

# Ensure Your Good Deed Goes Unpunished – Assisting Struggling Franchisees

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## **Ensure Your Good Deed Goes Unpunished – Assisting Struggling Franchisees**

### **Introduction**

The old adage provides that no good deed goes unpunished, and franchising is no exception. Despite best intentions, a franchisor's desire to voluntarily assist struggling franchisees could come back to haunt them if not done properly. For example, an offer of deferred royalties or other payment obligations could later result in a claim of waiver or estoppel when the franchisor attempts to collect amounts owing, or a dispute about the terms of the deferral. Additional support offered to one franchisee could result in claims of inequitable treatment from other franchisees. Tailored training provided to a franchisee's employees could raise joint-employer issues.

However, the benefits to the individual franchisees and the system as a whole should outweigh any fear of reprisals, and franchisors should not be deterred from well-intentioned efforts to assist their franchisees. For example, during the early days of the COVID-19 pandemic, many franchisors provided royalty relief and deferred payments for inventory to provide some help to franchisees who were facing unprecedented uncertainty. This generated significant goodwill for the franchisors, and sent a clear message to the franchisees that the franchisor was aware of the challenges that the franchisees were facing and that the franchisor was willing to share the burden during unprecedented times.

This workshop covers issues that franchisors should consider when assisting franchisees, whether on a system-wide, regional or individual level. Topics include waiver and estoppel, equal treatment of franchisees, and good faith and fair dealing. The workshop also presents practical tips to help franchisors avoid being victims of their own generosity, including ad hoc versus formal assistance programs, considerations regarding possible joint-employer issues, examples of assistance programs, including non-financial assistance, and setting and monitoring eligibility criteria for franchisee participation in the programs. This workshop also provides a brief overview of changes that have occurred over the last two years due to COVID-19 and the lessons franchisors have learned from these changes.

### **I. CHANGES IN FRANCHISING THAT OCCURRED IN LIGHT OF COVID-19**

One of the most pronounced changes that occurred during the COVID-19 pandemic for franchisors was the requirement to be flexible and lenient with struggling franchisees in order to avoid wholesale permanent closures across multiple industries. In many instances, franchisees were only able keep their door open because their franchisor offered rent and or royalty relief for a period of time and worked closely with each struggling franchisee to identify problems and possible solutions that benefit both parties. The communication between franchisor and franchisee has been paramount to the success of both parties over the last two years. As such, this section discusses the franchisors' ability or willingness to adjust fixed payments and other business obligations, problem-solving with individual franchisees, and the lessons learned through these practices.

## **A. Adjusting Fixed Payments and Other Business Obligations**

Both franchisors and franchisees were forced to make a number of difficult decisions during the pandemic. In various industries such as food, fitness, salons, and other service-related fields, franchisees were forced to operate at reduced hours, reduced capacity, operate with reduced staff or even close their doors on certain days or in perpetuity to account for staffing-related issues or lockdowns in certain jurisdictions. In turn, a franchisee's inability to operate at full capacity (or in some cases, at all) impacted its ability to pay royalty fees, advertising fees, rent or other operational costs as required by the franchise agreement and stay afloat, let alone turn a profit. Unless a franchisor intended to shut down each franchisee that was unable to make its required payments during the COVID-19 pandemic, these problems mandated leniency and creative problem-solving from franchisors. This has led to rent and royalty deferral or relief, individualized payment plans, relief from other fixed payments and business obligations, and even assistance with selling or transferring the franchise.

For a franchisor looking to create an assistance program for its franchisees, the franchisor should first decide whether it will create a formal policy that is offered to all franchisees or whether it will create an individualized program that assists franchisees on a case-by-case basis (i.e., an ad-hoc program). A different section in this paper will explore the considerations in creating a formal versus ad-hoc assistance program, and what might work best for certain franchises. But as long as a franchisor does not unlawfully discriminate against other franchisees in offering certain assistance, it is generally acceptable to require that a struggling franchisee meet a certain threshold of deficiencies before qualifying for relief.<sup>1</sup>

Along the lines of providing informal support or advice to struggling franchisees, a franchisor should encourage its franchisees that were impacted by the government ordered closures or other closures related to the COVID-19 pandemic to review their lease agreements for "force majeure" or "business interruption" type provisions. This may provide rent relief or possible deferral of rental payments during the period when COVID-19 or other government related closures impacted the franchisee's business the most. Even if the lease does not contain any applicable provisions that require rent relief during these times, a franchisee should not hesitate to ask either the franchisor or landlord for relief. Generally, a franchisor or landlord has at least two options for providing rent relief, either by waiving rental payments or deferring rental payments. If rental payments are waived, the landlord agrees not to collect that money in the future and that rent for a certain time period is forgiven. If the landlord defers rental payments, the franchisee is still obligated to make a payment for rent, but it will likely be made on a more generous timeframe than what was initially required. Whether a franchisor offers complete relief for a period of time or a deferral of payments, the assistance provided to the struggling

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<sup>1</sup> See, e.g., HAW. REV. STAT. ANN. § 482E-6(c)(iv); 815 ILL. COMP. STAT. ANN. 705/18(d); WASH. REV. CODE ANN. § 19.100.180(c).

franchisees may make a difference between whether the franchisee is able to remain open and operating or whether it closes its doors permanently.

Additionally, franchisors may offer struggling franchisees royalty payment deferrals or waivers. Again, the franchisor should decide whether a formal or ad-hoc program would work best for its particular situation. As with a deferral of rental payments, royalty payment deferrals still require the franchisee to make regular payments but perhaps on a more generous schedule. Royalty waivers, on the other hand, involve the franchisor forgiving scheduled payment without an expectation that that payment will be made in the future. A franchisor may also offer payment deferral or forgiveness in connection with other fees required in the franchise agreement such as marketing or advertising fees. Regardless of whether the franchisor offers a formal or informal relief program, it will want to be sure to document all of the relief provided or offered to its franchisees, the timeline of the relief program, and whether it expects certain payments to be made in the future. This could be accomplished in a relief agreement or an amendment or addendum to the franchise agreement. As long as the franchisor provides clear expectations to its franchisee, it should protect itself and its right to seek payment in accordance with its deferral program or agreement with the franchisee.

Last, there may be other business obligations that require flexibility by the franchisor depending on the industry it operates in and how it is grappling with obstacles in light of the COVID-19 pandemic. For instance, if a franchisor requires its franchisees to attend certain training in person or obtain certain certifications, it may need to cancel, postpone or make the trainings and certifications available online. In addition, if a franchisor requires its franchisees to use specific vendors, but those vendors are struggling to obtaining a regular supply and cannot meet required deadlines, the franchisee may need to take advantage of other vendors in order to continue to operate. In short, franchisors should work with their franchisees to identify what fixed business obligations may need to be adjusted so that the franchisee can continue to operate in the least disruptive manner possible, without damaging the franchise brand.

## **B. Creative Problem-Solving**

Although COVID-19 had a number of negative impacts to various industries across the world, many business owners were able to find creative solutions to their problems that will carry forward beyond the pandemic. This section discusses ways that franchisors and franchisees were able to overcome obstacles, adapt to the new and evolving environment, and prepare (or begin to prepare) for what is to come in the future.

Open communication between franchisor and franchisee was critical to addressing and overcoming issues during the pandemic. At the beginning of the pandemic in March 2020, when multiple state governments ordered the shutdown of nonessential businesses and for people to “shelter in place,” it was vital that franchisors and franchisees were in communication about the various state or provincial regulations, and that franchisees in turn were actively communicating with its employees and customers. In an attempt to satisfy potential compliance issues with various government regulations, some franchisors took it upon themselves to break down the various federal, state and/or

provincial COVID-19 requirements and help their franchisees remain in compliance with the new laws. Some franchisors sent out company-wide messages to its franchisees and their employees, keeping them apprised of how the business is handling the changes, and provide weekly, bi-weekly, and sometimes daily updates. Other franchisors worked with their franchisees and employees to solicit feedback and make sure that employee safety concerns were adequately addressed. For many front-line industries, changes were made to business operations by putting in place contactless systems for customer interactions, putting limits on the number of customers entering buildings, creating and improving sanitization routines, and in many places, plexiglass and other shields were installed to protect employees. Creative problem-solving that set customers' minds at ease about safety and sanitation also resulted in advantages over competitors.

Other issues that required creative problem-solving involved the staffing and supply shortages that became incredibly pronounced as the pandemic wore on. In some instances, franchisees were forced to slow down their marketing efforts, so the current staff did not get overwhelmed with demand, operate at reduced hours or only provide online ordering options because there simply was not enough staff in the store or restaurant to handle in person transactions. Some of these problems could be handled on a company-wide basis, but some issues hit certain franchisees harder than others, whether because of different geographic challenges, political challenges or the individualized health issues of employees at the franchisee.

As mentioned above, supply chain issues and product shortages also created problems for many franchisees and required assistance and flexibility from the franchisor to resolve. For instance, if a franchisor requires its franchisees to use certain vendors, but significant supply chain issues impacted the vendors' ability to service the franchisee, the franchisor may need to work with individual franchisees to determine what viable alternatives are acceptable to both parties and able to keep the business up and running. Many franchise agreements already include provisions that permit the franchisees to source alternate vendors – these establish a convenient framework for the franchisor to establish programs whereby the franchisees can, on a short-term basis, seek such alternate vendors. However, in instances where the procedures described in the franchise agreement are too onerous to be complied with in a timely manner, the franchisor may need to be flexible in allowing its franchisees to find their own vendor source. Above all, these problems all require active communication between the franchisor, franchisee, and the franchisee's employees. Franchisors have found that it is important to listen to the franchisee's concerns in order to avoid permanent closures and failed locations.

### **C. Lessons Learned from Operating Franchises During the Pandemic**

Successful franchisors helped their franchisees adapt to the ever-changing COVID-19 regulations, guidelines and assistance programs. Franchisors that provided reopening plans, guidance on applicable regulations, best practices for its industry, health screening forms and waivers for customers and employees, disposable masks, thermometers, etc. all gave their franchisees an advantage to being able to continue to operate as efficiently as possible during this new era. As long as the franchisee and its employees felt supported, it was generally able to keep operations running as best as

possible and had a plan for how to handle obstacles that would arise during various stages of the pandemic.

Another lesson franchisors and franchisees learned from the pandemic is that good employees are some of the most valuable assets of the business. Franchisees and franchisors should no longer be solely focused on how to attract customers, but they must think about how to attract and maintain talented employees. In fact, one of the most pressing issues to come out of the pandemic relates to staffing shortages. Therefore, franchisees and franchisors should continually think about how to attract qualified employees. Franchisors and franchisees can work together to offer signing bonuses to employees, revamp employee benefits, training programs, working with reputable recruiters, and also determine how to advertise and where to look for future employees. Frankly, the ability to attract and retain employees should be top of a franchisees' list of priorities.

Over the last two years most businesses learned the value of being able to connect virtually with co-workers, customers, and clients. If there is another important takeaway from the pandemic, it is that virtual or remote meetings are here to stay. Franchisors should consider continuing to offer virtual as well as in-person training and information sessions for franchisees and prospective franchisees. The information sessions that cater to prospective franchisees are an important touchpoint before the prospective franchisee agrees to sign a franchise agreement. By providing virtual as well as in person sessions, it is likely that more people will be able to attend the events and learn about the franchise opportunity.

The same reasoning applies to hosting virtual meetings or virtual training sessions for franchisees and their employees. In general, accessibility is greatly increased by offering virtual options. Company-wide meetings can happen on a regular basis without the added cost of airfare, car rentals, and hotels and time away from home. Additionally, by having more frequent, virtual meetings, the relationship between the franchisor, franchisee, and employees will likely strengthen as more people feel connected to the brand and invested in the success of the company. Many changes made due to the pandemic actually resulted in increased efficiency and communication and will likely be retained even once the pandemic is over.

## **II. FRANCHISEE ASSISTANCE PROGRAMS: WHY HAVE THEM AT ALL?**

It is clear from the COVID-19 experience that flexibility and implementing franchisee assistance programs can be critical in ensuring a franchisee's business has the resources and resilience it needs to operate effectively through unprecedented times. However, in the more "normal" course of business and outside the extenuating circumstances of a global pandemic, for the franchisors, there are advantages and disadvantages to implementing a franchisee assistance program.

### **A. Advantages of Franchisee Assistance Programs**

Franchisee assistance programs can help a franchisee reach its full potential and realize the full benefit of being part of the franchise system. Clearly, this has an immediate and direct benefit for the particular franchisee. However, the franchisor and the franchise system also benefit. In addition to the obvious advantage of increased royalties, the franchisor also benefits from the goodwill built within the franchisee community. Other franchisees also benefit by not having a poor operator damage goodwill with the brand. Implementing a franchisee assistance program can also serve as a proactive means of dispute management, by course correcting issues or behaviours before a conflict arises. The type of assistance offered by the franchisor in a franchisee assistance program may vary and may include offering financial support (i.e., through reduced royalties, rent and marketing fund contributions, as described above), assisting with loans, offering additional training and mentorship to increase operational efficiency and improve compliance with system standards, offering operational support and temporary management/control, and assisting with marketing and advertising initiatives. Depending on the type and nature of the assistance offered by the franchisor, the benefit the franchisor derives from the program may vary.

Offering franchisees financial assistance through a reduced fee structure may seem disadvantageous to a franchisor in the short-term, as the franchisor will be bringing in less revenue from a particular franchise. However, this form of assistance may keep a franchise location open and operating when it otherwise wouldn't, meaning the franchisor avoids the potential expense associated with terminating or transferring the franchise agreement and possible brand damage as a result of a closed location. Further, franchisee assistance programs are temporary in nature, and by helping a particular franchise stay afloat in the short term, the franchisor may realize longer-term gain from that location. The financial benefit that a franchisor experiences from implementing a franchisee assistance program is perhaps the most important consideration for a franchisor when developing and implementing a franchisee assistance program.

Programs or assistance may also serve as a means of conflict management and as a way to avoid potential disputes between franchisors and franchisees. By recognizing an area in which a franchisee requires support, and offering such support proactively, a franchisor is able to address and correct areas of concern which may have otherwise ultimately have resulted in default under the franchise agreement. Further, by offering a support program to their franchisees, a franchisee is more likely to feel like the franchisor is a partner in the endeavour. However, as discussed below, the implementation of franchisee support programs also has the potential to introduce conflict between the franchisor and franchisee. As such, it is critical for a franchisor to balance the benefit to be gained by offering franchisee assistance programs against the potential negative outcomes, and to ensure that any assistance is properly structured.

## **B. Disadvantages of Franchisee Assistance Programs**

While there are many advantages associated with establishing and implementing franchisee assistance programs, there are indeed disadvantages that a franchisor must consider. These may include complaints about equality among franchisees if not all franchisees receive the same assistance (a particular concern for ad-hoc programs,

discussed in more detail below). A potentially more serious consideration is whether franchisees might seize the opportunity to argue that the franchisor's support, such as an offer of rent or royalty relief, should persist permanently. Similarly, a franchisee may claim waiver in respect of the relief, or confusion in respect of the repayment obligations or schedule. Further, as described further below, if the assistance programs include training for the franchisees' employees, this could raise the risk of claims about the franchisor being a joint or co-employer, which may open the franchisor up to unexpected liability with respect of a franchisee's employees. Finally, developing, implementing and administering a franchise assistance program is time consuming and expensive both from an administrative perspective and also in respect of the actual out-of-pocket costs of deferring or waiving payments, so balancing the advantages and disadvantages is critical to the franchisor's decision.

One of the most common points of contention among franchisees concerning franchisee assistance programs is fairness and equity. The main objective of franchisee assistance programs is to assist those franchisees that require assistance, and absent wide-spread circumstances affecting all franchisees (such as the COVID-19 pandemic), it is rare that all franchisees will experience the same benefit of a franchisee assistance program. To high-functioning and well-performing franchisees, this may feel unfair – the idea that performing well and complying with the terms of the franchise agreement results in receiving *less* support and *fewer* benefits from the franchisor may seem counterintuitive, and perhaps even offensive, especially given that higher performing franchisees generate more revenue for the franchisor, which in turn may be used to offer such programs to underperforming franchisees. Similarly, not all struggling franchisees are afflicted by the same problems. One may have issues with customer retention, another may continually struggle with in-store quality audits (though these typically lend themselves to ad-hoc programs, described below). To avoid concerns among franchisees around fairness and discrimination in respect of the implementation of franchisee assistance programs, it is critical for franchisors to communicate the purpose of these programs – particularly in respect of formal, as opposed to ad-hoc programs – clearly to franchisees, and for franchisees to understand the eligibility for such programs. By including a detailed description of franchisee assistance programs and the terms and conditions of the support offered by the franchisor at the time of disclosure, and by setting out the eligibility parameters for participating in franchisee assistance programs or receiving dedicated franchisor support in the franchise agreement, franchisors may quell or altogether avoid franchisee dissatisfaction and frustration at the prospect of some franchisees receiving “special treatment”.

In addition to fairness concerns *vis-à-vis* other franchisees, franchisee assistance programs may also have franchisees considering what is fair *vis-à-vis* the franchisor. By offering certain support, particularly financial support, franchisees may begin to wonder why the franchisor isn't always offering such discounts: *is it really fair for the franchisor to charge an 8.5% rent or royalties when obviously all they need is 4% to cover the rent or royalties for the premises?* This type of concern among franchisees is more likely to arise when the franchisor is offering long-term assistance, such that it becomes the “norm” for the franchisees; when the assistance is no longer provided, it may feel as though the franchisor is being unfair to the franchisee and taking something away, despite simply



exercising its rights under the franchise agreement. Such feelings of unfairness and resentment toward the franchisor may quickly spread throughout the franchisee network and could have a significant negative impact on franchisee goodwill toward the franchisor. To avoid this, franchisors should consider frequently updating franchisees that are participating in assistance programs on their progress and status of the program, such that the franchisees are reminded of the temporary nature of the program and are able to prepare themselves for withdrawal of the franchisor's support.

Franchisors must be careful to ensure that by offering struggling franchisee support, they are not inadvertently waiving or preventing themselves from exercising any rights or remedies granted to them under the franchise agreement. As such, the terms of the franchisee assistance program – whether ad-hoc or a formal, system-wide program – should be clearly set out and the franchisor should expressly reserve all rights and remedies under the franchise agreement, in the unfortunate event the franchisee ends up defaulting under or breaching the franchise agreement, despite participating in a franchisee assistance program.

The joint employer risk, as it particularly relates to taking over the operations of a franchise, is set out in Section VII below. However, the risk of being found as a joint employer should also be considered for those franchisee assistance programs that do not involve taking over the management of the franchise, but instead offering training and operational support through other avenues. Generally, franchisee assistance programs should be careful to never reach the level of influence over the working conditions within a franchise such that the franchisor is considered to have common direction and control over the franchise and its employees. Entering the premises and providing training onsite to a franchisee's employees may increase the risk of joint employer liability and should be carefully considered when establishing and implementing a franchisee assistance program. However, if there is a material risk of public health and safety or significant damage to brand goodwill, sometimes the franchisor may decide, upon balancing the risks, of proceeding with the assistance notwithstanding the joint employer issues.

To abate some of the potential disadvantages of a franchisee assistance program, planning and advance communication is often key. However, as discussed below, sometimes a more ad-hoc approach to franchisee assistance is preferred (and perhaps, required). The next section discusses how franchisors can plan for the unplanned, when it comes to ad-hoc assistance programs, to avoid or mitigate any negative outcomes.

### **III. TYPES OF ASSISTANCE PROGRAMS: FORMAL VERSUS AD-HOC; VOLUNTARY VERSUS MANDATORY**

There are several considerations involved in deciding what kind of franchise assistance program to implement. Regardless of form, a franchise assistance program should always involve consistency in expectations of franchisees and clear communication as to whether franchisees have an obligation to perform to a certain standard once provided with assistance. Other considerations include whether the program should be voluntary or mandatory, formal or ad-hoc, whether the franchisees should be required to periodically report financials, the duration and location of the training

program, and the responsibility for expenses associate with the program. Clearly articulating the terms of the program to the franchisees is of utmost importance – and perhaps even more so – papering those terms is critical.

#### **A. Formalized vs. Ad-hoc Assistance Programs**

A formalized franchisee assistance program involves establishing pre-determined training programs and support to select franchisees that meet certain criteria (or rather, fail to meet certain standards). These programs are usually well-developed by the franchisor, in the sense that the structure, format, milestones and evaluation criteria for meeting and successfully completing the program are well defined and implemented similarly across all franchisees. A formalized franchisee assistance program allows the franchisor to clearly communicate all the terms of the program to the franchisee *prior* to participating in the program, and the expectations and outcomes of the program can be more clearly defined and articulated to all franchisees. For example, a formalized program may clearly set out the criteria for participating in such program, the objectives of such program, and which party will incur the costs (such as, new appliances, new equipment, transportation, accommodation, and otherwise) (for the franchisee or franchisor representatives) during the program.

Ad-hoc franchisee assistance programs are less formal in nature and involve the franchisor providing certain customized assistance to select franchisees on an as-needed basis, typically resulting from a franchisor identifying a struggling franchisee through operation defaults, customer complaints, complaints from other franchisees, or the franchisee reaching out to the franchisor for assistance. If a franchisor identifies a franchisee struggling in a certain aspect of its business, an ad-hoc program allows the franchisor to address the problematic area directly with the franchisee in a highly tailored manner. While ad-hoc programs may be variable in the types of issues for which the franchisor provides support and the nature in which the support is provided, these programs can – and should – still be set out in the franchise agreement or, if needed, an addendum to the franchise agreement. Ad-hoc programs may be set out in the franchise agreement by providing the franchisee with a discretionary right to provide such support and implement such programs as may be required to ensure the franchisee is complying with system standards. Consider referring to such programs as “targeted” franchisee support programs, thereby making it clear that only certain franchisees fulfilling certain criteria will be subject to such programs. If franchisees participating in a franchisee support program are required to enter into a separate agreement setting out the terms and conditions of such program, these terms and conditions should be provided to the franchisee as part of the disclosure process in advance of signing the franchise agreement.

The common law and statutory (if applicable) duties of good faith and fair dealing apply to the performance and enforcement of the express terms of the franchise agreement and the exercise of any discretion under the franchise agreement. Where the franchisor is given discretion under a franchise agreement, the discretion must be exercised “reasonably and with proper motive, and may not do so arbitrarily, capriciously,

or in a manner inconsistent with the reasonable expectations of the parties”.<sup>2</sup> Therefore the duty of good faith and fair dealing does not require the franchisor to treat all franchisees the same; however, it does require the franchisor to have a good commercial reason for treating franchisees differently.<sup>3</sup> Given the importance of reputation and goodwill within a franchise system, providing certain struggling franchisees with assistance to comply with brand standards or make it through financial turmoil will generally be reasonable if it is in the interests of the franchise system as a whole.

Of course, costs are a major factor when determining whether a formal or ad-hoc program will be more beneficial to the franchisor. Whether an ad-hoc program or a formalized program will be a more cost-effective solution will depend on the nature of the franchised business and the types of challenges the franchisees face. If there are common areas of concern that many franchisees struggle with across the system, a more formalized approach may be preferred, and economies of scale will result in the franchisor expending fewer resources and incurring less cost in implementing such a program. Alternatively, if the issues franchisees face are location/region specific or highly variable depending on the franchisee, an ad-hoc program may prove to be more effective rather than attempting to solve for a problem within a region where the problem doesn't exist. While an ad-hoc program is more customized in nature and therefore, potentially more costly on a per-franchisee basis, fewer franchisees are likely to participate in the program, which may ultimately result in fewer resources and a lower cost in implementing these types of programs across the system.

While papering the terms of a franchisee assistance program is critical, there are, of course, many examples of franchisee assistance initiatives going awry, despite the franchisor's best efforts and diligence in contract formation. The implementation of these programs is often where the “rubber hits the road” so to speak, and franchisors must ensure their operations teams are alive to the various legal issues that can arise when offering franchisees assistance. Consider the following example in Ontario, Canada whereby a franchisor provided ad-hoc assistance to a franchisee in respect of a franchise resale and ended up receiving a notice of rescission for failure to disclose. In this particular case, the franchisee and franchisor mutually agreed to terminate the franchise agreement for a hotel; however, the franchisee asked the franchisor if it could remain in the system for an additional six months in order to find a buyer for its hotel. Given the mutual benefit associated with this arrangement – the franchisee would be able to recoup some of their investment in the franchise, and the franchisor would maintain its reputation and goodwill in the system by keeping the hotel operational – the franchisor agreed to extend the term

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<sup>2</sup> *Landsbridge Auto Corp v Midas Canada Inc* 2009 CanLII 12628 (ON SC) (“Landsbridge”) at para 17, citing *Carvel Corporation v. Baker* 79 F Supp 2d 53 (D Conn 1997) at para 69; *CivicLife.com Inc v Canada (Attorney General)* 2006 CanLII 20837 (ON CA), [2006] OJ No 2474 215 OAC 43 (CA) at para 50; *Shelanu Inc v Print Three Franchising Corporation* 2003 CanLII 52151 (ON CA) (“Shelanu”) at para 96.

<sup>3</sup> See also anti-discrimination provisions in various state franchise laws, including HAW. REV. STAT. ANN. § 482E-6(C); 815 ILL. COMP. STAT. ANN. 705/18; WASH. REV. CODE ANN. § 19.100.180(C),

of the franchise agreement. However, the franchisee subsequently served the franchisor with a notice of rescission on the basis that the franchisor extended the franchise agreement without issuing a franchise disclosure document to the franchisee (in Ontario, unless an exemption exists, disclosure is required on the extension or renewal of a franchise agreement). While the claim was ultimately unsuccessful, this example serves as a demonstration of how a franchisor may inadvertently fall off-side franchise legislation when implementing a franchisee assistance program. Thus, ensuring your well-intentioned operations teams understands how and when to offer franchisee assistance, and understanding the legal implications of same, is key.

## **B. Voluntary vs. Mandatory Programs**

In addition to considering whether to establish an ad-hoc or formal assistance program, a franchisor must consider whether a franchisee's participation in such a program is mandatory or voluntary. While mandatory programs may better protect and maintain the goodwill of the franchised business among customers by ensuring continuity of a particular franchised location and improving the quality of the product/service offerings at a particular franchise location, forcing franchisees to participate in a program may have the opposite effect on the franchisor's goodwill among franchisees. A franchise agreement which grants the franchisor a right to require participation in a franchisee assistance program, should ideally set out the high-level criteria for requiring such participation and, as noted above, the franchisor should exercise its discretion to require participation by a particular franchisee in a manner that is consistent with the duty of good faith and fair dealing.

Franchisors should also consider whether forcing a franchisee to engage in further training will be more beneficial (and cost effective), as compared to terminating the franchise agreement or finding a mutually acceptable exit of the business. For a franchised business with a low start-up investment and where little institutional expertise is required, terminating a franchise agreement with a low-performing franchisee and granting the rights in that particular territory/location to a new franchisee may be preferable compared to investing further resources into a franchisee that may ultimately end up breaching the franchise agreement anyway. It is a difficult decision to make and may require the franchisor to approach the situation clinically, particularly if the franchisor otherwise has a good relationship with the franchisee on a personal level.

Not all struggling franchisees will acknowledge that they're struggling. By making participation in such programs voluntary, the franchisor is at risk of a franchisee declining to participate in a program and generating suboptimal levels of revenue for the franchisor. Considering the desired outcomes and objectives of the particular program will help guide a franchisor as to whether such a program should be mandatory or voluntary.

If considering establishing a voluntary program, franchisors should give thought to whether a franchisee will be required to meet certain criteria to participate and meet certain performance milestones during the program. If considering a establishing a mandatory program, the franchisor should clearly communicate the factors that would trigger the franchisee's mandatory participation. In both cases, this will assist with

complying with the franchisor's duty of good faith and fair dealing. If the franchisor either wants to implement a voluntary program, or does not have the right in the franchise agreement to make participation mandatory, it should ensure that it clearly communicates to the potential participants the benefits of the program in order to incentivize participation.

The nature and format of a franchisee assistance program is highly variable and regardless of whether the program is formalized, ad-hoc, voluntary, or mandatory, participation in the program will ultimately be driven by franchisee performance. As such, understanding which franchisees require assistance and are candidates for participating in these programs is key to the success of the programs. The next section discusses how a franchisor can recognize and identify franchisees that would benefit from a franchisee assistance program.

#### **IV. RECOGNIZING THE WARNING SIGNS OF A STRUGGLING FRANCHISEE**

While the warning signs of a franchisee in distress will not be the same for all franchise systems across the country, there are some universal telltale signs that generally indicate that a franchisee is in trouble. These signs may include, but are not limited to, failure to make required payments to the franchisor, issues with the franchisees' supplier, skewed financial statements compared to other franchisees in the area, and a high turnover of employees consumer complaints, and poor quality assurance scores. If a franchisor is able to recognize these warning signs early, it can determine the best way to offer assistance and avoid negative outcomes for the franchise, including a bad brand experience for customers or the shutdown of a franchise in an important market area.

Perhaps the first and most obvious sign that a franchisee is in trouble is a missed or late rent, royalty or advertising fund payment. While a few missed or late payments here and there are generally not a cause for concern, a pattern of missed or late payments should set off some alarm bells for the franchisor. In that case, the franchisor should proactively reach out to the franchisee to check in and see what is causing the delinquent payment pattern. If the franchisor does not receive a satisfactory response, it should conduct further investigation into the franchisee by participating in a field visit or inspection and audit.

A field inspection will provide the franchisor with firsthand knowledge of what is happening at the franchisees' location. The franchisor can generally glean information regarding the operational aspects of the franchisee and observe the employees and customers interactions throughout the day. The franchisor may also choose to interview employees regarding any labor complaints they have or other observations about the way the franchise is run. The franchisor should also talk to the franchisees' landlord and ensure that rent payments are being made in a timely fashion and that the landlord does not have any complaints regarding lease compliance issues.

However, a franchisor may be hesitant to do a site visit if it thinks that the franchisee will simply put on a show while the franchisor is in town. If that is the case, the franchisor can go the route of "secret shopper" and pose as a customer and observe the activities of the franchisee anonymously. While this might not allow the franchisor to see

what is happening behind the scenes, it is often a good first look at how the location is generally being run, how the employees are behaving, and it allows the franchisor to evaluate the current status of customers service. Then, depending on the outcome of the secret shopper experience, the franchisor can decide if it would like to conduct an official site inspection and audit.

But, before jumping into a site inspection, either announced or anonymous, the franchisor may want to begin by assessing the franchisee's reported financial information and comparing it with other franchisees in the same or similar areas. Franchise agreements generally contain provisions that require the franchisee to provide regular reports of revenue or store performance. If the franchisees' sales are significantly lower or other aspects of the franchisees' financial statement is skewed, this may raise red flags that the franchisor should take note of. Other warning signs that may indicate trouble at a franchise location may include issues with a supplier. For instance, if the franchisee is delinquent in its payments to vendors and suppliers or not placing orders in a timely fashion, this may indicate a larger problem with the operation of the franchisee.

Last, a large amount of employee turnover and a franchisee's inability to maintain current employees could be indicative of a larger problem with the franchisee. Although these problems in isolation may just be part of the ups and downs of running a business, when some of these warning signs show up together, a prudent franchisor should take note and spring into action before the franchisee ends up closing its doors permanently and tarnish the name of the franchise.

## **V. HOW TO HELP**

Once the franchisor decides to implement a franchise assistance program, it then needs to decide what kind of assistance the program will consist of. Different forms of assistance include mentorship, training and consultation, temporary management, financial assistance like royalty/rent relief and franchisor or third-party loans, and other customized solutions. The following sections each describe the different ways in which a franchisor can offer support and assistance to their franchisees.

## **VI. MENTORSHIP, TRAINING AND CONSULTATION**

Providing struggling franchisees with operational support in the form of additional training – either directly, through mentorship programs, or using consultants – may help the franchisee operate their business in a more effective and efficient manner, and may result in increased compliance and adherence to system standards.

In some cases, a struggling franchisee may simply require some refresher training. In these situations, allowing the franchisee to re-take the initial franchisee training or complete certain modules or review certain materials from such training is a cost effective and resource-light way of reminding franchisees of the expectations and standards required to operate the business. Of course, this solution is reserved for franchisees that are struggling in those areas that are already covered in the franchisor's training materials/program. These programs are usually already established and the first and

simplest option for franchisors. However, while this type of training is perhaps the most cost-effective, it is also the least customized and may not get to the heart of the issue the franchisee is struggling with.

Mentorship programs involve partnering high-performing franchisees with low-performing franchisees, in the hopes that a higher-performing franchisee can advise the lower performing franchisee on how to improve their performance. Implementing a mentorship program may be less resource-draining on the franchisor since the franchisor isn't required to provide personnel and representatives to implement the program. Additionally, franchisees will be more willing to be candid about operational issues with another franchisee rather than the franchisor. This provides the struggling franchisee to have candid and open discussions about the source of their issues without the fear of revealing additional issues that could also give rise to defaults. However, the franchisor must be prepared to compensate the mentoring franchisee, meaning this program is not without cost to the franchisor. Further, the relationship between the franchisor and the franchisees providing the mentorship must be strong and reliable, as the mentoring franchisee is effectively serving as a "representative" of the franchisor. The "peer-to-peer" nature of mentorship programs may also quell any franchisee concerns about fairness, as described above, since it is not the franchisor directly providing the assistance to the struggling franchisees. Mentorship programs may be reserved and most effective for franchisees that require motivation and minor operational changes, but for franchisees experiencing significant business challenges, mentors may not have the expertise necessary to assist the struggling franchisee. In these situations, a franchisor may consider providing a struggling franchisee with consulting services (either internal to the franchisor or through an external third party).

In these types of programs, the consultant will assess the operations of the franchisee and identify areas of improvement. They will then work with the franchisee to develop a highly-tailored and customized solution to address the problematic areas. A franchisor should consider engaging external consultants when a franchisee is struggling in a particular area that is outside the franchisor's core competency. For example, if a franchisee is struggling with bookkeeping or employee culture issues – two areas that are not unique to the franchise system – a third party expert in these areas may be better suited to address the problem. This helps reduce the burden on the franchisor's personnel, and also the franchisee may be more receptive to receive this advice from an independent third party. Consulting services will likely be more expensive for the franchisee as compared to participation in a mentorship program or further franchisor training and as such, these types of programs should be reserved for franchisees that are experiencing significant financial or operational challenges.

Developing a business plan and ensuring the franchisee stays on track with the business plan is crucial to the efficacy of any type of training program, regardless of whether such training is implemented through mentorship, consulting services, or standard franchisor training. Making sure the objectives of any additional training are clearly articulated to the franchisee, and that quantifiable, measurable goals and criteria are used to determine the success of such training is critical to ensuring that both the franchisee and franchisor receive the full benefit of the training.

## VII. TAKING OVER TEMPORARY MANAGEMENT OF THE STRUGGLING FRANCHISEE

One option that a franchisor may choose to exercise in providing assistance to a struggling franchisee is to take temporary management of the franchisee's business. Franchisors generally enjoy a significant level of control over the franchisee's operation of the franchise. However, this is subject to the terms of the franchise agreement unless the franchisee agrees otherwise. For example, many franchise agreements include promises by the franchisor to provide various assistance to the franchisee. While franchisors typically offer assistance in the form of training, advertising, financial consulting, and research and development, a franchisor may decide that the best way to diagnose and solve the struggling franchisee's problems is to take temporary management of the struggling franchisee's business.

Taking over temporary management of the franchisee is not generally the first option that a franchisor will choose when determining whether and how to assist its struggling franchisees. In fact, the risk of potential liability for a franchisor is much higher when it participates in the day-to-day management of the franchisee's business. Further, it can result in accounting and administrative challenges, logistical issues, and be a drain on the franchisor's resources. Generally, a franchisor will resort to this option only after it has tried to help the struggling franchisee through mentorship, training programs or financial assistance.

If there is a higher risk of liability associated with taking over management of the franchisee's business, a franchisor may wonder why it would even consider going this route. However, the answer likely mirrors the franchisor's reason for offering any assistance to its franchisees. Franchises are successful because of brand recognition. If there are franchisees in the system that are tarnishing the reputation of the brand, the franchisor will want to ensure that the franchisee comes back into compliance as soon as possible. In fact, the general goal of franchise assistance programs is to maintain the goodwill of the brand and promote the greater success of the franchise business opportunity. Nevertheless, a franchisor should be aware of the risk it may face if it goes too far in helping its franchisees.

### A. Joint Employer Liability Under the National Labor Relations Act

Federal and state rules regarding joint employer standards raise significant issues in the franchise community when a franchisor seeks to assist its franchisees by providing certain assistance in the management of the franchisee's business.<sup>4</sup> In order to avoid potential liability for franchisee employment violations, Franchisors should pay close

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<sup>4</sup>See e.g., Joyce Mazero, Karen Boring Satterlee, Eric H. Karp, Leonard H. MacPhee, Jess A. Dance and William W. Sentell, *Drawing Lines in Franchisor Support—Is It Necessary and Where Are the Lines to Draw in Today's Joint-Employer Environment*, 38 Franchise L. J., 327, 330 (2019).



attention to and understand joint employer standards, particularly if businesses in the franchise community have unionized.

Since 2015, the “joint employer” standard has fluctuated depending on the political party of the executive office. Under the National Labor Relations Act (NLRA), two separate business entities are “joint employers” if “they share or co-determine those matters governing the essential terms and conditions of employment.”<sup>5</sup> For decades leading up to 2015, the National Labor Relations Board (NLRB) focused on whether the alleged joint employer exercised “direct and immediate control” over the applicable worker’s employment, including hiring, firing, discipline, supervision, and direction.<sup>6</sup> Prior to 2015, a franchisor was rarely considered a joint employer with its franchisees under this standard.<sup>7</sup>

In 2015, the NLRB overturned decades of precedent in *Browning-Ferris Industries of California, Inc.*<sup>8</sup> The Board overturned earlier decisions requiring “direct and immediate control,” and instead held that “indirect control through an intermediary or the reserved right to control, even if unexercised, may be sufficient to find a joint-employer relationship.”<sup>9</sup> The Board then provided a non-exhaustive list of factors that may indicate whether an employer is exercising control, including: “dictating the number of workers to be supplied; controlling scheduling, seniority, and overtime; assigning work and determining the manner and method of work performance.”<sup>10</sup>

Then, on February 26, 2020, the NLRB issued a final rule that restored the joint-employer standard that the Board applied prior to 2015.<sup>11</sup> This required that the putative employer exercise “substantial direct and immediate control” over the essential terms and conditions of the separate business’s employee. The rule clarified that the essential terms and conditions of employment are wages, benefits, hours of work, hiring, discharge, discipline, supervision, and direction.<sup>12</sup> However, in December 2021, the NLRB signaled that it intends to issue a proposed rulemaking that will roll back the 2020 joint employer

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<sup>5</sup> National Labor Relations Act of 1935, 29 U.S.C. §§ 151–169.

<sup>6</sup> Mazero, *supra* note 4, at 330.

<sup>7</sup> *Id.* at 331.

<sup>8</sup> 362 NLRB No. 186

<sup>9</sup> Mazero, *supra* note 4, at 331.

<sup>10</sup> *Id.*

<sup>11</sup> See *The Standard for Determining Joint-Employer Status*, NATIONAL LABOR RELATIONS BOARD (last visited March 4, 2022) <https://www.nlr.gov/about-nlr/what-we-do/national-labor-relations-board-rulemaking/the-standard-for-determining-joint>.

<sup>12</sup> 29 CFR § 103.40.

standard sometime in 2022. In short, if a franchisor seeks to take temporary management of its struggling franchisee, it should understand the current and former rules governing joint employer liability in order to make an informed decision regarding the best way to proceed.

## **B. Joint Employer Liability under the Fair Labor Standards Act**

Franchisors should also be cognizant of the Fair Labor Standard Act's (FLSA) definition of "employer," which includes "any person acting directly or indirectly in the interest of an employer in relation to an employee."<sup>13</sup> Given this broad definition, there have been varying interpretations of the joint employer standard in courts across the country. Nevertheless, a number of courts have applied the "economic realities test" holding that "employees are those who as a matter of economic reality are dependent upon the business to which they render service."<sup>14</sup>

Although there has been variation in the way courts apply this test, at least one court has found that a franchisor meets this standard, at least at the motion to dismiss stage. On a motion to dismiss in *Parrott v. Marriott International Inc.*, the court found that there was "no distinction between the franchisor's control incident to system-wide brand standards versus its alleged control over the franchisees' employment and personnel matters."<sup>15</sup> Then, in 2020, the Department of Labor revised FLSA's rules pertaining to joint employers, and adopted a four-factor test to determine joint employer status. It assesses whether the putative joint employer "(1) hired or fired the employee; (2) supervised and controlled the employee's work schedule or conditions of employment; (3) determined the employee's rate and method of payment; and (4) maintained the employee's employment records."<sup>16</sup> Then, along with the executive office administration change, in July 2021 the Department of Labor issued a final rule rescinding the 2020 joint-employer rule. While it may be frustrating that the legal standard for what constitutes a joint employer keeps changing every handful of years, it is definitely something a franchisor should keep on its radar when deciding how far to intervene with a struggling franchisee.

On a similar note, franchisors should also be aware of the potential application of state labor laws in determining whether a franchisee is operating as an independent contractor or employee in certain states. For example, on March 24, 2022, the Massachusetts Supreme Judicial Court ruled that a franchisor was subject to the Massachusetts' Independent Contractor Law's three-prong test to determine whether a

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<sup>13</sup> 29 U.S.C. § 203(d).

<sup>14</sup> Mazer, *supra* note 4, at 336.

<sup>15</sup> Mazer, *supra* note 4, at 338 (citing *Parrott v. Marriott International Inc.*, 2017 WL 3891805 (E. D. Mich. Sept. 6, 2017)).

<sup>16</sup> *Id.* at 341–42.

franchisor is subject to Massachusetts' wage statutes.<sup>17</sup> This test analyzes: (i) whether the work is done under the direction and control of the putative employer; (ii) whether the work is performed in the usual course of the putative employer's business; and (iii) whether the work is performed by someone who has an independent business or trade doing that kind of work.<sup>18</sup> Therefore, the amount of direct control that a franchisor exercises over its franchisee may have severe unintended consequences that will subject it to state labor laws that it otherwise could have avoided.

### **C. Other Challenges to Consider**

Other challenges the franchisor must consider before taking over temporary management of a struggling franchisee is whether it has the internal capacity to do so. For example, is the franchisor already stretched thin maintaining the status quo at headquarters? Is there enough staff to support the temporary management of a franchisee? In addition, the franchisor must think through any accounting challenges that come with the temporary management of the franchisee.

Finally, the franchisor must consider whether it is willing and able to assist other similarly situated struggling franchisees with temporary management. Unfortunately, it may not be a "one and done" situation. For instance, if there is a system-wide problem with the franchise, then there could be multiple struggling franchisees in need of this kind of assistance. Or, if there is an event happening in the world (such as a pandemic) that crippled many businesses, it may be hard to choose which franchisees to offer this kind of support. In order to avoid accusations of discrimination among franchisees, it is ideal, although not always practical, to offer similar assistance to those experiencing similar struggles. But if this is not a viable option, the franchisor should document its reasons for providing the assistance that it is willing to provide, and document how that assistance is or is not received by the franchisee. In short, before taking over temporary management of certain franchisees, a franchisor should consider whether it has the capacity and desire to assist all of its similarly struggling franchisees with temporary management or if there is a better way to address the issues.

## **VIII. PROVIDING ROYALTY OR RENT RELIEF TO STRUGGLING FRANCHISEES**

Since March of 2020, business owners, franchisors, and franchisees alike have all faced a number of obstacles that have likely hindered the growth of their business or their ability to remain open due to reasons such as the COVID-19 pandemic, the civil unrest related to racial injustice and policing, and foreign relations and its impact on the U.S. markets. A drop in consumer spending, as well as the inability for certain franchisees to open their doors for a period of time during the COVID-19 pandemic left many franchisees struggling to make their rent and other business obligation payments and still stay afloat. In times of financial crisis, many franchisors turn to rent and royalty relief to help their

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<sup>17</sup> Patel v. 7-Eleven, Inc., No. SJC-13166, 2022 WL 869486 (Mass. Mar. 24, 2022).

<sup>18</sup> G. L. C. 149, § 148B.

franchisees make it through the economic downturn. By putting some money on the table, the franchisor may raise the morale of the franchisee and in turn, boost customer service and positive brand experiences for customers. In a way, providing financial relief to the franchisee is the same as investing in the brand.

The first thing to consider when offering rent or royalty relief is the time period for which it is offered. Deferral or abatement agreements are popular tools that a franchisor will use generally before resulting to terminating the franchise agreement. Deferral or abatement agreements allow the franchisor and franchisee to restructure conditions under a franchise agreement when it is clear that the agreed upon route is no longer feasible for one of the parties, namely, the franchisee. A deferral agreement provides payment flexibility for a franchisee, so it can ideally improve its financial situation, which might have been impacted by a temporary circumstance such as the COVID-19 pandemic. The terms and conditions of a deferral agreement will vary depending on the individual circumstances, but general goal is to get the franchisee up to date on all of its outstanding financial obligations overtime. As long as the franchisee is making regular payments, it will slowly be able to chip away at their remaining balance, and the franchisor will eventually collect all amounts owed to it. While this is happening, the franchisor can also set certain conditional requirements, such as that the franchisee must provide the franchisor its financials on a more regularly scheduled basis; the franchisee must attend trainings or meetings, or make improvements to the business plan to help sustain long-term success.

But in some instances, particularly in industries that were hit hard by COVID-19, deferral of payments is not enough to keep struggling franchisees in business. Instead, many franchisees in the food industry or other service industries relied heavily on complete relief and forgiveness programs. As a franchisor considers its options, it should consider the time period for the relief program. For instance, maybe it makes sense to offer rent or royalty forgiveness for the months when a government mandate ordered that the franchisee close their business for a period of time. Franchisors can also use this opportunity to be creative and offer a mix of forgiveness and deferrals depending on the outstanding payment obligations. Moreover, the goal of the franchisor is to see a franchisee successful and able to make its payments in the future. This will not happen if the franchisee is forced to close its doors and possibly declare bankruptcy.

## **IX. PROVIDING OR ASSISTING A FRANCHISEE TO OBTAIN LOANS**

A franchisor may determine that the best course of action to help its struggling franchisee is to help them obtain additional financing. If the franchisor determines that a loan is the best way to help its franchisees, it should consider whether it is prepared to provide a loan internally or if it will assist the franchisee in obtaining a loan from a third party.

If the franchisor is not able to finance a loan internally, it should consider participating in the Small Business Administration (SBA) registry. If the franchisor joins the SBA registry, loan applications for franchises are generally processed much faster and more efficiently by the SBA and its lenders. In addition, the franchisor can improve

the franchisee's ability to obtain financing by guaranteeing the loan for the franchisee. However, if the franchisor goes this route, it should in turn obtain personal guarantees from the franchisee based on the amount of the loan, costs, and interest involved if the franchisee defaults.

Alternatively, if the franchisor has a list of preferred lenders it can connect the franchisees with a lender and provide the franchisee with a starting point of who to contact, so the franchisee does not have to waste valuable time filling out loan applications with lenders who likely won't approve a franchise loan. However, a third-party lender may require that the franchisor execute a subordination agreement before authorizing a loan. A subordination agreement prioritizes debts in terms of collecting if the borrower defaults. Franchise agreements generally grant the franchisor a security interest in the franchisee's assets. In this case, a lender may require the franchisor to execute a subordination agreement stating that the franchisor's interest in the franchisee's assets is subordinate to the lender's interest in the franchisee's collateral.

The franchisor may be in a position to offer internal financing. This often provides a huge advantage to franchisees looking for funding, especially during an economic downturn where lenders could be hesitant to take a risk on a new or struggling business or charge exorbitant interest rates. The franchisor can also set its own desired terms and conditions related to use of the loan money for the business. For instance, the franchisor may have strong thoughts about using the money to improve the space or making fixed payments on certain business obligations. If the franchisor is providing the loan to the franchisee, it can specify a mandatory use of funds as a condition to receiving a loan. That way, the franchisor has a little more control to help the franchisees' business in a way it thinks will promote the greatest growth.

## **X. CUSTOMIZED SOLUTION**

Sometimes, a franchisee will be struggling with issues that are unique to that particular franchisee for which the franchisor does not have an established assistance program. In this case, if the franchisor is committed to providing assistance, it will be a matter of working with the franchisee to determine what would help. The franchisor may have dealt with the issues with respect to other franchisees within this system, and have some suggestions on what can be done to assist. Alternately, or in addition, the franchisor could ask the franchisee what it believes would help (other than payment relief, of course). Consider the example where, due to municipal construction, a franchisee's pylon sign was removed, and temporary fencing obscured a significant portion of the façade of the building. In that case, the franchisor and franchisee worked collaboratively with the municipality to allow temporary signage that would have otherwise been against local codes, and the franchisor allowed an exception with respect to signage and brand restrictions in the franchise agreement. As noted below, any ad-hoc assistance must be clearly documented.

## **XI. EXITING THE RELATIONSHIP**

Sometimes, any assistance provided to the franchisee may not be sufficient to overcome the issues that the franchisee is experiencing or that the franchisee has “given up”. The franchisor must be cautious about spending time and resources assisting a franchisee if the franchisee is likely to fail in any event. It may seem counter-intuitive, but sometimes the best way to assist a struggling franchisee is to end the relationship. This could include mutually terminating the franchise agreement or assisting the franchisee with selling the business. Some franchise systems have some resources to assist the franchisee with finding a buyer. Again, as noted above, some struggling franchisees will not agree or recognize that they are struggling, so this may require some candid discussions with the franchisee. In other cases, the franchisee may be grateful to end the relationship and stem their losses. In either event, as with most of the assistance programs, clear and honest communication between the franchisor and the franchisee is critical.

Of course, there is a chance that the franchisee will not agree with a voluntary end to the relationship. The franchisor should have a plan for how to transition the franchisee’s business. As always, if the franchisor is going to terminate the franchise agreement and pursue the franchisee for outstanding payments, it must provide default notices in accordance with the franchise agreement, and consult the franchise agreement as well as applicable law regarding any requirements for non-renewal notice.

Another possibility to consider is whether the franchisee is likely to declare, or be forced into, bankruptcy. In providing any assistance a franchisor must be aware of the likelihood of this happening, as it will impact the nature of the assistance provided, particularly financial. In other words, a bankruptcy should not come as a surprise, and the franchisor should consider how to maximize its interest in a payout, and whether legal action to pursue amounts due to the franchisor would be fruitful. Further, given the stay of termination of contractual relations in bankruptcy and insolvency proceedings, a franchisor who believes that a franchisee may declare bankruptcy may also consider terminating the franchise agreement prior to a declaration of bankruptcy. This would require a careful review of the agreement to ensure that the franchisor had the right to do so, and also to ensure that such termination would not result in claims of any preferential conveyances or treatment from other creditors. If the franchisor has limited resources, it may not be the best use of time and money to try to collect from a franchisee that has no money and no assets. On the other hand, it may be worth the time to obtain a judgment against the franchisee, docket the judgment, and wait to see if the franchisee comes into any money or assets, and then collect on the judgment.

## **XII. OTHER CONSIDERATIONS FOR A FRANCHISOR ASSISTING STRUGGLING FRANCHISEES**

Whatever type of assistance program a franchisor chooses to offer, it should document everything on paper. This can protect the franchisor in the case of litigation, and can show that the franchisor did not waive its ability to collect certain payments in the case of offering deferrals, and it can show how the franchisor helped or offered to help its franchisees. The documentation can also help protect the franchisor against allegations of unlawful discrimination in offering assistance to franchisees.

This is not to suggest that all assistance needs to be the subject of a formal agreement or addendum to the franchise agreement. Depending on the type of assistance, it may be sufficient to provide unilateral notice to the franchisees of whatever program the franchisor is planning to implement, without having the franchisee sign and return an agreement. This can have the double benefit of permitting the franchisor to be nimble when introducing an assistance program, and also put the franchisees on notice about the terms of the program without being burdened with having to chase down each franchisee to get a copy of a signed agreement.

Franchisors should also be cautious about accidentally triggering additional legal burdens or consequences, particularly when providing ad-hoc assistance to franchisees. In the example provided above, the extension of the term of the franchise agreement – while well intentioned – could have triggered a disclosure obligation in Ontario. In that case, it led to an attempt at a “gotcha” moment from the franchisee, and while the claim was ultimately unsuccessful, the franchisor would have been better off not providing the concession in the first place.

The franchisor should take a hard look at what went wrong with this franchisee. If this is one of many franchisees in the system that are closing their doors, the franchisor should ask itself whether it is indicative of a system wide issue and what the franchisor could do to fix these issues on a larger scale. Certainly, the franchisor would like to avoid as many wholesale closures as possible. Yet sometimes, the environment and other factors that lead to closure are outside of the franchisors’ control. Nevertheless, in order to have a successful business model, the franchisor needs its brand to succeed, and it should be willing to dive in and figure out where it is hitting roadblocks and how it can move past them as smoothly as possible.

### **XIII. CONCLUSION**

Franchise assistance programs are often excellent tools for franchisors to use to strengthen the franchise brand by identifying struggling franchisees and providing targeted assistance to bring these franchisees back into compliance with the expectations of the franchise system. But it is notable that some of the problems plaguing struggling franchisees could result from a combination of internal and external factors beyond the franchisees’ direct control. For example, the COVID-19 pandemic served as the impetus for numerous financial relief programs provided to franchisees to help them stay afloat during uncertain times. Even the most diligent and hardworking franchisees could be negatively affected by the pandemic and the ensuing staffing shortages, supply shortages, and government ordered closures. Equally, however, most franchise systems have franchisees were also struggling to stay afloat before the pandemic, and those who will struggle afterwards for reasons unrelated to the pandemic. Therefore, in determining whether to provide a formal or ad-hoc assistance program, a franchisor should conduct a careful review of both internal and external factors affecting its specific franchise system and determine the best way to move forward for the franchisees and the franchise brand.

While this paper discusses a number of risks a franchisor should be aware of when determining how and whether to provide assistance to franchisees, many of these risks

are manageable when understood and handled properly. Indeed, the benefits of bringing up the lowest performing franchisee and strengthening brand recognition and goodwill outweigh many of the risks associated with poorly structured franchise assistance programs. Therefore, if a franchisor is thoughtful in its execution of an assistance program, and clearly documents the type of assistance it intends to provide and its expectations in return, both the franchisor and franchisee should reap the benefits of working together to create a stronger system and brand.