ David Gelles, "Red Brands and Blue Brands: Is Hyper-Partisanship Coming For Corporate America?" (23 November 2021), online: *New York Times* <<https://www.nytimes.com/2021/11/23/business/dealbook/companies-politics-partisan.html>>.

²¹ Deal Seal & Annie Gasparro, "McDonald's to Exit From Russia After Three Decades" (16 May, 2022) online: *Wall Street Journal* < <https://www.wsj.com/articles/mcdonalds-to-exit-from-russia-11652697074> >.

²² David Gelles, "Red Brands and Blue Brands: Is Hyper-Partisanship Coming For Corporate America?" (23 November 2021), online: *New York Times* <<https://www.nytimes.com/2021/11/23/business/dealbook/companies-politics-partisan.html>>.

²³ Foley & Lardner LLP, "Supply Chain Disruption Survival Guide" (2022) at 4, online: <<https://www.foley.com/en/general/supply-chain-disruption>>.

²⁴ Statistics Canada, *COVID-19 in Canada: A Two-year Update on Social and Economic Impacts*, Catalogue No. 11-631-X (Ottawa: Statistics Canada, 10 March 2022).

²⁵ Foley & Lardner LLP, "Supply Chain Disruption Survival Guide" at 4. "In September 2022, the consumer-price index (or CPI)—a measure of the prices consumers pay for products—rose at an annual rate of 8.2%" ... "the employer cost index (or ECI) demonstrates that, from June 2021 to June 2022, total compensation rose 5.1% wages and salaries rose 5.3%, and benefit costs rose 4.8" *ibid* at 4.

and shelter.²⁶ The rate of consumer inflation in Canada has increased at a faster pace than wages.²⁷

Franchised businesses will feel the impacts of economic uncertainty in three primary ways. First, as the cost of living increases it is possible that franchised businesses will see this impact overall sales which will in turn, impact profits. Second, in a franchise relationship, inflation is likely to also impact risk allocation in contracting between franchisor and franchisee as “consequences of that risk allocation will have greater financial impacts than we have seen in recent memory.”²⁸ However, some commentators in the industry project that inflation has the potential to expand franchising.²⁹ For instance one commentator made the observation that “[i]nflated costs tend to benefit brands charging royalties.”³⁰ Moreover, in response to COVID supply delays, there is an industry-wide shift to adapting supply chains to be vertically integrated reducing future risk of disruption and potentially cutting costs. Finally, the economic downturn unfortunately does not benefit small businesses which creates space for branded or big-box franchises to expend resources to capitalize on new market share.

2. Franchise Contracting in Times of Crisis

The basis of any franchise relationship is the franchise agreement. As such, general principles of contract law, including principles of enforcement and interpretation, will apply to dealings between franchisor and franchisee, in addition to the applicable franchise legislation.³¹ Thus, when dealing with franchise agreements in times of crisis, franchisors ought to be aware of the ways in which they can implement systemwide change and innovate within the parameters of these contracts. First, parties may look to a key contractual provision, the *force majeure* clause, but potentially only with measured success. Second, parties might consider how business innovations (such as artificial intelligence) can impact their business plans and incorporate these considerations into their contractual arrangements. Finally, franchise systems should consider how to safeguard supply chains necessary to operate their businesses and implement the contracts and contractual provisions necessary to support these systems.

(a) “Force Majeure” Clauses

Force majeure, or “superior force” in French, is understood in contracts as an “act of God.” In the realm of contract law, force majeure events are generally those which are out of the contracting parties’ control and prevent the performance of the contract.³² The concept stems from the English

²⁶ Prices for food and shelter rose steadily over 2021. In January, annual price increases for both food (+5.7%) and shelter (+6.2%) were above the headline rate. Grocery prices rose at their fastest yearly pace (+6.5%) since May 2009.

²⁷ Statistics Canada, COVID-19 in Canada: A Two-year Update on Social and Economic Impacts, Catalogue No. 11-631-X (Ottawa: Statistics Canada, 10 March 2022).

²⁸ Foley & Lardner LLP, “Supply Chain Disruption Survival Guide” at 4-5.

²⁹ Alicia Kelso, “Why franchising is expected to grow in 2023” (4 January 2023), online: *Nation’s Restaurant News* < <https://www.nrn.com/franchising/why-franchising-expected-grow-2023> >.

³⁰ Alicia Kelso, “Why franchising is expected to grow in 2023” (4 January 2023), online: *Nation’s Restaurant News* < <https://www.nrn.com/franchising/why-franchising-expected-grow-2023> >.

³¹ For example, several provinces in Canada have enacted franchise-specific legislation. See e.g., Alberta: *Franchises Act*, R.S.A. 2000, c.F-23; New Brunswick: *Franchises Act*, S.N.B. 2007, c. F-23.5; Ontario: *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c.3; Prince Edward Island: *Franchises Act*, S.P.E.I. 2005, c. 36.

³² *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp & Paper Co.*, [1976] 1 SCR 580 (SCC), 56 DLR (3d) 409.

common law doctrine of impossibility of contract performance.³³ However, the concept has subsequently evolved and exists now both in civil and common law countries, including Canada and the United States.³⁴ In Canada, force majeure clauses are creatures of contract law while Quebec has codified force majeure in its Civil Code.³⁵ Similarly, the United States common law recognizes force majeure clauses in contracts in addition to some states which impose force majeure principles in contracts through legislation.³⁶

In Canada, the leading case from the Supreme Court articulates the “force majeure” doctrine as follows:

An act of God clause or force majeure clause . . . generally operates to discharge a contracting party when a supervening, sometimes supernatural, event, beyond the control of either party, makes performance impossible. The common thread is that of the unexpected, something beyond reasonable human foresight and skill.³⁷

This definition provides that a contractually valid “force majeure” event will have two key features. First, it will be an event out of the contracting parties’ control or one that was not a result of actions of or taken by the parties. Second, it must make completion of contractual obligations impossible. While this definition stems from the Canadian legal regime, the doctrine’s components remain largely the same in the United States save for an additional notice requirement.³⁸

When included in a contract, a force majeure clause represents a contractual mechanism through which to allocate risk for future events that are beyond the control of the parties to a contract.³⁹ Parties to a contract may wish to plan for these events in their contractual dealings and choose how they would proceed in the event a force majeure clause must be relied upon. Formally, force majeure provisions are usually expressly provided for within a contract⁴⁰ and may either provide for triggering obligations generally or specifically.⁴¹ Therefore, the nature of the contractual

³³ Amy Sparrow Phelps, “Contract Fixer Upper: Addressing the Inadequacy of the Force Majeure Doctrine in Providing Relief for Nonperformance in the Wake of the COVID-19 Pandemic” (2021) 66 Vill. L Rev 647 at 652.

³⁴ Amy Sparrow Phelps, “Contract Fixer Upper: Addressing the Inadequacy of the Force Majeure Doctrine in Providing Relief for Nonperformance in the Wake of the COVID-19 Pandemic” (2021) 66 Vill. L Rev 647 at 652.

³⁵ David Outerbridge, Jessica R. Lumière & Rudyard Griffiths “Managing Contract Risks and Obligations During a Pandemic” (20 April 2020), *Torys LLP* at 8.

³⁶ Amy Sparrow Phelps, “Contract Fixer Upper: Addressing the Inadequacy of the Force Majeure Doctrine in Providing Relief for Nonperformance in the Wake of the COVID-19 Pandemic” (2021) 66 Vill. L Rev 647 at 652.

³⁷ *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp & Paper Co.*, [1976] 1 SCR 580 (SCC), 56 DLR (3d) 409.

³⁸ Amy Sparrow Phelps, “Contract Fixer Upper: Addressing the Inadequacy of the Force Majeure Doctrine in Providing Relief for Nonperformance in the Wake of the COVID-19 Pandemic” (2021) 66 Vill L Rev 647 at 653.

³⁹ Foley & Lardner LLP, “Supply Chain Disruption Survival Guide” (2022) at 40, online: <<https://www.foley.com/en/general/supply-chain-disruption>>; Zohar Levy & Nicholas Carmichael, “Covid-19 as a Force Majeure, and Other Contractual Considerations” (2020) 2 BLR (6th ed) 32 at 32.

⁴⁰ Foley & Lardner LLP, “Supply Chain Disruption Survival Guide” (2022) at 40, online: <<https://www.foley.com/en/general/supply-chain-disruption>>.

⁴¹ Inna Vorotynsteva, Ivanna Hranina & Maryna Pysarenko, “Comparative Legal Research on Contract Law Changes under COVID-19 Pandemic: England, United States, Asia, and Ukraine” (2021) 10:1 *Ius Humani*, *Revista de Derecho* 123 at 129.

language courts will generally take a fact-based and case-by-case assessment of whether a given event qualifies as a “force majeure” event.⁴²

(i) Using the “Force Majeure” cause in a franchise agreement

Force majeure provisions are standard contractual provisions that can be negotiated by parties to be included in commercial contracts. At the heart of the franchisor-franchisee relationship is the franchise agreement which can be characterized as the central document which both parties are required to sign. While the franchise agreement contains provisions dealing with unique issues specific to the brand and the franchisor-franchisee relationship (i.e., intellectual property, training and operation, advertising, and promotions, etc.) franchise agreements will also include more standard contractual provisions. Therefore force majeure clauses are similarly commonplace in franchise agreements.

In the franchise relationship context, force majeure clauses may appear to allocate risk between franchisor and franchisee. A series of global crises, as discussed in this paper, above, has put “force majeure” clauses in franchise agreements to the test. The exact bargain struck is ultimately up to the contracting parties, and the remedies in the event of a “force majeure” event typically include suspension of performance, rescission, renegotiation or repayment of monetary obligations.⁴³

(ii) Relative success of “Force Majeure” in the franchise context

In a time of crisis, force majeure clauses can be considered as one of the main legal mechanisms that contracting parties can rely on.⁴⁴ Whether a given supervening event, such as those canvassed above, will trigger a force majeure clause in a franchise agreement such that either franchisor or franchisee will be free of their obligations of performance pursuant to the agreement, and for how long, will depend on various factors, including the event at issue and the contractual wording. As the general law of contracts presumes parties intend to perform their obligations under contract these clauses are usually given both strict and narrow interpretation by courts.⁴⁵ It may be unlikely that even something as extraordinary as a global health pandemic or hostile wartime emergency will provide contractual parties with a “free pass” to their contractual obligations pursuant to a force majeure clause without express mention of these events in writing.⁴⁶ Even where a contract does, in fact, contemplate the event at hand, the party seeking to avoid performance must meet the high burden which must be met in order to demonstrate that it is also the reason you cannot perform the contract.⁴⁷

The question of whether a force majeure clause will withstand judicial scrutiny in relation to notable, recent crises including COVID and Russia’s invasion of Ukraine has yet to be tested in Canadian courts. U.S. courts have had this opportunity in relation to the COVID-19 pandemic

⁴² Zohar Levy & Nicholas Carmichael, “Covid-19 as a Force Majeure, and Other Contractual Considerations” (2020) 2 BLR (6th ed) 32 at 34.

⁴³ Canadian Franchise Guide, 9:150.

⁴⁴ Inna Vorotynsteva, Ivanna Hranina & Maryna Pysarenko, “Comparative Legal Research on Contract Law Changes under COVID-19 Pandemic: England, United States, Asia, and Ukraine” (2021) 10:1 *Ius Humani*, *Revista de Derecho* 123 at 129.

⁴⁵ Matthew Nied & Andre Hindi, “How Frustrating: The Doctrine of Frustration in the Age of COVID-19” (2020) 78 *Advocate* 685 at 689; Robert W Emerson & Zachary R. Hunt, “Franchisees, Consumers, and Employees: Choice and Arbitration” (2022) 13 *Wm & Mary Bus L Rev* 487 at 559.

⁴⁶ Matthew Nied & Andrew Hindi, “How Frustrating: The Doctrine of Frustration in The Age of COVID-19” (2020) 78:5 *Advocate* 685 at 692.

⁴⁷ David Outerbridge, Jessica R. Lumière & Rudyard Griffiths “Managing Contract Risks and Obligations During a Pandemic” (20 April 2020), *Torys LLP* at 7.

where courts have found that COVID falls into the generally used “natural disaster” term in force majeure clauses.” In the 2020 decision of *JN Contemporary Art LLC v. Phillips Auctioneers LLC*,⁴⁸ the New York federal court had the opportunity to consider whether the COVID-19 pandemic was contemplated by the force majeure clause in a contract to sell a painting between an auction house and buyer. The court definitively found that COVID-19 is an undisputed “natural disaster” within the general meaning of the word.⁴⁹

Ultimately, whether a court will decide that a given event is a force majeure event will depend, in large part, on the way the provision is drafted.⁵⁰ *In re Hitz Restaurant Group*,⁵¹ is an example where contractual wording allowed a bankruptcy court to find the alleged supervening event as force majeure. The court found specifically that government ordered restaurant shutdowns, which caused contractual non-compliance, were sufficient to be a force majeure event because the contract itself did not require “strict impossibility” of performance.⁵² Rather, it provided that a force majeure event was one that “prevented or delayed, retarded, or hindered” performance.⁵³ The force majeure clause’s wording provided the court with the ability to come to its conclusion and could serve as a model for crisis-era contractual drafting.

Courts in the United Kingdom have also had the opportunity to confront this question in the context of a franchise agreement. In *Dwyer (UK Franchising) Ltd v Fredbar Ltd*⁵⁴ parties were bound by a franchise agreement which included a “force majeure” clause that allowed the franchisor to designate a given event as “force majeure.”⁵⁵ The franchisor asserted a claim for breach of contract after the franchisee complied with COVID-related quarantine measures and disrupted service of the franchise. The franchisee claimed, in part, that the franchisor failed to comply with the franchise agreement by not recognizing the COVID-related self-isolation order as a “force majeure” event under the agreement.

The court found the franchisor had not exercised discretion to determine a “force majeure” event in accordance with the implied term of good faith which led to a baseless claim that the franchisee had breached the terms of their franchise agreements.⁵⁶ This case highlights that the effectiveness of a force majeure clause is dependent on the wording used in the agreement. If the franchisor in this case was not given discretion to declare a force majeure event, it may have been possible that the court would not have considered the franchisee’s actions to be consistent with the definition of a supervening event in the franchise agreement. This contract at issue in this decision and the decision itself may serve as a positive example for the relationship between franchise agreements and force majeure clauses. Even with a lack of specificity and clarity within

⁴⁸ 507 F.Supp.3d 490 (S.D.N.Y. 2020). Robyn S Lessans, “Force Majeure and the Coronavirus: Exposing the ‘Foreseeable’ Clash Between Force Majeure’s Common Law and Contractual Significant” (2021) 80 MD L Rev 799.

⁴⁹ 507 F.Supp.3d at 501.

⁵⁰ Robyn S Lessans, “Force Majeure and the Coronavirus: Exposing the ‘Foreseeable’ Clash Between Force Majeure’s Common Law and Contractual Significant” (2021) 80 MD L Rev 799 at 814.

⁵¹ 616 B.R. 374 (Bankr. N.D. Ill. 2020).

⁵² 616 B.R. 374 (Bankr. N.D. Ill. 2020). Robyn S Lessans, “Force Majeure and the Coronavirus: Exposing the ‘Foreseeable’ Clash Between Force Majeure’s Common Law and Contractual Significant” (2021) 80 MD L Rev 799 at 814.

⁵³ 616 B.R. 374 (Bankr. N.D. Ill. 2020). Robyn S Lessans, “Force Majeure and the Coronavirus: Exposing the ‘Foreseeable’ Clash Between Force Majeure’s Common Law and Contractual Significant” (2021) 80 MD L Rev 799 at 814.

⁵⁴ *Dwyer (UK Franchising) Ltd v. Fredbar Ltd.*, [2021] EWHC 1218.

⁵⁵ *Dwyer (UK Franchising) Ltd v. Fredbar Ltd.*, [2021] EWHC 1218 at paras 24, 261.

⁵⁶ *Dwyer (UK Franchising) Ltd v. Fredbar Ltd.*, [2021] EWHC 1218 at para 269.

the contractual provision itself, the court was willing to read in elements of the force majeure clause to make it effective, namely the exercise of that clause in good faith.

A final consideration as to the effectiveness of “force majeure” in times of crisis that must be considered is the apparent business realities of the contracting parties to franchise agreements. Even if a “force majeure” clause within a franchise agreement was drafted with sufficient detail, it is possible that the broader context of global business would impede the ability to act on it, making any sort of unilateral action to cease a franchise relationship difficult. This was the case in Russia at the outset of their invasion into Ukraine. While several large, franchised restaurants were able to cease operations or sell their business, others could not do so easily. And a “force majeure” clause may be of no help when the war is not in Russia but taking place in a neighboring country that Russia invaded. And of course, franchise agreements are complicated agreements which, in many cases, are long standing agreements that cannot just be easily or unilaterally changed or even re-negotiated.⁵⁷

(b) Innovations

While COVID-19 also caused severe economic uncertainty and hardship, as discussed in Part 1(a), above, emergency measures put in place to respond to COVID-19 also presented opportunities (out of necessity) for companies to develop creative solutions to their sudden business challenges. These innovations were especially evident in the restaurant industry, where many restaurant franchisors expanded service offerings to meet consumer needs. For example, salad bars and other buffet style offerings were replaced with pre-packaged and sealed offerings, and sit-down restaurants were suddenly closed and then quickly re-opened as delivery only locations.

Many food delivery services responded to the consumer’s need for a safe and efficient delivery experience during the pandemic with expanded online and mobile ordering options, extended hours, and creative packaging.⁵⁸ For many restaurant franchises, options that seemed years away from implementation (such as app development, loyalty programs, virtual and “ghost kitchen” restaurant offerings) were integrated rapidly into daily business practice. For those restaurants in areas where in-person dining was permitted, outside seating became the norm. New York City was particularly accommodating in permitting restaurants to set up on sidewalks in order to serve customers and generate revenues for these small businesses.⁵⁹ To address a global labor shortage, the food delivery industry accelerated Artificial Intelligence test programs to provide for contactless ordering and delivery.⁶⁰ These services were so successful that they have integrated seamlessly into post-pandemic life and are now commonplace not just in the food

⁵⁷ Hillary Russ, “McDonald’s, icon of pos-Soviet era, to close all restaurants in Russia” (8 March 2022), online: *Reuters* < <https://www.reuters.com/business/retail-consumer/mcdonalds-close-restaurants-russia-2022-03-08/>>.

⁵⁸ Diana Gavilan, Adela Balderas-Cejudo, Susana Fernandez-Lores, and Gema Martinez-Navarro, “Innovation in online food delivery: Learnings from COVID-19” (2021) *Int. J. Gastron Food Science*.

⁵⁹ New York City, News Release, “Open Restaurants: New York City’s Nation-Leading Outdoor Dining Initiative Surpasses Milestone of 10,000 Participants” (3 September 2020), online: <<https://www.nyc.gov/office-of-the-mayor/news/635-20/open-restaurants-new-york-city-s-nation-leading-outdoor-dining-initiative-surpasses-milestone-of>>.

⁶⁰ Bernard Marr, “Demand for These Autonomous Delivery Robots Is Skyrocketing During This Pandemic” (29 May 2020) online: *Forbes* <www.forbes.com/sites/bernardmarr/2020/05/29/demand-for-these-autonomous-delivery-robots-is-skyrocketing-during-this-pandemic/?sh=1c4ebd987f3c>.

space, but across a variety of sectors.⁶¹

While food delivery services were able to modify their existing services, other industries had to shift their business strategy entirely to survive. There are countless examples of franchisors that implemented systemwide changes in order to create new revenue streams and replace those that were no longer viable in a global COVID-19 economy. For example, Fastsigns International (Fastsigns), a forward thinking B2B graphic, design, and signage franchisor suddenly became an “essential business” engaged in the manufacture and sale of personal protective equipment (“PPE”), such as face shields, not just for paying customers, but also for first responders.⁶² Fastsigns also negotiated national contracts to provide social distancing signage and plexiglass protectors at cash registers and behind counters to enable employees to perform their jobs in a safer environment. These are products and services that were not even contemplated in the weeks before the pandemic reached US cities. By adapting quickly and providing innovative solutions with a focus on meeting current consumer needs, businesses were able to survive the economic shutdown created by the pandemic.

Franchisors also responded quickly to provide additional support and substantial relief to franchisees whose businesses were impacted by the pandemic. Of course, there was economic relief in the form of reduced, suspended, and/or abated royalty, advertising, and other fees. On the development side, franchisors accommodated franchisees by suspending development deadlines for new locations or delaying re-imaging and remodeling obligations for existing locations. Finally, franchisors took an active role in educating franchisees on benefits available to small business, including, in the United States, government subsidized programs such as the PPP funds, the Employee Retention Tax Credit or the Restaurant Relief Fund.

(c) Supply Chain Issues

During the height of the COVID-19 pandemic, supply chain distribution was severely impacted by international public health responses, a reduction or halt in manufacturing, and demand fluctuations, among other factors.⁶³ While almost all businesses experienced supply chain distribution disruption, small business owners in particular saw a significant impact.⁶⁴ Franchisees faced unique issues in disruptions to their supply chain distribution. In some cases, franchisees were unable to offer required products or services because they simply were not available. Most franchise agreements require franchisees to offer and sell only approved products from approved suppliers. But long-term manufacturing, distribution, and other supply relationships could no longer provide certain products, were delayed in providing certain products, or went out of business.⁶⁵ Franchisees found it difficult or impossible to comply with their franchise agreements when COVID supply chain issues arose, with little to no contractual guidance as to best address the problem. This lack of guidance caused concern for many franchisees who were unable to meet their contractual obligations due to supply chain disruptions.

⁶¹ Toby McClean, “Covid-19 Has Accelerated Digital Transformation with AI Playing A Key Role” (4 November 2020), online: *Forbes* <<https://www.forbes.com/sites/forbestechcouncil/2020/11/04/covid-19-has-accelerated-digital-transformation--with-ai-playing-a-key-role/?sh=e7cdc285a589>>.

⁶² Jayme Nelson, “How Small Businesses Are Adapting to Make an Impact in Their Community” (19 April 2020), online : *FASTSIGNS* <<https://www.fastsigns.com/blog/miscellaneous-trending/fastsigns-happenings/how-small-businesses-are-adapting-to-make-an-imp>>.

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⁶⁴ National Federation of Independent Businesses Inc., “COVID-19 Small Business Survey” (2022),online (pdf): < <https://assets.nfib.com/nfibcom/Covid-19-22-Questionnaire.pdf>>.

⁶⁵ Joyce Mazero & Emily Doan, “How Franchise Brands are Dealing with their Disrupted Supply Chains” (2022) online: *Franchise Update Magazine*.

Franchisors responded by identifying new sources of supply, which had not been explored pre-COVID-19. They also worked with franchisees to implement changes in pricing and in other areas to ensure that franchisees could operate profitably, notwithstanding the supplier chain challenges which inevitably led to increased prices for such products or services. Finally, franchisors needed to be more flexible in approving new suppliers or alternative products or ingredients because items were simply unavailable through other channels.

COVID brought about novel supply chain issues on an unprecedented global scale and illuminated the need for franchisees and franchisors to prepare when similar supply chain issues arise in the future. Supply chain issues have and will continue to remain a concern for the franchise industry. Just as the impact of COVID seemed to be receding, in early 2023 a global bird flu outbreak wiped out approximately 100 million poultry and caused egg prices to more than double, negatively impacting franchisees in the food and restaurant industry.⁶⁶ These types of issues can be addressed by franchises by following a two-pronged approach. First, franchisors and franchisees should plan for the unexpected by addressing supply chain disruption scenarios in their franchise agreements, which will provide guidance and clarity to franchisees. Whenever possible, franchisors should seek redundancy in the supply chain to avoid placing their proverbial “eggs in a single basket.” Second, franchisors should approach dealing with supply chain disruptions with an adaptive mindset. Franchisors should evaluate potential temporary suspensions of approved supplier restrictions if it appears that shortages are likely to develop. Where feasible, alternative suppliers should be located, or franchisors should allow franchisees to source goods or services from available resources until normal supply lines are restored.⁶⁷

(d) Case Study: The War in Ukraine

Beyond the obvious risks crises pose to human health and well-being, crises have the potential to severely disrupt franchisors’ and franchisees’ operations alike. In response, franchisors must proactively prepare a response plan to protect their customers, employees, franchisees, and brand, and to help minimize potential business disruption and losses.

As discussed briefly in Part 1(b), above, Russia’s “full-scale invasion” on its neighboring country Ukraine, resulted in intense political backlash coupled with coordinated economic sanctions from numerous countries and governing bodies, including the United States, Canada, United Kingdom, and European Union. Coordinated economic sanctions were imposed on Russian banks, organizations, oligarchs, and other high-profile individuals, and export restrictions on various categories of goods and technology were adopted.

As Russia’s invasion escalated, the expanding sanctions regimes and export controls evolved and became more complex, with updates coming almost daily. With each new update, franchisors were required to continue to evaluate the risks of doing business in the region and assess and manage the legal implications. To assess the evolving risk landscape, franchisors needed a fundamental understanding of their geographic footprint, business model, and customer base, amongst other factors.

⁶⁶ Agnieszka de Sousa, “Global Food Roundup: Even Pricier Eggs and How Hot Pots are Fueling Jets” (17 February 2023), online: <<https://www.bloomberg.com/news/newsletters/2023-02-17/supply-chain-latest-bird-flu-soaring-egg-prices-and-green-jet-fuel>>.

⁶⁷ Michael Sturm, “Franchise System Responses to the Coronavirus” (2022), online: <www.franchise.org/blog/franchise-system-responses-to-the-coronavirus>.

Several preliminary questions were raised: have we identified all of our counterparties? Can payments be made and received? Is any company software, technology, or other back-office support service subject to export? Is our assignment request process at risk of new lenders that are sanctioned persons?

An initial self-assessment of operational considerations helped assess direct and indirect exposure to potential sanctions risks, including identification of any employees, operations, customers, suppliers, and other counterparties located in the Ukraine, Russia, or Belarus, who were or could later become sanctions targets. Bank accounts, lenders, and other relationships with financial institutions where the franchisor maintains accounts or otherwise transacts, directly or indirectly, were required to be assessed. Exports or reexports of dual use or otherwise controlled goods, software, and technology were also inventoried, along with any service providers and independent contractors in Russia, Belarus, and Ukraine accessing software and systems in order to provide services. In addition, a review of currency exposure, including where business was being conducted in more than one global currency or could be affected by foreign exchange risk was reviewed for exposure.

Once identified, third-party business partners were thoroughly reviewed to understand their ownership structures, profiles, and relationships. Certain jurisdictions are opaque, and necessary information may be difficult to obtain. In those jurisdictions, on-the-ground human intelligence collection may be required, because public records may be unreliable, unavailable, or available only in-jurisdiction in hard copy. Initial screening and continuous monitoring was instituted on all third-parties with exposure as potential sanctions targets.

And even after the self-assessment of operational considerations has assessed the direct and indirect exposure to potential sanctions risks, the question remained: should operations be curtailed in light of reputational risk? Reputational and environmental, social, and governance factors are at play. Franchisors faced pressure from shareholders and the general public to shut down operations in Russia, but an exit could be as complex as the heightened risks of remaining.⁶⁸

3. How Should Franchisors Prepare for the Unknown?

The COVID-19 pandemic exposed critical weaknesses in the existing infrastructure and preparedness of many businesses, including franchise systems.⁶⁹ Businesses learned quickly which responses were effective, and which were not. As learned from the COVID-19 pandemic, these are four key components of a strategy for franchisors to consider when preparing for future crises. The strategies include building a crisis readiness team, ensuring franchisor's management and employees know the contents of their franchise agreements, having an actionable toolkit of legal resources, and testing a given crisis response plan. Each of the four strategies will be discussed, in turn, below.

(a) Building a Crisis Readiness Team

During the pandemic, many franchisors struggled. There was an urgent need to stabilize their companies, instill confidence in all stakeholders, including franchisees and company employees, reduce risk and liabilities, allocate limited reserves, and to adapt their businesses to meet the

⁶⁸ For further discussion of franchisors who acted on reputational risks, see Part 1(b), above.

⁶⁹ Adrian Felix & Jessica McGrath, "Once in a Blue Moon? Perhaps...Preparing Your Franchise for the Next Pandemic" (2022) 41:3 Franchise LJ.

changed demands and needs of their customers and employees.⁷⁰ Those franchisors that had engaged or assembled a crisis readiness team were in a better position to address these issues quickly. Going forward, franchisors must have a crisis management team and plan in place as part of its business strategy. This team should be composed of a range of experts from different fields, including marketing/communications, operations, legal, and accounting. This team should meet regularly and act like a microcosm of the franchisor, allocating resources for each aspect of the business and creating a tailored strategy for the unique issues in each field.

(b) Know Your Agreements

In times of crisis, it is imperative for franchisors to have a thorough knowledge of the agreements currently in place with franchisees. Understanding the range in contractual relationships among franchisees will help the franchisor better understand the obligations of each party and which parts of the business relationship will be most impacted in the face of a crisis. Franchisors must account for a range in legal outcomes based on discrepancies in their agreements. Assessing the less defined or legal gray areas of the contract provide flexibility in the relationship to survive times of hardship or provide an opportunity to amend the agreement in order to allow for structure and guidance. Facing an unknown situation with a deep understanding of the contractual landscape will equip the franchisor with a level of preparedness to tackle issues not only in the present, but develop a plan for how to structure agreements in the future.

(c) Prepare Toolkit

Developing a toolkit to serve as a single, comprehensive source of information, guidance, and resources will help manage the immediate crisis response across a range of key risks. Fundamental to the toolkit is the development of an exposure questionnaire with scoping questions that aim to help identify potential vectors of legal, commercial, and reputational risk exposure. The list of questions may vary for particular franchisors, depending on the business model, geographic footprint, customer base, and other factors. Nevertheless, a robust questionnaire will help to also exclude vectors of risk as potential issues as quickly as possible, and aid in risk assessment planning and data for responding to inquiries. At a minimum, the questionnaire should assist in identifying employees, contractors, and equity holders; franchisees and other counterparties; direct or indirect assets and/or entities; financial lenders and banking partners. Once the risk exposure has been scoped, additional guidance and resources can be appropriately deployed through internal and external partnerships.

(d) Test the Plan

Once a crisis management team has been assembled, contracts have been assessed, and a toolkit compiled, it is important to test all components of the plan regularly so that the business is prepared for the unforeseen crisis.

4. Ongoing Contractual Considerations Franchise Agreements

As Franchise Agreements are the contracts at the heart of the franchisor-franchisee relationship, evolving business realities and considerations will necessarily be reflected in these cornerstone documents. As franchisors continue to develop a legal toolkit to prepare for potential crises, several contractual mechanisms remain open for franchisors to use within their bargains to anticipate and allocate risk.

⁷⁰ Adrian Felix & Jessica McGrath, “Once in a Blue Moon? Perhaps...Preparing Your Franchise for the Next Pandemic” (2022) 41:3 Franchise LJ.

(a) Force Majeure Considerations

The overarching theme of contracting in times of crisis, is a general lack of contractual preparedness for the issues that arise, which can arise with respect to intellectual property terms⁷¹ or precision of force majeure clause language. When considering whether and how to declare a force majeure event, contracting parties should focus on the precise wording of the clause and the impact a given event may have on the company's ability to perform contracts.⁷² As in *In re Hitz Restaurant Group*, discussed above, a more lenient contractual clause allowed the claiming party to obtain a remedy.

It may be equally important to consider whether the intervening event is directly or indirectly impacting the ability to perform the contract.⁷³ Even in cases where an event contemplated by a force majeure clause has an indirect impact on the ability to perform a contract, US courts may be less willing to accept it as validly caught by a force majeure clause.⁷⁴ For example, the court in *Palm Spring Mile Associates v Kirkland's Stores, Inc.*⁷⁵ had difficulty finding that the failure of a commercial tenant to pay rent at the start of COVID was directly caused by COVID and relieved them of the obligation pursuant to the force majeure clause.⁷⁶

Ultimately, it is in each party's best interest to review contracts carefully for force majeure or other provisions that may excuse non-performance and pay special attention to the level of specificity used and whether discretion to declare such an event is afforded.

(i) The Favorability of the Force Majeure Clause

Even though the force majeure clause remains available to franchisors to bargain for in their agreements with franchisees, it remains to be determined whether this is the best available course to mitigate risk in an increasingly uncertain political and economic climate. Looking to how courts in the US have treated these contractual mechanisms in past eras of uncertainty and crisis do not provide hope. For example, courts in the US were reluctant to interpret contracts generously during the 2008 financial crisis where courts rarely modified contractual terms amidst economic turmoil.⁷⁷ Scholars note that a similar view was held in English law in response to financial crisis.⁷⁸

Force majeure's favorability as a contractual mechanism to deal with crises such as COVID-19 or wartime has been questioned especially given judicial interpretation of such clauses in a narrow manner.⁷⁹ Moreover, another variable which may impact judicial interpretation of force majeure

⁷¹ Foley & Lardner LLP, "Supply Chain Disruption Survival Guide" (2022) at 31, online: <<https://www.foley.com/en/general/supply-chain-disruption>>

⁷² Zohar Levy & Nicholas Carmichael, "Covid-19 as a Force Majeure, and Other Contractual Considerations" (2020) 2 BLR-ART 32. Amy Sparrow Phelps, "Contract Fixer Upper: Addressing the Inadequacy of the Force Majeure Doctrine in Providing Relief for Nonperformance in the Wake of the COVID-19 Pandemic" (2021) 66 Vill L Rev 647 at 652 at 663.

⁷³ Zohar Levy & Nicholas Carmichael, "Covid-19 as a Force Majeure, and Other Contractual Considerations" (2020) 2 BLR-ART 32.

⁷⁴ *Tenneco Canada Inc. v. British Columbia Hydro & Power Authority*, 1999 BCCA 415 at paras 44-45. Zohar Levy & Nicholas Carmichael, "Covid-19 as a Force Majeure, and Other Contractual Considerations" (2020) 2 BLR-ART 32.

⁷⁵ 2020 WL 5411353 (US Dist. SD Fla).

⁷⁶ 2020 WL 5411353 (US Dist. SD Fla).

⁷⁷ Mariana Pargendler, "The Role of the Sate in Contract Law" (2018) 43:1 Yale J Int'l L 143 at 162

⁷⁸ Mariana Pargendler, "The Role of the Sate in Contract Law" (2018) 43:1 Yale J Int'l L 143 at 162

⁷⁹ Cosmos Nike Newdu, "The Rise Of Force Majeure Amid The Coronavirus Pandemic: Legitimacy And Implications For Energy Laws And Contracts" (2021) 61 Nat Resources J 1 at 10-11.

clauses is the industry within which a franchise operates. Courts may be more favorable to categorize certain events outside of normal risks encountered where they are truly unforeseen by the nature of the relationship. Whether that makes, for example, geopolitical strife in the context of international franchising part of the category has yet to be determined.⁸⁰

Of course, moving forward, whether these kinds of events would be considered “unforeseen” may be questionable given their current prominence. The added benefit of hindsight, however, may inspire contractual drafting to become more adept at contemplating whatever new supervening event has yet to come into existence.

(b) Contractual Provisions to Address Future Wars or Pariah State

War can be unpredictable and not at the forefront of a franchisor’s mind when negotiating a business deal. The way a franchisor responds to political unrest in a specific area can also be affected by government sanctions, public opinion, and the severity of the conflict. But there are certain steps a franchisor can take to protect their business interests when entering business agreements internationally. The varied response of Western franchisors to the Russian invasion of Ukraine showed the impact of existing contracts and business relationships when assessing if a franchisor could terminate the franchise relationship.

(i) Provisions Addressing Supply Chain Shortage & Replacements

First, a franchisor needs to assess the business relationships anticipated in a future territory, as this will be critical later on if conflict has an impact on that franchisee. It is much more difficult for a franchisor to extricate itself from a territory in conflict once complex supply chain relationships have been established.⁸¹ Therefore a franchisor should assess the risk prior to making a significant investment into a foreign territory. After this assessment has been made, the franchisor can tailor the supply chain provisions in the franchise agreement to best fit a franchisor’s financial and legal goals. The Franchisor should consider whether or not local suppliers are permitted or even available in a market, guidance in the event certain products or services are restricted under sanctions, and whether or not the franchisee will have flexibility in choice of in the event of a conflict. Franchisors may consider supply chain language to be standard and overlook it in their initial development process, however it has a significant impact on how a business can respond when conflict arises.

(c) Additional Contractual Provisions to Consider

(i) Frustration or Impossibility of Contract

The law of contracts rests on the premise of certainty of contract or that “a contract must be observed.”⁸² Built into contract law are two exceptions to this principle which are the doctrines of impossibility of performance and frustration. Impossibility of performance relieves parties to a contract of their obligations when circumstances make performance impossible. Frustration relieves contractual performance when circumstances render the purpose for which the contract

⁸⁰ Zohar Levy & Nicholas Carmichael, “Covid-19 as a Force Majeure, and Other Contractual Considerations” (2020) 2 BLR-ART 32.

⁸¹ Adam Siegelheim, “McDonald’s Closure of Russian Location Spotlights the Proper Way to Franchise Internationally” (23 June 2022), online: *JD Supra* <<https://www.jdsupra.com/legalnews/mcdonald-s-closure-of-russian-locations-7555373/>>.

⁸² Restatement (Second) of Contracts 11 Intro. Note (1981), ch 11.

was made, moot.⁸³ For example, take the contract considered in *20th Century Lines v. Goodman*.⁸⁴ Parties contracted for the vendor to supply the buyer with a neon sign which was to be illuminated over the buyer's restaurant at night. The court found the contract was sufficiently frustrated when the United States entered World War II and imposed a government order which prohibited the illumination of signs at night.⁸⁵ While drastic, this example demonstrates the concept of frustration in stark relief.

The body of case law that has developed to create the doctrine of frustration has articulated four key elements that comprise the doctrine: 1) a party's principal purpose in making the contract was 2) totally frustrated (or nearly so) by 3) an extraordinary and 4) exogeneous event. Courts require each element of frustration be shown to a high standard, making this generally difficult to establish. Despite this high bar, scholarship points out that "truly extraordinary and unexpected event[s] completely destroy the anticipated value of a contract" the doctrine may prevail.⁸⁶

Canada similarly has the common law doctrine of frustration of contract which is distinct from a contractual force majeure clause. The latter is a clause where parties define the events that trigger the non-performance of the contract.⁸⁷ The doctrine of frustration is a creature of the common law which relieves a party of their contractual obligations where an unforeseen event makes performing the contract impossible. Frustration of contract has been defined in case law and subsequently adopted by Canadian courts as follows:

Frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances; in such case the law declares both parties to be discharged from further performance [emphasis added].⁸⁸

A key difference between frustration of contract and force majeure clauses is that in a case of frustration, the result is that the contract comes to an end. Similarly, to the United States, there is a higher threshold a party must meet if they wish to establish that a given contract has been frustrated. A "supervening illegality", where the law makes it such that the contract cannot be performed, may be considered onerous enough to meet this threshold, which is an optimistic hypothesis for parties seeking to establish frustration in the COVID-19 context.⁸⁹

Recent US case law arising out of COVID has held that where a force majeure clause is present in a given contract that will displace the application of the doctrine of frustration, despite scholarly

⁸³ Andrew A. Schwartz, "Frustration, the MAC Clause, and COVID-19" (2022) 55 UC Davis L Rev 1771 at 1782.

⁸⁴ (1994) 64 Cal.App.2d Supp. 938.

⁸⁵ (1994) 64 Cal.App.2d Supp. 938.

⁸⁶ Andrew A. Schwartz, "Frustration, the MAC Clause, and COVID-19" (2022) 55 UC Davis L Rev 1771 at 1786.

⁸⁷ Lorne Neudorf & Geoffrey Hunnisett, "Force Majeure Clauses in Comparative Perspective: The Canadian Common Law Approach in Light of Recent Developments in the Courts of Singapore and the United Kingdom" (2014) 65 UNB LJ 312 at 312.

⁸⁸ *National Carriers Ltd. v. Panalpina (Northern) Ltd.*, [1981] A.C. 675, at 700, [1981] 1 All E.R. 161, at 175 (H.L.). See also *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, 2001 SCC 58, [2001] 2 S.C.R. 943, at 967-68, 969, 204 D.L.R. (4th) 513.

⁸⁹ Zohar Levy & Nicholas Carmichael, "Covid-19 as a Force Majeure, and Other Contractual Considerations" (2020) 2 BLR-ART 32.

criticism.⁹⁰ While the application and use of this doctrine may be helpful, it might only be applicable where contract has no force majeure clause.

(ii) Limitation of Liability

Limitation of liability is a distinct contractual mechanism used by parties to shield or limit themselves from a certain degree of liability arising out of failure to perform a contract. Similar to force majeure clauses, a limitation of liability provision can be viewed as another way in which parties allocate and negotiate the risk they are willing to assume when entering into their bargain. While it would be rare to find a contract with a limitation of liability clause that completely shielded either party's liability, a cap of liability is generally set. Given the limits of a force majeure clause, namely, the strict interpretation the wording of these clauses is given, a limitation of liability clause has the potential to be more forgiving in providing contracting parties with a remedy in the event of a contractual breach.

(iii) Good Faith Performance

Contract law implies a general duty of good faith for the performance of a contract. A claim of bad faith is not itself a stand-alone claim but part of a claim for breach of contract.⁹¹ In U.S. law, the term "good faith" is codified in the Uniform Commercial Code⁹² and defined as "honesty in fact in the conduct or transaction concerned." Further, the contractual duty of good faith and performance in a contract requires "faithfulness to an agreed common purpose and consistency with the justified expectations of the other party."⁹³ Canadian law has recognized a similar concept. The Supreme Court of Canada recently clarified the duty of good faith contractual performance as an "organizing principle" of contract law.⁹⁴ In *Bhasin v Hrynew*⁹⁵ the Supreme Court described this principle as:

Commercial parties reasonably expect a basic level of honesty and good faith in contractual dealings. While they remain at arm's length and are not subject to the duties of a fiduciary, a basic level of honest conduct is necessary to the proper functioning of commerce. ... The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner.⁹⁶

As an overarching principle of contract law, then, a breach of the duty to act in good faith may support a claim of breach of contract in a crisis context. A claim of bad faith performance may accompany any claim for breach of contract. Thus, any party who breaches contractual obligations as the result of crisis, for example, COVID-19 must still adhere to performing their contractual duties in good faith.⁹⁷

(d) Current Government Protections

Various countries have enacted laws related to sanctions or other means by which governments can seek to preclude their citizens and resident businesses from dealing or conducting business

⁹⁰ Andrew A. Schwartz, "Frustration, the MAC Clause, and COVID-19" (2022) 55 UC Davis L Rev 1771 at 1811.

⁹¹ Xuan-Thao Nguyen, "Contracts as Emergency Law" (2021) Wash Int'l L J 420 at 463.

⁹² § 1-201(19)

⁹³ Restatement of the Law (Contracts) s. 205

⁹⁴ *Bhasin v Hrynew*, 2014 SCC 71 at para 64.

⁹⁵ 2014 SCC 71.

⁹⁶ 2014 SCC 71 at paras 60, 64.

⁹⁷ Xuan-Thao Nguyen, "Contracts as Emergency Law" (2021) Wash Int'l L J 420 at 463 at 464.

with certain named or sanctioned people, and/or the governments and/or people in certain countries. These may be particularly relevant in the context of this discussion, as they may make it illegal for a franchisor to conduct business with a franchisee who is so named, or is a franchisee located in a certain sanctioned country. And while franchisors can be on guard for that in advance of entering into a franchise agreement, and address it in their due diligence and/or in the agreement itself, it will be different if a franchisee or the country within which the franchisee is located is placed on a restricted list of sanctions after a franchise agreement is entered into. From that perspective the franchisor may effectively be in a force majeure or similar situation where it simply cannot legally engage further with its foreign franchisee.

While that may be legally required in the franchisor's home jurisdiction where the sanctions are enacted, it may be the opposite in the sanctioned country, a country from which the franchisor had once expected to derive revenue. Under the laws of that country the franchisor may simply be in breach of contract by not performing its obligations, and thereby putting its expected revenue stream in jeopardy.

An example of such laws is that, in the US, there are laws that enforce and regulate businesses that become especially relevant for businesses at the onset of global or domestic crisis. They are the Office of Foreign Assets Control (OFAC) and the *Foreign Corrupt Practice Act (FCPA)*.

OFAC is a branch of the US Department of the Treasury and is responsible for the administration and enforcement of economic and trade sanctions pursuant to US foreign policy. The OFAC offers public advisories on relevant sanctions that are aimed at helping businesses ensure their practices follow foreign policy objectives.⁹⁸

FCPA is legislation which prohibits payment of bribes to foreign officials to assist in establishing business dealings. The provisions of the *FCPA* apply to public companies operating in the United States or internationally, regardless of a US territorial connection.⁹⁹ The *FCPA* is enforced by the US Securities Exchange Commission (SEC) and the Department of Justice.

Conclusion

The varied responses by franchise systems to ongoing global crises demonstrate an opportunity for rapid innovation within the franchise industry moving forward. Amidst the adaptation and innovation, there remains questions as to the most effective legal mechanisms for franchise systems and franchise relationships to remain secure. A survey of prominent crises of the past five to ten years has highlighted the questions franchise systems should ask and the mechanisms at their disposal to plan for the future.

When it comes to protecting franchise system's supply chains, contracts should ensure there are multiple ways to achieve one goal and approach dealings with an adaptive mindset. As seen from franchisor's response to Russia's aggression in Ukraine, franchisors also must be sure to conduct a self-assessment to identify indirect and direct risks to sanctions and review contracting counterparties and reputational risks. This self-assessment is perhaps best aided by building an

⁹⁸ United States Department of the Treasury, Office of Foreign Assets Control, "Ukraine-/Russia-related Sanctions", online: <<https://ofac.treasury.gov/sanctions-programs-and-country-information/ukraine-russia-related-sanctions>>.

⁹⁹ United States, Department of Justice (Criminal Division) & US Securities and Exchange Commission (Criminal Division), "A Resource Guide to the US Foreign Corrupt Practices," 2nd ed (July 2020), online (pdf): <<https://www.justice.gov/criminal-fraud/file/1292051/download>>.

internal crisis readiness team. Franchisors must also ensure they are familiar with all elements of the franchise agreement to ensure knowledge of its flexibility.

Considering their contractual options, franchisors may rely on the *force majeure* clause of their agreements and seek to be both as broad and specific as possible. However, there may be no certain answer whether *force majeure* clauses are the best mechanism to use. Thus, there are other contractual mechanisms available to prepare to allocate risk appropriately found in the general doctrines of contract law including the doctrines of frustration, impossibility, good faith, and the limitation of liability clause.

This discussion does however highlight that there is an inherent risk and uncertainty in all international franchising, and a certain fragility in international franchising as a method of expansion, as there will always be events out of the control of franchisor and/or franchisee, made more likely due to the multi-jurisdictional nature of the arrangements.