COVID-19 pandemic impact on Franchise industry and Franchise dispute resolution

Tran Thi Thuy Dung
Law Institute, Peoples’ Friendship University of Russia, Moscow 117198, Russian Federation
Corresponding author. Email: tranthuydung1182@gmail.com

ABSTRACT
As the COVID-19 pandemic continues to spread worldwide, businesses, especially franchises, are facing significant levels of uncertainty and instability due to financial weakening, disruption of operations at workplaces, the number of consumers plummeted. For a cross-border business system that frequently involves parties from different countries, the challenge posed by COVID-19 to franchise is acute. This article analyzes and provides franchisors and franchisees options to save their businesses and brand reputation in an endangered pandemic situation. However, this instability has also led to an increase in the number and types of disputes, when franchise parties are unable or unwilling to fulfill their existing contractual obligations. This article also analyzes the franchise dispute resolution that mainly includes litigation and arbitration in order to help franchisors and franchisees make the most appropriate choices in the COVID-19 pandemic context.

Keywords: COVID-19 pandemic, franchise, franchise disputes, franchise dispute resolution, litigation, arbitration

1. INTRODUCTION
The World Health Organization has officially announced the acute respiratory infections caused by corona virus (COVID-19) as a global pandemic with long-term risk on 11 March 2020. At present, the business is reopening, but the impact of COVID-19 on the global economy as well as on the franchise industry is massively terrible. Franchising has been used by emerging markets as a tool of economic development and broader global integration [1], so it plays an extremely important role for the global economy with positive effects include output and job creation, increasing the tax base, modernizing the economy, adjusting the balance of payments, developing small and medium enterprises, etc. However, the coronavirus pandemic crisis has impacted the franchise industry in unprecedented ways and raises some earnest questions that need to be answered by all businesses in this industry. How franchisors and franchisees are able to cope with this crisis? Furthermore, in fact, bad times for the economy mean good times for dispute resolution practitioners. Under current circumstances, will litigation or arbitration be the appropriate method to be chosen by franchise parties if a dispute arises?

2. METHODS
The aim of this paper is to identify and demonstrate the effect of the corona virus pandemic on franchising activity and development. To do this, the article first uses the data collection method, then analyses it to prove its point. In addition to the analysis and synthesis method, Induction and deduction method, the comparative legal method, the formal logical method, the dialectical method, systematic research method are used in this work.

3. RESULTS AND DISCUSSION
3.1. COVID-19 impact on the franchise
3.1.1. Negative impact
The relationship between franchisors and franchisees is an interdependence where franchisors supply brand, training, systems, supply chain, and franchisees supply capital, time, and work effort. The COVID-19 pandemic significantly affected the franchise community and caused great economic instability. Franchisees face a shortage of cash flows due to a drop in customer sales and franchisors face a shortage of cash flows due to reduced royalties. These are some brands that were impacted by the coronavirus pandemic as following:
On June 10, the Starbucks coffee chain announced that it would close about 400 stores in the U.S., and up to 200 stores in Canada in the next 18 months.
In the second-quarter earnings report of 2020, Dunkin’ plans to permanently close 800 donut and coffee stores that located in the U.S. by the end of 2020. According to this report, Global systemwide sales decline of 20.8% in the second quarter. Compared to the prior-year period, revenues for the second quarter decreased $72.0 million (20.0%). [2]
On July 28, McDonald's announced in an earnings call that it planned to close around 200 restaurants by the end of 2020 permanently. [3] On August 17, NPC International, the largest franchisee of Pizza Hut that make up 20% of all U.S. Pizza Hut restaurants, announced that it would close up to 300 Pizza Hut locations and sell the rest Pizza Hut business. [4] In March, around 70% of H&M's stores were temporarily closed due to the virus outbreak. H&M had decided to drop its proposed dividend in a historic move. [5] H&M Group's net sales were dropped by 23% to £7.07 billion in the 6 months to May 31. [6] Sports giant Nike has swung to a quarterly loss of $790 million hit by global store closures up to May. [7] The German luxury fashion brand Hugo Boss’s group sales were down 39% to EUR275 million, retail sales dropped 58%, wholesale revenues decreased 64%, and about 30% global stores network closes [8] in the Q2 of 2020. In Vietnam, according to Ministry of Planning and Investment, in the first 6 months of 2020, the number of businesses operating in the field of Accommodation & Food (the area where fast-food franchises are mainly involved in) temporarily suspended for a period of time has increased by more than 71% (1,836 businesses), compared to the same period in 2019. [9] In South Africa, the franchise industry contributes approximately 13.9% towards the country’s gross domestic product. The widespread disruption seriously impacts on the small, medium, and micro-sized enterprises, that would have been forced to close temporarily, will affect thousands of lives in South Africa. [10]

3.1.2. Positive impact

As the COVID-19 pandemic continues to challenge businesses worldwide, some businesses, in contrast, have been able to do exceptionally well in this context. These companies either sell products tailored to this new environment or have adapted to a new business model during the COVID epidemic crisis. Many franchises, whether small businesses or large corporations are finding ways to keep customers coming back for more. Here are some of the franchises that have been successful in the pandemic.

Domino's Pizza, Inc., the largest multinational pizza company, estimated that about 900 international restaurants are currently temporarily closed. However, the Domino's system has responded rapidly to the COVID-19 environment, and the main change is the transition to 100% contactless delivery. The chain's sales at same stores in the United States rose 16% in the latest quarter. [11] In Q2, Domino’s borrowed the remaining $158 million available under its outstanding variable funding notes. It’s repaid $100 million of the borrowings and is currently generating positive operating cash flow. Domino’s has nearly $250 million in cash and $102 million of available borrowings. [12] Popeyes, the American fried chicken chain, continued to increase sales even during the pandemic in part thanks to its hugely popular chicken sandwich. The same-store sales at its more than 3,000 locations increased by about 25% in its latest quarter. [11]

A remarkable feature about the Spanish fashion retailer Mango is an impressive 50% grew in its online turnover in the period from March 15 till June 1 – compared to what it was during the same period last year. At the same time, it also has managed to get 900,000 new online customers. [13] Indeed, businesses that thrive instead of closing in this challenging economic crisis are part of the franchisor's efforts to support their franchisees that this article will discuss in the following section.

3.2. The options for franchise parties to combat the COVID-19 pandemic

To reduce the burden on franchisees during this unprecedented global pandemic, franchisors should consider some of the measures listed below to support franchisees to continue trading when the lockdown is loosened.

- Reduce or postpone the royalties generally for a reasonable period. In some cases, a franchise agreement may include a provision requiring the franchisee to pay a minimum royalty amount to the franchisor, regardless of the franchisee's actual revenue. However, in the current situation, if the franchisor insists on collecting the minimum royalty, it could cause the already troubled franchisee to collapse completely.
- Renting: The franchisors may agree to temporarily reduce or suspend the rent to relieve the franchisee's financial pressure if the franchisors directly lease the premises to their franchisees. Bin other cases, the franchisors could assist the franchisees in negotiating with their landlords.
- Supply chain problems: Currently, most businesses around the world are experiencing significant disruption to their supply chain problems due to government restrictions. In this case, the parties should consider where it is possible to relax certain obligations and restrictions to allow the franchisee to enter into a legitimate transaction without taking the risk of breach of contract with the third parties - the suppliers. To achieve this goal, the franchise parities could use the applicable force majeure provisions to allow themselves to cancel existing orders from one supplier and find goods at another supplier.
- Inside the franchise system: the franchisors should provide guidance with employee issues, re-evaluate their product offerings, and change distribution channels to contactless delivery.

The key to survival is flexibility and rapid learning in particular situations. Those advices above may be temporary, as economic circumstances and government constraints during the COVID-19 pandemic may change dramatically. However, the franchisor and the franchisee work together create the best chance of success. The support level is crucial for the franchisees, it shows the difference between a venture that survives and a franchise that thrives. For example, for the successful chain of fried chicken restaurants Miss Millie’s (Staple Hill) in United Kingdom...
(UK), the franchisor's first priority is to assist its franchisees in navigating changes affecting their business, so they take the necessary actions when it is clear that the UK has been shut down across the country. [14] Sarah Wilson, Miss Millie's franchisee, says franchisor's support is essential and the guidance also has been phenomenal. [14] They provide all of the personal protective equipment, take charity initiatives, donate 20% of the takings to the local National Health Services trust, and give meals to frontline heroes. This brand has maintained its position as a supplier of quality fast food brand, keeping customers safe, and creating jobs during the period of mass unemployment. Ritch Allison, CEO at Domino's Pizza Inc., one of the thriving businesses amid the coronavirus pandemic, said that they would continue to focus on providing the franchisees and stores the tools to maintain healthy operations and finances, while providing a reliable, secure, and affordable option to customer. Or business coaching franchise, ActionCOACH, has continued offering new and existing clients one-to-one and group coaching sessions, thanks to the virtual communication tools. This brand has continued to thrive throughout the pandemic and “that is down to the proactive measures franchise partners have put in place", [14] They maintained the high quality of business coaching, assisted business owners in navigating the new business landscape and increasing profits in many cases. [14] However, in case the franchisors are unable to agree or mutually assist each other, the dispute occurring is not surprising. In that context, the resolution of franchise disputes will be mentioned in the third section below.

3.3. Franchise dispute resolution

3.2.1. Franchise disputes

The satisfactory franchising relationship has long been recognized as critical to the success of a franchise system. [15] As with other contractual relationships, however, the relationship between the franchisor and the franchisee is inherently conflicting and tense. The franchisors have invested their intelligence, time, effort and money to create a franchise system. They also provide services for their franchisees, such as training, advertising and marketing support, management assistance [16], which means the franchisees must follow the franchisor's quality management guidelines. On the other hand, the franchise often attempts to counter unfair, overriding restrictions or regulations from the franchisor. Before the COVID-19 pandemic, most of the reasons of the disputes include franchise expectation gap [17], the inconsistencies in treatment, lack of clarity in franchisor communications, franchise disclosure document problems, tying arrangement in the franchise contract, franchise system changing, refusal to renew [18], providing adequate training and support, the territorial encroachment, the different jurisprudences and applicable law in the home country and target country, etc. [19]

When a pandemic begins to affect the operation of the franchise system, most disputes arising from a franchise relationship involve the termination of the contract because when franchising is at risk due to the circumstances change, franchisees may seek a legitimate outlet and disputes may arise. Force majeure claims are not just a matter of franchise parties with third parties outside the franchise system. During the health crisis, the force majeure clause is most used to seek the termination of contractual obligations. The contracting party, usually franchisees, may rely on the COVID-19 outbreak and government restrictive measures by as a force majeure event. Force majeure is usually considered an event or other situation beyond one's control, making it difficult or impossible to comply with a contract for a contracting party. Since there are no general rules, the parties can ultimately decide what "force majeure" is in their agreements. Usually, the force majeure clause fully or partially suspends the contract performance; or terminate the contract immediately or after a period of time.

3.2.2. Litigation or arbitration for franchise disputes amid COVID-19 pandemic?

The comparison of superiority between litigation and arbitration in the settlement of commercial disputes, that include franchise, has been a subject of contention for legal practitioners for many years. Before the outbreak of COVID-19, most scholars highly appreciated the suitability of commercial arbitration in settlement of commercial disputes in general and franchise disputes in particular. Compared with traditional court proceedings, commercial arbitration is more private and time-saving. Arbitration provides flexible procedures [20] to resolve disputes because it relies on the principle of autonomy in the contract. Furthermore, international arbitration institutions have teams of arbitrators who are neutral [21] with extensive experience in the field of franchising while this may be an issue to the judges in some local courts. Moreover, an arbitration award is generally “final and binding” with a very low chance of state court challenges, whereas a court judgment is usually appealed to higher courts. [22]

In the particular context of the COVID-19 epidemic disaster, the best way to resolve disputes is by going for a virtual hearing. Litigation or arbitration applying the better digital tools will win the franchise parties' choices.

3.2.2.1. Litigation

Several courts and tribunals have already moved online. In the European Union, the European Court of Justice has postponed a number of cases and is currently prioritizing urgent, expedited, and interim proceedings. The General Court is also prioritizing in urgent cases. Most jurisdictions of the member states postpone court hearings at the
beginning of the lockdown. However, at present, they have moved to use digital tools for litigation such as Bulgaria, Croatia, Austria, Finland, France, Hungary, Italy, Netherlands, Spain, Sweden, etc. [23]

In India, an entire bench of the Supreme Court conducted its first-ever paperless hearing on June 1. Virtual courts are a temporary emergency response to the COVID-19 pandemic, but a division of judges and lawyers want to include virtual courts in regular court proceedings even after a health crisis ends. [24]

In the UK, the new Coronavirus Act that came into effect in March 2020 also allows for more use of video/audio hearings. [25]

In the U.S., the Supreme Court and some other appellate courts have announced that they will hear oral arguments remotely. [26]

In China, the Supreme People’s Court ordered all courts to instruct the litigants to file cases using an online system. This Court has also promoted the use of “mobile micro-court” on the social media platform WeChat in some provinces and cities to help courts hear trials online. [25]

Teleconferences or videoconferences are occasionally being used in courts of South Africa. The Federal Court of Australia is putting in place the technology needed to hear all trials, to the extent necessary, via videoconferencing facilities. Nevertheless, apart from these jurisdictions, the idea of online courts and hearings in other jurisdictions has not been popular; the practice of using them so far has been limited. Judges are inherently accustomed to using traditional proceedings, so transition to online trial is a difficult move. Not only that, online jury trial is even more difficult. One example is the first test jury-trial-by-video that was held in Texas in May 2020. However, using virtual deliberation might cut off the normal interaction between jurors that some consider necessary to build group trust to give a verdict. [27] If more courts turn to video conferencing, making sure people who don't have wireless or poor quality can serve as jurors will also be a challenge. [27] The juries are pretty hard to adapt to this new jury trial.

3.2.2.1. Arbitration

Regarding to moving for using digital tools, most institutional arbitration rules already use such as video/call conference, telephone or other means of communication in their arbitral procedures such as International Chamber of Commerce (ICC) [28], London Court of International Arbitration (LCIA) [29], American Arbitration Association [30], etc. Leading international arbitration institutions, in turn, announced the amended arbitration rules and guidelines for arbitration proceedings in the context of the COVID-19 pandemic.

On April 9, 2020, the International Court of Arbitration at the ICC released its ICC Guidance Note on Possible Measures Aimed at Mitigating the Effects of the COVID-19 Pandemic. The Note sets out a series of measures to help minimize the impact of the COVID-19 pandemic on arbitral proceedings. In particular, this guidance includes organizing virtual hearings information, checklist for a virtual hearings protocol, and suggested clauses for procedural orders. [31]

On March 18, 2020, the LCIA announced a service declaring that it would begin operating remotely from the next day and providing the disputing parties and the arbitrators an instruction on communication with the LCIA. [32]

Hong Kong International Arbitration Centre (HKIAC) also produced Guidelines for Virtual Hearings. [33]

The Arbitration Institute of the Stockholm Chamber of Commerce (SCC) offered the SCC Platform to ad hoc arbitrations globally that is supposed to be a secure digital platform for the parties and the tribunal to communicate and share files. [34]

The International Centre for Settlement of Investment Disputes (ICSID) also issued an announcement that arbitration requests, petitions, and post-judgment applications would be submitted online to this center. [35]

Especially, on April 16, 2020, the most prominent international arbitration institutions, including ICC, ICSID, HKIAC, SCC, SIAC, VIAC, American Arbitration Association-International Centre for Dispute Resolution, Cairo Regional Centre for International Commercial Arbitration, Korean Commercial Arbitration Board, International Federation of Commercial Arbitration Institutions, German Arbitration Institute, and Milan Chamber of Arbitration issued a joint statement titled “Arbitration and COVID-19: the institutions speak with one voice” that encourages the parties and arbitrators to discuss the impact of the pandemic and possible ways to minimize the impact it has caused. This statement also encourages parties and arbitrators to use the appropriate institutional rules and case management techniques which can allow the arbitration to progress substantially without undue delay. This is the first joint statement made by the leading international arbitration institutions worldwide. This message shows that international arbitration representatives around the world tend to express their support during these challenging times with the potential use of digital means in dispute resolution, and they also encourage courts and parties to try to maintain momentum in pending cases, Annette Magnusson, SCC Secretary General. [36]

In fact, using the video conference or other technical means seemed to be the magic solution. The Seoul International Dispute Resolution Center reports that the number of cases of hearing using virtual hearing has increased by 500% and days of hearing using virtual hearing have increased by 460%. [35] HKIAC’s use of virtual auditory services increased dramatically amid the COVID-19 pandemic crisis. About 85% of all hearings have or will require virtual hearing services in April and May. Sixty five percent of all hearing-related inquiries received by HKIAC involved virtual hearing support for the period February to September 2020. [35] As a result, it seems that the experience with virtual hearings was positive. In March 2020, the sole arbitrator heard a case with the claimant’s counsel physically present in Singapore, respondent’s counsel in London, and six witnesses giving evidence from
London, Sydney, and Taipei via video conference. He shared his experience from this case that “Hearing oral argument was no different really from physical hearings.” [37]
There is little feedback yet on how virtual hearing is working in franchise practice, but it is in all court users and arbitration interests to make it work effectively and efficiently.

4. CONCLUSION

The impact of the covid epidemic on the economy in general and franchising in particular is enormous and terrible. Even though the businesses are reopening, the franchise will never be the same after COVID-19. Even when the short-term effects end, the long-term economic impact will ripple for years. Some brands go bankrupt, some are severely affected and closed many of their franchisees as a result, but on the contrary, there are some franchisees thrive regardless to the COVID-19 pandemic is continuing to spread worldwide. And the main reason here is the cooperation between franchisor and franchise.

In this pandemic context, the option for franchisors and franchisees is mutually cooperating to fight disease. An example would be a franchisees taking franchisors’ concessions to postpone or reduce royalty payments; the franchisors, in turn, support their franchisees in renting royalty premises, seek to resolve supply chain issues due to governmental restrictions, provide guidance with employee issues, re-evaluate their product offerings, and change distribution channels to contactless delivery, etc. The franchise may have never seen COVID-19 pandemic before, but it has seen very bad days, such as the 2008 financial crisis, but the franchise industry as well as the economy has always been able to overcome. Franchise is born of innovation and survive through resilience. However, if a dispute between franchisors and franchisees occurs, both parties can consider to choose either litigation or arbitration. Many courts in a number of countries have given instructions for using digital tools in the trial, but in many countries, this idea is still quite unrealistic. Moreover, compared to the arbitrators who are familiar with videoconference, the judges are only familiar with in-person traditional court proceedings. Arbitration itself is an alternative dispute resolution that has a flexible and consensus process, so it has a remarkable ability to react quickly to challenges in current circumstances. Indeed, the international arbitration community, led by large arbitration institutions, worked together to seek to maintain timely and effective access to justice in a very short time. Regard to the choice of dispute resolution mechanisms, court closures and delays as currently uncertain, franchise parties may look for comfort and effectiveness during the arbitration process.

REFERENCE

[1] I. Alon, "Global Franchising and Development in Emerging and Transitioning Markets," Journal of Macromarketing, vol. 24, no. 2, pp. 156-167, 2004. DOI: 10.1177/0276146704269320.
[2] "Dunkin' Brands," 2020. [Online]. Available: https://investor.dunkinbrands.com/news-releases/news-release-details/dunkin-brands-reports-second-quarter-2020-results. [Accessed 10 September 2020].
[3] "USA Today," 2020. [Online]. Available: https://www.usatoday.com/story/money/food/2020/07/28/mcdonalds-earnings-2020-coronavirus-impact-restaurant-closings/5527617002/. [Accessed 10 September 2020].
[4] 2020. [Online]. Available: https://retail.economictimes.indiatimes.com/news/apparel-fashion/apparel/hm-in-talks-with-tens-of-thousands-of-staff-to-cut-working-hours-due-to-pandemic/74949167. [Accessed 10 September 2020].
[5] 2020. [Online]. Available: https://retail.economictimes.indiatimes.com/news/apparel-fashion/apparel/hm-in-talks-with-tens-of-thousands-of-staff-to-cut-working-hours-due-to-pandemic/74949167. [Accessed 10 September 2020].
[6] "Drapers," 2020. [Online]. Available: https://www.drapersonline.com/news/coronavirus-tracker-how-the-industry-is-reacting. [Accessed 10 September 2020].
[7] "Drapers," 2020. [Online]. Available: https://www.drapersonline.com/news/coronavirus-tracker-how-the-industry-is-reacting. [Accessed 10 September 2020].
[8] B. Wright, "just-style," 4 August 2020. [Online]. Available: https://www..com/news/hugo-boss-q2-sales-knocked-by-covid-store-closures_id139309.aspx. [Accessed 10 September 2020].
[9] [Online]. Available: http://www.mpi.gov.vn/Pages/tinbai.aspx?idTin=46843 &idcm=209. [Accessed 11 September 2020].
[10] A. Protulis, "The Impact of COVID 19 on the Franchise Industry," 24 April 2020. [Online]. Available: https://www.lexisnexis.co.za/news-and-insights/covid-19-resource-centre/practice-areas/commercial-law/the-impact-of-covid-19-on-the-franchise-industry. [Accessed 11 September 2020].
[11] S. Ludwig, 8 Franchises That Are Thriving During the Pandemic, U.S Chamber of Commerce, 2020.

[12] D. Klein, Domino's is Thriving During Uncertain Times, 2020.

[13] "Apparel Resources," 2 July 2020. [Online]. Available: https://apparelresources.com/business-news/retail/50-jump-mangos-online-turnover-900000-new-digital-customers/. [Accessed 11 September 2020].

[14] "Miss Millies," 4 July 2020. [Online]. Available: https://missmillies.co.uk/franchise-brands/lead-the-way-during-covid-19-lockdown/. [Accessed 11 September 2020].

[15] A. Watson, & R. Johnson, "Managing the franchisor--franchisee relationship: A relationship marketing perspective," Journal of Marketing Channels, vol. 17, no. 1, pp. 51-68, 2010. DOI: 10.1080/10466690903436305

[16] L. F. Varotto and U. G. Parente, "Franchisor-franchisee relationship quality: Time of relationship and performance," RAE Revista de Administracao de Empresas, vol. 56, no. 6, pp. 600-610, 2016. DOI: 10.1590/s0034-75902016060603

[17] L. Frazer, S. Weaven, J. Giddings and D. Grace, "What went wrong? Franchisors and franchisees disclose the causes of conflict in franchising," Qualitative Market Research, vol. 15, no. 1, pp. 87-103, 2012. DOI: 10.1108/13522751211192

[18] B. Stephanie & J. Verhey, Basics Track: Franchise Litigation, Washington, DC, 2017, p. 43.

[19] Tran. T.T.D., Resolving international franchise disputes by Arbitration, RUDN University, 2019.

[20] C. Wang, "International Arbitration of Maritime Delimitation: An Alternative for East Asia?," Journal of East Asia and International Law, vol. 7, no. 2, pp. 427-441, 2014. DOI: 10.14330/jeail.2014.7.2.06

[21] C. A. Rogers, "The Arrival of the "Have-Not" in International Arbitration," Nevada Law Journal, vol. 8, p. 341, 2007.

[22] J. E. Grenig, "Alternative Dispute Resolution § 6:1," 3rd ed., 2005.

[23] "Digital Tools in Member States," 28 April 2020. [Online]. Available: https://e-justice.europa.eu/fileDownload.do?id=ebb02e1b-61f7-4872-8d2e-29745606ea13.