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FOOD DELIVERY SERVICE ISSUES:
The Last Mile − Navigating the Restaurant Food Delivery Paradigm Shift

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The Last Mile − Navigating the Restaurant Food Delivery Paradigm Shift[1]

Introduction

Customers have embraced the convenience and on-demand nature of third-party delivery apps or "aggregators" such as Uber Eats, DoorDash, SkipTheDishes and Grubhub. Fundamentally, aggregators provide a platform upon which customers can browse different, unrelated restaurant brands and place an order for delivery without ever interacting with the restaurant or switching to another application. Aggregators are different than third-party logistics companies, such as Postmates and Amazon Restaurants. Third-party logistics companies provide platforms to connect customers, merchants, and couriers.

In May 2018, the paper "Disruptive New Technologies and Franchising" identified three ways for orders to be placed and delivery to be made: (1) "The restaurant sells directly to the customer and engages a delivery person or delivery service as its agent to complete the order" (the familiar "pizza delivery" model); (2) "The restaurant sells directly to the delivery person or company, which, in turn, resells the food to its customer" (aggregators like Grubhub and Uber Eats); and (3) "The restaurant sells directly to the delivery person or company, which in effect acts as the customer's agent." (third-party logistics companies like Postmates and Amazon Restaurants.)[2] Some brands, like Panera, have invested in their own new delivery infrastructure similar to the familiar "pizza delivery" model, and still others, like McDonald's and Starbucks, have increased investment in technology focused on app development for easy ordering. This paper investigates new and evolving commercial and legal issues that accompany the arrangements described in (2) and (3) above resulting from a third-party's involvement in the order and delivery function between the restaurant and customer. As noted in 2018, the volume and cost of transactions taking place in this channel is what makes these new ordering platforms so intriguing,[3] and this is even more true in 2019.

The main difference between aggregators and third-party logistics companies is the way the transactions are structured. Transactions conducted through aggregators (like Grubhub and Uber Eats) are between the aggregator and the customer. The customer browses the aggregator's app which features a variety of unrelated restaurant brands, places the order with the aggregator; the aggregator places the order with the restaurant, and the aggregator's agent completes the delivery to the customer. The restaurant pays the aggregator a fee to be featured on the app (and may pay more for

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1 The authors would like to thank Kojo Hayward, Articling Student-at-Law at Osler, Hoskin & Harcourt LLP for his invaluable contribution to this paper.

2 Kara K. Martin, Melissa Murray, Lee J. Plave; Disruptive New Technologies and Franchising; IBA/IFA 34th Annual Joint Conference; May 9, 2018; p. 3.

3 *Id.* at 2.

more prominent placement or to participate in specials), and delivery charges may be per delivery or a flat monthly rate. Transactions conducted through third-party logistics companies (like Postmates and Amazon Restaurants) are between the restaurant and the customer, and the delivery service charges a fee for delivering the order. The logistics company acts as a broker among the customer, restaurant, and delivery driver. The commercial and legal issues addressed in this paper apply to both aggregators and third-party logistics providers, but for convenience, we refer to both types of third-party delivery services as "aggregators."

This Amazon-like shift in how consumers interact with the QSR, Fast-Casual, as well as the broader restaurant industry, creates both business opportunities and legal challenges for franchisors and franchisees alike. Although the supply chain remains materially unchanged in many respects, the final stretch of it, the last mile - getting goods into the hands of consumers, is evolving rapidly. The last mile has revolutionized the retail industry[4] as customers are increasingly demanding faster and more convenient services.

Netflix and Amazon may, at least in part, be credited for disrupting customer habits in a way that is now significantly affecting the restaurant industry.[5] They have introduced customers to one-stop platforms that provide a seemingly infinite number of options that were previously siloed or much less accessible. With the emergence of Netflix, gone are the days where customers must leave the comforts of their homes to pick up and return videos. With the emergence of Amazon, customers no longer have to choose between quick access to the products they desire or the convenience of e-commerce.

For most restaurants, embracing delivery as a means of fulfilling the last mile does not appear optional. Over the course of the coming decade, it can be argued that nothing will be more decisive than online food delivery in sorting out the winners and losers in the restaurant industry.[6] However, embracing delivery does not necessarily mean partnering with an aggregator. A last mile strategy embracing delivery can be fulfilled by both aggregators and directly by the restaurants themselves, and there are compelling reasons for considering both options.

While the drivers behind the rise of delivery as a means to get food to customers appears best classified as a trend in consumer behavior and industry fueled by technology, innovation and unparalleled competition amongst converging industries, there are also numerous legal considerations that may shape a franchise network's decision to partner with one, multiple or no aggregators in developing its delivery infrastructure. Although tempting, new and trendy, franchise networks should not neglect legal considerations in their quest to catch the current wave and promises of new customers and incremental business. From the minutiae in the Franchise Agreement or

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4 https://www.businessinsider.com/last-mile-delivery-shipping-explained

5 https://www.forbes.com/sites/aliciakelso/2018/10/31/restaurants-turning-to-off-premise-channels-to-gain-share/#5d2ee903fd55

6 https://www.bloomberg.com/opinion/articles/2018-07-18/uber-eats-grubhub-grub-can-save-restaurants-from-apocalypse

Aggregator Agreement to the potential for increased third-party liability claims as well as depreciation of a brand's goodwill, failing to consider the legal implications of partnering with aggregators may negate the benefits aggregators offer to the restaurant industry.

I. Customers Want Delivery – The Numbers

Not only do customers want delivery, they seem to increasingly want the simplicity of delivery fulfilled by third-party aggregators as opposed to restaurants themselves. Further, this increase in customers relying upon platforms as opposed to restaurants to fulfill their delivery demands is global. The countries with the seven highest platform-to-consumer delivery penetration rates are: Hong Kong at 26.6%, China at 23.3%, United States at 15%, Ireland at 11.9%, Singapore at 11.7%, the United Kingdom at 11.7%, Australia at 11.6% and Canada at 11.4%.[7] From North America to Asia, these platforms are gaining in popularity and cannot be ignored. Franchisors and franchisees should give consideration to the advantages and disadvantages of partnering with an aggregator, developing a standalone internal delivery infrastructure, or doubling down on the historical commitment to in-restaurant sales.

While delivery is on the rise, it does not appear as though consumer behavior is equally trending towards all forms of delivery ordering. Customers increasingly want delivery initiated via online transactions. A report by Cowen Inc. found that in 2017 online delivery accounted for $19.7 billion in gross merchandise volume, or 3.7%, of U.S. restaurant sales in 2017. Interestingly, this proportion of online sales relative to total sales is roughly in line with what, in 2008, was the proportion of online retail sales relative to total retail sales. In just a decade, the retail landscape has transformed drastically, and many believe that the same will occur in the restaurant industry just as rapidly. The growth rates in online delivery versus in-restaurant transactions is telling. Data from Cowen Inc. reveals that the year over year change in in-restaurant dining in 2014 was -1% whereas the year over year change in online delivery was 21%. Cowen Inc. data further reveals and forecasts that from 2015-2022 the year over year change in in-restaurant dining was or will be 0% to -1% while the change in online delivery was or will be 20% to 26%.[8] So, while in-restaurant transactions do not appear to be plummeting, they are at worst steadily declining and at best stagnant. As such, as the economy grows and transaction activity increases, delivery will account for a larger and larger proportion of total sales.

With the introduction of relatively high delivery fees or inflated online menu prices, customers are being asked to pay more for food than they would if they dined in restaurant, picked up their food, or ordered directly from a restaurant. However, data suggests that customers are willing to pay a premium for on-demand service and convenience. Uber Eats, Postmates, DoorDash and other aggregators have demonstrated that elevated customer costs are not a fatal barrier to growth and customer penetration. Convenience, specifically not having to prepare or pick up their own food, trumps modest increases in cost. Research conducted by Lux Research reveals that on

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[7] https://www.statista.com/outlook/376/100/platform-to-consumer-delivery/worldwide#market-arpu

[8] https://www.bloomberg.com/opinion/articles/2018-07-18/uber-eats-grubhub-grub-can-save-restaurants-from-apocalypse

average customers are willing to pay an additional 11% more for each added layer of convenience. Underscoring this point, Bobby Shaw, former Freebirds president and CEO of Salad and Go, was quoted as saying, "online ordering has been an important growth driver… The bottom line is customers are willing to pay more for the convenience of delivery. It's just a matter of finding the right vehicle." [9]

Given increased demand and data suggesting that this demand will sustain, franchise networks across the globe have or should consider what their delivery strategy will be. If it is determined by a particular franchise network that delivery is not for them, given their offering and/or consumer base, they nevertheless should consider how they will compete in the era of aggregators and the customer's desire for app-based services, delivery, convenience and speed.

General Survey of Current State of Food Delivery

There is no denying the growing popularity of food delivery. Nearly one-third of restaurant meals in the year ending in September 2018 were consumed at home, up 2% from the previous year, according to the NPD Group Inc.[10] Currently, the majority of restaurant orders are fulfilled by third-party services, which currently handle 52% of online restaurant orders, according to William Blair.[11] Some businesses have invested in their own delivery services in step with the delivery trend, and some businesses, such as pizza shops, traditionally have always offered delivery. Panera Breads made a unique investment in delivery (discussed below), which seems to be paying off. Other brands have declined to enter the delivery craze. For example, Texas Roadhouse Inc., a steakhouse with more than 500 restaurants in the U.S., decided not to offer delivery after tests with two services last year - consumers complained that the food quality wasn't good and that prices were higher than in the restaurants. [12] McDonald's Corp. started using San Francisco-based Uber Eats for delivery in January 2017 and, in a survey that a newly formed association of franchisees conducted of its members in January 2017, 565 respondents said that delivery is not contributing positive net cash flow to the business, while 198 said it is.[13]

II. Advantages

A. Incremental Purchases During Non-Traditional Mealtimes

Restaurants see sales fluctuate by day of the week and time of the day. The convenience and on-demand nature of aggregators appear to broaden consumers' eating habits. Some restaurants like McDonalds, who has partnered with Uber Eats, classify the bulk of orders that come through aggregators as "incremental". That is, sales that they

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9 https://www.qsrmagazine.com/outside-insights/how-restaurants-can-offer-delivery-and-make-money

10 https://www.wsj.com/articles/consumers-love-food-delivery-restaurants-and-grocers-hate-it-11552107610

11 *Id*.

12 *Id.*

13 *Id.*

believe they would not have realized if their brand was not listed on the aggregator's platform. To this point, McDonalds has reported that 70% of orders it receives on Uber Eats are incremental. Further, in prior years, McDonalds has reported that 60% of its Uber Eats orders were placed either in the evening or overnight.[14] This is not to say that customers are necessarily eating more than before; they may just be replacing walking to the refrigerator for a late-night ice cream craving with a McFlurry order on Uber Eats. This rise in incremental sales and the realization of revenue during off-peak hours may help negate some of the profitability concerns that accompany aggregators and their often steep commission fees.

In a partnership that demonstrates the confidence many in the industry have that aggregators will prevail long term and the value of incremental sales, Grubhub and Yum! Brands announced a U.S. Growth Partnership in February 2018. The partnership saw Yum! purchase $200M of Common Stock from Grubhub. The press release, issued in connection with the partnership, emphasized on three separate occasions that Yum! formed the partnership to drive incremental sales to Yum! Franchisees. Of note, Yum! expressed its belief that incremental sales may be sustainable long term, that franchise networks can partner with aggregators to not just generate new customers, but also drive order frequency from existing customers, and that aggregators like Grubhub may help franchise networks streamline operations.[15]

Yum! Brands is not the only major player embracing aggregators and Grubhub is not the only aggregator attracting the interests of massive franchise networks. In an effort to seemingly capture more incremental sales, approximately 30% or 11,500 out of over 37,800 of McDonalds restaurants around the world, are now capable of delivery. McDonalds reports that for these restaurants, delivery sales account for approximately 10% of total revenue. Despite only offering delivery in 30% of its restaurants, delivery therefore accounts for 3% of total McDonalds revenue. Looking forward, it is forecasted that delivery will be offered in approximately 50% of McDonalds locations by 2021, account for 17% of revenue in each restaurant, and be accountable for 8.6% of total McDonalds revenue.[16] On this basis, McDonalds would see an almost 300% increase in the proportion of revenue derived from online sales in just two years.

B. Reduced Customer Acquisition Expense

An immense added benefit of using aggregators is that they come with their own customer base and carry-out their own marketing in efforts to drive traffic to their website or application. As a result, new potential customers are instantly accessible via the aggregator.[17] Consequently, partnering with an aggregator to satisfy the delivery desires of customers may reduce the restaurant's promotional and other customer acquisition

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[14] https://money.cnn.com/2018/03/28/news/companies/uber-eats-grubhub-delivery-apps/index.html

[15] https://investors.grubhub.com/investors/press-releases/press-release-details/2018/Yum-Brands-and-Grubhub-Announce-New-US-Growth-Partnership/default.aspx

[16] https://www.forbes.com/sites/greatspeculations/2019/01/17/will-delivery-sales-constitute-a-new-source-of-revenue-for-mcdonalds-by-2021/#61016e505cae

[17] https://posbistro.com/blog/partnering-with-food-delivery-apps-like-uber-eats-or-deliveroo/

expenses as restaurants benefit from the customer pool and marketing expenses incurred by the aggregators. Viewed in light of this potentially immense benefit, aggregators should not be viewed solely as delivery partners; they also serve as marketing partners and customer acquisition partners and, on this basis, a portion of the commission fees payable to the aggregators can be justified as a marketing expense.

It must be noted that the full benefits of this inherited customer base are not guaranteed as it can be difficult to stand out and be noticed on popular platforms that give consumers access to a large number of restaurants. Restaurants that wish to be featured and more frequently noticed by customers must typically pay a premium to be amongst the first restaurants listed by the aggregator.[18] Given this reality, restaurants should consider if their reduced customer acquisition expenses are practically offset, and if so, whether or not they are offset enough to negate some of the other financial disadvantages that accompany partnering with aggregators.

Restaurants must be strategic in how they approach the acquisition and retention of new customers. For instance, consideration should be given to what is the optimal time to partner with an aggregator. Amongst other things, this determination will be influenced by the aggregator's growth and customer base as well as the restaurant's popularity, growth and customer base.

C. Reduced Delivery Infrastructure Risk

Developing sufficient restaurant-to-customer delivery capabilities may require substantial investments in employees, redesigned kitchens, assembly-line and product packaging modifications, and the acquisition or development of technology such as chatbots to support the new strategy.[19] It also goes without saying that delivery capabilities are only useful insofar as customers know delivery is an offered service. Restaurants, therefore, will have to commit marketing resources in order to give their internal delivery solution an opportunity to be viable, particularly where the restaurant is competing within the broader delivery aggregator ecosystem. Comparatively, partnering with aggregators may eliminate the need to substantially invest in new employees capable of executing an in-house delivery strategy, the need to promote recently developed delivery capabilities, and the related technology development costs.

Beyond the immediate cost savings, partnering with aggregators may also greatly reduce risk. The investments made in employees, technology and infrastructure cannot simply be undone if the in-house delivery strategy fails. The losses may largely have been incurred by the time a strategy failure has been realized. Comparatively, partnering with an aggregator requires minimal upfront investment by the franchise network.

Nevertheless, while providing his perspective on aggregators and the future of the restaurant industry, Don Fox, CEO of Firehouse Subs, pointed out that the profit upside

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[18] *Id.*

[19] https://www.qsrmagazine.com/outside-insights/how-restaurants-can-offer-delivery-and-make-money

is far greater if restaurants and franchise networks are able to get past the prohibitive base-line cost of building out their own inhouse delivery capabilities.

The shining example of the development of an inhouse delivery infrastructure is Panera Bread, which invested "six years and an estimated more than $100 million to develop the technology to process its own online orders. Its investment cut into profits for three years, until the effort began to pay off in 2016."[20] Panera's investment is paying off, especially in areas where delivery has been around the longest, and in which the company now derives 10% to 15% of its sales.[21] "We are substantially better off doing delivery than not," Chief Executive Blaine Hurst said.[22] If there were a blueprint for developing delivery, Panera would surely be the model given that its delivery option has gained Panera customers "who wouldn't otherwise come to eat in, and that the extra sales volume they're generating from delivery offsets the cost. Also, when people order delivery, they tend to order for larger groups, so the average check is higher than it is for dine-in orders."[23] Research indicates that Panera is the only major network that has made this kind of investment in an inhouse delivery infrastructure, although others may soon follow suit.

III. Disadvantages

A. Lost in-store revenue

In many cases, the value of incremental online sales may be offset by lost in-store revenue. These lost in-store revenues can be especially detrimental when restaurants see losses in sales of high margin items. Unfortunately, aggregator users are often not interested in buying high margin items. For example, customers are less likely to order high margin menu items like soda, coffee and alcoholic beverages when ordering delivery.[24]

Two of the most frequently mentioned advantages of using aggregators are 1) gaining new customers and 2) receiving incremental sales. Unfortunately, both of these advantages may be short-lived. While aggregators may in fact expose restaurants to new customers, and sales they may not have been able to realize otherwise, this "new" or "first time" customer benefit appears to diminish as these customers make repeat orders through the platform. Where restaurants offer their own complementary delivery services, repeat, commissioned, customer orders through aggregators may chip away at un-commissioned orders restaurants could fulfill themselves. Repeat or serial aggregator customers deprive restaurants of engaging customers through their own delivery infrastructure or of converting them to dine-in customers. If customers don't offer up

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[20] https://www.wsj.com/articles/consumers-love-food-delivery-restaurants-and-grocers-hate-it-11552107610?mod=searchresults&page=1&pos=2

[21] *Id.*

[22] *Id.*

[23] *Id*.

[24] https://money.cnn.com/2018/03/28/news/companies/uber-eats-grubhub-delivery-apps/index.html

incremental revenue, but instead replace dining in with the use of aggregators all-together, then the benefits of accessing these aggregator customers plummets.[25]

Given present commission fees, aggregators may be best embraced as complementary to core self-fulfilled delivery or dine-in business. However, as consumer penetration on these platforms rises and consumers continue to shift towards using these platforms for an increasing share of their restaurant meals, aggregators may chip away at the core business of restaurants instead of complementing it. Aggregators are undoubtedly introducing restaurants to new, and perhaps even increasing, business, however this business comes at a greater cost than traditional restaurant sales, be it dine-in or self-fulfilled delivery. Commissioned aggregator delivery orders replacing more profitable, commission-free, dine-in or self-fulfilled delivery orders does not bode well in the long term for restaurant profits.[26]

While some industries may be better equipped to adjust to a high volume, low margin shift in business, the restaurant industry may not be capable of sustainably adjusting to such a shift. The industry is already notorious for slim profit margins and appears ill-equipped to deal with shrinking margins as consumer preferences shift towards aggregators. A typical restaurant budget roughly allots 30% of revenue to cover the cost of ingredients, 30% to cover the cost of labor and the remainder of the budget for all other necessary expenses such as rent, insurance and supplies. Given this standard budget allocation, restaurants seem ill-equipped to also factor in 30% commission on aggregator sales if these sales become a substantial portion of total revenue.[27] In fact, it appears to be an accepted fact that, in the restaurant industry, as delivery increases, profitability decreases.[28] The impact of high aggregator commission fees is exacerbated in a franchised restaurant network where franchisees are also required to pay franchisors a royalty fee typically in the range of 4 to 6% of gross sales.

B. Online Demand versus Onsite Demands

The data on the rise of delivery and stagnation or modest, but steady, decline of in-store revenue appears to unequivocally suggest that delivery, led by the rise of aggregators, will continue to account for a growing proportion of revenue. As aggregator usage continues to grow and encroach into peak business hours, restaurants may struggle to satisfy delivery requests and heavy in-restaurant traffic. Even if restaurants manage to deal with the simultaneous heavy volume in online and onsite orders, they may encounter difficulty maintaining food quality and integrity with certain dishes.[29]

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[25] *Id.*

[26] https://www.newyorker.com/culture/annals-of-gastronomy/are-delivery-apps-killing-restaurants

[27] *Id.*

[28] https://www.zionandzion.com/research/food-delivery-apps-usage-and-demographics-winners-losers-and-laggards/

[29] https://www.forbes.com/sites/aliciakelso/2018/10/31/restaurants-turning-to-off-premise-channels-to-gain-share/#5d2ee903fd55

One option restaurants may consider in dealing with simultaneous heavy volume in online and onsite orders is to open up outlets that can serve as designated pick-up points to satisfy online orders (with no dine-in option). The theory here is that these outlets will contribute to more efficient and expedient preparation, collection and delivery of online orders.[30] On the surface, doing so appears to be a proactive and forward-looking investment into the changing landscape of the industry. However, as will be discussed later, this does not come without its drawbacks and is by no means a sure bet or panacea.

C. Reduced Customer Loyalty and Customer Service Control

Aggregators bring with them an already established customer base, but to whom are these customers loyal? Restaurants should consider the proposition by some that customer loyalties shift away from them to aggregators when they engage aggregators as their delivery partners.[31] While aggregators may in fact provide restaurants with new customers, they may also deprive restaurants the opportunity to build customer loyalty. Even murkier are the instances where existing, not new aggregator generated, customers move onto aggregators. Whereas previously the restaurant was directly connected to the customer, with the use of aggregators, the restaurant is further removed from the customer. In such circumstances, aggregators may see previously loyal customers introduced to a number of “new and interesting” restaurant competitors,[32] resulting in loyalty shifting away from the restaurant towards the platform that presents them with these new and interesting options.

Beyond considerations of customer loyalty, it is also important to consider whose customer is making the order – the aggregator’s or the restaurant’s. While it is difficult to deny, given the clear display of a restaurant’s brand and the restaurant’s ultimate accountability to the customer and subjection to reviews, that the customer belongs to both the aggregator and the restaurant, , it can also be argued that customers using aggregators are first and foremost the customers of aggregators. It is typically the aggregator who facilitates the order and delivery to the customer, and also communicates with the customer. Direct customer-to-restaurant communication or interaction is relatively minor.[33]

In a data and technology driven economy, who controls and owns customer data may be a strong factor as to whose customer it is. In order to gain a sense of who their best and most loyal customers are, and to monitor (and respond to) consumer trends, restaurants require customer data. To curate marketing towards their top and high potential clusters of customers, restaurants need data on order histories, email addresses and/or cell phone numbers. Given this, and the importance of having a degree of control over the consumer relationship, restaurants must assess the quality and nature of the data different aggregators will share with them, and ensure they get the data they need

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[30] https://posbistro.com/blog/partnering-with-food-delivery-apps-like-uber-eats-or-deliveroo/

[31] https://money.cnn.com/2018/03/28/news/companies/uber-eats-grubhub-delivery-apps/index.html

[32] *Id.*

[33] *Id.*

to meaningfully engage with and market to customers.[34] Failing to receive and leverage this data would deprive restaurants of the ability to maximize the advantages of aggregators and would further entrench customers who make orders via aggregators as the customer of the aggregator, not the restaurant.

Reduced, or eliminated, direct customer interaction and communication not only has the potential to shift loyalty from the restaurant to the aggregator, it also reduces the restaurant's control over customer service standards, and ultimately customer satisfaction. While it is within the control of restaurants to train their employees on how to cook, package and handle food with delivery in mind to reduce the risk of it arriving to customers in an unacceptable state, this is where their control on the customer service process ends. Aggregators' couriers generally facilitate multiple deliveries at a time and there is no guarantee as to which restaurant's food will be delivered first. Delays may occur, a particular customer may be scheduled to receive their delivery last, and food may arrive lukewarm or soggy as a result. Even if the cause of the food arriving to the customer's door lukewarm, soggy or late is not the fault of the restaurant, customers have a penchant for passing the blame onto the restaurant, as opposed to the aggregator, and may refrain from ordering from the restaurant again. Further, it is often the restaurant that is subject to a poor review as a result of food being delivered below optimal or acceptable standards. This is why some, like Kent Taylor, CEO of Texas Roadhouse, is reluctant to embrace aggregators and was quoted as saying, "we encourage all our competitors to do as much delivery as they can, so they can deliver lukewarm food to the people who order it."[35]

Considerations for Franchise Networks

I. Business Considerations

In order to compete in the rapidly changing restaurant industry, franchise networks must develop a forward-looking delivery strategy. Despite the credible disadvantages to using aggregators, data collected by Zion & Zion suggests that restaurants who refuse to engage with aggregators and embrace the era of online ordering via third-party applications risk facing significant revenue losses. This assertion is supported by the belief by analysts at Morgan Stanley that delivery may eventually account for more than 40% of all restaurant sales.[36] Given the increasing role delivery will play in overall sales, and the advantages and security afforded by aggregators, some consider it likely that restaurants will steadily lose business if they do not partner with one or more aggregators. However, as has been discussed, sustained use of aggregators may result in shrinking overall profits.[37] Consequently, restaurants and franchise networks may be forced to

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34 *Id.*

35 *Id.*

36 https://www.zionandzion.com/research/food-delivery-apps-usage-and-demographics-winners-losers-and-laggards/

37 *Id.*

reconsider their business models if they are to evolve and thrive in the restaurant industry of tomorrow.[38]

A. Aggregators Around the World

While some players like Uber Eats, Delivery Hero, and Just Eat have spread around the globe, several dominant regional players have emerged in different markets around the world. Where restaurants are located may determine which aggregators they select and if they partner with several to close gaps throughout their franchise network.

This is not an exhaustive list of the aggregator options around the world and restaurants, particularly those with a heavy presence in smaller markets, should research the unique offerings where they do business.

B. Differentiating Features Amongst the Aggregators

While there are many important subjective factors to consider when selecting the right aggregator for a particular franchise network, three appear to be objectively relevant in most cases and stand out as potential key differentiating factors amongst the leading aggregators: commission fees, delivery services, and marketing support. Anecdotally,

[38] *Id.*

brand owners are increasingly indicating a need for greater technical and customer support services as well as service commitment levels from their chosen aggregators.

Commission fees charged by aggregators may vary greatly, but typically the services offered are correlated with commission percentages so further analysis is required to determine whether, given a particular franchise network's needs, a lower commission rate is, in fact, a positive. Some aggregators include delivery services in their commission fees; others give restaurants a choice as to whether they would like to fulfill orders themselves or if they'd like to tap into the aggregator's delivery infrastructure. Those that do not include delivery in the standard commission fee, may charge an additional commission for delivery. Tapping into and leveraging an aggregator's marketing capabilities may also come at a steep price. Marketing fees can fluctuate based on location. Simply put, franchises in more densely populated cities and areas may be charged exorbitant marketing fees.[39]

The discrepancies between Grubhub, Uber Eats and DoorDash, three of the biggest aggregators in the North American market, exemplify how profound the differentiating factors between aggregators may be. In assessing these differentiating factors, franchise networks should determine what delivery services they require given their strategy, what marketing services they require given their location, and then do the math to arrive at what the practical cost of partnering with one aggregator over the other would be given the services they require.

DIFFERENTIATING FEATURES AMONGST THE AGGREGATORS

	Grubhub	Uber Eats	DoorDash
Commission	5 – 25%	30%	10 – 25%
Delivery service	delivery provided for an additional 10%	delivery included	delivery included
Marketing	fee depends on location	fee depends on location	none

Source: Kanika Gupta, Case Study: The Three Biggest Food Delivery Services and What They Mean for You, Bikky Inc. June 26, 2018.

C. Selecting the Right Aggregator

Selecting the right aggregator for your franchise network is a very subjective decision and will depend on where franchises and restaurants are located, what type of food is offered, and the franchise network's target demographics. There is no best aggregator for all cases – hence why numerous viable options have emerged. In addition

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[39] Kanika Gupta, Case Study: The Three Biggest Food Delivery Services and What They Mean for You, Bikky Inc. June 26, 2018.

to the variables discussed in the previous section, franchise networks should consider the following in determining which aggregators they wish to partner with:

1) The aggregator's standard terms, including service level commitments, and whether there is room for latitude and material negotiations,[40]

2) The level of technical and customer support offered by the aggregator,

3) Customer satisfaction rates,

4) User penetration rates in the franchise network's geographic area,

5) The aggregator's logistical capabilities,

6) The quality and reputation of the aggregator's other restaurant partners,

7) What countries and cities the aggregator operates in and their logistical capabilities in each place they operate relative to the franchise network's geographic area,

8) The data collected by the aggregator and the terms governing the aggregator's sharing of this data with the franchisor and franchisees, and

9) The underpinning technology of the aggregator and how it goes about matching couriers to orders.[41]

All of the above considerations are important; however, particular consideration should be given to which aggregators are most popular amongst the franchise network's target audience in its geographic area. Where different aggregators are popular in different areas, the network should strongly consider partnering with multiple aggregators. Indeed, franchise networks should consider partnering with multiple aggregators in any event.[42]

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[40] Regarding room for latitude, it is likely that larger franchise networks will have leverage to negotiate more favorable terms. As a result, room for latitude may be equally dependent on the aggregator being considered and the franchise network engaging the aggregator.

[41] This is critical to avoid possible issues regarding franchise territories.

[42] https://posbistro.com/blog/partnering-with-food-delivery-apps-like-uber-eats-or-deliveroo/

Another option for franchise networks that seek the benefits of being on an aggregator's platform without the potential financial consequences is to partner with third-party logistics services. Third-party logistics services differ from aggregators in that they allow restaurants to continue to own the customer relationship and interface directly with customers, as they just provide the logistical infrastructure to fulfill deliveries. Under a partnership with a third-party logistics service, restaurants may incur no additional costs as the delivery fee, the profits of the courier and service provider, may be entirely passed on to the customer leaving the restaurant to claim the full revenue of the sale without paying a third-party commission.

THIRD-PARTY LOGISTICS SERVICES VS AGGREGATORS

Third-Party Logistics Services	Variable	Aggregators
$30	Order Price	$30
$6.49	Delivery Fee	$3.99
0%	Commission	30%
$30	**Realized Revenue**	**$21**

Postmates On-Demand provides third-party logistics services that function very similar to how consumers use ridesharing services like Uber and Lyft.[43] Just like Uber and Lyft provide consumers with a real-time quote on the cost of moving them from location A to location B, Postmates On-Demand provides a real-time quote on the price of delivering food from a restaurant to the location specified by a customer.[44] Uber itself used to provide a competing logistics service called UberRUSH, but has shut down UberRUSH as it failed to garner adequate demand.[45]

D. Who Should Pay the Aggregator's Commission Fees?

The established practice appears to be that each individual restaurant pays commissions for orders processed through that restaurant. Yum Brands' arrangement with Grubhub allows KFC and Taco Bell franchisees to make "the same profit margins on delivery and in-store orders" thanks to a deal negotiated by the franchisor where the

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43 See <https://postmates.com/delivery-near-me> for more information.

44 https://www.qsrmagazine.com/outside-insights/how-restaurants-can-offer-delivery-and-make-money

45 https://www.forbes.com/sites/rogeraitken/2018/04/12/uberrush-shyps-on-demand-express-delivery-demise-begs-uberfication-questions/#3f85f31a4fe8

franchisees do not pay delivery fees.[46] In general, food sellers pay the services an average fee of 10% to 25% on each order, which means the actual deliveries often lose money.[47]

The research indicates that the current general practice is for franchisors to contract with aggregators for a master services agreement, and then each franchisee would sign its own agreement with the aggregator. One practical consideration is whether a franchisee would want to or would be able to sign up with an aggregator independently of and outside of a franchisor's decision to require that the franchise network participate in delivery. The franchised business is independently owned and operated by the franchisee, and is subject only to the controls the franchisor maintains in connection with the brand identity and other contractual limitations on the franchisee's ability to engage in marketing and alternative channels of delivery. As such, theoretically, the franchisee should be able to make its own decisions about whether to try new endeavors to increase sales. Practically, however, franchisees may be limited in their ability to sign agreements with aggregators due to a provision in the aggregator agreement that grants each party to that agreement the right to use each other's trademarks in connection with the delivery services.[48] As the franchisee does not have the right to license third-parties to use the restaurant's trademark, franchisees may be limited in their ability to contract directly with aggregators without franchisor approval. In fact, DoorDash's terms and conditions allow franchisees to use the service only if such use is sanctioned by the franchise agreement.[49]

As franchisors evaluate the value proposition of offering delivery for their network, one idea might be to subsidize delivery fees and commissions for franchisees during a delivery trial. Depending on the terms and conditions governing the franchisor's use of the network's advertising and marketing fund, the franchisor may even be in a position to cover or offset these subsidies using advertising fund revenues. While the authors have not encountered any cases where franchisors pay the delivery service commission fees for franchised restaurants, the case could be made for a franchise network to make the decision as a network to reimburse franchisees for delivery commissions as the network explores whether delivery is a good option. If a franchisor were to either reimburse or otherwise cover individual outlets' delivery fees during a delivery trial, the franchisor could use that trial as an opportunity to gather and analyze valuable data on delivery, including how much it costs, how it impacts profitability for franchisees, and the impact of offering delivery on the network as a whole. To this end, some franchisors have pursued measures that would encourage their franchisees to enlist third-party delivery services. Nevertheless, the underlying business model for third-party delivery presents challenges for the franchisor as well to craft meaningful incentives.

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[46] https://table.skift.com/2018/12/06/yum-brands-franchisees-dont-pay-delivery-fees-thanks-to-grubhub/

[47] https://www.wsj.com/articles/consumers-love-food-delivery-restaurants-and-grocers-hate-it-11552107610

[48] https://www.uber.com/legal/uber-eats/en-us/

[49] https://www.doordash.com/merchant/merchant-terms

E. Should Franchise Participation be Voluntary or Mandatory?

Fundamentally, the idea of a franchise is a uniform offering that offers customers a consistent experience. It follows, then, that all members of a franchise network should offer the same products and services, including delivery. Practically, the customer experience for customers ordering food through an aggregator would not necessarily suffer if all franchisees in a network did not offer delivery, as long as enough of them did. This is because the options offered on an aggregator's app are based on the customer's location, and even if the franchisee that is 0.2 miles from the customer at the time of the order may not offer delivery, the franchisee that is 0.6 miles from the customer that does offer delivery still would get the order. The customer is still satisfied, and the sale stays with the brand.

Although aggregators allow for a seamless customer experience, franchisors still must consider whether it is fair from a franchise network administration perspective to have some franchisees offering delivery and allow other franchisees to decline to participate. Equitably, if some franchisees are investing in their restaurants to accommodate delivery services, and also are taking the chance that their margins might be negatively impacted by delivery commissions, franchisors would be remiss to require some but not all franchisees to offer delivery. If a franchise network is considering delivery but is not ready to mandate it for the entire network, a fair way to evaluate the delivery proposition would be to conduct a voluntary delivery pilot program. By designing a delivery pilot program that is voluntary, clearly defined, and in which company-owned restaurants also participate, franchisors can take an equitable approach to testing the waters in this new channel of trade.

II. Legal Considerations

Franchise systems considering whether to offer delivery services must consider whether there are any legal obstacles to imposing their preferred method on franchisees. The first consideration is whether the use of the delivery service may be imposed upon franchisees under the existing contractual framework, discussed in Section II.A below. This involves, among other things, consideration of whether the franchisor is contractually permitted to impose a third-party delivery requirement; how the aggregator commission might affect franchisee profits and impact royalty calculations; and, the impact engaging an aggregator might have on territorial grants.[50] Second, franchisors should consider changes that can be made to the franchise agreement on a prospective basis to expressly cover the inclusion of aggregator services into the future, discussed in Section II.B. Third, franchisors should attempt to negotiate specific rights and protections in the contract with the aggregator in order to structure the relationship and protect the brand, discussed in Section II.C below. Finally, franchisors should consider other forms of legal liability that they may face from the use of delivery services, including potential tort liability arising from the transfer of food into third-party hands prior to deliver to the end user (discussed

[50] In Canada, when performing or enforcing its contractual rights or obligations or when exercising its discretion under the franchise agreement, the franchisor will be held to its statutory and common law duty of good faith and fair dealing and will be required to establish that it considered the impact of imposing a third-party delivery aggregator relationship on the franchisee.

in Section II.D below), and the potential impact on the trademark/brand resulting from the introduction of third-party delivery services.

A. Does the Franchise Agreement Permit Imposition of Delivery Services on Franchisees?

Once a franchisor has decided to engage an aggregator to provide delivery services, it must consider whether it has the right to require participation of the current franchise network. Most franchise agreements are drafted to give the franchisor broad authority to modify the "System" (as that term is frequently used in franchise agreements to describe the set of operational procedures that make a franchise unique). Accordingly, assuming the existing franchise agreements have a broad definition of "System" and provide the franchisor with flexibility to modify the "System" from time to time, it is likely that the franchisor will have a contractual basis to require franchisees to participate in delivery services.

<u>Perceived Change to Nature of Business/Breach of Implied Covenant</u>

Even if the franchise agreement permits modifying the "System" in a way that could permit requiring third-party delivery, unwilling participants might argue that requiring participation in delivery is a fundamental change to the nature of the franchise they acquired at the time of their investment. For example, franchisees might argue that delivery services bring an increased burden on the kitchen, increased labor costs for employees to prepare food and provide service during "off-hours" when restaurant traffic would not normally occur, and additional investment in the layout of the restaurant as well as packaging. These franchisees may have a yet-untested claim that requiring delivery materially changes the nature of the business in which they invested.

We have not identified any cases in either the U.S. or Canada addressing a franchisor's right to impose aggregator delivery services on franchisees. Nonetheless, given the caselaw that generally allows franchisors broad rights to modify their franchise systems when the contractual language permits modification, the franchisor likely would prevail in such a case. In the U.S. (assuming sufficiently broad contractual language), courts have consistently affirmed a franchisor's ability to modify system standards, even in situations in which the modification imposes perceived economic harm. For example, in *Economou v. Physicians Weight Loss Centers of America*,[51] a franchisee claimed that its franchisor's changes to the system (in this case, the change from a 700-calorie diet to a 900-calorie diet, which effectively modified the customer guarantee from a five to seven pound weekly weight loss to two pounds weekly weight loss) caused such grave economic harm to the franchisee that it was entitled to declare the contract terminated and to operate despite the subject franchise agreement's covenant not to compete. The court denied the franchisee's motion for a preliminary injunction, stating: "*. . .* the franchise agreements specifically allow (the franchisor) to make such changes. . . These contractual clauses serve to defeat plaintiffs' breach of contract claim. . . ".[52] Also, in *La*

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[51] 756 F.Supp. 1024, CCH Bus. Franchise Guide ¶ 9771 (N.D.Ohio 1991).

[52] *Id.* at CCH page 22,001.

Quinta Corp v. Heartland Properties, LLC,[53] the court found that the franchisee breached its franchise agreement by failing to comply with its contractual obligation to adopt new system standards as mandated by the franchisor. The court highlighted that other courts have consistently "upheld the right of franchisors to make changes to their systems, sometimes at the expense of the franchisee, if authorized under the franchise agreement."[54]

Franchisors wishing to impose delivery services could also face resistance from franchisees in the form of claims that such a requirement is a breach of the implied covenant to deal in good faith. Here again, to the extent the franchise agreement grants the franchisor broad and explicit discretion to add and/or modify system programs, courts typically have refused to invoke or apply the implied covenant of good faith and fair dealing to upset the express terms of a franchise agreement. The case of *Burger King Corporation v. E-Z Eating 41 Corporation,*[55] strongly affirms the ability of a franchisor to modify its operations manual. In this case, a Burger King franchisee alleged that Burger King breached its franchise agreement and the implied covenant of good faith and fair dealing by requiring the franchisee to participate in Burger King's systemwide "Value Menu" program. Strongly rejecting the franchisee's contention, the Court of Appeals held:

> *We agree with the district court… Section 5(A) of the Franchise Agreements provided that the franchisee "agrees that changes in the standards, specifications and procedures may become necessary and desirable from time to time and agrees to accept and comply with such modifications, revisions and additions to the… Manual which BKC in the good faith exercise of its judgment believes to be desirable and reasonably necessary". There is simply no question that (Burger King Corporation) had the power and authority under the Franchise Agreements to impose the Value Menu on its franchisees.*[56]

The leading case on good faith in Canadian franchising is *Fairview Donut Inc v The TDL Group Corp*. ("*Fairview Donut*")[57] After Tim Hortons instituted a lunch menu and a conversion to the "Always Fresh" baking method (which required franchisees to invest in new equipment), some franchisees responded to the new costs by launching a class action with a lengthy list of allegations. With respect to good faith, the franchisees claimed that Tim Hortons breached its duty of good faith by: misrepresenting costs and savings; exploiting their "captive supply" and placing unreasonably high costs on the franchisees;

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[53] 603 F.3d 327 (6th Cir. 2010).

[54] *Id.* at 337. *See also, Pai v. DRX Urgent Care, LLC, No. CIV.A.* 13-3558 JAP, 2014 WL 837158, at *10 (D.N.J. Mar. 4, 2014) *aff'd sub nom. Fabbro v. DRX Urgent Care, LLC,* 616 F. App'x 485 (3d Cir. 2015) (holding that franchisor was entitled to modify the system standards, such as changes in required vendors, even where doing so would require the franchisee to invest additional capital).

[55] 572 F.3d 1306 (11th Cir. 2009).

[56] *Id.* at 1314.

[57] 2012 ONSC 1252 [*Fairview Donut*], additional reasons 2014 ONSC 776, aff'd 2012 ONCA 867, leave to appeal to SCC refused, 35207 (16 May 2013).

refusing to address franchisee concerns; and requiring franchisees to sell the lunch menu items at costs that prevented them from earning a profit.

In dismissing the franchisees' claims, Justice Strathy of the Ontario Court of Appeal outlined the source, nature, and content of the duty of good faith and fair dealing. At common law, franchise contracts have unique characteristics that give rise to the duty of good faith[58]; it is widely accepted that this duty is codified directly into the provincial franchise statutes.[59] Good faith relates to the performance and enforcement of the franchise agreement.[60] Thus, while the parties' conduct must be considered in the context of and in conjunction with the contract that the parties have made, good faith is not a standalone duty that replaces or amends the express terms.[61] Good faith is also a "minimal standard": it is only breached when a party acts in bad faith (conduct that is "contrary to community standards of honesty, reasonableness or fairness").[62]

In *Fairview Donut*, the Ontario Court of Appeal found no breach of the duty of good faith and fair dealing. The franchise agreements explicitly permitted the changes in question, along with granting Tim Hortons the right to set the prices for supplies and ingredients (and even profit from the sales). There was no evidence that Tim Hortons exercised such discretion arbitrarily, capriciously, or for an improper motive, and the changes did not deprive franchisees of the fundamental benefits of the agreements. On the contrary, Tim Hortons made the decision on the basis of sound business judgment with an eye to increasing franchise profitability and competitiveness overall. None of the franchisees became unprofitable as a result, and the decision was made "honestly and reasonably" with due consideration for the interests of the franchisees. In fact, Tim Hortons took reasonable measures to discuss the changes with the franchisees and obtain their support for the alterations. They also committed to train and prepare the franchisees for the changes.

Justice Strathy assessed that the plaintiffs were effectively asking the Court to re-write their contracts and force Tim Hortons to perform them in a manner the plaintiffs found commercially reasonable. However, there was no right to profit on individual menu items: "There is nothing in the plaintiffs' franchise agreements that entitles them to make a profit on their franchises generally or on any particular product or product line".[63] The Fairview Donut case emphasizes the importance of the franchisor's business judgment

[58] *Fairview Donut* at para 497. These factors include unequal bargaining power at contract inception, the non-negotiable nature of most franchise contracts, and a power imbalance throughout the relationship.

[59] *Id.* at para 495, citing to *Landsbridge Auto Corp v Midas Canada Inc*, 2009 CarswellOnt 1655 at paras 24 and 59 (SCJ); *Machias v Mr. Submarine Ltd*, 2002 CarswellOnt 1176 at para 114 (SCJ); *1117304 Ontario Inc v Cara Operations Ltd*, 2008 CarswellOnt 6444 at para 66 (SCJ). See, for example, section 3 of *The Arthur Wishart Act (Franchise Disclosure), 2000*, SO 2000, c 3.

[60] *Fairview Donut* at para 500.

[61] *Id.* at paras 500-501.

[62] *Id.* at para 499.

[63] *Fairview Donut* at para 519.

and its consultation with franchisees prior to implementing the system changes. Generally speaking, Canadian courts will respect the business judgment of franchisors when analyzing whether an exercise of discretion is based on a proper motive and part of a defensible business plan.

Impact on Franchisee Profits

Franchisees might have a more palatable claim based on the significant impact that delivery services might have on their bottom line. The effect of commissions charged by aggregators is magnified in a franchise system, where franchisees pay a royalty to the franchisor, typically based on gross sales. In a series of articles on food delivery in March 2019, the Wall Street Journal found that food sellers pay aggregators an average fee of 10% to 25% on each order, which means the actual deliveries often lose money[64]. Franchisees may argue that the cost burden associated with delivery services should be borne or at least shared by the franchisor. In their paper, Disruptive New Technologies and Franchising, Martin, Murray and Plave provide an excellent example of the impact of delivery commissions on the franchisee's net profit, which illustrates a 14% reduction in net profit when a 20% delivery charge is factored into the revenues upon which royalty payments are based.[65] To date, there is no case law that addresses how a franchise system defines the revenue streams upon which the royalty is based, or requiring a franchisor to include or exclude delivery commissions from royalty calculations. Anecdotal evidence suggests that at this stage, some franchisors tend to be using the same methodologies they always have to calculate royalty payments.

If the headlines are any indication, good franchisors need to think carefully about the impact of delivery commissions on royalty rates; instead of simply basing royalties on gross or net sales, franchisors may develop a completely new methodology for defining which revenue streams count towards the royalty calculation.[66] Franchisors wishing to impose delivery on their franchisees might address this issue proactively by including a carve-out in the definition of gross sales in the franchise agreement to exclude delivery commissions paid from the revenue upon which the royalty is based or excluding a percentage of such commissions. Alternatively, or in addition, and depending on the bargaining power of the franchisor, the franchisor may seek to negotiate lower commission rates on behalf of the franchise network, as was done by Yum Brands[67].

Impact on Definition of "Territory"

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64 https://www.wsj.com/articles/consumers-love-food-delivery-restaurants-and-grocers-hate-it-11552107610

65 Disruptive New Technologies and Franchising, at 6.

66 *Id.* Disruptive New Technologies suggested this as a possibility as well, querying whether the old definitions might "need to be modified to create clear exclusions and carve-outs for situations that were not contemplated when the definition of gross sales was drafted. . . . One possibility is to rethink how royalties and marketing fees are collected and on what terms, including a sliding scale, reduced percentage, or dollar cap."

67 https://table.skift.com/2018/12/06/yum-brands-franchisees-dont-pay-delivery-fees-thanks-to-grubhub/

Where a franchisor has offered a franchisee an exclusive territory, those territory rights may need to be examined in the context of delivery services. Typically, exclusive territory agreements provide a franchisee with a promise that a franchisor will not allow another "bricks and mortar" store to open within a protected radius. Presumably, the franchisee bases its business expectations on the customer base existing within and/or nearby the protected area. Depending on how the aggregator's algorithms work, delivery services may fundamentally alter this equation: they may result in orders placed by customers within a protected radius being fulfilled through delivery from a franchisee outside the protected radius. Of course, typical exclusivity provisions do not guarantee a franchisee the business of customers within any particular locale, but instead a protected radius in which other units will not be opened. Nonetheless, a franchisee who holds the rights to an exclusive territory might try to argue that the addition of delivery services effectively "negates" the territory rights granted to the franchisee, because mobile orders placed from a customer located within the exclusive territory might be fulfilled by a franchisee outside of the exclusive territory. As noted, "the emergence of delivery providers such as Grubhub and UberEats means that local third-party drivers may execute the delivery, and while that should ostensibly be within the local delivery area, that zone may not correlate with the protected area under a franchise agreement."[68] It is not clear (and practically speaking, unlikely) that franchisors would be able to influence the aggregator's algorithms to direct traffic to the franchise located within the territory. The exclusive franchisee might argue that the franchisor has breached the contractual relationship and might seek to bar the use of the delivery service via injunction.

These arguments have not been tested by caselaw to date, but, again, might be addressed by a prophylactic remedy negotiated between franchisor and franchisees to address the practical realities of mobile ordering and equitably managing the issue among the franchise network to avoid a dispute. Such solutions could include data that shows that franchisees will have a net gain from accessing more customers within its territory. As delivery services evolve, it may be possible for franchise systems to collaborate with the aggregator and customize ordering algorithms to ensure that orders placed from within the territory are allocated in accordance with the franchise network's exclusive territories.

B. Provisions of Franchise Agreement That May be Modified to Account for Delivery Services

In the event that a franchisor decides to adapt its franchise network to permit delivery, there are several key provisions of the franchise agreement that might be most pertinent.

i. Delivery

To the extent franchise agreements do not already explicitly address delivery, franchisors should modify their agreements to expressly refer to the requirement that franchisees offer the delivery services designated or approved by the franchisor. These provisions should address the franchisor's right to require the franchisee's participation in

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68 Disruptive New Technologies and Franchising at 3.

the delivery program and the franchisor's requirements for the delivery program, including provisions related to mobile order processing, mobile order preparation, the relationship with the delivery drivers, and proper handling of customer data.

ii. Royalty

As discussed above, franchisors should decide whether and/or how to modify royalty provisions to account for delivery commissions.

iii. Proprietary Information

Ownership of customer data in a franchise network is a critical issue, made only more complicated by including a third-party aggregator. Rights to customer data between the aggregator and the restaurant are addressed in the next section, but franchisors and franchisees still must address this issue in the franchise agreement. For franchise networks that have inhouse delivery services, such as Domino's Pizza and Panera, the franchisor and franchisee can address data ownership issues in the franchise agreement, and there is no third-party claiming rights to customer data. Franchise networks that use third-party delivery services, however, face more complex questions of how to collect the data (are orders placed through the franchise network app, the aggregator's app, or over the internet or phone?) in the first place, then the franchise agreement must delineate whether the customer information belongs to the franchisor, franchisee, or both, as well as which parties have which rights to customer data, and how that data can be used within the franchise network.

iv. Operations Manual and System Standards

The contents of both the operations manual and system standards assuredly may incorporate new sections on delivery. Even if franchise networks transition to system-wide delivery over time, both franchisors and franchisees should be mindful that delivery services (whether third-party or in house) are an innovation like any other, and good franchise governance principles should be applied to this transition. While no one wants to penalize outlets that may need more time, financial assistance, or other resources to successfully incorporate delivery into their business models, networks must always be mindful of the impact on the larger brand.

v. Condition & Appearance of Restaurant

Franchisors will need to consider their current provisions related to the condition and appearance of the restaurant and decide whether to revise them to include the requirement to designate space for delivery order prep and storage. Franchisors may also consider adding maintenance and care requirements for delivery related areas.

It is too early to report on all the ways that delivery is impacting the real estate needs of restaurants, but one clear trend appears to be making dedicated space for delivery orders. For example, in July 2018, "all 1,102 Firehouse locations replaced some of their tables and chairs with shelves where delivery orders can be stacked. About 10 square feet that used to be seating is now a place for couriers to grab orders."[69] Among

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[69] https://www.bloomberg.com/news/articles/2018-10-29/restaurants-shrink-as-food-delivery-apps-get-more-popular

the challenges that delivery has presented to restaurants is the basic organizational and logistical challenge of how to tender the delivery order to the delivery driver; restaurants are not designed to efficiently make the handoff (particularly dine-in restaurants), and are trying to figure out how to efficiently manage the shift occurring inside and outside the restaurant.[70]

One such change is the decrease in foot traffic, which has resulted in demand for a smaller footprint. For example, whereas Firehouse Subs had traditionally rented spaces between 2,000 and 2,200 square feet for each of its restaurants, they now consider the ideal maximum size to be 1,800 square feet.[71] David Orkin, head of the U.S. restaurant division of real estate advisory firm CBRE, notes "other restaurants are also adjusting to fewer visitors" and he has seen "an overall downsizing of restaurant seating space as chains experience less foot traffic and more online and mobile-ordered pickups."[72] The impact of delivery on the size of sites required for a restaurant, as well as the buildout and floorplan of the restaurant will doubtless be reflected in franchise agreements as the trend develops.

vi. Required Software and Equipment

Franchise systems may need to prepare for aggregators who require restaurants to install shelving, a special computer system, or other equipment or software to participate in or facilitate delivery service. Franchisors or even the aggregators themselves may require franchisees to purchase, install, or use software or equipment that are either compatible with or designed to process delivery orders. Currently, delivery orders can come through the brand's app (for example, the Domino's Pizza or McDonald's app), the aggregator's app (Uber Eats), and can be called in the old-fashioned way. Outlets that are part of a franchise network that participates in delivery – whether through an inhouse delivery team, like Panera or Domino's, or through an aggregator – must have the technical capability to receive and process the orders through a common platform.

vii. Products & Services the Restaurant Offers

Generally, franchisees must make available all of the products and services offered by the franchise network at large. Delivery should be no exception. That said, however, once a franchise network decides to offer delivery, like any other system-wide improvement, it may take time to equip all outlets for participation in delivery services. Franchise networks converting to delivery may consider fulfilling delivery orders from outlets that are equipped to do so while the transition takes place across the network, while being careful to manage the dynamic this option may present in terms of the economic advantage multi-unit franchisees may have with respect to their peers in a franchise network.

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70 https://www.fastcompany.com/90287861/the-future-of-the-13b-food-delivery-industry-rests-on-better-shelves

71 https://www.bloomberg.com/news/articles/2018-10-29/restaurants-shrink-as-food-delivery-apps-get-more-popular

72 *Id.*

viii. Approved Products, Distributors, and Suppliers

If a franchise network decides to offer delivery services with a particular aggregator, the franchisor may designate that service as a required supplier. As a required supplier, the aggregator should be disclosed properly in the U.S. FDD but, more importantly, franchisees may be restricted in whether they could use other aggregators to fulfill mobile orders. In addition to the question of whether a franchise network will use one aggregator exclusively, some aggregators may impose their own requirements for equipment and software to use the delivery service.[73]

A related issue for consideration is whether restaurants will and, in the case of franchised restaurants, whether franchisees will be required to make available via delivery all of the products on the restaurant's dine-in menu or just a subset of the products (selected on the basis, for example, that profit margins are sufficient to support the additional commission fees charged by the aggregators or on the basis that the menu items are suitable for delivery).

ix. Insurance

Franchise systems that have inhouse delivery drivers will need to require the appropriate type and amount of insurance to cover the drivers. Franchisees of franchise systems that deliver through a third-party also may be required to purchase insurance to cover third-party delivery drivers.

x. Quality Assurance

Quality assurance provisions in franchise agreements (or operations manuals) may need to be revised to account for provision of delivery services. This could include incorporating new product standards for food that is sent out for delivery, new packaging requirements, and new procedures for packing and verifying orders sent out for delivery to ensure they are correct and meet quality standards before they leave the restaurant. Quality assurance provisions likely will be specific to each franchise system and tailored to the specific product offering, with the common theme of delivering a delicious, attractive product to the customer.

xi. De-identification

De-identification provisions (and post-termination requirements generally) may need to be revised to require franchisees to remove franchisee branding from aggregator platforms as well as online search engine listings.

C. Provisions to Negotiate with Aggregators

Franchisors that negotiate with aggregators on behalf of the entire franchise network may have unique bargaining power as well as special considerations related to the administration of that network that differ from the needs of one or two local

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[73] See the provision II.C.iv below re Quality Standards and the Delivery Process in the aggregator agreement.

restaurants. Some provisions that franchisors should consider negotiating with aggregators include:

i. Commercial Terms – Commission and Placement

Aggregators set commission rates based on the types of services the aggregator provides. If the service receives the mobile order, processes it, and completes delivery, the commission is higher than if the order is processed through the franchisor's own mobile app. Franchise networks who process orders through their own apps can save 10% to 15% in commission fees.[74] As with any other supplied product, large franchisors may be able to negotiate better prices for delivery services on behalf of the franchise network.[75]

Franchisors should also evaluate aggregators based on the way required payments are structured, including considerations such as the amount of time it takes for each franchisee to receive its revenue from the aggregator for orders placed through the aggregator's app, and whether that revenue will be net of commissions, or whether the product sale revenue and commission payments are two separate transactions. For example, Grubhub pays restaurants once a week via direct deposit or once a month via check; payments are the sum of the total orders placed through Grubhub minus Grubhub's commission;[76] DoorDash pays its merchants using the same structure (sum of orders minus DoorDash's fees) and makes payments on the same day of each week.[77] Orders placed through aggregator's apps do not go straight to the restaurant's account; it may take up to two weeks for the restaurant to receive proceeds from product sales.[78] Franchisors and franchisees should work closely together to evaluate whether an aggregator or a third-party logistics provider is a better fit for the franchise network, how the payments are structured, and how delivery transactions will impact cash flow at the franchisee level.

ii. Exclusivity/Priority

If possible, the franchisor on behalf of the network should negotiate with the aggregator for either exclusivity (meaning that the brand would be the only burger restaurant, for example, on the aggregator's platform) or, at a minimum, priority for the brand's products through either a devoted delivery driver, a maximum wait time, maximum delivery time, or some other measurable performance indicator that imposes minimum service level commitments on the aggregator thereby allowing the brand to maintain some standards around the product. Note that these terms are ideal and not what we have seen in practice; in practice, there is not yet a clear trend, but large

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74 https://www.wsj.com/articles/consumers-love-food-delivery-restaurants-and-grocers-hate-it-11552107610?mod=article_inline

75 https://table.skift.com/2018/12/06/yum-brands-franchisees-dont-pay-delivery-fees-thanks-to-grubhub/

76 https://get.grubhub.com/faq

77 https://www.doordash.com/merchant/merchant-terms

78 https://posbistro.com/blog/partnering-with-food-delivery-apps-like-uber-eats-or-deliveroo/

franchise networks may have an aggregator they partner with exclusively, while smaller networks may have arrangements with multiple aggregators.

iii. Agency Issues

The aggregator agreement should clearly state that its drivers are not agents of the franchisor or franchisee. Franchisors should attempt to negotiate a provision that the aggregator will indemnify both franchisee and franchisor for claims related to the driver's acts or omissions, including claims brought under a theory of *respondeat superior* or negligent hiring or entrustment. The indemnity might also include claims related to the driver's acts or omissions that affected the product itself.

iv. Quality Standards & Delivery Process

Ideally, an aggregator agreement would bind the service to comply with the same brand standards that apply to the franchise network (which is meaningful as long as the brand standards cover delivery). If that option is not available, the agreement should at least set out clearly defined handling procedures, quality standards, and timelines for delivery. One important consideration is whether a franchise network can set requirements that affect third-party aggregator drivers (for example, safety, customer interaction, and drug-free standards) without exerting undue control that could muddy any agency issues that may arise. Typically, this would be achieved by imposing an obligation on the aggregator to ensure such measures are imposed on the drivers under the terms of the agreement between the aggregator and driver.

All three parties need to be clear on customer support and remedies for customer service complaints. Given the franchise network's interest in maintaining its brand – and the unfortunate reality that customers attribute defective products and even substandard services to the restaurant, not the aggregator – all three parties need to take care not to turn a customer service experience into a finger pointing exercise where dissatisfied customers are left with no remedy, or a situation where the restaurant bears the burden of financing refunds for product issues over which it has limited control.[79]

Franchisor, franchisee, and the aggregator also need to clearly define a system to process customer refunds. If a customer, after delivery, complains about a meal, the aggregator and franchisee should have a process established to resolve the dispute and see whether the issue should be handled by the franchisee or the aggregator, and whether/how to process any customer refunds. Franchisor and franchisee also need the capability to process debits and credits for delivered products. Finally, the franchisee and the aggregator need to properly account for debits and credits for delivered products.

The DoorDash terms and conditions call for restaurants to "install any equipment reasonably required by DoorDash for Merchant to receive Orders (including, without limitation, a tablet, fax machine, or other automated, electronic means of receiving

[79] DoorDash's terms indicate that the restaurant is responsible for complaints related to "nature, quality, content, number, or packaging" of the product, and that DoorDash would only consider crediting the restaurant for late deliveries if the order is more than 45 minutes late and the delay is DoorDash's fault. https://www.doordash.com/merchant/merchant-terms

Orders).[80] Requirements such as these that come from the aggregator and not the franchisor raise disclosure issues for franchise systems and may need to be harmonized with existing franchise requirements for the layout and infrastructure of the restaurant.

v. Ownership of Customer and Other Data

In today's marketplace, data is key, and franchise networks considering engaging an aggregator may be reluctant to do so given that orders may be placed through a third-party platform, so that neither the franchisee nor the franchisor ever has the chance to collect the customer data. Franchise networks also will want to know that the order was delivered on time and be advised of any product quality or customer service issues that surfaced during the delivery experience.

DoorDash's terms and conditions provide for notifications like the ones described above, but they also clearly state that "DoorDashData" (which means any information transmitted to the restaurant through the DoorDash platform) is the aggregator's Confidential Information.[81] Grubhub, on the other hand, has shown a willingness to work with restaurants, as reflected in remarks by Grubhub Chief Executive Matt Maloney indicating "the key to mutual long-term success is to come up with a way to share data with restaurants."[82] Uber Eats' terms and conditions restrict the use of confidential information to use only as necessary to perform each party's obligations under the agreement.[83] Franchisors therefore need to take care to negotiate provisions with aggregators that allow them to use delivery data in the administration of the franchise network.

vi. Use of Marks

If the aggregator is granted a license to use the franchise network's trademark, such license must clearly define the terms of the license and explicitly state that the aggregator has no, and will not have any, rights to the trademark. The agreement should clearly allocate the goodwill that may accrue to the trademark expressly to the benefit of the franchisor.

One illustration of branding and customer challenges faced by restaurants doing business with aggregators is that of Sol Burrito in Rochester, New York, which has offered online ordering on various platforms throughout its 12 year existence.[84] The owner, Mike Bremmer, claims that he has been unable to remedy a Google search issue which directs searchers not to his website, but to Grubhub, and, despite his best efforts, had been unable to direct Google search results away from Grubhub and to his restaurant's website

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80 https://www.doordash.com/merchant/merchant-terms

81 *Id.*

82 https://www.wsj.com/articles/consumers-love-food-delivery-restaurants-and-grocers-hate-it-11552107610?mod=article_inline

83 https://www.uber.com/legal/uber-eats/en-us/

84 https://www.democratandchronicle.com/story/lifestyle/rocflavors/2018/08/16/doordash-grubhub-uber-eats-rochester-restaurant-online-food-delivery-services-swillburger-dogtown/833124002/

until the issue received sufficient media attention.[85] Bremmer believes it is only because of this error that Grubhub orders comprise a quarter of his business, and characterizes the mistake as "stealing his customers."[86]

In situations like these, traditional legal remedies may not be helpful – while well-established franchise networks may be able to afford to send lawyers to court for an injunction, many small and medium-sized franchisors may not be able to do so. Franchisors of small and medium-sized networks should consider carefully the impact that a scenario like this could have on the bottom line of the franchised restaurants.

D. Potential Liability Issues for Franchisors to Consider

i. Agency issues – Tort/Vicarious Liability

Franchisors considering the use of aggregator services should also give some thought to the potential for increased third-party claims. Delivery service greatly alters the customer/franchisee relationship: end customers will receive food in their homes, and will be served food that has traveled some distance and has passed through the hands of a third-party before reaching the customer. Customers who allege to have been harmed by the tortious acts or omissions of a delivery driver may decide to seek remedies from the aggregator, the franchisor, and the franchisee.

The basic principles of vicarious liability and agency law suggest a franchisor will only be liable for the torts of an agent that is sufficiently 'controlled" by the franchisor. As various courts have put it, "Vicarious liability is imputed liability. It is imposed upon an innocent party for the torts of another because the nature of the agency relationship – specifically, the element of control or right of control – justifies it."[87] Put another way, "[i]ntimacy of relation is still the basic idea which today distinguishes the servant from the non-servant."[88] Given the nature of the franchisor/aggregator relationship, a franchisor should have a strong argument that the aggregator is not a servant, but instead an independent contractor -- that is, "a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking."[89] Even if the franchisor were to succeed in negotiating some quality standards with the aggregator, this would not likely be enough for a court to find that either the franchisor or franchisee controlled the driver to the degree that it would be fair to impute liability for the driver's torts to either the franchisor or the franchisee.

Nonetheless, franchisors will want to consider whether the aggregator is willing to consider indemnification and insurance provisions that can insulate the franchisor and franchisees against such claims.

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85 *Id.*

86 *Id.*

87 *Kerl v. Rasmussen* 682 N.W.2d 328, 332; (2004 Wisc.).

88 *Id.*

89 *Id.*

ii. Trademark

The trademark is the essence of every franchise system. The value of the mark – the brand – is the reason franchisees pay money to invest in a proven concept instead of opening their own unbranded restaurant. It is imperative that franchisors police their trademark to protect its value. This is a tricky prospect in the world of aggregators, however, because when an order that arrives through a delivery aggregator is incorrect or otherwise below the expected standard, consumers tend to blame the restaurant, not the aggregator.[90] Franchise networks offering delivery should take care to protect the goodwill and value of the mark by negotiating provisions with the aggregator that enforce brand standards and impose minimum delivery standards.

It is worth noting that, over time, aggregators and social media are changing the way customers see trademarks. Although customers may blame the restaurant for perceived product and service deficiencies, aggregators also have made it clear that they are developing their own brands; it is only natural that, as they do so, consumers will develop a more sophisticated understanding of the delivery supply chain and separate the delivery methods and style of one aggregator with respect to another, separate and apart from the restaurant brand.

The Next Chapter

Without a doubt, the popularity of delivery services is growing. Whether the delivery driver knocking on the door to deliver the product is an employee or contractor of the franchisee or of an aggregator, that delivery driver is a brand ambassador for franchise networks offering delivery. Networks with inhouse delivery systems have the advantage of controlling the product quality, delivery experience, and the ability to manage liability issues, but those networks have significantly invested in those delivery systems. Franchise networks that use third-party delivery systems may negotiate agreements that use either the aggregator platform or the franchise network platform to place orders.

Although these three options generally represent the state of food delivery today, we can't rule out future innovations, especially considering that the challenges highlighted by delivery today, when the service is novel, likely are challenges that will be solved with innovation and increased competition over time. Time will tell how individual outlets will fare under the current margin structure; franchisors may be pushed to innovate in this new space whether they are ready or not; recently, a franchisee organization informed the franchisor, "Our margins do not allow for the commissions that [the aggregator] is taking nor the added rent and service fees [the franchisor] is enjoying," and "Delivery is a growing segment of our business and it will one day cannibalize our on-premise

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[90] https://www.wsj.com/articles/consumers-love-food-delivery-restaurants-and-grocers-hate-it-11552107610?mod=article_inline

restaurant sales. If we allow this to occur under the current arrangement, our net cashflow will go down."[91]

More innovative still is the "ghost" kitchen or restaurant, which are restaurants that accept only delivery orders. Described as "a similar revolution to what Henry Ford did in the automotive industry with the assembly line,"[92] ghost restaurants "can bring down the price of handmade meals. . . Eventually, ghost restaurants will start to replace home kitchens,"[93] according to Martti Paatela of Epic Foods, a food delivery company and ghost restaurant in Helsinki, Finland. Customers cannot sit down and order a drink at Epic Foods, but they can order from the ghost restaurant and have the food packaged in recyclable materials brought to your home by an electric car.[94]

While franchisors work to solve the most pressing problems facing their franchisees, innovations surely will continue to pop up to meet the practical and logistical challenges posed by delivery. One creative idea is ViDDL-iT, a mobile food prep truck that currently offers products from two brands, Wayback Burgers and Willey's BBQ, and offers its own app that allows customers to place mobile orders and track the food truck.[95] As the relationship between franchise networks and delivery evolves, franchise networks may commission their own mobile food preparation vehicles; delivery demand may launch a new industry altogether for the sale and lease of food preparation vehicles. Or perhaps franchise lawyers of the not-so-distant future will be drafting and negotiating contract provisions for delivery by drones.[96]

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91 https://www.chicagobusiness.com/restaurants/mcdonalds-franchisees-dump-delivery

92 https://www.forbes.com/sites/lanabandoim/2019/01/28/how-ghost-restaurants-are-changing-the-restaurant-business-model/#6c36a77c41d7

93 *Id.*

94 https://www.forbes.com/sites/lanabandoim/2019/01/28/the-ghost-restaurant-of-finland-exclusive-interview-with-martti-paatela-of-epic-foods/#577257c93e39

95 http://viddl-it.com/about-us/

96 https://www.forbes.com/sites/lanabandoim/2018/10/23/uber-plans-to-launch-food-delivery-drones/#721d2e06e147