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Interesting Developments in Franchising

Force Majeure Clauses - Egypt Reminds us of the Risks

Many franchisors include, as a matter of form, a force majeure provision in their franchise agreements, area development agreements and master franchise agreements. The incredible and historical events taking place in Egypt provide a real-life example of the risks of doing so, not only in international franchise agreements but also in domestic ones.

The events unfolding in Egypt are clearly having a tremendous impact on that country's political situation, but they are also dramatically affecting the country's (if not the region's) economic situation and business environment. Any franchisor expecting to enforce a franchise agreement in Egypt will undoubtedly be met with the franchisee's argument that it was "excused" from performance because of the impact of the protests against the Mubarak regime (for example, the actions of the protesters disrupted supply chains, caused damage to property, and shut down commerce generally). The question, though, is whether, in asserting its defense, the franchisee will argue that its performance is excused under the terms of the contract (where a force majeure provision is included in the agreement) or because performance was rendered "impossible" as a matter of applicable law (where a force majeure provision is not included), or both. The franchisee's burden with respect to establishing its defense will be different, and the ultimate success of the defense may vary, depending on whether the franchisee can take advantage of a force majeure provision in the agreement or is relegated to a legal impossibility argument.

Force majeure provisions are agreed upon by the parties to a contract and typically excuse performance by one or more parties to a contract where, depending on the wording of the provision, performance is impeded or rendered impossible by certain events that are beyond the control of the party obligated to perform. A typical force majeure clause might read as follows:

If either party is prevented from performing any of its obligations under this Agreement due to any cause beyond the party's reasonable control, including, without limitation, an act of God, fire, flood, earthquake, explosion, war, strike, riots, embargo, government regulation, civil or military authority (a "force majeure event"), the time for that party's performance will be extended for the period of the delay or inability to perform due to such occurrence.

Force majeure provisions are often insisted upon by prospective franchisees during the negotiation of the franchise agreement, but these provisions are inherently vague and can create uncertainty around performance of the very things - like unit development and payment of royalties - that, from the franchisor's perspective, are at the core of the agreement. For example, while the actions of the protesters in Egypt have clearly disrupted normal commerce, the application of a provision like the one cited above is riddled with factual issues with respect to things like (1) whether the franchisee's inability to perform is "due to" the cited actions, (2) whether the actions were beyond the control of the franchisee (consider, for example, the impact of the franchisee's participation in the political protests and whether its participation took the protests outside of the franchisee's "reasonable control"), and (3) whether the franchisee has truly been "prevented" by the political protests from performing its specific obligations under its specific contract. All of these issues create uncertainty around the franchisor's ability to enforce the agreement.

While a franchisor might want to consider pivotal events such as the political protests in Egypt in deciding whether to actually declare a default under its franchise agreements, the franchisor should be careful not to be hamstrung in its decision by a contractually available excuse such as that found in an overly broad force majeure provision. Where negotiations lead to inclusion of such a provision in the agreement (which franchisors should avoid if possible), care should be taken to keep them narrow and specific. For example, rather than providing that the franchisee is excused from performance "due to any cause beyond the party's reasonable control, including, without limitation ...," consider providing that the franchisee "may" be excused from performing "certain" obligations where performance is "rendered impossible, directly and proximately, by natural disaster or war that, in each case, was not directly or indirectly caused by, contributed

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to, or exacerbated by any act or omission of the franchisee or any person acting on the franchisee's behalf or for its benefit." Consider also including a few provisos to further limit the effects where the franchisee is legitimately unable to perform. For example:

- provided, however, that franchisee will not, under any circumstances, be excused from its obligations with respect to the use and protection of franchisor's marks and confidential information, the payment of any sums of money owed by franchisee to franchisor, or the restrictions regarding Competitive Businesses;
- provided, however, that if franchisee is unable to re-commence performance within 30 days, franchisor may terminate this Agreement effective on notice to franchisee.

Finally, since there have been instances where the franchisee has asserted that the global financial crisis was a performance excuse, consider adding an expressed acknowledgement that economic depressions and recessions and other economic downturns are deemed not to be "force majeure" events.

Events of the magnitude of those that are unfolding in Egypt and surrounding countries rarely happen in modern-day United States. They should absolutely be kept in mind by franchisors engaged in international development; but even those franchisors who limit their activities to the United States should remember that strikes, riots, political protests and other similar events that get swept up into a typical force majeure provision can and do happen here even if perhaps on a smaller scale. The events in Egypt serve as a reminder of the impact that external events can have on a franchisor's contracts and the need to be forward-thinking when negotiating and drafting them.

For more information or to discuss your specific questions, please contact us at your convenience.

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