The Potential Impact of COVID-19 on Franchise Lost Profits Claims

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I. Introduction

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The COVID-19 pandemic initially had a devastating impact on business worldwide, and franchised businesses and franchisors in the United States were not spared. A study conducted by the International Franchise Association (IFA) on the impact of the pandemic in the United States found that, during the first six months of the pandemic, more than 1.4 million franchise jobs were lost, of which 40.2% were permanent, and over 32,000 franchised businesses closed, of which 10,875 were permanent.[1] The pandemic and public health measures instituted to combat it eroded business revenues and profits by generally depressing consumer activity and confidence, limiting the number of customers that may be in the business at the same time, requiring the adoption of mitigation procedures that increased operating costs and, in some cases, requiring that businesses stop operating in whole or in part. Some sectors, however, actually experienced an increase in business, such as restaurants that already offered or quickly adapted to offer takeout and delivery services, and businesses that offered products for delivery to a bored and largely stay-at-home population.

In the franchise world, economic pain was acutely felt by both the franchisees, whose profits evaporated or businesses closed, and by the franchisors, who saw the market for new franchises shrink in the face of economic headwinds and royalty streams decline as franchise-level businesses slowed or stopped. States reopened at varying rates, and vaccines began to rollout in

1. IFA: *1.4 Million Franchise Jobs Lost, 32 Franchises Closed Since March* (Sept. 21, 2020), https://www.franchise.org/media-center/press-releases/ifa-14-million-franchise-jobs-lost-32000-franchises-closed-since-march.

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mid-December 2020. By mid-February 2021, the outlook for the franchise sector had improved greatly, with IFA predicting that the number of franchised businesses would grow by the end of the year to offset 2020 losses and the number of franchise jobs would grow more than 10%, almost recovering fully from the 11.2% decline in 2020 employment, provided that COVID-19 was managed.[2] In July 2021, a fourth wave of COVID-19 swept through the United States fueled by the more transmissible Delta variant.[3] The new surge in cases led businesses to delay their plans to require employees to return to the office starting in September 2021, creating concern that the economic recovery could be negatively impacted.[4] At the time of this article's publication, the Omicron variant has just been discovered, with conflicting reports about its transmissibility and severity.[5]

When the influence of the pandemic recedes from the economy, the abatement may not benefit all sectors. The business challenges that existed and may continue to exist for some may translate into increased tension between franchisor and franchisee. Indeed, the burden of complying with parties' respective obligations under their franchise agreements may seem to outweigh the benefits of continued participation in a franchise system that has been hamstrung by the pandemic. Some of the tens of thousands of franchised businesses that have closed or may still close, and the many more that have seen their profits erode, have sought or will seek early termination of their franchise agreements to avoid continued losses. When faced with the burden of operating at a loss or trying to compensate for losses sustained at the height of the pandemic, franchisees may simply close their businesses regardless of the commitments in their franchise agreements. On the other hand, franchisors may become more aggressive about pursuing claims against franchisees for potential violations to try to enforce quality controls and preserve goodwill if the franchisees have fallen behind in compliance with brand standards due to the economic stresses of the pandemic, in which case the franchisors will seek to recover their lost future royalty streams to compensate for the loss of revenue until they can install a new franchisee to service the terminated franchisee's service area. Thus, it is likely that the pandemic's long-term impact will cause an overall increase in franchisor-franchisee disputes and litigation.

2. Kate Rogers, *Franchising Industry Expects It's Poised to Rebound, If Covid Is Brought Under Control*, CNBC (Feb. 17, 2021), https://www.cnbc.com/2021/02/17/franchising-industry-expects-rebound-if-covid-under-control.html.

3. Karen Weintraub, *The Fourth Wave of COVID-19 Cases Is Here. Will We Escape the UK's Fate? It's Too Soon to Know*, USA TODAY (July 16, 2021), https://www.usatoday.com/story/news/health/2021/07/16/covid-19-fourth-wave-pandemic-surge-deaths-hospitalizations/7976034002.

4. Matt Egan, *The Delta Variant Is Slowing Office Reopenings. It Could Slow the Recovery Too*, CNN Bus. (Aug. 5, 2021), https://www.cnn.com/2021/08/05/economy/delta-economy-office-reopening/index.html.

5. Joanna Sugden & Gabriele Steinhauser, *Omicron, the New Covid-19 Variant: What to Know*, Wall St. J. (Dec. 10, 2021), https://www.wsj.com/articles/omicron-coronavirus-variant-what-to-know-11637935500.

While the pandemic forced in-person hearings into indefinite stasis in many jurisdictions and substantially immobilized many court dockets, it is inevitable that, as restrictions are lifted and court and arbitration proceedings resume in earnest, there will be new disputes that arose during the pandemic involving claims by both franchisors and franchisees that are likely to lead to litigation or arbitration. At the same time, pre-existing franchise litigation that had been disrupted during the pandemic will resume, albeit with potentially substantial changes in the underlying claims because of the pandemic's impact. The impact of the pandemic will extend far beyond scheduling delays in these pending and as-yet unasserted cases. Indeed, as set forth below, the pandemic may serve to limit the potential damages available in franchise litigation by compromising a plaintiff's ability to meet its burden of proof to sustain a claim for lost profits. Similarly, a defendant may assert that the pandemic or the government-mandated closures may, under certain circumstances, excuse performance under the parties' agreement. As a result, for some claims, the onset of the pandemic might serve as a functional barrier on lost profit damages available to a plaintiff in a franchise dispute.

The purpose of this article is to examine the potential impact of the COVID-19 pandemic on franchise lost profits claims. The specific issues include whether the impact on business operations caused by the pandemic might sever the causal chain between a purported breach and the alleged resulting lost profits, providing a potential defense by excusing performance or making the calculation of lost profits too speculative.

II. Proving a Lost Profits Claim in Franchise Litigation

A plaintiff seeking lost profits must, of course, prevail on its underlying cause of action as a prerequisite to receiving an award of lost profits.[6] Commonly in franchise litigation, lost profits claims are asserted as breach of contract claims arising out of one of the parties' alleged failure to perform their respective obligations under the franchise agreement. In a standard breach of contract claim, a plaintiff must establish the existence of a contract, a breach of that contract, and damages caused by the breach.[7] Thus, a breaching party will only be liable for the harms for which its breach is the "proximate cause" of the damages sustained by the plaintiff.[8]

6. *See*, *e.g.*, Meineke Car Care Ctrs., Inc. v. RLB Holdings, LLC, 423 F. App'x 274, 281 (4th Cir. 2011).

7. *See*, *e.g.*, Khorchid v. 7-Eleven, Inc., 2018 WL 149643, at *21 (D.N.J. Oct. 22, 2018).

8. *Meineke Car Care Ctrs.*, 423 F. App'x at 281. A minority of courts have disavowed the proximate cause approach and instead claim to use "traditional contract law analysis." *See*, *e.g.*, Legacy Acad., Inc. v. JLK, Inc., 765 S.E.2d 472, 475 (Ga. Ct. App. 2014) (collecting cases). One such court framed the inquiry as follows: "Under Georgia law, damages growing out of a breach of contract must be such as could be traced solely to breach, must have arisen according to the usual course of things, and be such as the parties contemplated as a probable result of such breach." Progressive Child Care Sys., Inc. v. Kids 'R' Kids Int'l, Inc., 2008 WL 4831339, at *4 (Tex. Ct. App. Nov. 6, 2008) (citations omitted). However, as a practical matter, the approaches

A. *Proximate Cause*

"Proximate causation" limits the extent to which a breaching party can be held responsible for injuries to other parties where those injuries were the result of some act or cause other than the alleged breaching conduct.[9] This same causal analysis also applies to claims for lost profits. To be entitled to lost profits, the loss must have been caused by the underlying breach rather than some other cause or source of harm.[10]

Lost profit damages will only be available to a plaintiff if that plaintiff can prove that the lost profits flowed consequentially from the claimed breach. As the Third Circuit has held, lost profit damages must be "a proximate consequence of the breach, not merely remote or possible."[11] Thus, for a plaintiff to establish that it is entitled to an award of lost profits, it must prove not only that the underlying breach was both the "but-for" cause of its lost profits, but also that the conduct was a "substantial factor in bringing about the harm" and that the lost profits were caused by the breach and not some other factor.[12] Moreover, if a plaintiff cannot prove that its lost profits were attributable specifically to the underlying breach where there are other potential causes of their loss, that lost profits claim should be rejected.[13]

B. *Proving the Amount of Lost Profits*

Given that an award of lost profits necessarily requires an evaluation of potential events that ultimately did not come to pass, courts must weed out claims for damages that are too remote or speculative.[14] Claims for lost profits are subjected to a heightened burden and must be proven with

of these minority jurisdictions may substantially mirror the superseding/intervening cause analysis conducted by the majority jurisdictions described in more detail below.

9. *See* Exxon Co., U.S.A. v. Sofec, Inc., 517 U.S. 830, 839–40 (1996) ("Although the principles of legal causation sometimes receive labels in contract analysis different from the 'proximate causation' label most frequently employed in tort analysis, these principles nevertheless exist to restrict liability in contract as well.") (citations omitted); Nat'l Mkt. Share, Inc. v. Sterling Nat'l Bank, 392 F.3d 520, 525 (2d Cir. 2004) (holding that "as in tort, a plaintiff must prove that a defendant's breach *directly and proximately caused* his or her damages") (citations omitted).

10. *See*, *e.g.*, *Meineke Car Care Ctrs*., 423 F. App'x at 282 (applying North Carolina proximate cause analysis to franchisor's claims of lost profits); Interim Healthcare Inc. v. Health Care@ Home, LLC, 2018 WL 830113, at *3 (S.D. Fla. Feb. 12, 2018) (applying Florida law and incorporating proximate cause into franchise lost profits analysis); JTH Tax, Inc. v. Lee, 514 F. Supp. 2d 818, 825 n.9 (E.D. Va. 2007) (same); Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 2d 365, 368–69 (Ct. App. 1996) (same); *see also* Maaco Franchisor SPV, LLC v. Cruce, 2021 WL 706424, at *4–6 (W.D.N.C. Feb. 23, 2021) (applying North Carolina law and following *Meineke*); Grout Doctor Global Franchise Corp. v. Groutman, Inc., 2015 WL 2353698, at *2–3 (E.D.N.C. May 14, 2015) (same); Hardee's Food Sys., Inc. v. Hallbeck, 2011 WL 4407435, at *3 (E.D. Mo. Sept. 21, 2011) (applying Missouri law and following *Meineke*); Kissinger, Inc. v. Singh, 304 F. Supp. 2d 944, 949–51 (W.D. Mich. 2003) (agreeing with *Sealy*).

11. Nat'l Controls Corp. v. Nat'l Semiconductor Corp., 833 F.2d 491, 496 (3d Cir. 1987) (citation omitted).

12. *Id.* (citation omitted).

13. *See id*.

14. DeMent v. Abbott Cap. Corp., 589 F. Supp. 1378, 1386 (N.D. Ill. 1984) ("Of course, recovery of lost profits should be subject to the ordinary limitations concerning remoteness (or proximate cause) and speculativeness (or certainty) . . . .").

"reasonable certainty," or they will be deemed "too speculative" and will be rejected.[15]

Unfortunately, this "reasonable certainty" standard is not well defined, and courts have observed the difficulty in determining the precise quantum of proof needed to meet this standard.[16] When making this evaluation, courts seek to balance the possibility of awarding a windfall to a wrongdoer by applying too high a bar to the recovery of lost profits, but also prevent that wrongdoer from becoming an unwitting guarantor of profits for plaintiffs.[17]

To carry its burden, a plaintiff must present evidence that is sufficiently persuasive not only to prove that it should be granted relief on its underlying claim, but also to prove that it meets this heightened "reasonable certainty" standard required for an award of lost profits and do so without the benefit of bright-line rules about what that standard requires or how it will be applied. Carrying this burden requires a showing of objective facts and other proof of the profits lost.[18] In evaluating the adequacy of a plaintiff's proof, courts will look to case-specific factors—such as the length of the contract, the nature of the items or services to be provided thereunder—as well as other factors that may impact the plaintiff's ability to generate a profit based on the contract, including the plaintiff's expertise in the particular business, and other external factors that may have influenced an alleged lost profit.[19] As set forth below, the impact of the pandemic will make proving that a defendant's conduct was responsible for a plaintiff's lost profits with "reasonable certainty" increasingly complicated.

III. Intervening and Superseding Acts May Affect Proximate Cause Analysis

A. *Definitions of Intervening and Superseding Acts*

There are two primary ways in which the causal chain necessary to establish a claim for lost profits can be impacted: (1) through an intervening force or act, which "actively operates in producing harm to another after the actor's negligent act or omission has been committed"; or (2) by a superseding cause "which by its intervention prevents the actor from being liable for harm to another which his antecedent negligence is a substantial factor in bringing

15. Delahanty v. First Pa. Bank, N.A., 464 A.2d 1243, 1261 (Pa. Super. Ct. 1983).

16. *See* Hardwick v. Dravo Equip. Co., 569 P.2d 588, 594 (Or. 1977) ("I must confess, however, that I have no more idea what reasonable certainty means than I have as to the meaning of certainty. I would assume that it is some lesser quantum of proof than that we require in criminal cases; namely, proof beyond a reasonable doubt or to a 'moral certainty.'") (Lent, J., concurring).

17. *See* Burger King Corp. v. Hinton, Inc., 203 F. Supp. 2d 1357, 1366 (S.D. Fla. 2002); TRI Cnty. Wholesale Distribs., Inc. v. Labatt USA Operating Co., LLC, 828 F.3d 421, 433–35 (6th Cir. 2016).

18. *See*, *e.g.*, Brisbin v. Superior Valve Co., 398 F.3d 279, 289–93 (3d Cir. 2005).

19. *See id.*

about."[20] Thus, given multiple potential causes for the loss of profits, a plaintiff must distinguish the impact of distinct factors capable of causing its loss of profits and prove that, among other things, the defendant's alleged misconduct is a substantial and proximate cause of the loss of profits.

As the Supreme Court explained in *Exxon Co., U.S.A. v. Sofec, Inc.*, the superseding cause doctrine "is applied where the defendant's negligence in fact substantially contributed to the plaintiff's injury, but the injury was actually brought about by a later cause of independent origin that was not foreseeable."[21] An event operates as a superseding cause if it occurs (1) later than the defendant's alleged misconduct, (2) was the actual cause of the harm to the plaintiff, (3) originated from some source other than the defendant's alleged misconduct, and (4) was not reasonably foreseeable.[22]

Thus, in instances where the plaintiff's lost profit injury may have been caused by two or more events, and either one "operating alone would have been sufficient to cause the identical result, some test of proximate causation, other than 'but-for' is needed."[23] However, "[a] cause can be thought 'superseding' only if it is a 'cause of independent origin that was not foreseeable.'"[24]

An event is an intervening cause if it is an independent event unrelated to the defendant's alleged misconduct that was not reasonably foreseeable and "completely breaks the connection between fault and damages."[25] In conducting a proximate cause analysis, a court also examines whether there were other superseding or intervening causes that show that some other act, cause, or party was responsible for the lost profits damage and, as a result, the defendant should not be required to pay an award.

B. *Plaintiff Bears Burden of Negating Existence of Intervening and Superseding Acts*

The plaintiff bears the burden of establishing that the defendant's conduct was the proximate cause of its loss even where the defendant asserts that a separate cause severed the causal chain in its defense. In *Nycal Offshore Development Corp. v. United States*, an oil company plaintiff argued that because the defendant asserted that it was not liable for lost profits damages due to intervening causes that interrupted the chain of causation, the burden

20. Rabutino v. Freedom State Realty Co., 809 A.2d 933, 941 (Pa. Super. Ct. 2002) (quoting Restatement (Second) of Torts § 441 (1965)).

21. Exxon Co., U.S.A. v. Sofec, Inc., 517 U.S. 830, 837 (1996) (cleaned up).

22. *See, e.g.*, Canada *ex rel.* v. McCarthy, 567 N.W.2d 496, 507 (Minn. 1997) ("For an intervening cause to be considered a superseding cause, the intervening cause must satisfy four elements: 1) its harmful effects must have occurred after the original negligence; 2) it must not have been brought about by the original negligence; 3) it must have actively worked to bring about a result which would not otherwise have followed from the original negligence; and 4) it must not have been reasonably foreseeable by the original wrongdoer.") (citation omitted).

23. Eagle-Picher Indus., Inc. v. Balbos, 604 A.2d 445, 459 (Md. Ct. App. 1992) (quoting W. Keeton, Prosser & Keeton on The Law of Torts § 41, at 266 (5th ed. 1984)).

24. Staub v. Proctor Hosp., 562 U.S. 411, 420 (2011) (quoting *Exxon Co., U.S.A.*, 517 U.S. at 837).

25. Kilpatrick v. Wiley, Rein & Fielding, 909 P.2d 1283, 1293 (Utah Ct. App. 1996).

of proof on causation shifted to the defendant. The court refused to shift the burden and held that "the plaintiff must show, by a preponderance of the evidence, that the plaintiff's alleged loss was 'the proximate result of the breach.'"[26] The court also declined to separate other potential causes of loss (like the presence and market price of oil, production costs, and the impact of the prevailing regulatory scheme) from the general proximate cause analysis; that is to say, the analysis requires comparison of defendant's alleged conduct against all other potential causes of loss.[27]

Plaintiffs pursuing lost profits claims must prepare to prove that, among the variety of case-specific potential causes of their loss, the defendant's conduct and not the collective impact of all other causes led to that loss. In some jurisdictions, a claim for lost profits from breach of contract specifically and expressly incorporates proximate causation requirements including intervening cause analysis. For example, in Oklahoma, "[t]o recover for anticipated lost profits, [plaintiff] must demonstrate: 1) [that] the loss is within the contemplation of the parties at the time the contract was made, 2) [that] the loss flows directly or proximately from the breach . . . and 3) [that] the loss is capable of reasonably accurate measurement or estimate."[28]

Many other jurisdictions include a proximate cause analysis when evaluating a claim for lost profits.[29] In some jurisdictions, a party claiming loss of future profits from a breach of contract must demonstrate with certainty that the lost profits were caused by the breach and not a separate intervening cause while establishing the defendant's liability.[30] Thus, to prevail on a claim for lost profits, a plaintiff must necessarily demonstrate that the defendant's conduct was the proximate cause of its harm.[31] A necessary component of

26. Nycal Offshore Dev. Corp. v. United States, 743 F.3d 837, 843 (Fed. Cir. 2014) (quoting Energy Cap. Corp. v. United States, 302 F.3d 1314, 1324–25 (Fed. Cir. 2002)); Cal. Fed. Bank, F.S.B. v. United States, 245 F.3d 1342, 1349 (Fed. Cir. 2001) (applying Federal Circuit law).

27. *Nycal Offshore Dev.*, 743 F.3d at 844 n.2 ("Evidence of such 'intervening causes' is not analyzed separately from other causes, but is 'an integral part of the proximate cause analysis.'") (quoting Nat'l Mkt. Share, Inc. v. Sterling Nat'l Bank, 392 F.3d 520, 527 (2d Cir. 2004)).

28. Specialty Beverages, L.L.C. v. Pabst Brewing Co., 537 F.3d 1165, 1179 (10th Cir. 2008) (Oklahoma law) (refined).

29. *See*, *e.g.*, ID Sec. Sys. Canada, Inc. v. Checkpoint Sys., Inc., 249 F. Supp. 2d 622, 696–97 (E.D. Pa. 2003) (Pennsylvania law); Tacoma Auto Mall, Inc. v. Nissan N. Am., Inc., 279 P.3d 487, 499–500 (Wash. Ct. App. 2012); *cf.* IBP, Inc. v. Hady Enters., Inc., 267 F. Supp. 2d 1148, 1169 (N.D. Fla. 2002) (Florida law) ("[L]ost profits are only allowed if the court is satisfied that the wrongful act of the defendant caused the loss of profits.") (citations omitted); Siga Tech., Inc. v. PharmAthene, Inc., 132 A.3d 1108, 1152–53 (Del. 2015) ("[U]ncertainties not attributed to the wrongdoer in a breach of contract case should be excluded from the damages calculus.") (citation omitted); Cook Assoc., Inc. v. Warnick, 664 P.2d 1161, 1165 (Utah 1983) (causation requirement).

30. *See*, *e.g.*, Kenford Co., Inc. v. Erie Cnty., 493 N.E.2d 234, 235 (N.Y. 1986) ("[T]he damages may not be merely speculative, possible or imaginary, but must be reasonably certain and directly traceable to the breach, not remote or the result of other intervening causes.") (citation omitted).

31. In some jurisdictions, proximate cause analysis in lost profits claims takes the form of a separate "substantial factor" test. For example, in Florida, a "plaintiff need not show that the defendant's action was the sole cause of the damages sought; instead, the plaintiff's burden is to show that the defendant's action was a 'substantial factor' in causing the lost profits and

that analysis is an evaluation of other potential causes of harm that could have interrupted the causal chain of events such that the defendant should not be held liable for a plaintiff's claimed loss.

C. *Proximate Cause and Lost Profits in Franchise Litigation*

In franchise litigation, disputes are common regarding whether the causal chain has been severed by an intervening act. A defendant may allege that the plaintiff-franchisor's termination of a franchise agreement is an intervening act that precludes the recovery of lost profits by the franchisor in a later claim for breach. In such instances, it is not uncommon for the franchisee to claim that the franchisor should not be entitled to an award of lost profits because the franchisor's act of terminating the franchise agreement was the actual and intervening cause of any lost profits in that the termination severed the causal chain between the alleged breach and the claim for damages. However, the effectiveness of this argument depends on the underlying facts unique to each case.

In *Meineke Car Care Centers, Inc. v. RLB Holdings, LLC*, the Fourth Circuit used a "straightforward" proximate cause approach to evaluate whether to award lost profits where the Meineke franchisee chose to shut down its franchises and, thereafter, the franchisor terminated the franchise agreements.[32] The court observed that, "[e]ven where a court has held that the franchisor is not entitled to recover lost profits, the rationale for that decision has usually been that the franchisor's lawful termination of the parties' agreement was the proximate cause of lost profits rather than the franchisee's breach; the most common example being a franchisee's breach for failing to pay past due royalties."[33] But, because the franchisee chose to cease operating before the franchisor terminated the franchise agreements, the franchisor's actions did "not cause [the franchisee] to stop operating the Shops and thereby stop generating revenues."[34] Thus, the franchisor's termination of the franchise agreement did not sever the causal chain between the franchisee's earlier misconduct and the franchisor's lost profits damages.[35] As a result, the Fourth Circuit overturned the district court's grant of summary judgment and allowed the franchisor's claim for lost profits to proceed.

Postal Instant Press, Inc. v. Sealy[36] is an example of the converse outcome on similar facts where a franchisor terminated the franchise agreement in response to a franchisee's failure to make past royalty payments. The court held that the franchisor's action (not the franchisee's) caused the loss of future profits and, as a result, the franchisor could not establish the required

establish the amount with reasonable certainty." Ariz. Chem. Co., LLC v. Mohawk Indus., Inc., 193 So. 3d 95, 103 (Fla. Dist. Ct. App. 2016) (citations omitted).

32. Meineke Car Care Ctrs., Inc. v. RLB Holdings, LLC, 423 Fed. App'x 274, 282 (4th Cir. 2011).

33. *Id.* at 282 n.8.

34. *Id.* at 283.

35. *See id.*

36. Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 2d 365 (Ct. App. 1996).

link between the franchisee's conduct and the loss of profits. The court noted that "it was the franchisor's own decision to terminate the franchise agreement that deprived it of its entitlement to those future royalty payments."[37] The court determined that a failure to pay past royalties would not be a "natural and direct" cause of a loss of future royalties and advertising fees and, therefore, declined to award the franchisor lost profits.[38] The court also found that awarding future royalties would have been "unreasonable, unconscionable and oppressive" and explained that, even if the franchisor had made an adequate showing that the franchisee's conduct caused it to lose future profits, the court would have declined to grant an award of those damages as "contrary to substantial justice."[39]

The analysis of whether a plaintiff is entitled to lost profits in cases where there are other potential causes of the underlying damages often hinges on the critical issues of the timing of the breach as compared to the occurrence of the potential alternative cause and whether a sufficient factual link exists between the defendant's alleged conduct and the loss of future profits.

IV. Proximate Cause Determinations Involving Crises

A. *Proximate Cause in Pre-COVID-19 Crises*

While the COVID-19 pandemic may present unique challenges to potential litigants, examining the impact of prior crises and other widespread market disruptions on lost profits claims provides some insight into how a court might handle the impact of the pandemic on pending and future claims. In *Gregory v. Popeyes Famous Fried Chicken & Biscuits, Inc.*,[40] a franchisee claimed that its failure to pay royalties and advertising fund contributions required under the franchise agreement should be excused due to the "supervening impossibility of performance," caused by an economic recession in the area its stores operated and the entry of a new competing chain offering similar products that caused the franchisee to sustain substantial losses and close multiple stores as a result. However, the Sixth Circuit rejected this claimed impossibility defense reasoning that "economic recession and the failure of a franchise business to live up to its hoped for potential is not a viable affirmative defense to a claim of debt for failure to pay an unambiguous contractual obligation."[41]

37. *Id.* at 370.
38. *Id.* at 369–71.
39. *Id.* at 373.
40. Gregory v. Popeyes Famous Fried Chicken & Biscuits, Inc., 857 F.2d 1474 (Table), 1988 U.S. App. LEXIS 12304 (6th Cir. Sept. 9, 1988).
41. *Id.* at *4; *see also* Medallion Bank v. Makridis, 2021 WL 53155, at *2 (N.Y. Sup. Ct. Jan. 6, 2021) (the court rejecting defendant's claim that failure to make note payments should be excused under the impossibility doctrine due to the collapse of the taxicab industry: "Impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible. Moreover, the impossibility must be produced by an unanticipated event that could not have been foreseen or

In *EV Scarsdale Corp. v. Engel & Voelkers North East LLC*,[42] the plaintiffs alleged statutory claims under the New York and Rhode Island franchise statutes for fraudulent misrepresentations in connection with the sales of real estate agency franchises between late 2007 and 2009, coinciding with the timing of the Great Recession. The court granted defendant's summary judgment due to plaintiff's failure to rebut defendant's prima facie showing of the absence of loss causation.[43] The court first observed that "loss causation—proof that plaintiff's loss was caused by defendant's fraudulent misrepresentation—is an 'essential,' indispensable element of a fraud claim."[44] The court then noted that one New York appellate court, "[t]aking a page from the well-settled federal caselaw concerning securities fraud during a period where the overall market experienced a downturn," had "effectively adopted [the] federal standard, and held that it is *plaintiff's* burden to demonstrate loss causation."[45] The court found the litigation emanating from the financial crisis persuasive precedent "concerning the question of if and how a real estate investor must disentangle the causes of his own losses as being a product of the defendant's alleged fraud from the overall market events that caused everyone's real estate investments to fail."[46] The defendants proffered an expert report explaining why the plaintiff's franchises likely failed due to the financial crisis. The plaintiff did not submit any fact or evidence concerning causation or offer a theory as to how much of their losses were caused other than by the market downturn and "utterly doom[ed] their fraud claims."[47]

In *Mrs. Fields Franchising, LLC v. MFGPC*, the Tenth Circuit reversed a district court's ruling that the plaintiff's damages were irreparable because they could not be reasonably calculated due to the impact of the Great Recession and a warehouse fire that purportedly impacted the plaintiff's profitability.[48] The Tenth Circuit disagreed and instead found that lost profits could be adequately calculated based on the "years prior to or following the recession" and the warehouse fire as a "reasonable proxy" to calculate the plaintiff's claimed damages.[49] Thus, the court acknowledged that the recession and warehouse fire would impact profitability, but ultimately determined that there was sufficient evidence from periods where the business was unaffected by these challenges to allow the parties to isolate their effect and calculate lost profit for the remaining term of the underlying agreement.

guarded against in the contract.") (quoting Kel Kim Corp. v Cent. Mkts., Inc., 519 N.E.2d 295 (N.Y. 1987)).

42. EV Scarsdale Corp. v. Engel & Voelkers N.E. LLC, 2017 WL 5513329 (N.Y. Sup. Ct. Nov. 16, 2017).

43. *Id.* at *2, *9.

44. *Id.* at *5 (citations omitted).

45. *Id.* at *6 (citations omitted).

46. *Id.*

47. *Id.* at *8.

48. Mrs. Fields Franchising, LLC v. MFGPC, 941 F.3d 1221, 1235 (10th Cir. 2019).

49. *Id.* at 1236.

When adjudicating claims which have arisen during or after the COVID-19 pandemic, courts are likely to employ a similar approach when evaluating a claim for lost profits. For businesses that operated both before and after the pandemic, a similar analysis to that conducted in *Mrs. Fields Franchising* may become the standard for establishing lost profits claims. For businesses that closed or for which the pandemic caused longer lasting or more complex effects, finding a "reasonable proxy" for lost profits may be substantially more challenging. The uneven nature of the economic recovery, with multiple waves of the pandemic and potential difficulty in finding a demarcation point to identify when the pandemic's effects ended, will contribute to the challenge.[50]

In other instances, where the prevailing economic conditions are directly tied to discrete profit-making opportunities, courts have reduced lost profit awards to account for the impact of recessions where those prevailing economic conditions specifically relate to the underlying business activities at issue in the litigation. In *Haven Associates v. Donro Realty Corp.*, the court found that the plaintiff was entitled to lost profits that it would have received for the sale of certain unsold real estate lots but did not award the full amount that the plaintiff sought. Rather, the court determined that the impact of a housing recession would have eroded the profits which the plaintiff would have earned and reduced the potential award accordingly.[51] In franchise litigation, courts may be willing to reduce potential lost profit awards if a defendant can show that the impact of the pandemic would have had a specific impact on the plaintiff's ability to make a profit.

In *Federal Insurance Co. v. General Electric Co.*,[52] the court found that damage to an MRI machine that occurred during Hurricane Katrina could have resulted from a variety of factors and was not a direct result of the storm. Thus, there was a genuine issue of material fact as to the underlying cause of the damage, which made summary judgment inappropriate notwithstanding the vast destruction caused by the storm.[53] In another case arising from Hurricane Katrina, the court declined to draw a causal link between the government's construction of certain protective measures and damages caused by the storm.[54] The court distinguished between the actions taken by the government in constructing and installing floodwalls and the damage caused by the storm. The court held that the government's action "did not in the least cause the flood" and, as such, "it would not follow that the flooding was 'directly attributable' to the [government's] protective measures, as opposed to the severe nature of the storm."[55] The court did not reach the question of

50. *See supra* Part I.
51. *See* Haven Assoc. v. Donro Realty Corp., 121 A.D.2d 504, 508 (N.Y. App. Div. 1986).
52. Fed. Ins. Co. v. Gen. Elec. Co., 2009 WL 4728696 (S.D. Miss. Dec. 3, 2009).
53. *Id.* at *6
54. *See* Nicholson v. United States, 77 Fed. Cl. 605, 618 (2007).
55. *Id.*

whether "a storm of [Hurricane Katrina's] magnitude is foreseeable," because the floodwalls that the government constructed did not *cause* the flooding.[56]

In a case arising out of damage caused by Typhoon Paka, the court noted that an especially strong typhoon near Guam was "not 'so far outside the range of human experience that ordinary care did not require that it should be anticipated or provided against.'"[57] The court also found that because the defendant had received notice of the storm forty-eight hours before it struck, the defendant could have taken additional measures to prevent damages that it caused and, as such, the storm would not act as an intervening cause.[58] As described in more detail below, issues regarding foreseeability of the COVID-19 pandemic and its overall role in the causal chain leading to a plaintiff's alleged loss may be determinative of certain potential defenses, though that evaluation will be fact-specific to each case.

In *Moulthrop v. Hyett*, the plaintiff sued the manufacturer of a brick-drying machine that it had purchased because the device only processed between 7,500 and 10,000 bricks a day instead of the promised 25,000.[59] The court refused to award lost profit damages for the entire period of the machine's faulty operation because, during that time, a yellow fever epidemic spread through the region and the market for construction imploded.[60] Because the lost profits caused by the outbreak and the attendant decrease in demand was neither contemplated by the parties nor "the necessary or natural consequence of the partial incapacity of the machine," the purchaser could not recover those damages.[61]

As evidenced from the foregoing cases, there is not a bright-line rule that delineates whether a court will determine whether or not an external crisis severs the causal link between a plaintiff's claim and the potential damages. In some instances, as in *Mrs. Fields Franchising, LLC v. MFGPC*,[62] where the external crisis occurred after the alleged breach, courts appear willing to allow a plaintiff to establish their claim for damages based on the parties' other business dealings. Moreover, where a plaintiff would stand to reap a windfall from potential lost profits from a crisis not contemplated and/or reasonably foreseeable to the parties, courts appear reluctant to award the additional measure of lost profits that was caused by the crisis. On the other hand, a defendant may be able to persuade a court to limit potential recovery where a plaintiff's ability to make a profit would have also been impacted by external factors as in *Haven Associates*. The key distinction is seemingly whether the loss is attributable to the alleged breach or the impact of the external crisis.

56. *Id.*
57. Nissan Motor Corp. v. Sea Star Grp. Inc., 2002 WL 1471713, at *4 (Guam 2002) (quoting Olan Mills, Inc. v. Cannon Aircraft Exec. Terminal, Inc., 160 S.E.2d 735, 741 (N.C. 1968)).
58. *Id.*
59. Moulthrop v. Hyett, 17 So. 32, 33 (Ala. 1895).
60. *Id.* at 34.
61. *Id.*
62. Mrs. Fields Franchising, LLC v. MFGPC, 941 F.3d 1221 (10th Cir. 2019).

B. *Is COVID-19 an Act of God or Force Majeure, or Does It Make Performance Impossible?*

In addition to expecting defendants to argue that the pandemic was a superseding or intervening act in order to refute claims where alleging that their acts were the proximate cause of lost profit, defendants may also attempt to construct other potential defenses based solely on the occurrence of the pandemic. Among those defenses likely to be asserted are the impossibility defenses and the "Act of God" or force majeure clause.

The "Act of God" doctrine at common law "is an affirmative defense to . . . causation" that releases a defendant from liability "for an injury proximately caused . . . [and] due exclusively to forces of nature, without human intervention, which could not have been prevented by the use of due care and reasonable foresight."[63] The doctrine applies to "events in nature so extraordinary that the history of climatic variations and other conditions in the particular locality affords no reasonable warning of them."[64]

Traditional examples of the doctrine include "irresistible disaster[s], the result of natural causes, such as earthquakes, violent storms, lightning and unprecedented floods."[65] However, in cases where human actions caused the harm, the doctrine typically does not apply.[66] For example, where wastewater disposal injections "caused the seismic and earthquake activity in question," there were legitimate questions about liability.[67] In *Phelps v. School District No. 109, Wayne County*, the court decided that diseases causing school closures did not remove a school's contractual duties. The court stated that "[t]he general rule . . . is that, where performance of the contract is rendered impossible by act of God or the public enemy, the district is relieved from liability, but where the school is closed on account of a contagious disease, or destruction of the school building by fire, and the teacher is ready and willing to continue his duties under the contract, no deduction can be made from his salary for the time the school is closed."[68] The court reasoned that while the school closed to protect the public health, a closure because of disease "was a contingency that might happen, and whether the school authorities took the initiative, or whether it was done by action of the board

63. Eli Invs., LLC v. Silver Slipper Casino Venture, LLC, 118 So. 3d 151, 156 (Miss. 2013) (internal quotation marks and citations omitted); *see also* Aspen Am. Ins. Co. v. Interstate Warehousing, Inc., 372 F. Supp. 3d 709, 723 (N.D. Ind. 2019) (Michigan law); Phoenix Lithographing Corp. v. Bind Rite Servs., Inc., 27 F. Supp. 3d 636, 640–43 (E.D. Pa. 2014) (Pennsylvania law; describing history of Act of God common law defense; defendant must prove not only that it breached the contract due to a natural force well outside human control but also did all a reasonable person could be expected to do to avoid injury to plaintiff; the defense (or exception) is often modified or set forth in the parties' agreement as a vis major clause) (citations omitted).

64. *Eli Invs., LLC*, 118 So. 3d at 156 (quoting McFarland v. Entergy Miss., Inc., 919 So. 2d 894, 904 (Miss. 2006)).

65. *See, e.g.*, Am. Water Mgmt. Servs., LLC v. Div. of Oil & Gas Res. Mgmt., 118 N.E.3d 385, 399 (Ohio Ct. App. 2018) (internal quotation marks and citation omitted).

66. *See id.*

67. *Id.*

68. Phelps v. Sch. Dist. No. 109, Wayne County, 134 N.E. 312, 312 (Ill. 1922).

of health, does not alter the rights of the parties to the contract. It works no hardship on any one [sic] to require school authorities to insert in the contract of employment a provision exempting them from liability in the event of the school being closed on account of a contagious epidemic."[69] That is, the court determined it to be the responsibility of the contracting parties to determine in advance that the teacher assumed the risk of a pandemic, not the school.

The prevailing consensus among courts appears to be that the COVID-19 pandemic constitutes a "natural disaster"; however, that factor alone is not sufficient to provide a blanket excuse for non-performance under a contract.[70] At present, it is unlikely that a court would view lost profits harm as an Act of God, as in most instances the underlying cause of a business's lost profits is human decision making and not the direct impact of the virus.[71] Indeed, the most likely cause for lost profits arising out of the virus is the business harm stemming from shutdown orders, business closures, and increased cleaning, sanitation, and other procedures, which are all human-driven factors. Therefore, it is likely that a court will look to potentially applicable contractual terms when evaluating a defense premised on the impact of the pandemic.[72]

Courts may look to the presence or absence of force majeure clauses in determining whether performance might have been excused under the contract through the proper exercise of a force majeure provision. Force majeure clauses represent the parties' allocation of risk between them and are not limited to acts of nature.[73] In *JN Contemporary Art LLC v. Phillips Auctioneers LLC*, the United States District Court for the Southern District of New York found that the pandemic and its impact on a contemplated art auction constituted "circumstances beyond our or your reasonable control"

69. *Id.* at 314; *see also* McKay v. Barnett, 60 P. 1100 (Utah 1900) (smallpox epidemic school closure).

70. *See* Easom v. US Well Servs., Inc., 2021 WL 1092344, at *7–8 (S.D. Tex. Mar. 19, 2021) (collecting cases where the pandemic has been determined to be or described as a "natural disaster").

71. *See* Act of God, Black's Law Dictionary (11th ed. 2019) ("An overwhelming, unpreventable event caused *exclusively* by forces of nature, such as an earthquake, flood, or tornado.") (emphasis added).

72. *See, e.g.*, AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, 2020 WL 7024929, at *55 (Del. Ch. Nov. 30, 2020) (evaluating the "Material Adverse Effect" clause of a purchase agreement to determine if the pandemic met the requirements); Lampo Grp. v. Marriott Hotel Servs., Inc., 2021 WL 3490063, at *8 (M.D. Tenn. Aug. 9, 2021) (denying plaintiff's motion for judgment on the pleadings and finding that factual issues existed regarding plaintiff's claims that it was justified in terminating a contract to host a large conference under the termination for cause and force majeure clauses: "[T]he COVID pandemic plus the attendant restrictions on business operations could, indeed, be deemed a *force majeure* that would authorize termination of the Agreement. The question is whether these conditions actually made performance of the contract, by either party, illegal or impossible.").

73. *See, e.g.*, 1600 Walnut Corp. v. Cole Haan Co., 530 F. Supp. 3d 555, 558–59 (E.D. Pa. Mar. 30, 2021).

within the scope of the governing contract's force majeure provision.[74] In reaching that conclusion, the court compared the impact of the pandemic to the non-exhaustive list of example "circumstances" provided in the contract, including a "natural disaster," as well as the contract specifically providing for an in-person (and not an online) auction.[75] The court concluded that the pandemic and its effects were sufficiently similar to the enumerated circumstances in the contract's non-exhaustive list of examples falling within the scope of the force majure clause and permitted the parties to terminate their agreement.[76] On the other hand, the United States District Court for the Northern District of Ohio in *Belk v. Le Chaperon Rouge Co*. specifically highlighted the *absence* of a force majeure clause in a settlement agreement executed at the outset of the pandemic in rejecting the defendant's arguments to set aside its defaults under that agreement.[77] Thus, parties must tailor their arguments to the specific provisions of their underlying contracts.

Some courts have already rejected similar defenses premised on the doctrine of impossibility of performance allegedly arising out of the pandemic's impact. Impossibility of performance and frustration of purpose are common law theories.[78] In *Lantino v. Clay LLC*, the United States District Court for the Southern District of New York held that financial difficulties triggered by the pandemic and its impact on the defendant's business did not excuse performance under the settlement agreement pursuant to New York's impossibility doctrine, which specifically excludes economic hardship.[79]

Other New York courts evaluating impossibility of performance defenses have also observed that the pandemic has not "destroyed" an underlying business but rather made operating it more costly and challenging. Absent destruction of the underlying business, a New York state court in *Cab Bedford*

74. JN Contemp. Art LLC v. Phillips Auctioneers LLC, 507 F. Supp. 3d 490, 501 (S.D.N.Y. 2020).

75. *Id.* at 503.

76. *Id.*

77. Belk v. Le Chaperon Rouge Co., 2020 WL 3642880, at *10 (N.D. Ohio July 6, 2020).

78. *See*, *e.g.*, *1600 Walnut Corp.*, 530 F. Supp. 3d at 558 (court should allocate risk based on common law theories such as impossibility and frustration of purpose only where there is no contractual allocation of risk under a force majeure clause).

79. *See* Lantino v. Clay LLC, 2020 WL 2239957, at *3 (S.D.N.Y. May 8, 2020); *see also* Gap Inc. v. Ponte Gadea New York LLC, 2021 WL 861121, at *7–12 (S.D.N.Y. Mar. 8, 2021) (granting summary judgment to landlord and rejecting tenant Gap's asserted defenses, finding that COVID-19 pandemic and resulting lockdowns did not constitute a "casualty" under the lease, did not frustrate the purpose of the lease, did not render performance impossible or impractical, did not lead to failure of consideration and the parties, and did not make a mutual mistake in drafting the lease by failing to foresee and address the possibility of a pandemic); A/R Retail LLC v. Hugo Boss Retail, Inc., 149 N.Y.S.3d 808 (N.Y. Sup. Ct. 2021) (similar). *But see* 267 Dev., LLC v. Brooklyn Babies & Toddlers, LLC, 2021 WL 963955, at *2 (N.Y. Sup. Ct. Mar. 15, 2021) (after noting the doctrine of impossibility was applied in a case involving travel contracts following the September 11 terrorist attacks where New York City was in virtual lockdown, the court held that performance under defendant's lease was excused by the common law doctrine of impossibility, finding the closures mandated by Governor Cuomo's Executive Orders in response to the COVID-19 pandemic had rendered defendant's performance under the lease "objectively impossible" and that the mandated closures were unforeseeable, which is a required element of the doctrine of impossibility) (citations omitted).

LLC v. Equinox Bedford Ave., Inc. declined to find that performance under the business's lease was "impossible."[80] Similarly, in *Fives 160th, LLC v. Zhao*, another New York state court would not imply a force majeure clause due to the pandemic when none existed in the lease and rejected the defendant tenants' alleged defense of impossibility, stating that "[f]inancial difficulty or economic hardship of the promisor, even to the extent of insolvency or bankruptcy, does not establish impossibility sufficient to excuse performance of a contractual obligation."[81] The court noted that "[t]he excuse of impossibility is generally limited to the destruction of the means of performance by an act of God, vis major, or by law" and that "[t]he impossibility must be produced by an unanticipated event that could not be foreseen or guarded against in the contract."[82] The court reasoned that "[t]he contract here was entered into by commercial parties who could have anticipated the possibility that future events might result in financial disadvantage on the part of either party, even if the precise cause or extent of such financial disadvantage was not foreseen at the time the contract was executed."[83]

In rejecting the "impossibility" defense, courts have found that these defenses require literal impossibility and not impracticability or an increasingly difficult performance. It appears unlikely that the COVID-19 pandemic will be considered an Act of God or have rendered contractual performance impossible absent extraordinary case-specific circumstances. Asserting these defenses is likely to become increasingly difficult as businesses have reopened and business restrictions have been lifted to varying degrees. Thus, a defendant will be unlikely to rely on the pandemic's interruption to, or impact on, operations as a complete defense.

C. *COVID-19's Impact on the Causation Analysis*

According to conventional proximate-cause principles, whether COVID-19 operates as an intervening cause in franchise lost profits cases depends on two issues: (1) the foreseeability of the pandemic; and (2) the pandemic's causal effect on profits. This analysis will be fact specific and guided primarily by two factors: (a) the timing of the contract execution or the alleged conduct as it relates to the onset of the pandemic; and (b) the particular mechanism by which the pandemic is alleged to have impacted the plaintiff's ability to make a profit.

While some scholars observe that "reasonable minds differ" on the question of whether the "pandemic is viewed as akin to other types of natural disasters," it is unlikely that a court will find that a litigant had advanced knowledge of the potential impact of the pandemic sufficient to affect the

80. Cab Bedford LLC v. Equinox Bedford Ave., Inc., 2020 WL 7629593, at *3 (N.Y. Sup. Ct. Dec. 22, 2020) ("That there are more hurdles to running the business is not a basis to invoke the impossibility doctrine.").

81. Fives 160th, LLC v. Zhao, 2021 WL 1298090, at *2 (N.Y. Sup. Ct. 2021 Apr. 6, 2021) (citations omitted).

82. *Id.* (citations omitted).

83. *Id.* at 4 (citation omitted).

causation analysis absent a specific evidentiary showing of such knowledge.[84] Indeed, some courts have rejected arguments that the effects of the pandemic would be foreseeable as "ridiculous."[85] However, for contracts that were formed during the course of the pandemic, it will be relatively likely that the potential impact will be determined to have been sufficiently foreseeable and that, consequently, the pandemic would not serve as an intervening cause.

For example, in *Belk*, the defendant defaulted on a settlement agreement by failing to make a payment required under that agreement. The defendant asserted that it was impossible to fund the required settlement payment due to the pandemic and the related closure orders' impact on business.[86] The court, however, found that "it was reasonably foreseeable on March 12, 2020 [the date of the agreement] that COVID-19 could have a significant negative impact on Defendants' business operations and financial ability to fund the settlement payment."[87] In these instances, where a contract is formed during the pandemic, a defendant will be precluded from asserting that the pandemic was an unforeseeable intervening cause.

The COVID-19 pandemic may also have a substantial impact as a confounding variable, making plaintiff's burden of proof more difficult. Indeed, as set forth above, to be entitled to lost profits, a plaintiff must establish with "reasonable certainty" that the defendant's misconduct was a "substantial cause" of those lost profits. In nearly every action for lost profits, a defendant will be able to assert that some or all of the loss suffered by the plaintiff was caused by the pandemic, and not the alleged misconduct, all the while knowing that the plaintiff bears the burden to prove causation and of untangling potential causes of its loss.[88] This circumstance will represent a substantial hurdle for plaintiffs that do not have a pre-pandemic history of operation capable of providing persuasive evidence of the business's profitability.

The issue of timing may be a critical one as courts try to determine if the pandemic itself was an intervening factor or substantial alternative cause, occurring after the breach, providing a separate and independent basis for the claimed damages occurring close in time to the breach or a wholly independent cause occurring before the breach. This analysis is not likely to be a simple one. Indeed, courts may struggle to identify the precise instant when COVID-19 started—is the relevant time attributed to the emergence of the pandemic in China, when it was first discovered in the United States, or

84. Andrew A. Schwartz, *Contracts and COVID-19*, 73 Stan. L. Rev. Online 48, 57 (2020).

85. ITS Soho LLC v. 598 Broadway Realty Assocs., Inc., 2020 WL 7629588, at *2 n.1 (N.Y. Sup. Ct. Dec. 22, 2020).

86. Belk v. Le Chaperon Rouge Co., 2020 WL 3642880, at *11 (N.D. Ohio July 6, 2020).

87. *Id.*

88. Nycal Offshore Dev. Corp. v. United States, 743 F.3d 837, 843–44 (Fed. Cir. 2014); *see also* Big City Dynasty Corp. v. FP Holdings, 2021 WL 1949384, at *4 (D. Nev. May 14, 2021) ("A jury will have to sort out whether and when the parties could have performed despite the shutdown orders, including whether the parties could have rescheduled as the force majeure clause required the parties to attempt to do and whether [Defendant] could have reconfigured its nightclub or dayclub to allow the parties to perform their contractual obligations.").

the first wave of shutdown orders in the United States? Further, at what point did the impact of the pandemic become "foreseeable" in relation to the underlying contract and/or breach? Courts may also examine the prevailing conditions in the specific location at issue to assist in that determination. For example, a court may be willing to fix a date for the onset of the pandemic based on a governmental emergency order or shutdown but could potentially struggle to determine the onset in a jurisdiction that did not issue shutdown orders until well after the effect of the pandemic had become clear.

For claims that accrued before the onset of the pandemic, a plaintiff must ensure that they are capable of marshalling sufficient proof to distinguish between profits which were lost as a result of the breach and those which were lost due to the pandemic. The susceptibility of this issue to proof will likely depend on the amount of time between the alleged misconduct and the pandemic. As in *Mrs. Fields Franchising*, a plaintiff that has a demonstrable history of operating and that can adequately establish a period of harm apart from the pandemic will be better suited for establishing with reasonable certainty the profits that it has lost than a plaintiff without the ability to make such a showing.[89] Those plaintiffs that cannot point to compelling evidence from pre- and post-pandemic operations will need to look elsewhere to find a "reasonable proxy" to support their damages claim. That may require conducting discovery into other similar businesses or employing other methods to calculate lost profit.

For a claim that accrued during the pandemic, a plaintiff must articulate how the defendant's conduct caused a separate loss of profits distinct from the harms caused by the pandemic. For a plaintiff whose business was shuttered entirely, it will be challenging to identify how the harm was attributable to the defendant as compared to arising from the pandemic or the corresponding shutdown orders. Indeed, it may not be possible to prove such matters until after the business, or appropriately comparable businesses, begin operating again so that there is an appropriate evidentiary basis to make a comparison and attribute the various harms.

On the other hand, defendants will be less likely to successfully rely on the pandemic's impact as an unforeseeable intervening cause in defense of claims arising out of contracts executed during or shortly before the pandemic began impacting business operations. This possibility could include situations where the franchisors and franchisees entered into new or amended franchise agreements, or where the franchisor offered certain programs specifically tailored to address the pandemic's impact or which required the franchisee to execute a new contract and/or renew or reaffirm an existing contract. A defendant will likely be unable to claim that the impact of the pandemic was not "foreseeable" and may not be able to assert a defense premised on the pandemic as an intervening cause as a result.

89. *See* Mrs. Fields Franchising, LLC v. MFGPC, 941 F.3d 1221 (10th Cir. 2019).

D. *Potential Defenses*

Given the significant impact that the pandemic may have on pending and as-yet unasserted cases, litigants must be aware of whether and how the pandemic's impact on the dispute at issue may impact potential defenses and the plaintiff's ability to carry its burden of proof. As set forth above, to prove that a plaintiff is entitled to lost profit damages, the plaintiff must establish that claim with "reasonable certainty": this obligation is more challenging and complex due to the impact of the pandemic. Moreover, while it is unlikely that the pandemic will be considered an Act of God or have rendered performance under a franchise agreement impossible as the primary impact appears to be financial and not the "destruction" of the underlying business, some other additional defenses may be available due to the pandemic that can serve to undercut or otherwise offset a claim for lost profits.

1. The Burden of Proof

Even if lost profit damages remain available as a matter of law, a plaintiff's ability to carry its burden of proof to show that it is entitled to such damages may be confounded by the pandemic. The most common methods of proving lost profits are through a "before and after" type of analysis or the "yardstick test."[90] Using the "before and after" analysis, a plaintiff seeks to prove its lost profits by comparing the amount that they were earning prior to the alleged breach and the amount that they were earning after the alleged breach, to show that the defendant should be liable for the difference.[91] The "yardstick test" substitutes data from comparable businesses when the plaintiff does not have a sufficient earnings record to allow the estimation of lost profits.[92] However, where the impact of the pandemic overlaps with the time period used in the "before and after" analysis, a plaintiff's ability to prove that the difference between those two amounts is properly attributed to the defendant's conduct will be more difficult. Further, a defendant will likely be able to point to longer term trends that extend beyond the initial tranche of shutdown orders. For example, the potential continued prevalence of work-from-home may disproportionately impact certain types of franchised businesses that catered to a class of customers that has potentially permanently shrunk, or that have not been able to adapt to shifting customer preferences that developed during the lockdown or mitigation measures.

90. *See, e.g.*, MM Steel, L.P. v. JSW Steel (USA) Inc., 806 F.3d 835, 851 (5th Cir. 2015) ("There are two generally recognized methods of proving lost profits: (1) the before and after theory; and (2) the yardstick test. The before and after theory compares the plaintiff's profit record prior to the violation with that subsequent to it. . . . [T]he yardstick test . . . consists of a study of the profits of business operations that are closely comparable to the plaintiff's. Although allowances can be made for differences between the firms, the business used as a standard must be as nearly identical to the plaintiff's as possible.") (quoting Lehrman v. Gulf Oil Corp., 500 F.2d 659, 667 (5th Cir.1974)).

91. *See, e.g.*, Meineke Car Care Ctrs., Inc. v. RLB Holdings, LLC, 423 Fed. App'x 274, 285–86 (4th Cir. 2011) ("Meineke's calculations were based on a historical analysis of the Shops' *actual* revenues projected into the future . . . .").

92. *Id.*

Moreover, defendants may claim that a plaintiff should not be entitled to the full measure of its lost profit even where the breach occurred before the onset of the pandemic by attempting to prove that the long-term effects of the pandemic will permanently impair future profitability. To do so, a defendant may present expert testimony and other evidence designed to show that the plaintiff's business would not have withstood the pandemic and therefore would have closed, or that the prevailing business trends and/or consumer habits shifted during or in response to the pandemic. This proof would require a substantial analysis of both the plaintiff's operation and financial condition, but also evidence showing prevailing market conditions, shifts in consumer behavior, and the impact on other similar businesses (which would almost certainly include some analysis of the average performance in at least similarly situated regions or areas of the franchise system at issue). The likelihood of success of such a defense will necessarily depend on the facts that gave rise to the specific claims at issue; however, it is likely that, if for no other reasons, defendants will attempt to invoke the potential impacts of the pandemic to muddy the waters and make plaintiff's burden of proof more challenging to meet.

Thus, a plaintiff may need to conduct more in-depth discovery than might have been required previously to ensure that it can distinguish and isolate the impact of the alleged breach and carry its burden of proof. To do so, a plaintiff should consider, for example, conducting third-party discovery of comparable franchised businesses that have a longer history of operations or that resumed operations after the pandemic and its impacts began to diminish in order to develop additional evidence of the profits that a comparable business unaffected by the alleged breach would have generated. On the other hand, a defendant must be prepared to demonstrate how such a comparison between a plaintiff's claimed damages and other businesses' financial performance would be inappropriate and/or unreliable. A defendant should seek to present evidence regarding the unavoidable business impact of the pandemic that would have eroded potential profits by undertaking a specific analysis of the timing of public health measures that impacted business, changes in consumer behavior during the pandemic, changes in operating costs, and other factors that may have impacted ongoing or future profitability.

Similarly, a defendant can attempt to distinguish between a plaintiff's business and those that are used as a basis for comparison using the "yardstick test." For example, a business that continued operating may have been able to take advantage of government assistance programs that would not have been available to one that had previously closed; a factor that could inflate the profits of that operating business and make it an inappropriate source for comparison. Moreover, the impact of the pandemic may vary substantially across different jurisdictions that have required different levels of restrictions on business activity. Thus, a business located in one county may have had a very different impact from the pandemic than one in a neighboring county simply on the other side of the county line. A defendant should

seek to highlight these differences in rebutting a claim for lost profits based on an inappropriate comparison between operating businesses.

2. Applicable Contractual Limitations

As set forth above, the pandemic's impact on any individual lost profits claim will depend on the specific underlying facts. However, there are likely to be features common across claims that may have significant impacts. For instance, where the underlying contracts contain liquidated damages clauses, such clauses will likely still apply regardless of the impact of the pandemic. Indeed, the purpose of liquidated damages is to "reasonably forecast the harm resulting from the breach"[93] and are enforceable if (1) at the time the parties executed their contract the actual damages that would follow from a breach were not readily ascertainable and (2) the stipulated damages represent a reasonable estimate and are not so grossly disproportionate so that they constitute an unenforceable penalty.[94] Thus, it is unlikely that a court would set aside a contractually bargained-for liquidated-damages clause due to the impact of the pandemic absent some other defect inherent in that clause or other contractually provided for basis for setting aside that clause.

Likewise, contractual limitations on the type or scope of damages permitted in actions for breach are likely to be enforced.[95] Thus, in instances where the parties have limited the availability of lost profits damages in enforceable contractual terms, it is unlikely that a court will modify those terms based on the impact of the pandemic. Indeed, to do so would likely be counter to the underlying motivation for agreeing to such terms in the first place, as their primary purpose would be to reduce uncertainty and provide for an efficient manner to assess damages for breach regardless of the circumstances surrounding that breach.

V. Conclusion

While the economic ripples caused by the pandemic will inevitably have a significant impact on current and future litigation, the effect will certainly not be uniform. Indeed, determining how and to what extent a potential claim has been impacted by the pandemic will require an intensive and fact-specific evaluation of the interplay between the claims and potential other causes for loss. Similarly, the complexity of litigation and the cost of pursuing the same are likely to increase as the parties will be required to

93. Knights Franchise Sys. Inc. v. First Value RC, LLC, 2017 WL 1170849, at *3 (D.N.J. Mar. 29, 2017) (citation omitted).

94. Circuitronix, LLC v. Kinwong Elec. (Hong Kong) Co., Ltd., 993 F.3d 1299, 1306 (11th Cir. 2021) (applying Florida law) (citations omitted).

95. *See*, *e.g.*, 1228 Inv. Grp. v. IDT Domestic Telecom, 852 Fed. App'x 684, 688 (3d Cir. 2021) (enforcing an unambiguous contractual provision which limited potential damages); United Inv. Grp., LLC v. Beggars Pizza Franchise Corp., 2017 WL 5642376, at *4–6 (Ill. App. Ct. Nov. 22, 2017) (enforcing a limitation of damages provision in a franchise agreement).

marshal more proof than they would have been required to before the onset of the pandemic. At the same time, the potential for a full recovery generally has likely decreased as profits have fallen and cash reserves have eroded impairing a defendant's ability to satisfy a potential judgment. Further, the negative impacts of the pandemic may fade or even be overcome for some businesses if the economy surges post-pandemic as some predict. As a result, parties must be especially mindful about the new challenges facing a plaintiff asserting a claim for lost profits and consider whether and how such challenges impact their litigation strategy and calculus.