

# Driving sales without driving you crazy

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## The unique challenges of delivery aggregators in franchise systems

The rise of food delivery “aggregators” such as Uber Eats, DoorDash and Grubhub is a consequence of the “Amazon Effect”. This term was coined to describe the impact created by online, e-commerce or digital marketplaces on the traditional bricks-and-mortar business model. As a result of this new “disruption technology”, businesses must address this significant market shift head-on to stay competitive.

Franchise systems are no exception to this need to adapt, but franchisors of fast-food, fast-casual and other restaurant types face many unique challenges in accommodating third-party food-delivery aggregators within their franchise systems. They will face legal, logistical and relationship issues that do not exist in a restaurant network comprised solely of corporate locations. As with any system change, some franchisees will welcome and embrace the new technology, others will be ambivalent, and a hopefully small percentage will resist any effort at change.

## Discussion

There are numerous business and legal issues that franchisors must address when considering whether and how to engage third-party food-delivery service providers. Each one is detailed below.

## Selecting an aggregator

Franchising adds additional complexity when a franchisor is selecting one or more aggregators. In Canada, franchisors owe their franchisees a common-law duty of good faith and, in six provinces, a statutory duty of fair dealing. Courts have noted that the statutory duty of fair dealing is a codification of the common law duty, and that under both duties, the franchisor may act in its self-interest so long as in doing so, it has due regard for the legitimate interests of the franchisee. Many questions arise as a result, including: How does this duty operate in respect of choosing an aggregator? What is the best time for deciding to partner with an aggregator? What happens if the aggregator does not provide coverage in all geographic areas in which the franchisor’s franchisees operate? Is the franchisor obligated to

choose a different aggregator? Could the franchisor use that aggregator but exclude territories that aren't covered? Important considerations when selecting an aggregator include assessing commission fees, delivery services, the nature of customer data the aggregator will share, marketing support and dealing with customer complaints.

## Terms of the franchise agreement

Franchisors must not only negotiate a commercial agreement with an aggregator, but also consider their legal relationship with their franchisees before executing any agreement with the aggregator.

Franchisors may be limited in terms of what they can promise the aggregator by the terms of their franchise agreements. For example, aggregators often try to get an exclusive relationship with the brand, and participation at all locations. Franchisors wishing to compel participation by the franchisees in the delivery programme may be faced with agreements that do not contemplate e-commerce activities, such as food delivery apps. In many cases, these agreements can significantly predate the invention of aggregators as a business model. Further, since most franchise agreements have five or 10-year terms, franchisors may be unable to wait until the next renewal to get their franchisees on the updated forms of agreement that squarely address online sales and the use of aggregators. Franchisors will therefore need to carefully determine what they can and cannot require their franchisees to do when it comes to food-delivery services. Franchisors run the risk that without a contractual basis for a system change, the consent of their franchisees is required to implement the use of aggregators. In such cases, franchisors will need to develop alternate strategies for engaging franchisee participation (eg, limited royalty relief for online sales or other incentives). Franchisors need to include comprehensive provisions in their franchise agreements going forward to address alternative distribution channels like third-party delivery. There are several issues that should be directly addressed in franchise agreements, including:

- the clear ability of the franchisor to require franchisee participation in the delivery service;
- no encroachment issues arising due to the aggregator's delivery into a franchisee's territory, even if it is otherwise exclusive;
- the handling of customer complaints in association with the aggregator's deliveries;
- franchisees not being awarded any virtual delivery territory; and
- clear determination on the responsibility for fees and payments to the aggregator.

Franchisors considering offering any incentives in relation to food delivery should consider requiring franchisees to sign a form of addendum addressing these issues.

## Encroachment

As part of its review of its franchise agreement, a franchisor must consider encroachment issues, especially since the aggregator's operating territory will unlikely match the territories the franchisor has granted to its franchisees.

If a franchisor has granted exclusivity to a franchisee for a certain territory, is it an encroachment on that territory if an aggregator delivers into that territory products from a different franchisee? If that is a concern, it is unlikely that the franchisor would be able to manage the issue. Many aggregators use independent contractors as couriers and are not willing to exercise the control necessary to obligate the couriers to patronise a particular location.

Even if no exclusive rights have been granted to a franchisee, and a franchisor has reserved rights to itself to engage in internet sales, a franchisor may still be exposed to claims that when performing or enforcing its contractual rights, it has not complied with its duty of good faith and fair dealing. If there is a contractual argument for involving aggregators in the franchise relationship, franchisors will have satisfied their duty of good faith and fair dealing by establishing that in making the decision to use aggregators, they had due regard for the impact on franchisees. Notably, bad faith is considered conduct that is contrary to community standards of honesty, reasonableness or fairness.

## Royalties

Franchisors must decide whether to charge royalties on the full purchase price of the products sold via the aggregator, recognising that franchisees may resist paying full royalty fees, in addition to the service fees charged by the aggregators. Part of this determination will, of course, depend on the terms of the franchise agreement.

## Brand protection

Another topic triggered by the growth of e-commerce and the demand for food delivery relates to the franchise system's brand, reputation and goodwill. There is the possibility of shifting customer allegiances since the delivery transaction is between the aggregator and the customer. As the customer's last point of contact is not with the brand itself, customers may become more attached to the convenience of the aggregator and its brand, favouring this over loyalty to the franchise brand. Further, allowing aggregators' couriers to be the last point of contact between a franchised restaurant and its customers, means the restaurant has reduced control over customer service standards. The opportunity for franchise systems to enter into an "inherited customer base" belonging to the aggregator, may not outweigh this loss of customer loyalty among existing customers.

A lack of uniformity across the franchise system in terms of participation or lack thereof on aggregators could also impact the franchisor's brand, causing annoyance or disappointment to customers who change locations, and frustration when the brand is not consistently available on their delivery app of choice. Food not travelling well or arriving cold affects brand perception, and possibly even specific franchisees who prepared the food, even if it is not the fault of the franchisee. Further, customers who want to dine in but find their restaurant experience negatively impacted by the commotion associated with pick-ups and deliveries (some restaurants may find it difficult to fill delivery orders and handle in-restaurant traffic) may choose not to return to the restaurant. As a result, the value of any incremental online sales may be offset by lost in-store revenue. If the franchisor "owns" the relationship with the aggregator, the franchisor may be putting itself in the unenviable position of being the go-between in the event of a dispute between the franchisee and the aggregator. Franchisors should require the aggregator to agree in the contract to promptly report any complaints by customers or the aggregator's couriers while they are at the franchise location.

Third party food delivery apps/aggregators are changing the restaurant industry. The promise of convenience to consumers and access to the aggregator's existing customer base, as well as another potential income stream, are attractive propositions for any restaurant business. While all restaurant businesses have to navigate this change, it presents unique and particular challenges for franchise systems. Adequately addressing these challenges requires active steps. To avoid the strain that partnering with an aggregator may put on the franchise relationship, franchisors should, where possible, be collaborating with their franchisees on food delivery issues, toward the common objective of driving sales.

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