

# COVID-19: BUSINESS IMPACTS ON FRANCHISORS - OVERVIEW AND ANALYSIS

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## Corporate/M&A Alert

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The World Health Organization (“WHO”) declared the coronavirus (“COVID-19”) a global pandemic on March 11, 2020. In less than a week after the declaration from WHO, the COVID-19 pandemic has caused the closure of fitness club franchises across the country. Popular fitness franchise systems announced the closure of corporate locations on Monday, March 16. Seven states (Washington, New York, New Jersey, Connecticut, Maryland, Michigan, and Pennsylvania) and several cities (including Los Angeles, San Francisco, Dallas, and Miami) around the country have instituted across-the-board closings of gyms and fitness centers as part of the temporary closures designed to limit public gatherings and the spread of COVID-19. Owners of fitness club franchises, who are small business owners and employers, are following the governmental guidelines requiring closings. In areas that do not have mandatory closings of fitness clubs, many franchisees are voluntarily following the example set by franchisors who closed their corporate locations.

Franchisors of restaurants across the country are now facing a landscape in which 19 states have mandated that restaurants and bars close their dining rooms during the COVID-19 outbreak. Some of the larger well-known brands released statements that they are closing in-store dining at corporate locations and would provide only drive-thru, takeout, and delivery options starting on March 17. These brands have instituted numerous in-store measures to better align with increasing regulations throughout the country and to better adhere to social distancing guidelines to ensure that large groups of customers do not gather inside their restaurants. Major franchisors have received support for their actions from their franchisee leadership, and many local franchises are following the lead of the corporate locations. On Tuesday, March 17, franchise CEOs joined a call with President Donald Trump and Secretary Steven Mnuchin. The White House reported that all the franchise executives on the call committed to encouraging customers to use drive-thru, pickup, or delivery options in response to the COVID-19 outbreak. Members of the group expressed their commitment to supporting public health and safety while continuing to ensure essential access to food.

COVID-19 has affected different sectors of the franchise industry to different degrees. Some sectors are facing mandatory or voluntary closure of businesses while other sectors are facing a drop in consumer demand and/or supply chain problems. For instance, many retail franchises are experiencing a drop in consumer demand as many consumers delay their purchases due to fear of the COVID-19 pandemic. In addition, these retail franchises may be facing significant supply chain challenges because the COVID-19 pandemic has hard hit China, Italy, France, Spain, and Germany and it may take a while for manufacturers in these areas to be able to fulfill orders. Disruption to consumer demand and the supply from manufacturers due to the COVID-19 outbreak has contributed to wild fluctuations in the stock markets and their recent meltdown. The day after WHO declared COVID-19 a global pandemic, the Dow Jones industrial average declined 2,353 points in an historic selloff. Four

days later, on March 16, the Dow Jones fell a record-breaking 2,997 points as franchisors and business owners scrambled to figure out their response to the COVID-19 pandemic. On March 18, the Dow Jones fell 1,335 points to close at 19,903 wiping out nearly all the gains made during the Presidency of Donald Trump.

Recently, FRANData: Franchise Market Research and Consulting, released an estimate of the impact of COVID-19 on a ninety (90) day shutdown of franchise businesses. The projection estimates that: (1) in the lodging sector, there will be between 1,000–1,500 lost facilities and between 25,000–38,000 lost jobs; (2) in the restaurant sector, there will be between 8,000–10,000 lost restaurants and 175,000–225,000 lost jobs; (3) in the personal services sector there will be between 7,000–9,000 lost businesses and 80,000–100,000 lost jobs; and (4) in the residential and commercial services sector, there will be between 2,000–3,000 lost businesses and between 18,000–30,000 lost jobs.

Franchisors may want to examine and evaluate their franchise agreements and look closely at “Force Majeure” clauses that could be implicated if franchisees are unable to perform certain obligations under the franchise agreement. (For More See Alert: [“COVID-19: Applicability of Force Majeure Clauses in the United States”](#)). In addition, franchisors may want to examine how “Approved Supplier” or “Supplies” clauses are written, and develop strategies for making sure that approved suppliers are able to meet the demand of franchisees. Proactive “Approved Supplier” strategies can eliminate possible interruption of franchisees' businesses due to their inability to obtain necessary product or supplies.

For franchisees in need of funding or with current bank lines of credit or Small Business Association loans, Franchisors can compile and share resources and relief programs, including emergency funding from the government and loan deferment. Programs like the SBA Economic Injury Disaster Loan Program offer low interest working capital loans. As of March 23, businesses in every state and US Territory are eligible for application. Municipalities also have relief packages. (For More See Alerts: [“COVID-19: Small Business Loan Relief Under Consideration”](#) and [“COVID-19: Q & A for Small Business Administration \(SBA\) Emergency Loans”](#)).

Now is also the time to assist franchisees in minimizing supply chain disruption. Key suppliers should be contacted to provide for extended payment terms and to identify proactively any shortages of products. New or additional suppliers may need to be identified to meet demands. There may be a need to create cooperative distribution among franchisees within territories for supplies and to optimize transportation availability and costs. Encourage sharing data on product availability among franchisees and create a centralized repository to track this information at the franchisor level.

Through active communication with franchisees, some proactive franchisors have chosen to assist franchisees with the economic impact of COVID-19 and develop strategies for helping franchisees with their landlords, lenders, vendors, and employees. Some of these strategies are sure to include business interruption insurance coverage that may force franchisees to hold off on closing their businesses until forced by either the state or local government. Most business interruption insurance policies include language that provide coverage if the business is shut down because of some governmental action. Franchise systems and their franchisees must develop plans to handle closure of locations, sudden operational changes, slumping consumer demand, and supply chain disruption while maintaining brand standards and reputation. Many franchise systems' survival will depend upon the joint and collaborative efforts of franchisors and franchisees. Franchisors and franchisees must prioritize the health and safety of employees and customers as they work together to develop the appropriate response to the COVID-19 pandemic.

For more information on how we can assist franchisors with managing COVID-19 or other legal and business concerns, please contact one of the lawyers listed below or one of the other members of the Franchise team at K&L Gates LLP. Recently, K&L Gates launched an online resource center to assist companies in their response to the COVID-19 pandemic, featuring alerts and programs on employment and workplace safety, supply chain management, force majeure, insurance coverage, corporate, capital markets, and asset management. To access these new resources, please click [here](#).

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