CHAPTER 1

Initial Pleadings

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I. Factors to Consider before Filing Suit

The parties to any dispute must consider numerous subjective and objective factors prior to filing a lawsuit. Franchise cases are no exception. In fact, the decision by both franchisees and franchisors to file suit requires heightened thoughtfulness and analysis given the complexities of franchise disputes. Moreover, such disputes often involve ongoing business relationships or transitions of those relationships that litigation will only complicate.

Consider the soil in which the dispute grows. Franchisors must comply with a complicated set of disclosure laws in order to offer and sell franchises. A lengthy and detailed contract governs the franchise relationship. Franchisees may often be overwhelmed by the voluminous paperwork and the complicated legal terminology. And franchisees often see a franchisor's sales efforts as emphasizing the advantages of the franchise system while providing little real information about the risks. From the franchisor's perspective, the disclosure laws and the contracts both protect the parties' rights, and detail and limit their duties and rights. From the franchisee's perspective, the contracts are often perceived as confusing, one-sided, and offered on a take-it-or-leave-it basis.

The perspective from which the parties experience the franchise system also affects the decision whether to file suit. Franchisors typically see the franchise system as a means to grow a concept through their franchisees and to share a well-developed system with others who are seeking standards and guidance. Franchisors typically have in-house counsel or outside counsel

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educated in the intricacies of franchise law to assist them in their decision-making prior to filing suit. Franchisees may not have the same access to legal and financial advisors or may not deem them necessary. When purchasing a franchise, franchisees are often making the transition from being wage earners to being self-employed. Initially, they may depend on the franchisor for guidance and assistance, but they may later resent the control and some of the very things that attracted them to the franchise concept in the first place. Once in a franchise relationship, the parties are interdependent. In most cases, the franchisor has greater economic power than the franchisee. Franchisees, however, often join or form associations and create multiunit franchises that help balance that power.

When the franchise relationship breaks down to the point where the parties are adverse and considering litigation, the goals of the franchisor and franchisee are frequently, and predictably, different. The franchisor wants to protect its system and ensure that the errant franchisee complies, is rehabilitated, or is removed from the system. Many times, other franchisees in the system essentially force the franchisor to take steps to ensure the noncompliant franchisee is no longer in the system.

Franchisees' litigation goals often differ depending on their perspective or the amount of time spent in the relationship. A franchisee who has voluntarily or involuntarily departed the system may have several goals in mind; for example: (1) obtaining money damages; (2) setting aside a noncompete provision; or (3) seeking to be reinstated as a franchisee after an alleged wrongful termination. A franchisee who is still operating will generally have different goals. If the franchisee has confidence in the system, but is unhappy about a particular aspect of it, he or she may seek "behavior modification" of the franchisor through litigation. Systemwide change through litigation can be expensive to achieve for the franchisee. It can also lead to unintended consequences across the system as a whole. A suit seeking systemwide changes is also more likely to provoke a vigorous defense from the franchisor. Thus, when faced with such circumstances, a franchisee attempting systemwide modification may consider joining forces with other franchisees or pursuing litigation through a franchisee association in order to spread the financial burden, as well as to minimize the risk of uncertainty and retaliation. A franchisor is more likely to seek a reasonable business solution when confronted by a large franchisee group. There is power in mass pursuits, and franchisors must balance franchisee efforts to achieve systemwide change with the reason a particular system initiative has been established in the first place.

When litigation is necessary, the combination of available statutory and common law causes of action, issues involving forum selection or arbitration provisions, contractual limitations of various kinds, and other factors all lead to complexities often not found in other types of litigation. And given that many franchisees' economic security is bound up in their franchise, emotions can run high when problems develop. Failed franchises have often led to financial ruin, bankruptcy, divorce, and, in rare cases, suicide.

For franchisor counsel, the costs of the litigation, both economic and on the system, must be considered. Franchisor counsel must also understand the

goals of the litigation and the strategy for achieving those goals. Franchisee counsel, in addition to playing the role of legal tactician, often plays the role of psychologist, life counselor, and financial adviser. Counsel must consider the status, goals, and emotional and financial state of the client. Lawyers representing franchisees should inform their clients that lawsuits never provide an immediate result and that they must get on with their lives as best they can while their case proceeds.

A. Impact of a Suit on the Parties' Continuing Relationship

Franchisors and franchisees contemplating litigation should consider the impact of a suit on the parties' continuing relationship. As with most litigation, the goal of the client is a defining factor in crafting a suitable approach to the dispute. If the franchisor does not want to sever the parties' relationship, initiating litigation may serve as a warning to the franchisee and to the rest of the system that failing to comply with terms of the franchise agreement will not be tolerated. If the franchisee is considering litigation but is relatively content with the franchise operation and wants to maintain its franchise, it is wise to craft the claims in narrow ways that ameliorate the impact of the litigation. Even when litigation has been initiated, the goal is normally to resolve the dispute through negotiation. With the ever-increasing cost of litigation and the reality that most civil cases do not go to trial, practitioners often consider litigation as an enhanced form of negotiation. Presuit communications may also serve to achieve the goal. This can be done by the client directly, by the attorney ghostwriting communications, or directly through the lawyers. Consider at this juncture any statute of limitations issues and the desirability of executing tolling agreements covering the duration of any presuit negotiations. Too often parties rush to the courthouse and lose sight of the power of slowing things down while seeking to solve the underlying problems. A tolling agreement is a powerful tool to ensure the availability of litigation if negotiations fail.

When attempting to negotiate a resolution for a franchisee seeking to stay in the system, counsel should focus on breach of contract issues and on compliance concerns. The franchisee is well-advised to avoid allegations of fraud, RICO, or other provocative claims if reconciliation is the goal. On the other hand, if the franchisee's goal is to exit the system and de-identify, then the suit should be drafted with that objective in mind.

B. Impact of Litigation Costs

Franchise disputes are often difficult to maintain and expensive to litigate. There are, of course, many reasons for the high cost. Litigation by its very nature is expensive.[2] Many franchise cases involve requests for injunctive

2. Notably, the ballooning cost of discovery over the past 30 years has prompted the Rules Advisory Committee to rein in the breadth of Federal Rule of Civil Procedure 26. *See* Noble Roman's, Inc. v. Hattenhauer Distrib. Co., 314 F.R.D. 304, 306–08 (S.D. Ind. 2016) (chronicling

relief or other provisional remedies that expend resources at a fast clip. The benefit is that, often, court orders resolving requests for preliminary relief put an end to the litigation and avoid protracted fights. Much of franchise litigation takes place in federal courts because of trademark issues or diversity jurisdiction, which may also lead to increased litigation costs.[3] A franchisee should understand that there may be increased franchisor resistance to resolution if the franchisor would be asked to concede any point that may have systemwide implications or trigger an adverse disclosure in the Franchise Disclosure Document (FDD). Procedural issues that are collateral to the merits—such as forum selection, arbitration, and various contractual limitations (e.g., on damages, statutes of limitation, or consolidation)—often consume significant resources and sometimes even require interlocutory appeals. The availability of statutory claims and remedies can interject further complexity and, therefore, increase cost.

Although franchisors are typically in a better position to afford the costs of litigation, the franchisor should decide whether this is the way it wants to expend its resources. Many franchisors have made the decision that they will sue to enforce the slightest trademark infringement or minor post-termination obligation. Others utilize prelitigation mediation or other forms of alternative dispute resolution as a first resort, filing suit only as a last measure. Regardless, the time commitments needed from the businesspeople in the organization, the resources dedicated by in-house counsel to litigation versus to doing business, and the real monetary costs of outside counsel must be considered in deciding whether to pursue litigation.

Counsel must always keep in mind the goal of the client, the available remedies, and the value of the remedy. Many franchise contracts contain damages limitations of one form or another. These may limit punitive damages and/or consequential damages. Some may limit damages to return of the franchise fee. These provisions need to be evaluated in light of the claims being brought and the applicable law of the jurisdiction in which the claims would be brought. Are the limitations enforceable? Do they run afoul of statutory rights or remedies? Do they preclude the franchisee from vindicating such statutory rights in whole or in part? Are they mutual?

The potential right to recover attorneys' fees may also play a significant role in the decision-making process. A good liability case with small relative damages will be more attractive to pursue when the contract or a statute entitles the prevailing party to recover its attorneys' fees. The reverse is also true: A difficult liability claim with greater damages may be less attractive if a fee provision is present for the prevailing party. Practical considerations include evaluating the financial circumstances of both the client and the opposing

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the mounting limitations placed on the scope of Rule 26 to address the decades-long swell of discovery costs, applying such limitations to prohibit a franchisee from obtaining discovery from one of franchisor's shareholders).

3. For example, Federal Rule of Civil Procedure 16 mandates rigorous pretrial scheduling and management in federal court, which increases costs for litigants. *See, e.g.*, E. Farish Percy, *Making a Federal Case of It: Removing Civil Cases to Federal Court Based on Fraudulent Joinder*, 91 Iowa L. Rev. 189, 206 n.110 (2005) (discussing a number of reasons why defendants generally prefer federal court, including the increased cost of litigation).

party. Counsel must also closely review the language of the fee-shifting provisions. In some jurisdictions, like California, the law mandates that the contracting parties (and courts) treat one-way fee shifting provisions as mutual provisions.[4]

C. Impact of a Suit on Franchisees and the Franchise System

The impact of a lawsuit on the franchise system should always be considered prefiling. An issue that may have systemwide implications requires a multifaceted evaluation. The opponent should be evaluated in crafting the strategy. In particular, franchisee counsel should examine the litigation history disclosed in the FDD and should perform independent reviews on PACER and on Westlaw. It may be helpful to contact other attorneys who have handled litigation against the franchisor. Who are the franchisor's counsel? Is the franchisor typically aggressive or open to meaningful early settlement discussions? Can the issue be resolved in a satisfactory fashion for the client without necessarily having systemwide implications? Would such a resolution accomplish the client's goals?

D. Potential Impact of a Decision on the Franchise System

The potential impact of an adverse decision on the system as a whole warrants substantial initial consideration. For example, arbitration proceedings will generally not have a claim-preclusive effect. Thus, if an issue may have potential systemwide impact, franchisee counsel may want to consider filing a lawsuit and resisting a motion to compel arbitration. If successful, this may provide extra leverage for a settlement. If unsuccessful, however, there may be a fee-shifting provision in the franchise agreement that will make this decision seem foolhardy in hindsight. In any event, the law of claim preclusion or offensive collateral estoppel in the applicable jurisdiction should be evaluated so that the correct claims strategy is pursued.

An adverse decision is not the only outcome that deserves consideration. A seemingly favorable decision may lead to unintended consequences for the system. For example, arbitration provisions in franchise agreements sometimes carve out an exception for requests for temporary or preliminary injunctive relief. A franchisee may believe that requesting such relief is desirable, particularly when an injury is substantial and imminent. But even if injunctive relief is granted, the scope of the court's decision may be broader than the franchisee anticipated. For instance, the court might rule that the arbitration provision is enforceable, thus limiting the franchisee to seeking further relief in arbitration only. A franchisee hoping to later oppose a franchisor's motion to compel arbitration may be dismayed by what initially appeared to be a favorable outcome. Furthermore, because the decision may have a claim-preclusive effect, the systemwide impact on the franchisee's interests may be far greater than the injury the franchisee sought to avoid in

4. *See* Cal. Civ. Code § 1717.

the first place. Therefore, franchisees and franchisors should be cognizant of the potential for adverse decisions, as well as the potential unintended consequences of favorable decisions.

E. Ability of the Opponent to Pay a Judgment

Another key issue to evaluate in any lawsuit is the solvency of the opponent. This issue applies to both franchisors and franchisees. A franchisee that has trouble paying monthly royalties because of poor financial performance may not be able to pay any judgment down the road. In that scenario, the franchisor not only fails to recoup past-due royalties but will often not be able to recover the fees it expends to pursue the litigation even if successful. This may not necessarily matter to a franchisor if the goal is to rid the system of a problematic franchisee, but the franchisor should keep this issue in mind and recognize this "cost of doing business."

Generally, the franchisee can develop a reasonable picture of the franchisor's financial status from the FDD. If the franchisor is insolvent or only marginally solvent, then counsel should evaluate potential claims and examine the franchisor's ability to pay to maximize the available recovery. For example, counsel should evaluate claims to determine if insurance is available. This might implicate general liability insurance or perhaps director's and officer's (D&O) and/or errors and omissions (E&O) coverage. Counsel should also evaluate potential alter ego liability to determine if parent companies, affiliates, officers, or shareholders may be potentially liable. In fraud cases, it may be proper to sue control persons making or participating in the misleading representations or omissions. When statutory claims are present, examine who may be civilly liable. In California, Wisconsin, and other jurisdictions, for example, certain statutory claims may be pursued against principals of the franchisor, particularly in the context of franchise sales.[5]

F. Whether the Opponent Is Likely to Sue Regardless of Your Decision

The presence of claims or possible counterclaims is always an important factor to consider in the prefiling evaluation. Both franchisors and franchisees must be vigilant about and attentive to how the other might respond to the filing of a claim. For example, a franchisor may be reluctant to file suit against a franchisee who owes only a relatively small amount of past-due royalties. But should the franchisee sue first, the franchisor will undoubtedly bring a counterclaim for any past-due amounts. What may be a relatively small sum to a franchisor may feel considerably larger to a franchisee. And depending on the cause(s) of action the franchisee asserts—a fraud claim, for instance—the franchisor might even respond by seeking lost *future* royalties. Of course, the same caution applies to franchisors, who may find themselves facing statutory deceptive trade practices counterclaims after filing suit against their franchisees.

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5. *See, e.g.*, CAL. CORP. CODE § 31302; WIS. STAT. § 553.51; MICH. COMP. LAWS ANN. § 445.1532; 815 ILL. COMP. STAT. ANN. 705/26.

In circumstances where the opponent is likely to sue regardless, or even where there is uncertainty one way or the other, there may be distinct advantages to filing first. The first filer generally has the ability to choose the jurisdiction and venue. As will be discussed later in this chapter, the decision of where to file will be guided in large part by the kind of relief your client wishes to obtain. When there are multiple places where the suit may be filed, your client may find value in being the first to choose among those available locations. For instance, a particular judge presiding over one of those locations may have a reputation of being friendlier to franchisees or franchisors or may simply have more experience with franchise disputes. As another example, being first to select where to file suit may impact which state laws apply in a choice-of-law analysis or which location is given preference in a forum non conveniens analysis. How proactive your client chooses to be in the face of potential claims and counterclaims may yield far-reaching benefits as the lawsuit plays out.

G. Prospects of Success

Decisions on whether to file a claim should, of course, be guided ultimately by the likelihood the claim will succeed. However, the definition of "success" may differ from situation to situation; it need not be synonymous with obtaining a judgment. For example, a franchisee may file suit primarily to force the franchisor to renegotiate aspects of the franchise agreement. Conversely, a franchisor may assert claims or counterclaims primarily as leverage to bring franchisees back into compliance with the terms of the franchise agreement or to "send a message" to the system. How the parties define their goals is an essential prerequisite to determining the probability they will succeed in litigation.

But even when the goals are clearly defined, assessing the likelihood of accomplishing them may be complicated. The foregoing subsections raise some of the factors one might consider, although numerous others exist. One important factor is whether the opponent is likely to file a motion to dismiss. When the stakes of a case are modest, the mere filing of a motion to dismiss may be enough to make the costs of a lawsuit outweigh its potential benefits. And even when the stakes are substantial, an ironclad defense may suffice to make a lawsuit an unwise investment. Thus, counsel should consider a potential motion to dismiss as a factor affecting the chances of success. Only after carefully considering the relevant factors can counsel give a thoughtful assessment of the likelihood that the client will succeed in meeting the objectives it has set out for itself.

II. Whether to Bring Suit in State Court or Federal Court

Plaintiffs often prefer a state forum.[6] There are many reasons for this, including, potentially, more favorable judges, fewer restrictions on the admissibility

6. *See, e.g.*, Percy, *supra* note 3, at 206 n.110.

of expert opinions, more permissive joinder of claims, less likelihood of summary judgment, and no need for a unanimous jury verdict.[7]

Defendants, on the other hand, frequently prefer federal court. The process in which a case unfolds is generally more prescribed, summary judgment or adjudication is more readily available, and a verdict must be unanimous unless the parties stipulate otherwise.[8] Obtaining discovery from out-of-state witnesses[9] is generally easier in federal court, and federal court judgments are relatively easy to enforce in other states.[10] A litigant may also prefer federal court, especially in the franchise context, because federal judges are more likely to be familiar with federal intellectual property statutes such as the Lanham Act. Further thought should be given to whether the case can be removed to federal court because a filing in state court that the plaintiff knows can legitimately be removed to federal court only increases the cost of litigation by having to expend time and resources on the removal.

A. Franchisee Perspective

In some cases, the franchisee will have a choice of pursuing its case in a manner that will dictate the forum. Indeed, the prospects of success and value of a case may hinge on initial strategic decisions about where to pursue the case. Like in a game of chess, strategy must be planned many moves ahead. There may be perceived or real advantages to litigating in federal court versus state court depending on the dynamics of the particular courts involved. Many factors should be considered when making this decision. In franchise litigation, these considerations are often driven by forum selection clauses, choice of law clauses, arbitration clauses, various laws of the franchisee's state of residence, and the facts of the case. There are also some inherent characteristics of federal court versus state court that might lead to a preference. For the purposes of this section, it is assumed that the franchise agreement does not contain an arbitration clause.

If a franchisee and franchisor are domiciled in the same state, then the decision is relatively simple. The matter will be heard in state court unless there is a federal statute or question at issue. Even then, state court jurisdiction over the matter may be concurrent (i.e., permissive under federal statutes such as the Lanham Act) and federal jurisdiction would depend on the defendant removing the action.[11] If a federal statute provides for exclusive

7. *See id.*

8. Fed. R. Civ. P. 48.

9. *See* Fed. R. Civ. P. 45 (providing for the authority to compel a witness to attend a deposition as long as the witness does not have to travel more than 100 miles from where the person resides, is employed, or regularly transacts business in person).

10. *See* 28 U.S.C. § 1963 (procedure for efficiently enforcing a federal judgment in another federal district without the need to relitigate the case).

11. *See* D'Agostino v. Appliances Buy Phone, Inc., 633 F. App'x 88, 91 (3d Cir. 2015) (noting that state and federal courts have concurrent jurisdiction over Lanham Act claims); Alpharma, Inc. v. Pennfield Oil Co., 411 F.3d 934, 938 (8th Cir. 2005) (same).

jurisdiction, as with the Sherman Antitrust Act,[12] for example, then the matter will be heard in federal court. The federal court will then have pendent jurisdiction over state law claims arising from the common nucleus of operative facts.[13]

If the franchisee and franchisor are domiciled in different states, more factors come into play. In the absence of a forum selection clause, the state where the franchisee resides will almost always be a viable forum for litigation against the franchisor. Additionally, the sale and operation of the franchise will almost always give rise to minimum contacts under a state's long-arm statute. The result may be different, however, if jurisdiction is sought over individual defendants (e.g., officers or directors) who are residents of other states and whose contacts with the forum may be tenuous, depending on their activities.

Forum selection and choice of law clauses add yet more complexity into the decision-making process. Certain state statutes may trump forum selection clauses—so-called "relationship statutes," for example—as may state law principles of unconscionability. For example, state public policy may trump a forum selection clause where it operates to defeat the substantial public policies of the home state, including statutory protections. Although generally bound to follow the substantive law of the states in which they sit, federal courts tend to uphold forum selection clauses more often than their state counterparts.[14]

B. Franchisor Perspective

1. Typical Methods for Transferring Venue in Federal Courts

a. 28 U.S.C. § 1404(a)

The usual statutory basis for transferring cases to a more convenient forum is 28 U.S.C. § 1404(a). This provision allows the district court to transfer actions "[f]or the convenience of parties and witnesses, in the interest of justice." In determining whether transfer is appropriate, courts traditionally consider: "(1) the convenience of the parties; (2) the convenience of the witnesses; (3) the relative ease of access to sources of proof; (4) the availability of process

12. *See* 15 U.S.C. § 15.

13. *See* 28 U.S.C. § 1367; United Mine Workers of Am. v. Gibbs, 383 U.S. 715, 725 (1966) (stating the requirement that "[t]he state and federal claims must derive from a common nucleus of operative fact").

14. *See, e.g.*, White v. Health Carousel, LLC, No. MO:19-CV-00066-DC, 2019 WL 7824787, at *2 (W.D. Tex. Oct. 18, 2019) (stating that "[w]hen analyzing the enforceability of [forum selection clauses,] federal law applies . . . in both diversity and federal question cases" and explaining that a forum selection clause "is presumed enforceable unless there is a clear showing that the clause is 'unreasonable under the circumstances'") (internal citations omitted); *see also* James L. McClammy, *Forum Selection Clauses in Contracts Governed by the New Jersey Franchise Practices Act Are Presumptively Invalid*, 28 Seton Hall L. Rev. 213, 216–17 (1997–1998) ("Over time, the increasing level of acceptance of forum selection clauses has led federal courts sitting in diversity to give force to forum selection clauses even if the law of the state in which the court sits would find the clause unenforceable.").

to compel the presence of unwilling witnesses; (5) the cost of obtaining the presence of the witnesses; and (6) the public interest."[15]

In *Medicap Pharmacies, Inc. v. Faidley*, the court analyzed section 1404(a) in a franchise context, and held that, with respect to the inconvenience factor, the franchisees "essentially waived the right to argue inconvenience when they agreed to the franchise agreement and the forum selection clause."[16] Under section 1404(a), many courts, in fact, focus almost exclusively on the impact of transfer on the convenience to and access to third parties while giving less weight to the other factors borne out in the well-established case law. This is because courts view the convenience to parties to be a "wash" as both sides of a dispute can argue that their particular forum is more convenient to them.

b. 28 U.S.C. § 1406(a)

This statute is used when an action is brought in an improper venue and requires the district court to "dismiss, or if it be in the interest of justice, transfer such case to any district or division in which it could have been brought."[17] In *Cottman Transmission Systems, Inc. v. Martino*,[18] a franchisor brought suit against a former franchisee, alleging violations of the Lanham Act, breach of the franchise agreement's noncompete provision, and unfair competition. The relevant franchise agreement did not include a forum selection clause.[19] The court held that the appropriate venue was the state where the former franchisee was located, rather than the state where the headquarters of the franchisor was located.[20] In reaching its decision, the court considered that the Lanham Act violations occurred primarily where the franchisee was located, and the franchise agreement that formed the basis of the state law claims was executed and performed where the former franchisee was located.[21]

c. Forum Non Conveniens Dismissal

This procedural motion is filed when the plaintiff files in an inappropriate federal court, and there is no other federal court where the action can or should be transferred. In such circumstances, the case may be dismissed. Federal common law governs forum non conveniens arguments.[22] The court

15. Stateline Power Corp. v. Kremer, 404 F. Supp. 2d 1373, 1380 (S.D. Fla. 2005) (emphasis omitted).

16. 416 F. Supp. 2d 678, 686–90 (S.D. Iowa 2006). For a case discussing a motion for change of venue in the trademark context, see Pepsi-Cola Co. v. Dr. Pepper Co., 214 F. Supp. 377, 380–83 (W.D. Pa. 1963).

17. 28 U.S.C. § 1406(a).

18. 36 F.3d 291, 292 (3d Cir. 1994).

19. *Id.* at 293.

20. *Id.* at 292, 296.

21. *Id.* at 295–96.

22. *See, e.g.*, Ravelo Monegro v. Rosa, 211 F.3d 509, 511–12 (9th Cir. 2000); Rivendell Forest Prod., Ltd. v. Canadian Pac. Ltd., 2 F.3d 990, 992 (10th Cir. 1993); De Aguilar v. Boeing Co., 11 F.3d 55, 59 (5th Cir. 1993); Royal Bed & Spring Co. v. Famossul Industria e Comercio de

must weigh multiple factors in deciding a forum non conveniens motion, and should not place undue emphasis on any one factor.[23] Private interest factors to be considered include ease of access to proof, compulsory process for attendance of unwilling participants and the cost of obtaining their presence, the possibility of an inspection of the premises (if appropriate), the enforceability of any judgment obtained, and, generally, "all other practical problems that make trial of a case easy, expeditious and inexpensive."[24] Public interest factors to be considered include congested dockets, the interest in having local matters tried locally, and the appropriateness of conducting a diversity case where the law of the forum matches the law applicable in the case.[25]

2. Immediate Appeal of Rulings on Injunctions

In federal court, an appeal may be taken from an interlocutory order "granting, continuing, modifying, refusing or dissolving injunctions, or refusing to dissolve or modify injunctions."[26] This may play a prominent role in the franchise context, where injunctions involving Lanham Act trademark issues and post-termination covenants are often a central focus of litigation.

3. Typical Subject Matter Jurisdiction in Franchise Cases

a. Diversity Jurisdiction

Federal courts have diversity jurisdiction over actions between citizens of different states where the amount in controversy exceeds $75,000, exclusive of interest and costs.[27] There must be complete diversity between all plaintiffs and all defendants.[28] Significantly, for diversity purposes, limited liability companies (LLCs) are treated in the same manner as partnerships; that is, they are citizens of every state where their members are citizens.[29] This may be important because LLCs are popular business vehicles for owning and operating franchises. The party filing suit in federal court should be mindful that when relying on diversity jurisdiction in a case involving an LLC, it must plead the citizenship of each member of the LLC.

Moveis Ltda., 906 F.2d 45, 50 (1st Cir. 1990); Miller v. Davis, 507 F.2d 308, 316 (6th Cir. 1974), *abrogation on other grounds recognized by* Woodford Health Care, Inc. v. Bank of New York, 247 F. Supp. 2d 830, 832 (E.D. Ky. 2003).

23. Piper Aircraft Co. v. Reyno, 454 U.S. 235, 249–50 (1981).

24. Gulf Oil Corp. v. Gilbert, 330 U.S. 501, 508 (1947), *superseded by statute on other grounds by* Am. Dredging Co. v. Miller, 510 U.S. 443 (1994).

25. *Id.* at 508–09.

26. 28 U.S.C. § 1292(a)(1).

27. 28 U.S.C. § 1332.

28. Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267, 267 (1806), *overruled in part on other grounds by* The Louisville, Cincinnati & Charleston R.R. Co. v. Letson, 43 U.S. (2 How.) 497 (1844).

29. *See, e.g.*, Camico Mut. Ins. Co. v. Citizens Bank, 474 F.3d 989, 992 (7th Cir. 2007); Gen. Tech. Applications, Inc. v. Exro Ltda., 388 F.3d 114, 120 (4th Cir. 2004); GMAC Commercial Credit LLC v. Dillard Dep't Stores, Inc., 357 F.3d 827, 829 (8th Cir. 2004).

b. Federal Question Jurisdiction

Federal question jurisdiction exists when a claim "aris[es] under" federal law within the meaning of 18 U.S.C. § 1331. The typical basis for federal question jurisdiction in franchise cases is a Lanham Act claim for trademark infringement and/or unfair competition.[30] Such claims arise under federal law because Congress has created several special statutory grounds for federal jurisdiction in trademark cases. 28 U.S.C. § 1338(a) provides: "The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents, plant variety production, copyrights and trademarks." In addition, the Lanham Act has its own jurisdictional statute, which provides: "The district and territorial courts of the United States shall have original jurisdiction . . . of all actions arising under this chapter, without regard to the amount in controversy or to diversity or lack of diversity of the citizenship of the parties."[31] Finally, ancillary state law claims, such as claims for breach of contract and unjust enrichment, may be litigated with Lanham Act claims in federal court under supplemental jurisdiction.[32]

c. Considerations for Removal

Any state court action that could have been filed in federal court may be removed to federal court by the defendant pursuant to 28 U.S.C. § 1441(a).[33] As to removal jurisdiction based on diversity of citizenship, where all parties on one side of a state court lawsuit are of different state citizenship than all parties on the other side, the defendant may choose to remove the proceeding to federal court. If there are multiple defendants, they must all agree to effectuate a removal. The careful state court plaintiff will foresee removal opportunities when drafting the complaint. Indeed, strategic decisions regarding whom to sue are sometimes made for the very purpose of destroying diversity of citizenship. Such are the lengths that some franchisees—and occasionally some franchisors—will go to avail themselves of state courts.

By contrast, removal based on a federal question may be more complicated. A claim presents a federal question so as to "aris[e] under" federal law if: (1) federal law creates the cause of action asserted; (2) the plaintiff's right to relief on the claim necessarily depends on resolution of a substantial question of federal law; or (3) a federal statute wholly displaces the state law cause of action through preemption.[34] Under the "well-pleaded complaint rule," a court considers only properly pleaded portions of the complaint and does not consider potential defenses in determining whether a claim arises under federal law.[35] The practical result is that the plaintiff is "the master of the

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30. 15 U.S.C. §§ 1051 *et seq*.
31. 15 U.S.C. § 1121(a).
32. 28 U.S.C. § 1367.
33. Caterpillar, Inc. v. Williams, 482 U.S. 386, 392 (1987).
34. *See* Empire HealthChoice Assur., Inc. v. McVeigh, 547 U.S. 677, 689–90 (2006); Beneficial Nat'l Bank v. Anderson, 539 U.S. 1, 8 (2003).
35. *Caterpillar*, 482 U.S. at 392; *Beneficial Nat'l*, 539 U.S. at 6.

complaint" and "may, by eschewing claims based on federal law, choose to have the cause heard in state court."[36]

III. A Few Words about Pleading Standards

The minimum standards necessary to plead a claim vary by state, which in turn may differ from the now stricter federal standards. As a result, counsel should consider whether there are strategic benefits to pursuing claims in one jurisdiction versus another based on the level of detail required in the pleading. In all events, counsel will need to familiarize themselves with the applicable standards. Set forth below is a brief overview of the federal pleading standards.

Until 2007, pleading standards in federal court were generally well understood, in theory if not in practice, and so-called "notice" pleading ruled the day in both federal and state court. Under Federal Rule of Civil Procedure 8, a pleading only required "a short and plain statement of the claim showing that the pleader [wa]s entitled to relief."[37] This standard—labeled "notice pleading" by the Supreme Court—made it easier for a plaintiff to assert a claim in federal court.[38] As a result, a claim would not be subject to dismissal under Federal Rule of Civil Procedure 12(b)(6) unless "it appear[ed] beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."[39] The exception to this liberal standard was for claims of fraud and mistake, which had to be pled with particularity.[40] Into this relatively static environment came the Supreme Court's decisions in *Bell Atlantic Corp. v. Twombly* and *Ashcroft v. Iqbal*.[41]

In *Twombly*, an antitrust case, the Court announced a new "plausibility" standard, noting that:

> While a complaint . . . does not need detailed factual allegations, . . . a plaintiff's obligation to provide the grounds of his entitle[ment] to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do. . . . Factual allegations must be enough to raise a right to relief above the speculative level.[42]

36. *Caterpillar*, 482 U.S. at 398–99.

37. Fed. R. Civ. P. 8.

38. Conley v. Gibson, 355 U.S. 41, 47 (1957) ("all the Rules require is 'a short and plain statement of the claim' that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests").

39. *Id.* at 45–46.

40. Fed. R. Civ. P. 9(b) ("In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally.").

41. 550 U.S. 544 (2007); 556 U.S. 662 (2009).

42. 550 U.S. at 555 (citations and internal quotations omitted).

Thus, a plaintiff must plead "enough facts to state a claim to relief that is plausible on its face."[43]

In *Iqbal*, a discrimination case, the Supreme Court clarified that "*Twombly* expounded the pleading standard for 'all civil actions,'" and articulated a two-prong analysis for courts to follow.[44] First, the court should "begin by identifying pleadings that, because they are no more than conclusions, are not entitled to the assumption of truth."[45] Thus, "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice."[46] Second, "[w]hen there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief."[47] The Court went on to hold that "[d]etermining whether a complaint states a plausible claim" is a "context-specific task that requires the reviewing court to draw on its judicial experience and common sense."[48] And, "[w]here the well-pleaded facts do not permit the court to infer more than the possibility of misconduct," a complaint should be dismissed.[49]

The wisdom and implications of *Twombly* and *Iqbal* have been much debated by scholars and practitioners alike. At a practical level, and across a broad spectrum of cases, these decisions have resulted in (i) uncertainty as to what a plaintiff pursuing claims in federal court must actually allege to withstand a Rule 12(b)(6) motion to dismiss, and (ii) inconsistent application of the standards at the district court level. Franchise cases are no exception. Some courts have been reluctant to engage in the more rigorous analysis of the "plausibility" of the allegations as required by *Twombly* and *Iqbal*. Other courts, however, have seemingly been more willing to undertake the requisite review. Like much in litigation, some of it really does come down to the particular judge.[50]

IV. Claims for Relief

Claims typically asserted by the franchisor include (1) trademark infringement and related claims under the Lanham Act, state statutes, and common law; (2) misappropriation of trade secrets; (3) breach of a covenant not to compete; (4) breach of contract; (5) unjust enrichment; (6) breach of lease; and (7) breach of guaranty. Claims often asserted by the franchisee include

43. *Id.* at 570.

44. *Iqbal*, 556 U.S. at 684 (quoting Fed. R. Civ. P. 1).

45. *Id*. at 679.

46. *Id.* at 678.

47. *Id*. at 679.

48. *Id*. at 663–64.

49. *Id*. at 663.

50. Although more than a decade has passed since the Supreme Court's decisions in *Twombly* and *Iqbal*, it remains unclear whether the plausibility standard will ultimately replace the notice pleading standard in the states. Several states, including Massachusetts, Colorado, and South Dakota, have explicitly embraced the plausibility standard. Other states, including Washington, Minnesota, and Tennessee, have specifically declined to adopt the plausibility standard.

(1) wrongful termination and nonrenewal; (2) financial performance representations; (3) other contract claims, including breach of the duty of good faith and fair dealing; (4) violations of state relationship statutes; (5) common law fraud; (6) market withdrawal; (7) refusal to permit transfer of the franchise; (8) statutory and common law encroachment; (9) failure to register or improper registration; (10) breach of fiduciary duty; and (11) antitrust claims, including price-fixing, improper price maintenance, and tying claims.

A. Claims Typically Asserted by Franchisors

1. Trademark Claims

a. Trademark Infringement and Related Claims under the Lanham Act

Trademark owners may pursue a variety of claims under the Lanham Act. It is now generally settled that in order to bring a claim under the Lanham Act, a franchisor must first make "some type of showing" that the franchisee's license to use the trademark was properly terminated.[51]

Paragraph 32 of the Lanham Act, 15 U.S.C. § 1114(1)(a), provides:

> Any person who shall, without the consent of the registrant[,] use in commerce any reproduction, counterfeit, copy or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with such use is likely to cause confusion, or to cause mistake, or to deceive . . . shall be liable in a civil action by the registrant.

The basic elements required to prove a violation of this provision vary slightly by jurisdiction. Generally, "a complainant must demonstrate that it has a valid, protectible trademark and that the defendant's use of a colorable imitation of the trademark is likely to cause confusion among consumers."[52] Other courts require proof of somewhat different elements.[53]

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51. *See, e.g.*, McDonald's Corp. v. Robertson, 147 F.3d 1301, 1308 (11th Cir. 1998) (to "demonstrate that *unauthorized* trademark use occurred to prevail on the merits of a trademark infringement claim against a franchisee necessitates some type of showing that the franchisor properly terminated the contract purporting to authorize the trademarks' use, thus resulting in the *unauthorized* use of trademarks by the former franchisee") (emphasis in original); *see also* S & R Corp. v. Jiffy Lube Int'l, Inc., 968 F.2d 371, 375 (3d Cir. 1992) ("Once a franchise is terminated, the franchisor has the right to enjoin unauthorized use of its trademark under the Lanham Act."); 7-Eleven, Inc. v. Dhaliwal, No. 12-CV-02276-KJM-GGH, 2012 WL 5880462, at *5 (E.D. Cal. Nov. 20, 2012) ("A franchisee's use of the franchisor's marks is unauthorized if the franchisor properly terminated the franchise agreement.").

52. Lone Star Steakhouse & Saloon, Inc. v. Alpha of Va., Inc., 43 F.3d 922, 930 (4th Cir. 1995).

53. *See, e.g.*, Burger King Corp. v. Mason, 710 F.2d 1480, 1491 (11th Cir. 1983) ("the registrant must show that (1) its mark was used in commerce by the defendant without the registrant's consent and (2) the unauthorized use was likely to cause confusion, or to cause mistake or to deceive"); TGI Friday's Inc. v. Great Nw. Rests., Inc., 652 F. Supp. 2d 763, 767 (N.D. Tex. 2009) ("To succeed on a trademark infringement claim, a plaintiff first must show ownership of a legally protectable mark, and then it must establish infringement of the mark.").

Although courts may examine different factors when evaluating alleged customer confusion, the factors typically considered include the: (i) type and strength of the mark at issue; (ii) similarity of the marks; (iii) similarity of the products or services being sold; (iv) identity of purchasers and similarity of retail outlets; (v) similarity of advertising campaigns; (vi) defendant's intent; and (vii) actual confusion.[54]

Courts have consistently held that the likelihood of confusion is especially high when a franchisee continues to use the franchisor's mark(s) in the "holdover" context—that is, after its right to use the mark(s) has terminated or expired. For example, in a well-known decision involving the Church of Scientology, the Second Circuit reasoned:

> A licensee or franchisee who once possessed authorization to use the trademarks of its licensor or franchisor becomes associated in the public's mind with the trademark holder. When such party, as defendants here, loses its authorization yet continues to use the mark, the potential for consumer confusion is greater than in the case of a random infringer. Consumers have already associated some significant source identification with the licensor. In this way the use of a mark by a former licensee confuses and defrauds the public.[55]

Similarly, in another well-known case, *Burger King Corp. v. Mason*, the 11th Circuit held that "because Mason used the Burger King trademarks after the revocation of that right without [Burger King's] consent, a trademark infringement claim was established so long as the trademarks were employed in a manner that was likely to cause confusion, to cause mistake or to deceive."[56] The court further stated, "[c]ommon sense compels the conclusion that a strong risk of consumer confusion arises when a terminated franchisee continues to use the former franchisor's trademarks."[57]

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54. *See, e.g.*, Zerorez Franchising Sys., Inc. v. Distinctive Cleaning, Inc., 103 F. Supp. 3d 1032, 1041 (D. Minn. 2015); Ice Cold Auto Air of Clearwater, Inc. v. Cold Air & Accessories, Inc., 828 F. Supp. 925, 935 (M.D. Fla. 1993).

55. Church of Scientology Int'l v. Elmira Mission of the Church of Scientology, 794 F.2d 38, 44 (2d Cir. 1986).

56. 710 F.2d at 1492–93.

57. *Id.* at 1492; *see also* The Shell Co. (P.R.) Ltd. v. Los Frailes Serv. Station, Inc., 605 F.3d 10, 22 (1st Cir. 2010) (gas station franchisee who had previously sold Shell brand gasoline was likely to confuse consumers when it sold non–Shell brand fuel without completely obscuring the Shell trademarks); Team Tires Plus, Ltd. v. Tires Plus, Inc., 394 F.2d 831, 835 (10th Cir. 2005) ("the relevant confusion under trademark law is not limited to confusion of consumers as to the source of the goods, but also includes confusion as to sponsorship or affiliation, such as a consumer's mistaken belief that a retailer is part of a larger franchising operation"); 7-Eleven, Inc. v. Grewal, 60 F. Supp. 3d 272, 280 (D. Mass. 2014) (former franchisees "do not deny they continue to operate a business purporting to be a 7-Eleven franchise, thereby necessitating the court's presumption that customers of this 'rogue' establishment are likely to be confused"); Steak 'n Shake Enters., Inc. v. Globex Co., LLC, No. 13-cv-01751-RM-CBS, 2013 WL 4718757, at *11 (D. Colo. Sept. 3, 2013) ("It is well established that a terminated franchisee's continued use of the former franchisor's trademarks is likely to cause consumer confusion

However, not all cases involving holdover franchisees are resolved in favor of the franchisor. For example, in *Anheuser-Busch, Inc. v. A-B Distributors, Inc.*, the court denied Anheuser-Busch's motion for a preliminary injunction, finding that it had not established a likelihood of success on the merits of its claim for trademark infringement against a former distributor.[58] The court concluded that because the defendant's warehouse was idle and the trucks with plaintiff's trademark remained parked at the warehouse, there was no "use" in commerce as required for a Lanham Act claim.[59]

Franchisors also often pursue claims under Paragraph 43(a) of the Lanham Act, 15 U.S.C. § 1125(a). Although Paragraph 32 of the Lanham Act (15 U.S.C. § 1114(1)) only applies to registered marks, Paragraph 43(a) "protects qualifying unregistered trademarks," and "the general principles qualifying a mark for registration under § 2 of the Lanham Act are for the most part applicable in determining whether an unregistered mark is entitled to protection under § 43(a)."[60]

Paragraph 43(a) of the Lanham Act provides a remedy for "false association" and "false advertising":

> Any person who, on or in connection with any goods or services . . . uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—
>
> (A) [False Association:] is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or
>
> (B) [False Advertising:] in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.[61]

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and constitutes trademark infringement."); Dunkin' Donuts Franchised Rests. v. Elkhatib, No. 09 C 1912, 2009 WL 2192753, at *5 (N.D. Ill. July 17, 2009) ("[W]here a holdover franchisee . . . utilizes the franchisor's marks, the 'likelihood of confusion is inevitable.'") (citations omitted).

58. 910 F. Supp. 587, 591–92 (M.D. Fla. 1995).

59. *Id.*; *but see* All Star Championship Racing, Inc. v. O'Reilly Auto. Stores, Inc., 940 F. Supp. 2d 850, 861 (C.D. Ill. 2013) (rejecting former licensee's argument that "inadvertent appearance" of marks without evidence of "personal gain or advancement" does not constitute use for purposes of establishing trademark infringement).

60. Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763, 768 (1992).

61. 15 U.S.C. § 1125(a)(1).

Paragraph 43(a) is often referred to as the unfair competition provision of the Lanham Act.[62]

Paragraph 43(c) of the Lanham Act protects against dilution of a "famous" trademark. It provides:

> [T]he owner of a famous mark . . . shall be entitled to an injunction against another person who, at any time after the owner's mark has become famous, commences use of a mark or trade name in commerce that is likely to cause dilution by blurring or dilution by tarnishment of the famous mark, regardless of the presence or absence of actual or likely confusion, of competition, or of actual economic injury.[63]

There are separate definitions for "dilution by blurring" and "dilution by tarnishment" in the statute.[64] The statute was amended in 2006 to eliminate the requirement of showing actual or likely confusion, competition, or actual economic injury.[65] Instead, a plaintiff now only must establish a "likelihood of dilution."[66]

b. State Statutory Claims

Various state statutes can also be used to pursue trademark infringement claims.[67] In 1949, as part of an effort to promote uniformity in the regulation of trademarks, the International Trademark Association (formerly the United States Trademark Association) promulgated the Model State Trademark Bill (MSTB).[68] To date, almost all 50 states have adopted some version of the various Model State Trademark Bills drafted between 1949 and 2007.[69] The MSTB provides a state process for the registration of trademarks, and the statute includes a civil cause of action for trademark infringement and dilution.[70] The MSTB was modeled after the Lanham Act, and courts have often

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62. *See, e.g.*, Lone Star Steakhouse & Saloon, Inc. v. Alpha of Va., Inc., 43 F.3d 922, 930 (4th Cir. 1995); Peterbrooke Franchising of Am., LLC v. Miami Chocolates, LLC, 312 F. Supp. 3d 1325, 1341 (S.D. Fla. 2018).

63. 15 U.S.C. § 1125(c).

64. *See* 15 U.S.C. § 1125(c)(2)(B) (defining "dilution by blurring" as "association arising from the similarity between a mark or trade name and a famous mark that impairs the distinctiveness of the famous mark" and listing six factors a court may consider in determining whether dilution by blurring is present); 15 U.S.C. § 1125(c)(2)(C) (defining "dilution by tarnishment" as "association arising from the similarity between a mark or trade name and a famous mark that harms the reputation of the famous mark").

65. Trademark Dilution Revision Act of 2006, Pub. L. No. 109–312, 120 Stat. 1730 (2006); *see* Dan-Foam A/S v. Brand Named Beds, LLC, 500 F. Supp. 2d 296, 306–07 (S.D.N.Y. 2007).

66. *Id.* at 307.

67. *See, e.g.*, Cal. Bus. & Prof. Code §§ 14200 *et seq.*; N.Y. Gen. Bus. Law §§ 360 *et seq.*; N.C. Gen. Stat. §§ 80-1 *et seq.*; Tex. Bus. & Com. Code §§ 16.01 *et seq.*

68. *See* J. Thomas McCarthy, 3 McCarthy on Trademarks and Unfair Competition § 22:5 (5th ed. 2020).

69. *Id.*

70. Model State Trademark Bill §§ 2-5, 12-13.

interpreted state statutes patterned on the MSTB with reference to Lanham Act case law.[71] The MSTB has been amended several times, most recently in 2007 to reflect the Federal Trademark Dilution Revision Act of 2006.[72] As with any model statute, adoption of the MSTB's provisions varies by state, and counsel must review any particular variations in the forum in question.[73]

c. State Common Law Claims

There are also various state common law doctrines that protect trademarks. For example, many states recognize a common law cause of action for trademark infringement.[74] The elements of a common law trademark infringement claim are usually the same as a Lanham Act claim.[75] In general, the Lanham Act does not preempt state trademark law.[76] The same is true with respect to the MSTB, which specifically provides that nothing in it shall "adversely affect the rights or the enforcement of rights in marks acquired in good faith at any time at common law."[77] However, some courts have held that in certain circumstances, state trademark claims are preempted by federal law.[78]

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71. *See, e.g.*, ICENY USA, LLC v. M & M's, LLC, 421 F. Supp. 3d 204, 218 (D. Md. 2019) ("Maryland law applies the same legal framework for trademark infringement and unfair competition claims as the Lanham Act."); Peterbrooke Franchising of Am., LLC v. Miami Chocolates, LLC, 312 F. Supp. 3d 1325, 1341 (S.D. Fla. 2018) ("The analysis of the Florida statutory and common law claims of trademark infringement . . . is the same as under the federal trademark infringement claim.") (citation omitted); Eagles Eye, Inc. v. Ambler Fashion Shop, Inc., 627 F. Supp. 856, 860 (E.D. Pa. 1985) (holding that plaintiff's state statutory trademark claim was "coextensive" with its Lanham Act claim).

72. *See* McCarthy, *supra* note 68, at 22:5.

73. *See, e.g.*, Cmty. First Bank v. Cmty. Banks, 360 F. Supp. 2d 716, 727 n.4 (D. Md. 2005) (noting that Maryland had not adopted the 1992 revision to the MSTB providing for the cancellation of a registration in part and holding that therefore the court could not order the cancellation of a registration in part).

74. *See, e.g.*, Skydive Ariz., Inc. v. Hogue, 238 Ariz. 357, 366–67, 360 P.3d 153, 162–63 (Ct. App. 2015) ("[E]ven without Arizona's trademark law, liability would exist under the common law theory of unfair competition, which encompasses several tort theories, including trademark infringement."); Hot-Hed, Inc. v. Safehouse Habitats (Scotland), Ltd., 333 S.W.3d 719, 730 (Tex. App. 2010) ("The elements in common law trademark infringement under Texas law are the same as those under federal trademark law."). Plaintiffs can usually choose between common law remedies, state statutory remedies, and the Lanham Act without much difficulty.

75. *See, e.g.*, Crafty Prods., Inc. v. Michaels Cos., Inc., 389 F. Supp. 3d 876, 884 (S.D. Cal. 2019) (claims for trademark infringement under California law are subject to the same legal standards as claims under the Lanham Act); Ritani, LLC v. Aghjayan, 880 F. Supp. 2d 425, 448 (S.D.N.Y. 2012) ("the elements of a cause of action for New York common law infringement . . . mirror the requirements of claims stated under the Lanham Act").

76. *See, e.g.*, Int'l Franchise Ass'n, Inc. v. City of Seattle, 803 F.3d 389, 409 (9th Cir. 2015) ("As the Lanham Act does not expressly preempt state law, and courts have said that it does not occupy the field, the ordinance can only be preempted if it conflicts with the Lanham Act.") (internal citations omitted); Emerson Power Transmission Corp. v. Roller Bearing Co. of Am., Inc., 922 F. Supp. 1306, 1313 (N.D. Ind. 1996) ("[T]he Lanham Act generally does not preempt state regulation of trademarks, whether statutory or at common law.").

77. Int'l Trademark Ass'n, 2007 Model State Trademark Bill, § 16.

78. *See, e.g.*, True N. Cos., L.C. v. TruNorth Warranty Plans of N. Am., LLC, 423 F. Supp. 3d 604, 617–22 (N.D. Iowa 2019) (reaffirming that the Lanham Act preempts state trademark law

A franchisor may also elect to assert a state cause of action for "unfair competition" in the trademark infringement context. Paragraph 43(a) of the Lanham Act and state common law claims for unfair competition are composed of similar elements.[79]

2. Misappropriation of Trade Secrets

Trade secrets are at the heart of many franchise systems. Perhaps the most well-known example in the franchising context is Kentucky Fried Chicken's "secret blend of 11 herbs and spices."[80] In addition to recipes and formulas,[81] methods of doing business,[82] customer lists,[83] planned, but nonpublic marketing and advertising campaigns,[84] and proprietary software[85] have all been found to be trade secrets. Whether a franchisor's proprietary recipes, method of doing business, and the like rise to the level of a trade secret is, of course, fact-specific and may vary by jurisdiction despite the existence of a uniform trade secret statute. In evaluating a potential claim for trade secret misappropriation, counsel will need to carefully analyze whether the claimed trade secret actually meets the requisite standard.

In addition to applicable common law, every state with the exception of New York (and possibly North Carolina) have promulgated trade secret

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as applied to interstate commerce); Kerzner Int'l Ltd. v. Monarch Casino & Resort, Inc., 675 F. Supp. 2d 1029, 1048 (D. Nev. 2009) ("The Lanham Act does not have broad preclusive effect; rather, it only preempts state laws which would provide less protection than the Lanham Act, and thus would permit federal trademarks to be infringed.") (citation omitted); Capcom Co., Ltd. v. MKR Grp., Inc., No. C 08-0904 RS, 2008 WL 4661479, at *15 (N.D. Cal. Oct. 20, 2008) (common law trademark infringement and dilution claims preempted by the Lanham Act).

79. Lone Star Steakhouse & Saloon, Inc. v. Alpha of Va., Inc., 43 F.3d 922, 930 n.10 (4th Cir. 1995) ("The test for trademark infringement and unfair competition under the Lanham Act is essentially the same as that for common law unfair competition under Virginia law because both address the likelihood of confusion as to the source of the goods or services involved."); Choice Hotels Int'l, Inc. v. Zeal, LLC, 135 F. Supp. 3d 451, 470 (D.S.C. 2015) ("[P]laintiff has also advanced claims for unfair competition under Section 43(a) of the Lanham Act and common law trademark infringement against [defendant]. It appears that the standards to prevail on these claims are the same as those applicable for trademark infringement."); *Ritani*, 880 F. Supp. at 448 ("the elements of a cause of action for New York common law . . . unfair competition mirror the requirements of claims stated under the Lanham Act").

80. KFC Corp. v. Marion-Kay Co., 620 F. Supp. 1160, 1172 (S.D. Ind. 1985).

81. *See, e.g.*, *id.*; Kreh v. Baskin-Robbins Ice Cream Co., No. CV 76-1797-DWN, 1979 WL 1662, at *2 (C.D. Cal. Aug. 7, 1979), *aff'd*, 664 F.2d 1348 (9th Cir. 1982).

82. *See, e.g.*, Tan-Line Studios, Inc. v. Bradley, No. CIV.A. 84-5925, 1986 WL 3764, at *4–5 (E.D. Pa. Mar. 25, 1986), *aff'd sub nom.* Paul v. Tanning, Health & Fitness Equip. Co., 808 F.2d 1517, 1517–18 (3d Cir. 1986) (table); Snelling & Snelling, Inc. v. Armel, Inc., 360 F. Supp. 1319, 1321 (W.D. La. 1973).

83. *See, e.g.*, Am. Express Fin. Advisors, Inc. v. Yantis, 358 F. Supp. 2d 818, 831 (N.D. Iowa 2005); Jackson Hewitt, Inc. v. Childress, No. 06-CV-909, 2008 WL 199539, at *7 (D.N.J. Jan. 22, 2008).

84. *See, e.g.*, H & R Block Eastern Tax Servs., Inc. v. Enchura, 122 F. Supp. 2d 1067, 1074–76 (W.D. Mo. 2000).

85. *See, e.g.*, NaturaLawn of Am., Inc. v. West Grp., LLC, 484 F. Supp. 2d 392, 399 (D. Md. 2007).

laws based in whole or part on the Uniform Trade Secrets Act ("UTSA").[86] And, recently, the federal government enacted the Defend Trade Secrets Act ("DTSA").[87] The DTSA provides a federal private right of action and federal subject matter jurisdiction.[88] A franchisor may thus have a range of potential claims and remedies arising from a franchisee's misuse or disclosure of the franchisor's trade secrets.[89]

3. Breach of Covenant Not to Compete

Many, if not most, franchise agreements include some form of a covenant not to compete, both during the term of the agreement ("in-term") and after the agreement has terminated ("post-term"). Much has been written about the enforceability of such provisions.[90] Historically, but subject to notable exceptions, franchisors were often successful in enforcing covenants not to compete.[91] In recent years, however, courts have increasingly scrutinized claims to enforce covenants not to compete, especially in the context of motions for injunctive relief.[92]

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86. *See Trade Secrets Act*, Unif. Law Comm'n (Apr. 21, 2021, 5:07 PM) https://www.uniformlaws.org/committees/community-home?CommunityKey=3a2538fb-e030-4e2d-a9e2-90373dc05792.

87. 18 U.S.C. §§ 1831 *et seq.*

88. 18 U.S.C. § 1836(b)(1), (c).

89. For a thorough discussion of potential claims and remedies for trade secret misappropriation, see Scott McIntosh & Natalma McKnew, *A New World for Trade Secrets in Franchising: New Options and Strategies under the Federal Defend Trade Secrets Act*, ABA 40th Annual Forum on Franchising (2017); Michael J. Lockerby, James P. Mittenthal & Heather Carson Perkins, *Protection of Franchise System Trade Secrets and Confidential Information, and Enforcement of Non-Disclosure Agreements in the Digital Age*, ABA 35th Annual Forum on Franchising (2012); *see also* Jason Adler, Eleanor Vaida Gerhards & Michael J. Lockerby, *Cybersecurity: Putting the Toothpaste Back in the Tube—Best Practices for Responding to a Security Breach*, ABA 41st Annual Forum on Franchising (2018).

90. *See, e.g.*, Covenants against Competition in Franchise Agreements (Michael R. Gray & Natalma M. McKnew eds., 3d ed. 2012); Michael R. Gray & Erin Conway, *Noncompete Enforcement Today: Slam Dunk or Red Zone Problem?*, ABA 42nd Annual Forum on Franchising (2019); Devona Reynolds Perez, Trishanda Treadwell & C. Griffith Towle, *The Slippery Sands of Post-Termination Enforcement—Opportunities for Franchisees & Pitfalls for Franchisors*, Int'l Franchise Ass'n, 50th Annual Legal Symposium (2017); Jess A. Dance & William W. Sentell, *Turning an (Occasional) Blind Eye: Selective Enforcement of Franchisee Post-Term Non-Compete Covenants*, 37 Franchise L.J. 245, 247–48 (2017).

91. *Id.*; *but see* Cal. Bus. & Prof. Code § 16600 ("Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.").

92. *See, e.g.*, Novus Franchising, Inc. v. Dawson, 725 F.3d 885, 894–95 (8th Cir. 2013) ("After considering all of the arguments made by both parties for and against the need for a preliminary injunction to enforce the non-compete clause, we conclude the district court did not abuse its discretion when it determined Novus failed to show irreparable harm under the particular facts involved in this case."); 7-Eleven, Inc. v. Grewal, 60 F. Supp. 3d 272, 280, 283 (D. Mass. 2014) ("Though the court acknowledges 7-Eleven's restrictive covenant will probably be deemed enforceable, it is not clear that delaying the enforcement of this covenant will cause 7-Eleven irreparable harm."); Steak 'n Shake Enters., Inc. v. Globex Co., LLC, No. 13-cv-01751-RM-CBS, 2013 WL 4718757, at *14 (D. Colo. Sept. 3, 2013) (Any harm caused by defendants operating a competing business "within five miles of the Authorized Locations

4. Breach of Franchise Agreement

Claims for breach of the franchise agreement are, of course, common and have several advantages for a franchisor. First, depending on the nature of the claimed breach, a franchisor may be able to recover both any unpaid royalties and lost future profits. For example, in *Burger King Corp. v. Barnes*,[93] the court held that Burger King was entitled to recover unpaid royalties and lost future profits from a franchisee after he abandoned his business. The court distinguished a prior case where Burger King had failed to present sufficient evidence to establish lost profits, stating, "[i]n the present action, Burger King has cured the evidentiary problem it encountered in *In re Mid-America* by providing the Court with undisputed evidence regarding costs incurred for operating a franchise and deducting those costs from future royalty payments."[94]

Recovering lost future profits is, however, considerably more difficult in California. In *Postal Instant Press, Inc. v. Sealy*, the franchisor terminated the franchisee for failing to pay royalties and filed suit seeking to recover past due royalties, as well as future royalties for the remaining term of the franchise agreement.[95] The court concluded "[i]n what apparently is a case of first impression not only in California but the entire nation," that an award of future royalties was inappropriate, but did award unpaid royalties, attorneys' fees, and costs to the franchisor.[96]

In reaching its decision, the *Sealy* court first analyzed franchise cases that awarded future profits for breach of the franchise agreement, and concluded that an award of future profits may be appropriate where the franchisor breaches and the franchisee loses the profits it would have otherwise earned during the term of the agreement.[97] The court then held that the proximate cause of the franchisor's claimed future damages was the *franchisor's* decision to terminate the agreement, and not the franchisee's failure to pay royalties.[98] The court reasoned that "a mere failure to pay moneys owed for past performance" was insufficient to support an award of future lost profits.[99] The court noted, however, that a franchisor may be able to recover lost future royalties depending on the type of breach committed by the franchisee.[100]

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or the Development Area between now and trial is strictly theoretical. And to that extent, prevention of such theoretical harm will not be prevented by injunctive relief."); Tutor Time Learning Ctrs., LLC v. KOG Indus., No. 1:12–CV–4129(NGG) (RER), 2012 WL 5497943, at *3 (E.D.N.Y. Nov. 13, 2012) ("Generally, when a party violates a [reasonable] non-compete clause, the resulting loss of client relationships and customer goodwill built up over the years constitutes irreparable harm. But the Second Circuit has rejected the proposition that irreparable harm must inevitably be assumed in breach of covenant cases.") (citations and quotations omitted); *see generally* Gray & Conway, *supra* note 90.

93. 1 F. Supp. 2d 1367, 1370 (S.D. Fla. 1998).

94. *Id.* at 1371.

95. 51 Cal. Rptr. 2d 365, 367–68 (Ct. App. 1996).

96. *Id.* at 367, 373.

97. *Id.* at 369.

98. *Id.* at 370.

99. *Id.*

100. *Id.* at 371.

A subsequent Florida federal case, *Lady of America Franchise Corp. v. Arcese*, analyzed the lost future profits issue and reached a different result, holding that lost future profits could be recovered by the franchisor.[101] The court reconciled the *Barnes* and *Sealy* cases, noting that although the franchisor officially terminated the franchise agreement, the franchisee had previously notified the franchisor of its intent to close the business.[102] The court concluded that the franchisee had therefore effectively terminated the agreement, and so the franchisor's lost future profits were proximately caused by the franchisee's breach.[103] This case and *Sealy* suggest that franchisors will have a much easier time obtaining lost future royalties if they can establish the franchisee terminated or effectively terminated the franchise agreement.

Since *Sealy*, courts have gone both ways when deciding whether a franchisor can recover lost future profits if the franchisor terminates the franchise agreement.[104] Whether a franchisor is successful in recovering lost future profits may very well rest on how a court perceives the causal connection linking the franchisor's assertion of liability and the resulting future harm.

5. Unjust Enrichment

Although uncommon, a claim for unjust enrichment may be another way a franchisor can recover lost future profits from a franchisee for ongoing trademark infringement after termination. An example of such a case is *Burger King Corp. v. C.R. Weaver*,[105] where the franchisee continued using Burger King's trademarks after the franchise was terminated as a result of his failure to pay royalties and other amounts owed to the franchisor. The court held that such use constituted unjust enrichment and found that Burger King was entitled to an award of profits based on the franchisee's unjust enrichment.[106] Absent some sort of ongoing post-termination infringement, an unjust enrichment claim will likely be very difficult to sustain in that such claims are typically only available where there is no valid contract.[107]

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101. No. 05-61306-CIV, 2006 WL 8431025, at *13–18 (S.D. Fla. May 26, 2006).

102. *Id.* at *17.

103. *Id.* at *18.

104. Following *Sealy*—Dunkin' Donuts, Inc. v. Arkay Donuts, LLC, No. CIV. 05-387 (WHW), 2006 WL 2417241, at *5 (D.N.J. Aug. 21, 2006); Kissinger, Inc. v. Singh, 304 F. Supp. 2d 944, 949–50 (W.D. Mich. 2003); Burger King Corp. v. Hinton, Inc., 203 F. Supp. 2d 1357, 1366 (S.D. Fla. 2002); rejecting or questioning *Sealy*—Leisure Sys., Inc. v. Roundup, LLC, No. 1:11-CV-384, 2013 WL 12178132, at *6 (S.D. Ohio Jan. 23, 2013) (finding that franchisee's failure to pay royalties "proximately caused those future damages of [franchisor] that are proven with reasonable certainty"); Radisson Hotels Int'l, Inc. v. Majestic Towers, Inc., 488 F. Supp. 2d 953, 963 n.9 (C.D. Cal. 2007) (stating in dicta, "this Court believes that the *Sealy* decision is mistaken").

105. Bus. Franchise Guide (CCH) ¶ 11,058 (S.D. Fla. 1996), *aff'd*, 169 F.3d 1310 (11th Cir. 1999).

106. *Id.*

107. *See, e.g.*, Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp., 139 F.3d 1396, 1413 (11th Cir. 1998) ("Recovery on a theory of unjust enrichment, however, is only available 'when as a matter of fact there is no legal contract.'") (citations omitted); Carreno v. 360 Painting, LLC, No. 19CV2239-LAB (BGS), 2020 WL 1275651, at *4 (S.D. Cal. Mar. 17,

6. Breach of Lease

In a number of franchise systems, the franchisor owns or leases the real estate and enters into a lease or sublease with the franchisee. As a result, in circumstances where the franchisee breaches the franchise agreement, the franchisor may also have a cause of action for breach of the lease.[108] In situations where a franchisor has both a franchise agreement and a lease with a franchisee, the breach of one will not necessarily constitute a breach of the other because these are separate contracts. However, there are typically cross-default provisions. When the franchisee leases the location directly from a third party, it is not uncommon for the franchisor to require the franchisee to assign the premises to the franchisor in the event the franchise agreement is terminated. Although such collateral assignment provisions are generally enforceable,[109] it is not uncommon for the franchisee and/or landlord to refuse to assign the lease. In such circumstances, the franchisor may need to initiate litigation to compel the assignment.[110]

7. Breach of Guaranty

Guaranties are common in franchise relationships, particularly when the franchisee is a corporation or limited liability company. In such situations, the franchisor typically will require that the entity's principals personally guaranty the franchisee's performance of the franchise agreement, particularly if the franchisee entity was established solely to own the franchise and has few, if any, other assets as is often the case. These guaranties are usually fairly simple agreements, pursuant to which the principals guarantee the full performance of the franchisee entity under the franchise agreement, and are usually executed at the same time as the franchise agreement.[111] A claim for

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2020) ("[A] claim for unjust enrichment cannot lie where a valid, express contract covering the same subject matter exists between the parties."); Am. Casual Dining, L.P. v. Moe's Sw. Grill, L.L.C., 426 F. Supp. 2d 1356, 1372 (N.D. Ga. 2006) (Under Georgia law, "unjust enrichment is available only when there is no legal contract."); Aerel, S.R.L. v. PCC Airfoils, L.L.C., 371 F. Supp. 2d 933, 943 (N.D. Ohio 2005) ("Ohio law is clear that a plaintiff may not recover under the theory of unjust enrichment or quasi-contract when an express contract covers the same subject."); Holiday Hospitality Franchising, Inc. v. H-5, Inc., 165 F. Supp. 2d 937, 941 (D. Minn. 2001) ("Unjust enrichment is an equitable theory which cannot be asserted where the rights of the parties are governed by a valid contract.").

108. *See, e.g.*, Dunkin' Donuts Inc. v. Martinez, 01-3589-CIV-HUCK, 2003 WL 685875, at *3–5, *12 (S.D. Fla. Feb. 21, 2003) (granting judgment to franchisor on its claims for breach of franchise agreement and breach of an associated lease).

109. *See, e.g.*, Snelling & Snelling v. Martin, No. C 97-4479 FMS, 1998 WL 56995, at *4 (N.D. Cal. Jan. 28, 1998).

110. *See, e.g.*, Dunkin' Donuts, Inc. v. Dowco, CIV 5:98-cv-166, 1998 WL 160823, at *4 (N.D.N.Y. Mar. 31, 1998).

111. For a general discussion regarding personal guaranties in the franchise context, see Alison McElroy & Robert A. Smith, *International Development—Personal Guarantees and Other Mechanisms to Secure Franchisee Payment and Performance*, Int'l Franchise Ass'n, 50th Annual Legal Symposium (2017). *See also* Suzie Trigg & Chris Wallace, *Beyond the Franchise Agreement: A Look at the "Other" Agreements between the Franchisor and Franchisee*, ABA 41st Annual Forum on Franchising (2018).

breach of a guaranty is almost automatic whenever the franchisor brings a claim against a franchisee that is an entity.[112]

B. Claims Typically Asserted by Franchisees

1. Wrongful Termination and Nonrenewal Claims

Because of the generally long-term nature of franchises and the investment recovery period, many franchise agreements include express and implied covenants prescribing the franchisor's ability to terminate or not renew the agreement. Additionally, many states have relationship statutes governing franchise terminations and renewals. Thus, a wrongful termination and nonrenewal of a franchise may give rise to both statutory and common law claims.[113] Industry-specific federal and/or state statutes may also apply. For example, gas station franchises are governed by the federal Petroleum Marketing Practices Act, and car dealer franchises are governed by the federal Automobile Dealers' Day in Court Act.[114] Jurisdiction may be exclusively federal, or it may be concurrent with state statutes, depending on the nature of the claims.

a. Common Law Claims

A franchisor's wrongful termination or failure to renew a franchise agreement may give rise to claims for breach of the franchise agreement and/or breach of the implied covenant of good faith and fair dealing. Depending on the facts of the termination or nonrenewal, counsel also should consider other potential common law claims (e.g., fraud, violation of public policy or conversion).

When evaluating potential claims, counsel should carefully review the FDD and the franchise agreement (including all addenda and incorporated materials) and interview the client to determine if there are other documents that may bear on the termination or nonrenewal. Correspondence between the parties, operations or other types of standards manuals, brochures and advertising materials may also be relevant.

Most franchise agreements (and franchise relationship statutes) include provisions requiring that the franchisor provide notice and an opportunity

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112. *See, e.g.*, Century 21 Real Estate LLC v. All Prof'l Realty, Inc., 600 F. App'x 502, 506 (9th Cir. 2015) (holding individual defendants personally liable under the terms of a guaranty of a franchise agreement in an action by a franchisor); Red Roof Franchising, LLC v. AA Hospitality Northshore, LLC, 877 F. Supp. 2d 140, 154 (D.N.J. 2012), *aff'd sub nom.* Red Roof Franchising, LLC v. Patel, 564 F. App'x 685 (3d Cir. 2014); Tutor Time Learning Ctrs., LLC v. Larzak, Inc., 3:05-CV-322 RM, 2007 WL 2025214, at *1, *14 (N.D. Ind. July 6, 2007) (same).

113. For a comprehensive discussion of potential claims, defenses, and issues related to terminations, see Karen Marchiano, Glenn Plattner & Leonard Vines, *Roadmap for the Default and Termination Process*, ABA 35th Annual Forum on Franchising (2012); *see also* Joseph Fittante Jr. & Meredith Bauer, *Defaults and Terminations: An Unfortunate Reality of a Challenging Economy*, 28 Franchise L.J. 214 (2009).

114. 15 U.S.C. §§ 2801 *et seq.* (Petroleum Marketing Practices Act); 15 U.S.C. §§ 1222 *et seq.* (Automobile Dealers' Day in Court Act).

to cure a breach and, thus, termination will only be appropriate after notice has been provided and the franchisee has failed to cure. However, some transgressions may be specifically identified in the contract (or statute) as grounds for immediate termination. Whether any such contract provision is enforceable may depend on whether it is consistent with any applicable state relationship statute.

In evaluating potential claims, franchisee counsel should also evaluate the franchisor's expressed rationale and potentially unexpressed motivations for the nonrenewal or termination. A franchisor will generally not terminate or refuse to renew a well-performing franchisee in the absence of other reasons for termination. Such reasons can, of course, vary greatly. For example, there may be a personality conflict, or the franchisee may be unduly critical of some of the franchisor's practices, or the franchisee may be perceived as not working hard enough. Counsel should explore whether these or other reasons underlie the termination or franchisor's refusal to renew the franchise agreement. For example, the franchisor may have sought to terminate a long-term franchisee with a large, exclusive geographic territory in order to split the territory and sell more franchises.[115] Often, when a franchisee fails, a new one is recruited as a replacement. Counsel should be aware of such potential saturation and "churning," particularly if the franchisee is a substantial customer of goods produced by the franchisor.

Counsel should consider the range of common law remedies available when a franchise is terminated or not renewed. In appropriate circumstances, injunctive relief may be available to prevent the termination of a franchise involving unique products or a termination that will result in the destruction of the business. Specific performance may also be an available remedy for a franchisor's wrongful termination or failure to renew. For example, a court may order that a franchise agreement be renewed on the same terms as the previous agreement if the franchisor delayed in offering renewal for an extended period without justification, forcing the franchisee to sue for specific performance in offering a renewal franchise agreement.[116]

Franchisees may also sue for damages in cases where specific performance may not be available. In such cases, the franchisee may sue for lost profits, as well as other consequential damages.

b. Statutory Claims

A number of states have general franchising statutes that provide protection to franchisees, requiring "good cause" for termination, which generally must be preceded by notice and an opportunity to cure.[117] What constitutes good cause, as well as the notice and cure requirements, vary, and counsel will

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115. This may result in there being more franchises in a particular market area than can be profitably operated by creating territories that are too small.

116. *See, e.g.*, Prudence Corp. v. Shred-It Am., Inc., Bus. Franchise Guide (CCH) ¶ 13,986 (C.D. Cal. Mar. 18, 2008).

117. *See, e.g.*, Cal. Bus. & Prof. Code §§ 20000 *et seq.*; Haw. Rev. Stat. §§ 482E-1 *et seq.*; Ill. Comp. Stat. §§ 705/1 *et seq.*; Ind. Code tit. 23, art. 2, ch. 2.7 §§ 1 *et seq.*; Mich. Comp. Laws §§ 445.1501 *et seq.*; Minn. Stat. §§ 80C.01 *et seq.*; Mo. Stat. §§ 407.400 *et seq.*; N.D. Cent.

need to familiarize themselves with the applicable relationship statute and the cases that have interpreted it. In addition to general franchise statutes, there are state and federal statutes that apply to industry-specific franchises. Some of these are discussed below.

i. Automobile Dealers

The Automobile Dealers' Day in Court Act (ADDCA) permits automobile dealers to seek damages from automobile manufacturers for a breach of good faith in performing their obligations under the franchise agreement or in terminating, canceling, or not renewing the franchise.[118] The ADDCA does not preempt state legislation where there is no irreconcilable conflict between the state and federal law.[119] Thus, a number of states have enacted regulatory schemes designed to eliminate unfair and coercive practices by automobile manufacturers and distributors.[120]

ii. Petroleum Dealers

The Petroleum Marketing Practices Act (PMPA) prohibits the termination or nonrenewal of any gas station franchise except on specific grounds and after notice.[121] The PMPA generally preempts state laws dealing with the termination or nonrenewal of franchises.[122] The PMPA does not, however, preempt all state laws regulating such franchises or common law or statutory claims that only incidentally affect termination and renewal issues.[123]

iii. Other Dealers

Various statutes regulate other specific industries. For example, many states have specific statutes related to farm equipment dealers or alcoholic beverage dealers.[124]

c. Nonrenewal Claims

Most franchise agreements include one or more renewal options. Such options typically require that the franchisee pay a renewal fee, sign the

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Code §§ 51-19-01 *et seq.*; N.J. Stat. §§ 56:10-1 *et seq.*; R.I. Gen. Laws §§ 6-50-2 *et seq.*; Va. Code §§ 13.1-557 *et seq.*; Wash. Rev. Code §§ 19.100.010 *et seq.*; Wis. Stat. §§ 135.01 *et seq.*

118. 15 U.S.C. §§ 1222 *et seq.*

119. 15 U.S.C. § 1225.

120. *See, e.g.*, California New Motor Vehicle Board Statute, Cal. Veh. Code §§ 3000 *et seq.*; Colorado Automobile Dealers Act, Colo. Rev. Stat. §§ 12-6-101 *et seq.*; New York Franchised Motor Vehicle Dealer Act, N.Y. Veh. & Traf. Law §§ 460 *et seq.*; Wisconsin Motor Vehicle Dealers Law, Wis. Stat. §§ 218.0101 *et seq.*

121. 15 U.S.C. §§ 2801 *et seq.*

122. 15 U.S.C. § 2806.

123. *See, e.g.*, Unocal Corp. v. Kaabipour, 177 F.3d 755, 768 (9th Cir. 1999) ("The preemptive scope of the PMPA is limited; it does not reach any state laws which only incidentally affect franchise termination or nonrenewal.").

124. *See, e.g.*, Maryland Equipment Dealer Contract Act, Md. Code Com. Law §§ 19-101 *et seq.*; Texas Farm, Industrial, Off-Road Construction, Forestry Harvesting Equipment, and Outdoor Power Equipment Dealer Agreements Statute, Tex. Bus. & Com. Code §§ 19.01 *et seq.*; Kansas Agricultural Equipment Dealership Act, Kan. Stat. §§ 16-1201 *et seq.*

then-current franchise agreement, execute a release, and other such items. Most franchise agreements also require the franchisor to provide notice of a renewal or nonrenewal of the agreements. And many state statutes also require notice and/or good cause for nonrenewal.[125] If there is such a statute, the franchisee may have a claim if the franchisor fails to comply with the requirements.[126]

2. Other Contract Claims

Franchise agreements typically give rise to a host of contractual obligations. Although many of the express obligations set forth in a franchise agreement flow from the franchisee to franchisor, there are some express obligations or those implied by the covenant of good faith and fair dealing that give rise to various claims when breached by the franchisor. Such obligations may go to the very essence of the bargain, including, for example, the franchisor's obligation to provide support, training, advertising, products, territorial protection, and the like. Counsel should review the franchise agreement for any express and implied obligations. In addition, both pre-offer and post-offer materials (e.g., brochures and other similar communications) may bear on the nature and terms of the bargain. In the case of implied obligations, litigating such issues may implicate the parol evidence rule and the validity of merger and integration clauses. Counsel should also analyze any threats to terminate a franchise under anticipatory repudiation theories.

The majority of jurisdictions and the Restatement recognize the covenant of good faith and fair dealing. Courts in states that have embraced the implied duty of good faith and fair dealing do not hesitate to apply this duty in franchise situations, provided the claim is tethered to provisions in the franchise agreement and not attempting to create an altogether new contractual obligation.[127] It is possible that that Uniform Commercial Code (UCC) may also give rise to a duty of good faith in the manufacturer/distributor context.[128] However, courts have generally resisted franchisee efforts

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125. *See, e.g.*, Cal. Bus. & Prof. Code §§ 20025; Minn. Stat. § 80c.14(4); N.J. Rev. Stat. § 56:10-5; *see generally* Robert M. Einhorn & Craig R. Tractenberg, *Renewals and Conditions of Renewal*, ABA 27th Annual Forum on Franchising 7–13 (2004).

126. *See, e.g.*, Prudence Corp. v. Shred-It-Am., Inc., No. SACV 07–555–AG, 2008 WL 11342748, at *1–2 (C.D. Cal. Sept. 30, 2008), *aff'd*, 365 F. App'x 859 (9th Cir. 2010).

127. *See, e.g.*, TCBY Sys., Inc. v. RSP Co., 33 F.3d 925, 928–29 (8th Cir. 1994) (affirming the district court's instruction to the jury that the franchise agreement imposed a duty of good faith and fair dealing); Carvel Corp. v. Diversified Mgmt. Grp., Inc., 930 F.2d 228, 230–31 (2d Cir. 1991) (holding that the district court erred in failing to give an instruction on the implied duty of good faith in a distributorship agreement).

128. *See* E. Allen Farnsworth, *Duties of Good Faith and Fair Dealing under the UNIDROIT Principles, Relevant International Conventions, and National Laws*, 3 Tul. J. Int'l & Comp. L. 47, 52 (1995) (noting that over 50 UCC provisions specifically mention good faith). The UCC's definition of "good faith" is found in section 1-201(19) defined as "honesty in fact in the conduct or transaction concerned." U.C.C. § 1-201(19).

to engraft the UCC, along with its good faith and fair dealing provisions, to traditional franchises.[129]

3. Financial Performance Representation Claims

The question of how much money a franchisee can make is at the heart of any prospective franchisee's presale due diligence. Given this, the Federal Trade Commission (FTC) Franchise Rule permits a franchisor to provide certain financial information in Item 19 of its disclosure document.[130] Notwithstanding this, most franchisors historically eschewed providing financial performance information in their disclosure documents. Over time, however, this has changed, and more and more franchisors are now providing such disclosures, especially after the 2007 amendment to the Franchise Rule, which defines a "financial performance representation" (FPR) as:

> [A]ny representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.[131]

If the franchisor elects to provide an FPR to a prospective franchisee, it "must have a reasonable basis and [provide] written substantiation for the representation at the time the representation is made and must state the representation in the Item 19 disclosure," and also must identify the source and "material bases" of the information.[132] If, however, the franchisor decides not to provide this information, it must state in Item 19 that "[w]e do not make any representations about a franchisee's future financial performance or the past financial performance of company-owned or franchised outlets. We also do not authorize our employees or representatives to make any such representations either orally or in writing."[133]

Not surprisingly, franchisees' routinely assert claims based on a franchisor's alleged violations of the Franchise Rule, including that an Item 19 FPR was false, misleading, or omitted material information. Because there is no

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129. *See* McDonald's Corp. v. Watson, 69 F.3d 36, 43–44 (5th Cir. 1995) ("[B]ecause no Illinois law or contractual provision imposes the UCC's good faith obligation on the franchise relationship, we refuse to extend the UCC policy beyond the buyer/seller context."); Am. Casual Dining, L.P. v. Moe's Sw. Grill, L.L.C., 426 F. Supp. 2d 1356, 1369 (N.D. Ga. 2006) (declining to apply UCC to restaurant franchise and stating that "when a contract deals with both goods and services, the contract falls within the scope of the UCC only if the primary, or predominant, purpose of the agreement is the sale of goods").

130. 16 C.F.R. § 436.1. The "original" Franchise Rule, which was superseded by the "amended" Franchise Rule in 2007, also allowed a franchisor to provide "earnings" information, but in a much more limited manner than is now permitted.

131. 16 C.F.R. § 436.1(e).

132. 16 C.F.R. § 436.1(s)(3).

133. 16 C.F.R. § 436.1(s)(2).

private right of action for violations of the Franchise Rule,[134] claims alleging violations of Item 19 must be based on state common law theories or statutes. The most common claims are for intentional or negligent misrepresentation, fraudulent concealment or omission, violations of state disclosure statutes, or violations of statutory unfair trade practices acts (often referred to as "Little FTC Acts").[135] Such claims may be premised on any number of theories, including that the disclosed information was inaccurate, incomplete, misleading, or not representative of the performance of franchisees, or that the franchisor provided FPRs despite disclaiming that it was doing so in its disclosure document.

4. Market Withdrawal Claims

A franchisor's decision to withdraw from a market may give rise to a statutory claim or common law claim for breach of contract. For example, the PMPA includes statutory criteria for terminating or not renewing a franchise agreement based on a franchisor's withdrawal from a market.[136] Some states' relationship statutes either do or may proscribe or otherwise limit a franchisor's withdrawal from a market.[137]

5. Transfer Claims

The right to transfer or sell a franchise is often a major factor influencing a prospective franchisee's decision to purchase a franchise. Many state franchise relationship statutes specifically regulate transfers and impose limitations on a franchisor's right to refuse to consent to a transfer.[138] Moreover, even in the absence of such a statute, restrictions on the franchisee's right to transfer are generally narrowly construed and courts have held that the franchisor must exercise its discretion in reviewing a prospective transferee in good faith.

One such case is *Larese v. Creamland Dairies, Inc.*, where the Tenth Circuit held that a franchisor could not unreasonably withhold its consent to a

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134. *See, e.g.*, Yumilicious Franchise, LLC v. Barrie, No. 3:13-CV-4841-L, 2015 WL 2359504 (N.D. Tex. May 18, 2015) ("Courts in this and other circuits have recognized that there is no private right of action for violations of the [Franchise Rule]."), *aff'd*, 819 F.3d 170 (5th Cir. 2016); A Love of Food I, LLC v. Maoz Vegetarian USA, Inc., 70 F. Supp. 3d 376, 382 (D.D.C. 2014) (same).

135. For a thorough discussion of FPR claims, see Frank J. Sciremammano & Hon. Nicole S. Zellweger, *When Is a Lie Actionable? Litigating Misrepresentation Claims and the Requirement of Reasonable Reliance*, ABA 41st Annual Forum on Franchising (2018); Stuart Hershman, David Koch, Peter Lagarias & James Susag, *Advanced FPRs: Writing, Using, Attacking and Defending Financial Performance Representations*, Int'l Franchise Ass'n, 46th Annual Legal Symposium (2013); W. Michael Garner & Earsa R. Jackson, *Litigating Unlawful FPRs and Practical Tips for Doing So*, ABA 33rd Annual Forum on Franchising (2010).

136. 15 U.S.C. § 2802(b)(2)(E).

137. *See, e.g.*, Cal. Bus. & Prof. Code § 20025(e); *see also* Ark. Code § 4-72-204(a) (not listing market withdrawal as an occurrence constituting "good cause" for terminating a franchise).

138. *See, e.g.*, Ark. Code Ann. § 4-72-205(b), (c); Cal. Bus. & Prof. Code § 20027; Haw. Rev. Stat. § 482e-6(2)(I); Ind. Code § 23-2-2.7-2(3); Iowa Code § 523h.5; Mich. Comp. Laws § 445.1527(G); Minn. Stat. § 80c.14(5); Neb. Rev. Stat. § 87-405; N.J. Rev. Stat. § 56:10-6; Wash. Rev. Code §§ 19.100.030(1), 19.100.180(1), 2(h).

transfer when the franchise agreement contained a provision stating that the franchisee must obtain franchisor consent prior to the transfer.[139] The court relied on an implied requirement of reasonableness in reaching its holding, and stated that if the franchisor wanted an absolute right to disallow transfers, such a right must be expressly granted.[140]

On balance, however, franchisee claims that their franchisor unreasonably refused to consent to a transfer have generally not fared well provided the franchisor acted in good faith and there are legitimate business reasons for denying the prospective transferee and/or the transaction.[141] The cases are, of course, fact-specific and generally turn on the provisions in the franchise agreement and whether the franchisor acted reasonably.[142]

6. Common Law Fraud Claims

Claims based on material misrepresentations and omissions, whether intentional or negligent, are routinely asserted by franchisees. Typical fraud claims include, but are not limited to: (1) "earnings claims" (e.g., representations concerning revenues and/or profits (discussed above); (2) "success rate" or "failure rate" claims (e.g., claiming false success rates or omitting failure information); (3) working capital and overhead claims (e.g., underestimating the amount of the "estimated initial investment" set forth in Item 7 of the disclosure document; and (4) claims regarding the nature of the business to be franchised (misrepresenting the demand for services, need for specialized training, etc.).

Claims based solely on oral misrepresentations may be difficult to prove and frequently fail because of the parol evidence rule and/or provisions in a franchise agreement that require all understandings to be in writing (integration clauses) and that disclaim representations not contained in the agreement (no-reliance clauses).[143] However, there are exceptions to the parol

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139. 767 F.2d 716, 718 (10th Cir. 1985).

140. *Id.*

141. Dunkin' Donuts Inc. v. Sharif, Inc., 177 F. App'x 809, 811–14 (10th Cir. 2006); J.K.P. Foods, Inc., v. McDonald's Corp., 420 F. Supp 2d 966, 968–69 (E.D. Ark. 2006); Perez v. McDonald's Corp., 60 F. Supp. 2d 1030, 1032–35 (E.D. Cal. 1998); Burger King Co. v. H&H Rests., No. 99-2855, 2001 WL 1850888, at *4–6 (S.D. Fla. Nov. 30, 2001); Keating v. Baskin Robbins USA Co., No. 5:99-CV-148-BR(3), 2001 WL 407017, at *9–10 (E.D.N.C. Mar. 27, 2001); Zuckerman v. McDonald's Corp., 35 F. Supp. 2d 135, 144 (D. Mass. 1999); Cook v. Little Caesar Enters., Inc., 972 F. Supp. 400, 416–17 (E.D. Mich. 1997).

142. For a comprehensive discussion regarding transfers, see Phyllis Alden Truby & David A. Beyer, *Fundamentals 201: Transfers and Assignments in Franchising*, ABA 37th Annual Forum on Franchising (2014).

143. *See, e.g.*, Cook v. Little Caesar Enters., Inc., 210 F.3d 653, 659 (6th Cir. 2000) (franchisee's claim for violations of the Michigan Franchise Investment Law dismissed on summary judgment based on integration clause); Moxie Venture L.L.C. v. UPS Store, Inc., 156 F. Supp. 3d 967, 970 (D. Minn. 2016) (motion to dismiss franchisee's statutory fraud claims granted; "the Franchise Agreement firmly establishes that even if TUPSS made misrepresentations in connection with the sale of Moxie's franchise, Moxie did not rely upon any of them and, if it did (contrary to the express terms of the Franchise Agreement), such reliance was unreasonable as a matter of law"); JM Vidal, Inc. v. Texdis USA, Inc., 764 F. Supp. 2d 599, 623 (S.D.N.Y.

evidence rule in certain circumstances, and evidence of some types of presale *representations* (not promises) may be admissible to show that the agreement was fraudulently induced.[144]

2011) ("[T]he Franchise Agreement's express disclaimer, which specifically warrants that JMV did not rely on any representation regarding the potential success of its franchise, precludes JMV from proving that it reasonably relied on Gomez's alleged statement (or others like it), just as it precludes JMV from proving reasonable reliance in the context of its WFIPA fraud claims."); Motor City Bagels, LLC v. Am. Bagel Co., 50 F. Supp. 2d 460, 471–72 (D. Md. 1999) (franchisor's motion for summary judgment granted on franchisee's Indiana Franchise Act claim based on integration clause in franchise agreement and disclaimer in UFOC (predecessor disclosure document to the FDD)); Carlock v. Pillsbury Co., 719 F. Supp. 791, 828–29 (D. Minn. 1989) (franchisee's claims for fraudulent inducement based on presale earnings representations dismissed on summary judgment because no justifiable reliance); *but see* Cluck-U Chicken, Inc. v. Cluck-U Corp., 358 F. Supp. 3d 1295, 1311 (M.D. Fla. 2017) ("disclaimers in the franchise disclosure document and the franchise agreement remain factually relevant and may persuade the jury on the issues of materiality of the alleged misrepresentations and omissions and the reasonableness of Plaintiffs' reliance on them"); Long John Silver's Inc. v. Nickleson, 923 F. Supp. 2d 1004, 1021 (W.D. Ky. 2013) (stating that "[a] broadly-worded, strategically placed disclaimer should not negate reliance as a matter of law where A & W allegedly shared objectively false data to induce Defendant to enter into the Franchise Agreement" and denying franchisor's motion for summary judgment); Randall v. Lady of Am. Franchise Corp., 532 F. Supp. 2d 1071, 1086 (D. Minn. 2007) (denying franchisor's motion for summary judgment based on the "no earnings claim" disclaimer and stating that "[g]eneral disclaimers and integration clauses are given no effect . . . under Minnesota law"); Burgo v. Lady of Am. Franchise Corp., Bus. Franchise Guide (CCH) ¶ 13,430 (C.D. Cal. Sept. 7, 2006) (stating that anti-waiver provision in California Franchise Investment Law [Cal. Corp. Code § 31512] "makes merger and integration clauses and disclaimers of franchise agreements, void, thus rendering the parol evidence rule inapplicable to the instant case" and denying franchisor's motion to dismiss); Ramada Franchise Sys., Inc. v. Tresprop, Ltd., 188 F.R.D. 610, 616 (D. Kan. 1999) (denying franchisor's motion to dismiss and stating that "boilerplate merger and integration clauses do not 'specifically' disclaim reliance on [franchisor's] oral representations during the negotiations").

144. *See* Juarez v. Jani-King of Cal., Inc., No. 09-3495 SC, 2012 WL 177564, at *6 (N.D. Cal. Jan. 23, 2012) (The fraud exception does not apply where "the alleged oral promises directly contradict the terms of a written agreement. . . . To be admissible, parol evidence 'must tend to establish some independent fact or representation, some fraud in the procurement of the instrument or some breach of confidence concerning its use, and not a promise directly at variance with the promise of the writing.'") (citations omitted); Leung v. Sumitomo Corp. of Am., No. C 09-05825 SI, 2010 WL 816642, at *5 (N.D. Cal. Mar. 9, 2010) ("'[T]he parol evidence rule applicable to contract disputes ha[s] no force in a tort action alleging fraudulent misrepresentation in the inducement to execute an agreement.'") (citations omitted); Luso Fuel, Inc. v. BP Prods. N. Am., Inc., No. 08–CV–3947 (DMC), 2009 WL 1873583, at *6 (D.N.J. June 29, 2009) ("the parol evidence rule includes an exception that allows the introduction of extrinsic evidence to prove fraud in the inducement . . ."); It's Just Lunch Int'l, LLC v. Polar Bear, Inc., No. Civ. 03-2485 WQH(JFS), 2004 WL 3406117, at *3 (S.D. Cal. Apr. 29, 2004) ("It is well established that the promissory fraud limitation on the fraud exception to the parol evidence rule does not preclude evidence of misrepresentations of fact in connection with claims of fraud in the inducement."); *see generally* Christina Fugate, George Gasper & Paul Schmitt, *Protecting Your Franchise Agreement: Understanding Exceptions to the Parol Evidence Rule*, 37 Franchise L.J. 507 (2018).

7. Encroachment Claims

In some circumstances a franchisee may have a potential claim for "encroachment."[145] This includes traditional bricks-and-mortar encroachment, such as when a franchisor opens a corporate location or grants franchise rights to a competing franchisee in or in close proximity to another franchisee's territory. Or the encroachment may be through e-commerce or alternative distribution arrangements (e.g., food or beverage sales in supermarkets). In all events, the success of these claims will usually depend on language in the franchise agreement and whether an applicable state franchise relationship statute regulates territorial and encroachment issues.

a. Common Law Claims

Some courts have held that a franchisor may be liable for encroachment based on a breach of the covenant of implied duty of good faith and fair dealing theory. The success or failure of such claims is largely dependent on the provisions (or absence thereof) in the franchise agreement. The most well-known cases in which a franchisee was successful in asserting a claim for encroachment are *Scheck v. Burger King Corp.* and *In re Vylene Enterprises, Inc*.[146] In most cases, however, encroachment claims are unsuccessful in large part based on a strict reading of the provisions of the franchise agreement.[147]

b. Statutory Claims

Several states have implemented statutes that expressly or indirectly regulate franchise territory issues and encroachment to one degree or another.[148] Thus, a franchisee may also have a claim for encroachment under these statutes or industry-specific encroachment regulations (e.g., motor vehicle statutes).

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145. For a discussion of encroachment issues, see Charles S. Marion, Daniel J. Oates & Ari N. Stern, *Stepping on Toes: Territorial Rights and Encroachment*, ABA 42nd Annual Forum on Franchising (2019); Deborah S. Coldwell, *2019 Judicial Update—Encroachment*, Int'l Franchise Ass'n, 52nd Annual Legal Symposium (2019); Jennifer Dolman, Scott Korzenowski & Erick Wulff, *Stop Invading My Space: Encroachment Issues in Franchising*, Int'l Franchise Ass'n, 51st Annual Legal Symposium (2018).

146. Scheck v. Burger King Corp., 756 F. Supp. 543, 548–49 (S.D. Fla. 1991); Scheck v. Burger King Corp., 798 F. Supp. 692, 697 (S.D. Fla. 1992); *In re* Vylene Enters., Inc., 90 F.3d 1472, 1477 (9th Cir. 1996).

147. *See, e.g.*, Burger King Corp. v. Weaver, 169 F.3d 1310, 1318 (11th Cir. 1999); Clark v. America's Favorite Chicken Co., 110 F.3d 295, 297–98 (5th Cir. 1997); Davis v. McDonald's Corp., 44 F. Supp. 2d 1251, 1257–59 (N.D. Fla. 1998); Cook v. Little Caesar Enters., Inc., 972 F. Supp. 400, 409–10 (E.D. Mich. 1997); *cf.* Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp., 139 F.3d 1396, 1403–05 (11th Cir. 1998) (denying Sheraton's motion for summary judgment and noting that the covenant of good faith and fair dealing would not have prohibited Sheraton from licensing a competing franchise "directly across the street" from the plaintiff, but the franchise agreement was silent regarding Sheraton's right to operate a competitive hotel in close proximity to plaintiff's hotel).

148. *See* Fla. Stat. § 817.416(2)(a); Haw. Rev. Stat. § 482E-6; Ind. Code § 23-2-2.7-1; Iowa Code §§ 523H.1, 537A.10(6); Minn. Stat. § 80C.14(1); Minn. R. 2860.4400(C); Wash. Rev. Code § 19.100.180(2)(f); Wis. Stat. § 135.03.

8. Registration/Disclosure Claims

The Federal Trade Commission mandates certain disclosure requirements for franchisors. In 2007, the FTC issued a revised set of disclosure requirements, commonly referred to as the Amended Franchise Rule, which became mandatory for franchisors on July 1, 2008.[149] The Amended Franchise Rule requires a franchisor to provide prospective franchisees with 23 specific categories of pertinent information in a Franchise Disclosure Document (FDD) before the parties enter into the franchise relationship.[150] Although the Amended Franchise Rule does not provide for a private right of action,[151] franchisees are often able to assert claims based on alleged violations of the Rule under various common law fraud theories and state deceptive trade practices statutes (frequently referred to as "Little FTC Acts").[152] Not surprisingly, there are numerous cases involving claims based on a franchisor's alleged improper disclosures or total failure to disclose required information.[153]

To the extent they are applicable, the various Little FTC Acts may be particularly useful for potential claimants in light of the enhanced damages that many of them provide.[154] For example, some Little FTC Acts provide for treble damages.[155] Many of the statutes also provide for statutory attorneys' fees.[156] Under certain Little FTC Acts, the failure to comply with the Amended Franchise Rule may constitute a per se violation of the statute itself.[157] Even if not a per se violation, franchisees may still be able to argue

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149. *See* 72 Fed. Reg. 15,444 (Mar. 30, 2007).

150. *Id.*

151. *See* Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities; Final Rule, 72 Fed. Reg. 15,444, 15,478 n.350 (Mar. 30, 2007) (providing FTC Statement of Basis and Purpose) ("We note that there is no private right of action to enforce the Franchise Rule."); *see also* Robinson v. Wingate Inns Int'l, Inc., Civil Action No. 13-cv-2468, 2013 WL 6860723, at *2 (D.N.J. Dec. 20, 2013) ("It is well-settled that there is no private cause of action for violation of the FTC franchise disclosure rules.").

152. *See, e.g.*, Cal. Bus. & Prof. Code §§ 17200 *et seq.*; Ohio Rev. Code §§ 1334.01 *et seq.*; Tex. Bus. & Com. Code §§ 41.001 *et seq.*

153. *See* cases cited in John D. Holland, Deborah Coldwell & David M. Byers, *Litigating Disclosure Claims*, ABA 31st Annual Forum on Franchising (2008).

154. *See* Bethany L. Appleby, Robert S. Burnstein & John M. Doroghazi, *Cause of Action Alchemy: Little FTC Act Claims Based on Alleged Disclosure Violations*, 36 Franchise L.J. 429 (2017); Altresha Q. Burchett-Williams, Robert M. Einhorn & Paula J. Morency, *Claims under the "Little FTC Acts": The High Stakes of Risk and Reward*, ABA 33rd Annual Forum on Franchising (2010).

155. *See, e.g.*, Ohio Rev. Code § 1345.09 (providing for treble damages); Tex. Bus. & Com. Code § 17.50 (same).

156. *See, e.g.*, Fla. Stat. § 501.2105 (providing for attorneys' fees).

157. *See, e.g.*, KC Leisure, Inc. v. Haber, 972 So. 2d 1069, 1073–75 (Fla. Dist. Ct. App. 2008) (franchisor's alleged violation of Franchise Rule supports claim for violation of Florida's Little FTC Act); Morgan v. Air Brook Limousine, Inc., 510 A.2d 1197, 1205–07 (N.J. Super. 1986) (franchisor's failure to provide disclosure document constitutes per se violation of New Jersey Consumer Fraud Act); *but see* 859 Boutique Fitness LLC v. Cyclebar Franchising, LLC, No. 5:16-CV-018-KKC, 2016 WL 2599112, at *1 (E.D. Ky. May 5, 2016) (franchisee's claim for violations of the Kentucky Consumer Protection Act (KCPA) based on alleged FTC Rule violation fails because KCPA only applies to goods and services purchased for household use); Family Wireless #1, LLC v. Auto. Techs., Inc., No. 15-CV-1310 (JCH), 2016 WL 183475, at *5 n.17 (D.

that a franchisor's failure to follow the Amended Rule constitutes an unfair or deceptive trade practice.[158]

Certain required disclosure items under the prior version of the FTC's Franchise Rule proved to be particularly fertile grounds for franchisee disclosure claims.[159] As the Amended Franchise Rule does not substantively change these requirements, these items continue to be particularly scrutinized by franchisees. These include FDD Item 7 (estimated initial investment),[160] Item 8 (restrictions on sources of product and services),[161] and Item 19 (financial performance representations).[162] These, along with other franchisor disclosures, may provide the basis for a fraud or misrepresentation based deceptive business practices claim.

9. Breach of Fiduciary Duty Claims

Courts have all but universally held that a franchisor/franchisee relationship does not create a fiduciary duty.[163] However, in particularly compelling and

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Conn. Jan. 14, 2016) ("[T]he Pennsylvania Unfair Trade Practices and Consumer Protection Law . . . do[es] not apply to the sale of franchises."); St. Martin v. KFC Corp., 935 F. Supp. 898, 907 (W.D. Ky. 1996) ("Because Congress did not intend to permit a private cause of action under the FTC Act and regulations, plaintiffs cannot invoke KRS 446.070 to create this type of private right."); Symes v. Bahama Joe's, Inc., No. CIV.A. 87-0963-Z, 1988 WL 92462, at *5 (D. Mass. Aug. 12, 1988) (holding that a violation of the FTC Rule does not necessarily result in a violation of the Massachusetts Little FTC Act).

158. *See, e.g.*, Edible Arrangements Int'l, Inc. v. Notaris, Bus. Franchise Guide (CCH) ¶ 13,487 (C.D. Cal. Oct. 19, 2006).

159. *See* Holland et al., *supra* note 153.

160. 16 C.F.R. § 436.5(g) (requiring franchisors to provide certain estimated expenditures associated with starting up the franchised business).

161. 16 C.F.R. § 436.5(h) (requiring disclosure of requirement to purchase supplies or other items from the franchisor or the franchisor's approved sources).

162. 16 C.F.R. § 436.5(s) (stating that a franchisor is not required to give earnings projections, but if it does, it must have a "reasonable basis and written substantiation" for the representations).

163. *See, e.g.*, Broussard v. Meineke Discount Muffler Shops, Inc., 155 F.3d 331, 347–49 (4th Cir. 1998) ("By all lights, Meineke franchisees are independent, sophisticated, if sometimes small, businessmen who dealt with Meineke at arms' length and pursued their own business interests. . . . [T]hese circumstances do not give rise to a fiduciary relationship."); Original Great Am. Chocolate Chip Cookie Co., Inc. v. River Valley Cookies, Ltd., 970 F.2d 273, 280 (7th Cir. 1992) ("parties to a contract are not each other's fiduciaries—even if the contract is a franchise") (citations omitted); O'Neal v. Burger Chef Sys., Inc., 860 F.2d 1341, 1349 (6th Cir. 1988) ("in general, franchise agreements do not give rise to fiduciary or confidential relationships between the parties. This observation is in accordance with the vast majority of courts which have considered this issue"); Boat & Motor Mart v. Sea Ray Boats, Inc., 825 F.2d 1285, 1292 (9th Cir. 1987) ("The relation between a franchisor and a franchisee is not that of a fiduciary to a beneficiary."); Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698, 711 (7th Cir. 1984) ("The common law of Wisconsin does not make the franchisor a fiduciary of his franchisees."); Coca-Cola Bottling Co. of Elizabethtown, Inc. v. Coca-Cola Co., 696 F. Supp. 57, 73–75 (D. Del. 1988) (collecting cases and holding that a franchise relationship does not give rise to a fiduciary duty); *see also* William L. Killion, Annotation, *Existence of Fiduciary Duty between Franchisor and Franchisee*, 52 A.L.R.5th 613 (1997).

unique circumstances, some courts have not ruled out the possibility that a franchisor may owe a fiduciary duty to a franchisee.[164]

10. Antitrust Claims

For many years, federal antitrust laws and to a much lesser extent state antitrust laws played a central role in governing certain aspects of the franchisor-franchisee relationship. Although expensive and often time-consuming to prove, federal price-fixing, tying, and price-maintenance claims were, if not common, at least not unusual. However, this all began to change beginning with the Supreme Court's 1977 decision in *Continental T.V., Inc. v. GTE Sylvania, Inc.* in which the court held that vertical customer or territorial restraints would be evaluated by the "rule of reason" and were no longer per se illegal.[165]

In the 30 years after *GTE Sylvania,* the Supreme Court issued a series of decisions that further eroded the applicability of antitrust laws to the franchisor-franchisee relationship.[166] These decisions and lower courts' application of them have resulted in dramatically circumscribed circumstances in which franchisee antitrust claims are potentially viable.[167]

V. Defenses

Defenses typically asserted by a franchisee include: (1) procedural defenses, such as lack of personal jurisdiction; (2) statutory defenses to termination claims; (3) defenses to trademark infringement claims; (4) defenses to breach of contract claims, such as fraud in the inducement, challenges to liquidated damages clauses, and challenges to claims for lost future royalties. Defenses

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164. *See, e.g.*, Manhattan Motorcars, Inc. v. Automobili Lamborghini, S.p.A., 244 F.R.D. 204, 219–20 (S.D.N.Y. 2007) (dealer's allegation that the distributor had "the authority to exercise near life and death economic power over [Manhattan] . . . , [including] requiring [Manhattan] to provide reports to [Lamborghini] concerning sales, inventories, customer data, and all information concerning [Manhattan]'s business . . . ." was sufficient to withstand motion to dismiss breach of fiduciary duty claim).

165. 433 U.S. 36 (1977) (overruling United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967)).

166. *See* Jefferson Parish Hosp. Dist. No. 2. v. Hyde, 466 U.S. 2 (1984) (limiting per se liability for tying arrangements); State Oil v. Khan, 522 U.S. 3 (1997) (in the absence of "market power," vertical maximum resale price restrictions subject to the rule of reason test); Ill. Tool Works, Inc. v. Indep. Ink, Inc., 547 U.S. 28 (2006) ("[I]n all cases involving a tying arrangement [including those in which the tying product is patented], the plaintiff must prove that the defendant had market power in the tying product."); Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (minimum retail price maintenance restrictions subject to the rule of reason test).

167. For a detailed discussion regarding the impact of the Supreme Court's decisions, starting with *GTE Sylvania*, on the franchisor-franchisee relationship and potential franchisee claims, see Robert T. Joseph, *Antitrust Law, Franchising, and Vertical Restraints*, 31 Franchise L.J. 3 (2011); Allan P. Hillman & Michael K. Lindsey, *The Fallout Eight Years after* Leegin*: When and Where Can Franchisors Fix the Prices Charged by Franchisees?*, ABA 38th Annual Forum on Franchising (2015); *see also* Allan P. Hillman & Kay L. Brumbaugh, *Fundamentals 201: Antitrust Essentials for Franchise Lawyers*, ABA 35th Annual Forum on Franchising (2012).

typically asserted by a franchisor include: (1) procedural defenses, such as forum selection and choice of law clauses, mediation or arbitration provisions, and statutes of limitation, statutes of repose, and contractual periods of limitation; (2) defenses to fraud claims, such as the parol evidence rule; and (3) defenses to fraud in the inducement claims.

Some defenses can be raised by motion, some by separate defense, and some by both. This chapter does not address issues relating to waiver of defenses or the overlap between defenses and affirmative claims. The following discussion analyzes some common defenses asserted by franchisees and franchisors, but note that, depending on the posture of the case, some franchisee defenses may be helpful for franchisors and vice versa. For example, franchisees often assert lack of personal jurisdiction as a defense when facing a claim brought by a franchisor in a foreign state based on a forum selection clause, but lack of personal jurisdiction may also be asserted by a franchisor defending a claim brought in a franchisee's home state.

A. Defenses Typically Asserted by Franchisees

1. Procedural Defenses

Franchise agreements often contain forum selection clauses mandating suit in the franchisor's home state. An obvious defense for a franchisee that finds itself sued in a foreign state is asserting lack of personal jurisdiction.

For instance, if a franchisee is faced with suit in a foreign jurisdiction, in a state where the franchisor is a *nonresident*, a franchisee should raise the U.S. Supreme Court's decision in *Bristol-Myers Squibb Co. v. Supreme Court of California, San Francisco County*.[168] There, the Court built on its 2011 decision in *Goodyear Dunlop Tires Operations, S.A. v. Brown* and ruled that in order to obtain specific jurisdiction over a defendant, a nonresident plaintiff's claims must have a sufficient connection to the underlying forum.[169] There must be an "activity or an occurrence that takes place in the forum State and is therefore subject to the State's regulation."[170] Therefore, in that case the Court ruled there was no specific personal jurisdiction.[171] In essence, a franchisor cannot choose to file suit in just any favorable jurisdiction; its claims must have a connection to the forum.[172]

168. 137 S. Ct. 1773 (2017).

169. *Id.* at 1782.

170. *Id.* at 1780 (quoting Goodyear Dunlop Tires Operations, S.A. v. Brown, 564 U.S. 915, 919 (2011)).

171. *Id.* at 1782.

172. The *Bristol-Myers Squibb* decision also presents a defense for a *franchisor* faced with a franchisee mass action brought by residents of many different states. In *Bristol-Myers*, instead of bringing suit where they could obtain general jurisdiction over defendant, primarily nonresident plaintiffs from multiple different states brought suit in California. *Id.* at 1777. The Court ruled that the nonresident plaintiffs' claims did not have a sufficient link to the forum. *Id.* at 1782. This decision is likely to impact plaintiff forum-shopping, and both franchisees and franchisors are advised to keep it in mind when selecting venue for suit.

One of the seminal Supreme Court cases regarding personal jurisdiction arose in the context of a franchisee challenging the personal jurisdiction of Florida courts. In *Burger King v. Rudzewicz*, the Court held that Florida's exercise of personal jurisdiction over a Michigan-based franchisee did not offend due process.[173] The Court specifically identified several features of the franchise relationship that justified Florida's exercise of personal jurisdiction.[174] The Court concluded that the franchisee deliberately contacted a Florida corporation, Burger King, and negotiated the purchase of a franchise from that corporation.[175] The Court noted the 20-year term of the franchise agreement and the "exacting regulation" of the franchisee's business by the Florida-based Burger King.[176] The Court further explained that the franchisee's refusal to make royalty payments to Florida and his continued use of Burger King's trademarks after the termination of his franchise meant that it was reasonable that he should foresee being sued in Florida for those actions.[177] The Court also noted the various contractual provisions between the parties that involved Florida, such as where to send payments and notices.[178] Finally, the Court held that the Florida choice-of-law provision in the franchise agreement should be considered a factor in deciding whether the franchisee purposefully invoked Florida's jurisdiction.[179]

Other courts have held that franchisees are subject to the jurisdiction of the franchisor's home state.[180] However, sometimes franchisees can successfully assert a lack of personal jurisdiction defense.[181] For example, in *Lee's Famous Recipes, Inc. v. Fam-Res, Inc.*, an Indiana franchisee was able to obtain a dismissal of the Florida-based franchisor's complaint in Florida based on lack of personal jurisdiction.[182] The court stated that it was not enough that the franchisee merely entered into a franchise agreement with a Florida company.[183] It was significant to the court that the franchisee's relationship with the Florida company began when the Florida company acquired another company that had been the franchisee's franchisor.[184] The franchise agreements were originally negotiated between the franchisee and a Tennessee company, and included a Tennessee forum selection clause.[185] The court held that the Florida franchisor's unilateral action of acquiring the Tennessee-

173. 471 U.S. 462, 487 (1985).

174. *Id.* at 478–82.

175. *Id.* at 479.

176. *Id.* at 480.

177. *Id.*

178. *Id.* at 480–81.

179. *Id.* at 481–82.

180. *See, e.g.*, Johnson v. Schlotzsky's, Inc., No. 03-03-00468-CV, 2003 WL 22964291, at *1, *4–5 (Tex. App.–Austin Dec. 18, 2003, no pet.) (holding that a Nebraska-based Schlotzsky's franchisee was subject to personal jurisdiction in Texas).

181. *See, e.g.*, Protocol, LLC v. Henderson, 18 F. Supp. 3d 689, 704 (M.D.N.C. 2014), *as amended* (May 15, 2014).

182. 2007 WL 1451808, at *1, *5 (N.D. Fla. May 15, 2007).

183. *Id.* at *4.

184. *Id.*

185. *Id.*

based franchisor was not enough to show that the franchisee directed any activity toward Florida sufficient to satisfy the minimum contacts test.[186]

Whether forum selection clauses are enforceable often depends upon a particular state's franchise laws. For example, forum selection clauses in franchise agreements are invalid in California pursuant to the California Franchise Relations Act,[187] but such clauses are enforceable in Missouri.[188]

2. Defenses to Termination Claims

Often, specific franchise-protection statutes contain provisions that may provide franchisees with defenses to franchisors' termination claims. For example, the California Franchise Relations Act and the Illinois Franchise Disclosure Act provide a statutory "good cause" requirement for terminating franchises.[189] Moreover, under the New Jersey Franchise Practices Act, it is a violation "to cancel a franchise for any reason other than the franchisee's substantial breach, even if the franchisor acts in good faith and for a bona fide reason."[190] Applying this principle in *Westfield Centre Service, Inc. v. Cities Service Oil Co.*, the New Jersey Supreme Court held that a franchisor was liable under the New Jersey Franchise Practices Act when it terminated a franchisee whose chosen location, the franchisor believed, was not "economically feasible."[191] The court reasoned that good faith business decisions do not in and of themselves constitute "good cause" to justify termination.

3. Defenses to Claims for Trademark Infringement and Related Claims

The Lanham Act sets forth nine statutory defenses to a claim for trademark infringement, including, among others, abandonment of the trademark, that the trademark is functional, and equitable defenses such as laches and estoppel.[192] For abandonment, "[c]ourts have consistently held that trademark nonuse must be intentional to constitute abandonment."[193] Abandonment can

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186. *Id.*

187. Cal. Bus. & Prof. Code § 20040.5; *see also* Kubis & Perszyk Assocs., Inc. v. Sun Microsystems, Inc., 680 A.2d 618, 626 (N.J. 1996) (forum selection clauses presumptively invalid under the New Jersey Franchise Practices Act).

188. Minuteman Press Int'l, Inc. v. Hoffman, 826 S.W.2d 34, 37 (Mo. Ct. App. W.D. 1992).

189. Cal. Bus. & Prof. Code § 20020; 815 Ill. Comp. Stat. 705/19. See Judy Marsh, Eunice Nakamura & Leslie Smith, *Basics Track: Handling Defaults and Terminations*, Int'l Franchise Ass'n, 50th Annual Legal Symposium (2017), for a further discussion of "good cause" requirements, and see also David C. Gurnick, Frederick F. Simmons & C. Griffith Towle, *Incurable Defaults and Good Cause Requirements—Can Sound Drafting Reconcile the Two?*, Int'l Franchise Ass'n, 43rd Annual Legal Symposium (2010), for a compendium of state franchise statutes requiring "good cause" for termination or nonrenewal of a franchise.

190. *See* Gen. Motors Corp. v. Gallo GMC Truck Sales, Inc., 711 F. Supp. 810, 816 (D.N.J. 1989).

191. 432 A.2d 48, 51–52, 56–57 (N.J. 1981); *but see* Iowa Code § 537A.10(7)(a) ("good cause" for termination is "cause based upon a legitimate business reason").

192. 15 U.S.C. § 1115(b).

193. Lone Star Steakhouse & Saloon, Inc. v. Alpha of Va., Inc., 43 F.3d 922, 931 (4th Cir. 1995); *see also* 3 Rudolph Callmann, Unfair Competition, Trademarks, and Monopolies § 19.65 (4th ed. 1992).

also occur when an owner's actions cause the trademark to become generic.[194] As for functionality, "[t]he doctrine of functionality is intended to permit the general use of features having value independent of identification; and the functionality of the copied feature supplies an explanation for the copying other than merely trading on the plaintiff's goodwill."[195] State trademark laws often contain defenses similar, if not identical, to the defenses to a Lanham Act claim.[196] Finally, equitable defenses such as laches are a defense to trademark infringement.[197]

4. Defenses to Claims for Damages for Breach of the Franchise Agreement

a. Fraud in the Inducement

Fraudulent inducement defenses can be difficult for franchisees to assert successfully if the franchise agreement contains a "merger" or "integration" clause that specifies that all prior understandings or agreements between the parties are superseded by the agreement.[198] Many franchise agreements also contain disclaimers of reliance (so-called "no-reliance" clauses) regarding representations not set forth in the agreement.[199] However, courts have held

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194. 15 U.S.C. § 1127 (defining abandonment of a trademark as occurring when there has been discontinued use coupled with intent not to resume such use or when the owner's use causes the trademark to become generic).

195. *Developments in the Law—Competitive Torts*, 77 Harv. L. Rev. 908, 918 (1964).

196. *See* Int'l Trademark Ass'n, 2007 Model State Trademark Bill § 1(i) (defining trademark abandonment as occurring when there is (1) discontinued use plus intent not to resume, or (2) a course of conduct that causes a mark "to lose its significance as a mark"). Almost all 50 states have adopted some version of the various Model State Trademark Bills enacted between 1949 and 2007. *See* J. Thomas McCarthy, 3 McCarthy on Trademarks and Unfair Competition § 22:5 (5th ed. 2020).

197. *See*, *e.g.*, Prudential Ins. Co. of Am. v. Gibralter Fin. Corp. of Cal., 694 F.2d 1150, 1152 (9th Cir. 1983) (plaintiff's claims barred by laches because it failed to sue after defendant had used the trademark in question for 28 years).

198. *See*, *e.g.*, Steak 'n Shake Enters., Inc. v. Globex Co., LLC, 110 F. Supp. 3d 1057, 1082 (D. Colo. 2015), *aff'd*, 659 F. App'x 506 (10th Cir. 2016) (Under Colorado law, "[w]here the integration clause contains the requisite specific language, it is sufficient to preempt a misrepresentation claim as a matter of law."); Jackson Hewitt, Inc. v. Childress, No. CIVA 06-CV-0909 DMC, 2008 WL 834386, at *11–12 (D.N.J. Mar. 27, 2008); Papa John's Int'l, Inc. v. Dynamic Pizza, Inc., 317 F. Supp. 2d 740, 745 (W.D. Ky. 2004) ("[I]f any misrepresentations fraudulently induced Defendants into entering the Development Agreement, *i.e.*, misrepresentations made prior to the signing of the agreement, the merger and integration clause prevents this action from being brought."); *but see* Altruist, LLC v. Medex Patient Transp., LLC, 308 F. Supp. 3d 943, 950–51 (M.D. Tenn. 2018) (stating that "there is no rule that a merger clause makes reliance on oral representations unreasonable *per se* so as to necessarily defeat a fraudulent inducement or promissory fraud claim") (internal citations omitted).

199. *See* Interim Healthcare Inc. v. Health Care@Home, LLC, No. 17-CV-61378, 2019 WL 1506707, at *12 (S.D. Fla. Mar. 20, 2019) (holding that plaintiff's fraud in the inducement claim failed based on the warranties and representations it made in the franchise agreement, including in the "no-reliance" clause warranting that it was not relying on any representations made outside of the agreement); Sears Home Appliance Showrooms, LLC v. Charlotte Outlet Store, LLC, No. 17 CV 8478, 2018 WL 3068459, at *7 (N.D. Ill. June 21, 2018) ("[W]hile a no-reliance clause may effectively ward off a fraudulent misrepresentation claim, Illinois courts have suggested that a no-reliance clause will not bar a fraudulent concealment claim unless the clause

on occasion that these disclaimers are not effective to bar evidence of fraudulent inducement.[200]

b. Liquidated Damages Clauses

Liquidated damages clauses are sometimes enforceable but are also subject to being stricken by some courts as unenforceable penalties,[201] and may run afoul of state franchise protection laws.[202] However, as noted, courts often uphold liquidated damages clauses in franchise agreements, particularly in hotel agreements.[203]

c. The *PIP v. Sealy* Issue

As discussed above in section IV.A.1.c.4., in *Postal Instant Press, Inc. v. Sealy*, a California Court of Appeal held that a franchisor could not recover lost future royalties on the basis that the franchisor's decision to terminate the franchise agreement was the proximate cause of its "harm," as opposed to the franchisee's failure to pay past royalties.

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specifically references omissions."); Prince Heaton Enters., Inc. v. Buffalo's Franchise Concepts, Inc., 117 F. Supp. 2d 1357, 1361–62 (N.D. Ga. 2000) (finding, in the context of a fraud claim, that plaintiffs could not show justifiable reliance on alleged statements by franchisor when they had "expressly agreed they would not rely on representations made by Defendants").

200. *See*, *e.g.*, Randall v. Lady of Am. Franchise Corp., 532 F. Supp. 2d 1071, 1086 (D. Minn. 2007) (holding that general disclaimers of reliance are given no effect in misrepresentation cases under Minnesota law and that even specific disclaimers present a jury question rather than negating reliance as a matter of law); *but see* Ellering v. Sellstate Realty Sys. Network, Inc., 801 F. Supp. 2d 834, 845 (D. Minn. 2011) (holding, in the context of a claim under the Minnesota Franchise Act, that "as a matter of law, . . . Plaintiffs cannot show reasonable reliance upon the alleged misrepresentations" in the face of a no-reliance clause).

201. *See*, *e.g.*, Leisure Sys., Inc. v. Roundup, LLC, No. 1:11-CV-384, 2012 WL 5378302, at *19 (S.D. Ohio Oct. 31, 2012) (finding that stipulated damages under franchise agreements "operate[d] as an unenforceable penalty"); Shree Ganesh, Inc. v. Days Inn Worldwide, Inc., 192 F. Supp. 2d 774, 785–87 (N.D. Ohio 2002) (striking a liquidated damages clause in a hotel franchise agreement because it was at extreme variance with the amount of damages actually sustained).

202. *See* Holiday Hospitality Franchising, Inc. v. H-5, Inc., 165 F. Supp. 2d 937, 940 (D. Minn. 2001) ("There is no question that the Minnesota Franchise Act precludes liquidated damages for premature termination of the franchise license agreement."). Note, however, that just because a state franchise law precludes enforcement of a liquidated damages clause does not mean that damages such as lost profits would not be recoverable. *See id.* (noting that even though the Minnesota Franchise Act precluded liquidated damages, a franchisor could still seek lost profits as part of its contractual damages).

203. *See*, *e.g.*, Red Lion Hotels Franchising, Inc. v. First Capital Real Estate Invests., LLC, No. 2:17-CV-145-RMP, 2018 WL 4259241, at *5–6 (E.D. Wash. Sept. 6, 2018); Radisson Hotels Int'l, Inc. v. Majestic Towers, Inc., 488 F. Supp. 2d 953, 960–61 (C.D. Cal. 2007); Best W. Int'l, Inc. v. Oasis Invs., L.P., 398 F. Supp. 2d 1075, 1080–81 (D. Ariz. 2005); Ramada Franchise Sys., Inc. v. Hanna Hotel Enters., LLC, 147 F. Supp. 2d 840, 848–49 (N.D. Ohio 2001).

B. Defenses Typically Asserted by Franchisors

1. Procedural Defenses

a. Forum Selection Clauses

Forum selection clauses in franchise agreements are often found to be enforceable.[204] As discussed above, however, sometimes courts have found that these clauses run afoul of a particular state's franchise protection laws.[205] "Mandatory" forum selection clauses, as opposed to "permissive" forum selection clauses, require an action to be dismissed if it is brought in the incorrect forum.[206]

b. Choice of Law Clauses

Franchisors seeking to avoid inconvenient laws or legal precedent often specify favorable governing law in the franchise agreement. The principle of freedom of contract underlies the public policy of many states, mandating enforcement of valid choice of law clauses.[207] However, many states' franchise statutes contain anti-waiver provisions dictating that the application of a particular state's franchise laws cannot be contracted around or waived.[208] In such situations, courts have generally held that franchisors cannot avoid application of protectionist state franchise statutes.[209] In *Wright-Moore Corp. v. Ricoh Corp.*, for example, the Seventh Circuit examined the anti-waiver provision in Indiana's franchise statute and stated: "The public policy, articulated in the nonwaiver provisions of the statute is clear: a franchisor, through its superior bargaining power, should not be permitted to force the franchisee to waive the legislatively provided protections, whether directly through waiver provisions or indirectly through choice of law."[210]

In addition, despite a governing law provision, a court's choice of law analysis may dictate that the provision will be unenforceable if it violates

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204. *See*, *e.g.*, Williams v. Aire Serv., LLC, No. 1:18-CV-099-NT, 2018 WL 4955198, at *6 (D. Me. Oct. 12, 2018); Luv2BFit, Inc. v. Curves Int'l, Inc., No. 06 CV 15415 (CSH), 2008 WL 4443961, at *1 (S.D.N.Y. Sept. 29, 2008); Moss v. Curves Int'l, Inc., No. 06-21876-CIV, 2007 WL 9703132, at *1 (S.D. Fla. Apr. 19, 2007); Zaks v. TES Franchising, No. 3:01cv2266 (JBA), 2004 WL 1553611, at *8 (D. Conn. July 9, 2004); Eiseman v. Cinema Grill Sys., Inc., 87 F. Supp. 2d 446, 452 (D. Md. 1999).

205. *See supra* note 187.

206. *See*, *e.g.*, Fla. Polk Cnty. v. Prison Health Servs., Inc., 170 F.3d 1081, 1083 n.8 (11th Cir. 1999); N. Cal. Dist. Council of Laborers v. Pittsburg-Des Moines Steel Co., 69 F.3d 1034, 1036–37 (9th Cir. 1995).

207. *See*, *e.g.*, Change Capital Partners Fund I, LLC v. Volt Electrical Sys., LLC, No. CV N17C-05-290 RRC, 2018 WL 1635006, at *4 (Del. Super. Apr. 3, 2018) ("Upholding freedom of contract is a fundamental policy of this State."); Mazzoni Farms, Inc. v. E.I. DuPont De Nemours & Co., 761 So. 2d 306, 311–12 (Fla. 2000) (noting Florida's "fundamental policy of the right to freedom of contract between parties").

208. *E.g.*, M.S.A. § 80C.21; Md. Code Ann. Bus. Reg. § 14-226; Cal. Corp. Code § 31512; Wis. Stat. § 553.76; N.Y. Gen. Bus. Law § 687(4).

209. *See*, *e.g.*, Wright-Moore Corp. v. Ricoh Corp., 908 F.2d 128, 132 (7th Cir. 1990); Three M Enters., Inc. v. Texas D.A.R. Enters., Inc., 368 F. Supp. 2d 450, 458 (D. Md. 2005).

210. 908 F.2d at 132.

public policy. The district court in *Zounds Hearing Franchising, LLC v. Bower*, relying on the Restatement (Second) Conflict of Laws, noted that *even absent* an anti-waiver provision, some statutes represent such fundamental public policy that parties are not permitted to modify them by contract: "It is not necessary under the Restatement § 187(b)(2) for a statute to recite that its policy is fundamental to fall beyond the parties' ability to contract out of it. It only has to *be* fundamental. No thaumaturgic words are required."[211]

Yet, franchisors have also been successful in arguing that a state's franchise statute does not override a valid choice of law provision.[212] Some courts have concluded that state franchise statutory regimes that do not explicitly include an anti-waiver provision do not evince a strong enough public policy to override parties' ability to contract around these protections. For example, in *Zounds Hearing Franchising LLC v. Moser*, the district court reasoned that Florida did not have "a materially greater interest in the dispute . . . particularly . . . given that Florida did not include an anti-waiver provision in the FFMA [Florida Franchise Misrepresentation Act]."[213]

And even when a statute includes an anti-waiver provision, some courts have still found that a valid choice of law provision will govern. For example, in *Banek Inc. v. Yogurt Ventures U.S.A., Inc.*, the Sixth Circuit agreed with the district court and found that Michigan's anti-waiver provision was "not so strongly worded" as to void a valid choice of law provision providing for the application of Georgia law.[214] The court reasoned, "The statute does not expressly void choice of law provisions, and we decline to imply such a prohibition. . . . Providing that waivers and releases are void is not equivalent to voiding choice of law provisions."[215] Taking a different approach, some courts have "split the difference" and ruled that a valid choice of law provision will govern any *nonfranchise* claims not brought under the state's franchise statute.[216] The analysis in many instances depends on the language of the particular anti-waiver statute at issue.

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211. No. CV-16-01462-PHX-NVW, 2017 WL 4399487, at *8 (D. Ariz. Sept. 19, 2017).

212. *See id.* at *7 n.3 (collecting cases). In *1-800-Got Junk? LLC v. Superior Court*, the franchisor found itself arguing the reverse: that a choice of law provision should *not* be enforced because it contravened the fundamental public policy enshrined in the California Franchise Relations Act. The court held that the trial court properly concluded that California's anti-waiver provision did not void the franchise agreement's Washington choice of law provision because Washington's franchise law was even more protective of franchisees than that of California. 116 Cal. Rptr. 3d 923, 936 (2010), *as modified* (Nov. 19, 2010). The court explained: "*[T]he public policy of this state is not offended by a franchise agreement giving a franchisee superior protection from summary termination under the chosen law of another state.* Therefore, enforcement of the instant choice of law provision is not barred . . . ." *Id.* (emphasis in original).

213. No. CV-16-00619-PHX-DGC, 2016 WL 6476291, at *6 (D. Ariz. Nov. 2, 2016).

214. 6 F.3d 357, 360 (6th Cir. 1993).

215. *Id.*; *see also generally* Hoodz Int'l, LLC v. Toschiaddi, No. 11-CV-15106, 2012 WL 12929896, at *6 (E.D. Mich. Oct. 10, 2012).

216. Long John Silver's Inc. v. Nickleson, 923 F. Supp. 2d 1004, 1010–11 (W.D. Ky. 2013).

c. Arbitration and Mediation Provisions

Arbitration agreements in franchise agreements are often, if not usually, upheld. However, provisions within arbitration clauses are occasionally successfully attacked by franchisees. For example, in *Bolter v. Superior Court,* a California court of appeal held that, while an arbitration agreement was otherwise enforceable, the "place and manner" provision of the agreement mandating arbitration of a California franchisee's claims in Utah was unconscionable and should be stricken.[217] In a later case from California, *Independent Association of Mailbox Center Owners v. Superior Court*, a different court of appeals held that a ban on group arbitrations in a franchise agreement was unconscionable and unenforceable.[218] In applying the unconscionability doctrine to the arbitration provisions, the court stated that franchise agreements "have the same qualities of adhesion contracts as do certain consumer contracts."[219] The court also held that the arbitration provisions could not restrict arbitrators from awarding punitive, consequential, or incidental damages.[220]

Franchisors are often successful in defending against franchisee claims using a franchise agreement's mandatory mediation provision. Courts will often dismiss or stay suits filed without satisfying the mediation requirement.[221] In addition, even when a state franchise statutory scheme includes an anti-waiver provision, franchisors may still be able to force mediation (as opposed to arbitration or litigation) outside of the franchisee's home state—causing the franchisee to incur increased costs. For example, in *Delamater v. Anytime Fitness, Inc.*, the court enforced the franchise agreement's mandatory mediation provision—against a California franchisee—that required the franchisee to mediate outside the state of California.[222] The court reasoned that California Franchise Relations Act's venue restriction statute, Cal. Bus. & Prof. Code § 20040.5, voided only provisions forcing franchisees to litigate or arbitrate because, in those forums, "claims" were at issue; mediation, in contrast, did not involve the assertion of "claims" as it was an informal dispute

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217. 104 Cal. Rptr. 2d 888, 896 (Cal. Ct. App. 2001).

218. 34 Cal. Rptr. 3d 659, 670–71 (Cal. Ct. App. 2005).

219. *Id.* at 670.

220. *Id.* at 672–73. For a discussion of California unconscionability law as applied in the litigation context, see generally Bethany L. Appleby, C. Griffith Towle & Carmen Caruso, *Unconscionability and Franchise Litigation*, ABA 29th Annual Forum on Franchising 17–31 (2006).

221. *See, e.g.*, Delamater v. Anytime Fitness, Inc., 722 F. Supp. 2d 1168, 1181 (E.D. Cal. 2010) (dismissing suit filed without satisfying mandatory mediation provision in franchise agreement and stating that defendant was "entitled to seek attorneys' fees for having to defend against [franchisee's] motion for summary judgment because [franchisee] violated the mediation provision."); R&F, LLC v. Brooke Corp., No. 07-2175-JWL, 2008 WL 294517, at *3 (D. Kan. Jan. 31, 2008) (staying suit filed without satisfying franchise agreement's mediation provision).

222. 722 F. Supp. 2d at 1177–79. The mediation provision provided that the mediator would select the mediation location; the proposed mediator had selected Georgia. *But see* Nygaard v. Prop. Damage Appraisers, Inc., No. 16-CV-02184-VC, 2017 WL 1128471, at *2 n.2 (E.D. Cal. Mar. 23, 2017) (noting that "the California Business and Professions Code might . . . invalidate [a] forum-selection clause" requiring out-of-state mediation).

resolution process.[223] Thus, a franchisor may be able to use mediation provisions to their advantage as another "line of defense" to franchisee claims.

d. Statutes of Limitation, Statutes of Repose, and Contractual Periods of Limitation

Statutes of limitation and repose are valuable tools in the franchisor's defense "toolkit" as they have the ability to eliminate a claim at the beginning of a lawsuit. Some statutes of limitation for claims under state franchise laws are relatively short, meaning they may expire before a franchisee retains an attorney and makes a claim. For example, the Illinois Franchise Disclosure Act has a one-year statute of limitation in 815 Ill. Comp. Stat. Ann. 705/27.[224] However, the application of statutes of limitation is rarely "black and white" as the accrual date of a claim may be subject to interpretation.[225] In contrast, statutes of repose provide an unambiguous bar to suit. These statutes "extinguish[] an action after a fixed period of time, regardless of the plaintiff's knowledge of the claim."[226] A limited exception to the certainty offered by statutes of repose is equitable tolling based on fraudulent concealment; some courts have made use of this doctrine to toll even statutes of repose.[227] In some states, violations of the limitation or repose periods must be pleaded in the answer or initial motion or they are waived; thus, practitioners should consider these defenses at the outset.[228]

Contractual periods of limitation in franchise agreements are typically enforced as long as they are reasonable.[229] Reasonableness is subject to interpretation under applicable state law. In some states, contractual periods of limitation that do not allow for the application of the discovery rule are per se unreasonable.[230] Contractual periods of limitation that bind only one

223. *Delameter*, 722 F. Supp. 2d at 1177–78.

224. *See also* Cal. Corp. Code § 31303 (one-year statute of limitations for violation of Cal. Corp. Code § 31300 in California's Franchise Investment Law).

225. *See, e.g.*, Pyramid Controls, Inc. v. Siemens Indus. Automations, Inc., 176 F.R.D. 269, 273–74 (N.D. Ill. 1997) (addressing parties' dispute as to when the one-year period of limitations for an Illinois Franchise Disclosure Act claim began to run and concluding that "at a minimum, the one-year time limitation would have begun to run once [the franchisee] presented sufficient facts to its attorney that would reasonably indicate an IFDA claim.").

226. David Gurnick, *Franchise Law Jury Instructions*, 39 Franchise L.J. 289, 332 (2020). For example, Wisconsin's Franchise Investment Law contains a three-year statute of repose: "No action may be maintained against any person to enforce any liability under this section unless it is brought before the expiration of 3 years after the act or transaction constituting the violation upon which the liability is based . . . ." Wis. Stat. § 553.51(4).

227. *See* Putzier v. Ace Hardware Corp., 50 F. Supp. 3d 964, 978 (N.D. Ill. 2014) (noting that fraudulent concealment "consist[s] of affirmative acts or representations calculated to lull or induce a claimant into delaying filing of his or her claim, or to prevent a claimant from discovering a claim," but holding that as plaintiffs failed to allege the elements of fraudulent concealment, the statute of repose under the Illinois Franchise Disclosure Act would not be tolled).

228. *See, e.g.*, Christenson v. Argonaut Ins. Cos., 380 N.W.2d 515, 519 (Minn. Ct. App. 1986); Narragansett Elec. Co. v. Carbone, 898 A.2d 87, 101 (R.I. 2006); Fed. R. Civ. P. 8(c).

229. Sandy T. Tucker, *Contractual Limitations of Action Periods in Franchise Agreements*, 24 Franchise L.J. 18, 20 (2004).

230. *See* Creative Playthings Franchising Corp. v. Reiser, 978 N.E.2d 765, 770 (Mass. 2012).

party—for example, solely the franchisee—may be subject to greater scrutiny by a court.[231] Before adding a mutually binding contractual limitations period to its franchise agreement, a franchisor should consider whether it is more likely to be a plaintiff or a defendant should litigation arise. This, in turn, should guide the franchisor's position on how long (or short) the limitations period ought to be.[232]

In some instances, contractual periods of limitation will be construed not to completely bar a claim but, rather, to limit liability for damages.[233] For instance, in *Fantastic Sams Salons Corp. v. Moassesfar*, the franchise agreement contained a one-year, or six months from discovery, contractual limitations period.[234] The franchisees stopped making weekly payments as required under the franchise agreement, and the franchisor, Fantastic Sams, brought suit more than one year later.[235] Instead of barring Fantastic Sams' claim completely, the court determined that the clause limited the franchisees' liability for the missed payments to one year prior to the date of suit.[236]

Parties are advised to plead a contractual limitations period in their answer, just as with statutes of limitation and repose, to avoid any argument that they have waived it as an affirmative defense.[237]

2. Defenses to Fraud Claims

a. Parol Evidence Rule

There are a number of defenses that franchisors can assert in the face of fraud claims.[238] Many of these defenses are based on the franchise agreement itself. There are multiple provisions that are common to many franchise agreements that may defeat fraud-based claims. The first line of defense, however, may be a straightforward parol evidence rule argument. A franchisee's fraud claim is typically based on representations made outside of the franchise agreement. A parol evidence argument frames the franchise agreement as the entirety of the parties' understanding, so that alleged misrepresentations made outside the agreement and that contradict the express terms of the agreement are inadmissible to alter the agreement. For example, in *Cottman Transmission Systems, LLC v. Kershner*, the court held that the Pennsylvania

231. *Compare* Mobil Oil Corp. v. Earhart Petroleum, Inc., 213 F.3d 632 (4th Cir. 2000) (finding that a one-sided contractual limitations period was not unconscionable under Virginia law), *with* Storto Enters., Inc. v. ExxonMobil Oil Corp., No. CIV. WDQ-10-1630, 2011 WL 231877, at *5 (D. Md. Jan. 24, 2011) (determining, under Maryland law, that a one-sided contractual limitations period would be enforced "if supported by a 'valid justification'").

232. *See generally* Fantastic Sams Salons Corp. v. Moassesfar, No. 2:14-CV-06727-ODW, 2015 WL 263022, at *4 (C.D. Cal. Jan. 21, 2015) (enforcing contractual period of limitation against franchisor to limit damages for breach of contract to one year preceding the filing of the complaint).

233. *Id.* at *3–4.

234. *Id.* at *1.

235. *Id.* at *2.

236. *Id.* at *4.

237. *See generally* Fed. R. Civ. P. 8(c).

238. *See supra* Section IV.B.6.

parol evidence rule prevented the franchisees from relying on extrinsic evidence, including the UFOC (predecessor disclosure document to the FDD) itself, to establish common law fraud in the inducement or negligent misrepresentation claims.[239]

b. Integration and No Oral Modification Clauses

As with most commercial contracts, a common provision in franchise agreements is an integration clause. This clause helps reinforce a parol evidence rule argument by stating directly in the franchise agreement that the agreement itself constitutes the entirety of the understanding between the parties. Courts have held that these clauses reinforce parol evidence arguments.[240] Another common provision in franchise agreements requires any modifications to the terms of the agreement to be in writing. These types of provisions will prevent a party from claiming that a supervening oral agreement modified the written terms of the franchise agreement.[241]

c. No-Reliance Clauses

In addition to parol evidence and integration clause arguments, no-reliance clauses, found in many franchise agreements, may also provide a defense to fraud-based claims.[242] These clauses amount to representations by the franchisee that the franchisee has made an independent business judgment and has not relied on any previous representations made by the franchisor. Franchisors have been successful in using these provisions to bar fraud claims based on representations outside the franchise agreement. For example, in *Hall v. Burger King Corp.*, the plaintiffs asserted fraud-based claims based on alleged presale representations concerning future profitability.[243] The court held that the plaintiffs could not establish justifiable reliance, citing the no-reliance clause in the franchise agreements that the plaintiffs signed after the alleged misrepresentations were made.[244] Other cases have reached similar conclusions.[245]

d. Predictions of Future Events

Franchisors are also often successful at using non-contract-based defenses to fraud claims. A misrepresentation or fraud claim must be predicated upon

239. 536 F. Supp. 2d 543, 551–52 (E.D. Pa. 2008).

240. *See id.* at 554; *but see* Thrifty Rent-A-Car Sys., Inc. v. Brown Flight Rental One Corp., 24 F.3d 1190, 1195 (10th Cir. 1994) (holding that an integration clause does not bar a fraud in the inducement claim under Oklahoma law). Special issues relating to fraud in the inducement claims are discussed in Section V.B.3, *infra*.

241. *See* LaGuardia Assocs. v. Holiday Hospitality Franchising, Inc., 92 F. Supp. 2d 119, 128–29 (E.D.N.Y. 2000) (holding that a provision requiring modifications to be in writing defeated a franchisee's argument that a subsequent oral agreement modified the franchise agreement).

242. *See supra* Section IV.B.6.

243. 912 F. Supp. 1509, 1529 (S.D. Fla. 1995).

244. *Id.*

245. *See, e.g.*, Lady of Am. Franchise Corp. v. Malone, No. 05-61304-CIV, 2006 WL 7354110, at *1 (S.D. Fla. Feb. 13, 2006).

assertions of past or existing facts susceptible to knowledge. Franchisors often use this principle of law as a first line of defense. Statements that are nothing more than unfulfilled predictions of future events or conditions are not actionable as they are not considered representations of fact. Similarly, a promise of future performance or a projection of future costs is not considered a representation of fact; instead, such statements are regarded as opinions. The distinction can be crucial for franchisors. For example, in *Pai v. DRX Urgent Care, LLC*, two New Jersey franchisees of urgent care centers sued their franchisor for common law fraud and negligent misrepresentation, alleging that the start-up costs, capital contributions, and operating cost projections in the FDD were inaccurate.[246]

The franchisor argued in motions to dismiss that, in contrast to the predictive statements in the FDD, fraud and misrepresentation claims must be based on present or past factual assertions.[247] The court agreed, holding "[s]tatements as to future or contingent events, to expectations or probabilities, or as to what will or will not be done in the future, do not constitute misrepresentations, even though they may turn out to be wrong."[248] Because the FDD did nothing more than forecast anticipated upfront and operating costs, the franchisees had failed to state an actionable misrepresentation or fraud claim against DRX.

The franchisees in *Pai* argued that the franchisor must have known that its estimates were false given the fact that the FDDs were "grossly inaccurate."[249] This counterargument—that is, that the defendant knew that the cost or revenue estimates were wrong at the time it represented them—is often encountered by franchisors and is an exception to the rule that statements of future performance are not actionable.[250] The *Pai* court declined to give the argument any weight, however, because the franchisees had failed to allege *in the complaint* that the initial cost estimates were inaccurate at the time they were made (or that DRX knew them to be false).[251] Franchisors should anticipate this counterargument and, where possible, cite similar weaknesses in the pleadings.

e. Puffery

Franchisors may defend against fraud or misrepresentation claims by asserting that the statements made amounted to mere puffery or sales talk. In *Steak 'n Shake Enterprises, Inc. v. Globex Co., LLC*, franchisees of multiple Steak 'n Shake restaurants asserted claims of fraud against the franchisor, alleging that employees of the franchisor told them their branches would be "highly profitable," that they could expect to profits exceeding $500,000 annually if

246. 2014 WL 837158, at *12 (D.N.J. Mar. 4, 2014).

247. *Id.*

248. *Id.* (quoting Alexander v. CIGNA Corp., 991 F. Supp. 427, 435 (D.N.J. 1997)).

249. *Pai*, 2014 WL 837158, at *12.

250. *See generally*, *e.g.*, Cousins Subs Sys., Inc. v. McKinney, 59 F. Supp. 2d 816, 820 (E.D. Wis. 1999) ("An exception to the preexisting fact rule exists, however, where the promisor, at the time the promise was made, had a present intention not to perform.").

251. *Pai*, 2014 WL 837158, at *12.

they brought in $2 million in revenue, and that the 21.5+% return estimate in the franchise disclosure document was "conservative."[252] According to the franchisees, none of these statements turned out to be true.

The franchisor argued that a statement that a franchise would be "highly profitable" and other projections of future profitability were puffery and, therefore, not representations of fact.[253] The court agreed, stating that, "[i]n a sales or marketing context, and franchisor-franchisee negotiations certainly are to be placed in that context, . . . expressions of opinion are known as 'puffing,' 'trade talk,' or 'sales talk' and do not constitute actionable fraud."[254] Although the line between puffery and statements of future performance can be blurry, forward-looking statements of opinion are almost never actionable. Again, as discussed above, the exception to this is when one could draw the inference that the franchisor had formed a belief *at the time the statement was made* that it was false.

f. No Proof of Falsity

The previous two subsections recognized that courts sometimes find predictions of future events or puffery to be actionable when one could draw the inference that the franchisor believed or knew the statements to be false at the time they were made. Against this charge, some franchisors have successfully established that franchisees cannot prove that the assertions were actually untrue.[255] For example, in *Steak 'n Shake*, the court explained that "the assertion that [the franchisee's] restaurants did not perform as well [as the estimates in the FDD] is not sufficient to create an inference that the projections in the FDD are false."[256] Instead, the franchisees were required to present some evidence that would establish that the projection was inaccurate in fact and by how much; that their own performance may not have lived up to the projection is insufficient alone to sustain a claim for fraud.[257]

g. No Reliance or Reliance Unreasonable

Franchisors are sometimes also able to demonstrate that a franchisee cannot show proof of reasonable reliance. Reasonable reliance has been held to be a requirement under many state franchise misrepresentation statutes, even though it is not always explicitly enumerated as a requirement under the particular statute.[258]

In some cases, a franchisor can argue that there could have been no reliance at all if a franchisee admits that he or she did not read the written

252. 110 F. Supp. 3d 1057, 1081 (D. Colo. 2015), *aff'd*, 659 F. App'x 506 (10th Cir. 2016).

253. *Id.* at 1083.

254. *Id.* (quoting Vaughn v. Gen. Foods Corp., 797 F.2d 1403, 1411 (7th Cir. 1986)).

255. *Steak 'n Shake*, 110 F. Supp. 3d at 1084; *see also* Qdoba Rest. Corp. v. Taylors, Inc., 2010 WL 1240410, at *4–5 (D. Colo. Mar. 23, 2010).

256. *Steak 'n Shake*, 110 F. Supp. 3d at 1084 (citing *Qdoba Rest. Corp.*, 2010 WL 1240410, at *5).

257. *Qdoba Rest. Corp.*, 2010 WL 1240410, at *5.

258. *See* Cal. Bagel Co. v. Am. Bagel Co., No. CV 97-8863 MMM MANX, 2000 WL 35798199, at *18 (C.D. Cal. June 7, 2000) (collecting cases).

misrepresentations at issue.[259] For example, in *California Bagel Co. v. American Bagel Co.*, the court determined that reasonable reliance was an element of a claim under section 31200 in the California Franchise Investment Law.[260] The court held that the franchisees could not establish reliance as a matter of law because they could not have relied on allegedly false statements in an Offering Circular they never read; consequently, the court granted summary judgment to the franchisor on the claim.[261]

But not only must the franchisee show that it relied upon a franchisor's misrepresentations, such reliance must be reasonable. Franchisors have been successful in establishing that any reliance is unreasonable as a matter of law. As an example, one court found that it is unreasonable to "rely[] on an alleged misrepresentation that is expressly contradicted in a written contract that the plaintiff reviewed and signed."[262] Even when there are no contract documents with which an alleged misrepresentation is inconsistent, it may be unreasonable as a matter of law to rely on alleged misrepresentations that are inconsistent on their face.[263] In *Aron Alan, LLC v. Tanfran, Inc.*, the franchisor furnished the franchisee with three very different sets of franchisee financial performance data.[264] The court held that,

> [b]ecause the alleged misrepresentations are inconsistent and confusing, the documents containing them are inherently untrustworthy. Any reliance on the documents is therefore unreasonable. The truth of the matter was not apparent in the supporting documents, but at the very least it was clear that there were competing representations of the truth. There can be no fraud where it is apparent that all the representations cannot simultaneously be true.[265]

Accordingly, although it may often be a question of fact for the jury as to whether reliance on a misrepresentation is reasonable, these

259. *See* Earsa R. Jackson, Harris J. Chernow & Michael Einbinder, *Death by Dangled Carrot—Litigating Financial Performance Representations*, Int'l Franchise Ass'n, 49th Annual Legal Symposium 34 (2016).

260. 2000 WL 35798199, at *20–21.

261. *Id.* The court linked the concept of reliance to damages. Franchisors faced with a fraud claim should argue both failure to rely and lack of damages, as the two concepts go hand in hand. The court explained: "Misstatements, however egregious, cannot 'cause' damage unless franchisees read and rely on them. Here, the evidence is undisputed that plaintiffs did not read the Offering Circular carefully prior to executing the Franchise Agreement. Consequently, whatever its misstatements or omissions, it cannot have caused them damage." *Id.* at *20.

262. Aron Alan, LLC v. Tanfran, Inc., 240 F. App'x 678, 682 (6th Cir. 2007) (citing Novak v. Nationwide Mut. Ins. Co., 599 N.W.2d 546, 553–54 (Mich. 1999); Nieves v. Bell Indus., Inc., 517 N.W.2d 235, 237–38 (Mich. 1994)).

263. *Aron Alan,* 240 F. App'x at 683 ("The question is thus whether, construing the documents in the light most favorable to them, Plaintiffs–Appellants could have reasonably relied upon financial documentation that is inconsistent on its face. They could not.").

264. *Id.*

265. *Id.* (internal citation omitted) (citing Webb v. First Mich. Corp., 491 N.W.2d 851, 853–54 (1992)).

examples demonstrate that there are instances where reliance is *inherently* unreasonable.

h. Failure to Plead Claim with Particularity

Under Federal Rule of Civil Procedure 9(b) and many state statutes, the circumstances underlying claims of fraud must be pleaded with particularity. This provision requires plaintiffs to carefully describe "the who, what, when, where, and how of the fraud."[266] A franchisor against whom a fraud claim has been asserted should consider Rule 9(b) as a sword as well as a shield. While it may not result in a dismissal on the merits, it may force the franchisees to amend their pleadings, disclose more information about their claim, and expend more resources in the process. And in some cases, franchisees may not possess the information necessary to formulate their claim with the requisite level of specificity. In either event, motions to dismiss often provide franchisors with a useful tool in defending fraud claims.

3. Defenses to Fraud in the Inducement Claims

One potential problem for franchisors asserting a parol evidence defense to a fraud claim is that some courts have held that in the case of fraud in the inducement (as opposed to promissory fraud), parol evidence may be admissible. For example, in *Randall v. Lady of America Franchise Corp.*, general contractual disclaimers of reliance were held to be ineffective in barring evidence of extracontractual representations that were alleged to have induced the franchisees to sign the franchise agreements.[267] Some courts, however, have created an "exception to the exception" for the fraudulent inducement issue, providing franchisors with room to argue that the parol evidence rule and/or an integration clause applies in fraudulent inducement situations. The purpose behind the "exception to the exception" is to prevent plaintiffs from artfully pleading their way around the parol evidence rule by converting a promissory fraud claim into a fraudulent inducement claim.[268] These cases hold that the exception to the parol evidence rule for fraud claims does not apply when the alleged misrepresentations are directly at odds with the written agreement. An example of this can be found in *Quality Inns International, Inc. v. Dollar Inns of America, Inc.*[269] The court in that case held that the integration and no-reliance clauses were directly inconsistent with the

266. Camasta v. Jos. A. Bank Clothiers, Inc., 761 F.3d 732, 737 (7th Cir. 2014).

267. 532 F. Supp. 2d 1071, 1084–85 (D. Minn. 2007); *see also* Thrifty Rent-A-Car Sys., Inc. v. Brown Flight Rental One Corp., 24 F.3d 1190, 1194–95 (10th Cir. 1994) (holding that, under Oklahoma law, evidence of fraudulent inducement is admissible despite an integration clause); It's Just Lunch Int'l, LLC v. Polar Bear, Inc., 2004 WL 3406117, at *2–3 (S.D. Cal. Apr. 29, 2004) (noting that it is well established in California law that the parol evidence rule does not bar evidence of fraudulent inducement); RadioShack Corp. v. Comsmart, Inc., 222 S.W.3d 256, 260 (Ky. Ct. App. 2007) ("But false and fraudulent representations made by one of the parties to induce the other to enter into the contract are not merged in the contract.").

268. *See* Oak Indus., Inc. v. Foxboro Co., 596 F. Supp. 601, 607–09 (S.D. Cal. 1984) (discussing the origin of the exception to the exception).

269. Bus. Franchise Guide (CCH) ¶ 10,007 (D. Md. Feb. 10, 1989).

alleged extracontractual representations, and therefore, the franchisee's fraud claim could not stand.[270]

In *Cottman Transmission Systems v. Kershner*, the court framed the exception slightly differently. The court held that the parol evidence rule barred evidence of the extracontractual representations underlying the franchisees' fraudulent inducement claim because the plaintiffs had not pled fraud in the execution of the contract.[271] The court explained that under Pennsylvania law, the parol evidence rule does not apply to a fraud claim when the alleged fraud relates to whether a particular term was fraudulently omitted.[272] The parol evidence rule otherwise applies to normal fraudulent inducement claims in Pennsylvania.[273]

In addition, the "exception to the exception" defense to fraud in the inducement claims can be framed in terms of waiver of reliance clauses. For example, in *Rosenberg v. Pillsbury Co.*, the franchisee plaintiffs alleged that they were fraudulently induced into entering the franchise agreements by representations concerning future earnings.[274] The court held that the plaintiffs' fraud claims were barred by the no-reliance clauses in the franchise agreement, which specifically addressed earnings representations in detail. The clauses were explicit in stating that no earnings forecast was authorized by the franchisor and that the franchisee should undertake its own investigation.[275] The court held that these disclaimers were sufficiently explicit to render any reliance on alleged extracontractual representations unreasonable.[276]

270. *Id.*

271. 536 F. Supp. 2d 543, 553–54 (E.D. Pa. 2008).

272. *Id.* at 552–53.

273. *Id.*

274. 718 F. Supp. 1146, 1149–50 (S.D.N.Y. 1989).

275. *Id.* at 1152–53.

276. *Id.* at 1154; *see also* Carlock v. Pillsbury Co., 719 F. Supp. 791, 829 (D. Minn. 1989); JM Vidal, Inc. v. Texdis USA, Inc., 764 F. Supp. 2d 599, 623–24 (S.D.N.Y. 2011).