PREFACE

When published in 2010, the original version of this book marked the first comprehensive publication focused on franchise litigation. As franchising has continued to proliferate as a method for distributing goods and services, this book has served as a useful tool for practitioners who represent franchisees and franchisors in the inevitable disputes that will necessarily arise in such a prevalent type of business relationship.

This book will be particularly useful for those lawyers who may not yet have significant experience with franchise law and franchise disputes. It is a valuable tool to understand how franchise disputes typically arise and how they are addressed by experienced practitioners. Franchise disputes can arise from the very formation of the business relationship and even well after the termination of such relationships. This book provides a framework for franchise practitioners to evaluate and address their client's dispute, however or whenever it arises.

As franchising has grown in the past decade, franchise law has also continued to develop and expand, and it became time to update and bring this publication current. Many of the original authors agreed to update their chapters and other experienced franchise law practitioners agreed to join in the effort where needed.

The result is an updated and detailed publication addressing those issues that most frequently arise in franchise disputes. Much of the original chapters remain, but they have been updated and revised as necessary to address developments in the law over the past decade.

I. The Fundamental Characteristics of Franchise Relationships

The sale of franchises is regulated by the Federal Trade Commission and is also separately regulated by several states. As part of the presale process, franchisors are required to provide prospective franchisees with government-mandated "Franchise Disclosure Documents." The adequacy of the disclosures made by a franchisor in its Franchise Disclosure Document (FDD) and other representations made as part of the sales process, may lead to disputes brought by franchisees contending that they were misled or that the disclosures were inadequate. Some disputes even arise as to the very question of whether a given business relationship is a franchise relationship or not. Some business opportunity sellers may attempt to characterize the

business relationship as something other than a franchise to avoid franchise regulations and the related expenses of compliance. Of course, there are also many business relationships which do not fall within the franchise rubric and regulation of franchising, but if a business relationship meets the criteria of a franchise, a business seller's failure to comply with the applicable regulations is illegal.

Franchise relationships usually exist for an extended duration. Specifically, the express terms of franchise agreements are often between five and 20 years. Under the law of many states, franchise agreements can only be terminated or not renewed for "good cause," which typically means the failure of the franchisee to comply with the material terms of the franchise agreement.

Mature franchise systems may be very large in number of units and geographic dispersal. Some successful franchise systems have hundreds or even thousands of franchises located throughout the United States and in other countries.

Because FDDs are required to provide details about the terms of the proposed franchise agreement (which is to be attached as an exhibit to the FDD), franchise agreements are almost always standard form contracts. Thus, franchisors may be inflexible in varying the terms for individual franchisees. Regardless of the franchise system, most franchise agreements address similar subjects, such as the parties' rights to use the franchisor's intellectual property; the franchisee's monetary obligations to the franchisor; the franchisor's obligations to provide services to the franchisee; the franchisor's ability to compel compliance with system standards; the bases for termination and/or nonrenewal of the franchise relationship; and the post-termination obligations of the parties, which often include noncompetition restrictions.

Franchise relationships may deteriorate for many reasons, including economic and other factors that are unique to any franchisee, franchisor, or franchise system. Some causes for disputes between franchisees and franchisors are more general and recurring. For example, some of the most significant litigation between franchisors and franchisees arises from the franchise sales process and the inception of the relationship. Another frequent area of dispute arises when franchisors alter the way they distribute their goods and services, such as by adding or deleting franchises, developing direct distribution channels, and eliminating existing brands or acquiring new ones. And, even in franchise-specific situations, the disputes between franchisees and franchisors tend to revolve around common causes, such as a franchisee's failure to pay royalties and fees, or a franchisor's failure to provide promised services.

One or more of the fundamental characteristics of the franchisee/franchisor relationship plays a role in the subjects addressed in each chapter of the book summarized below:

Chapter 1, Initial Pleadings: The complaints, answers, and motions to dismiss filed in franchise cases are characterized by recurring procedural and substantive issues. The recurring procedural issues are driven, in part, by the relatively large, multi-state scope of mature franchise systems. Size

and geographic dispersion underlie the efforts to manage litigation risk by most franchisors through forum selection and arbitration clauses, choice of law clauses, and jury and class action waivers. The recurring substantive issues reflected in the claims and defenses in franchise litigation are largely a result of the common ways in which franchise relationships are formed (through sales efforts using standard offering documents); the similarity of the themes (either real or imagined) associated with the deterioration of franchise relationships (e.g., the economic dependence of franchisees on franchisors); the similarity of the subjects that are addressed by the contracts between the parties (e.g., the use and protection of intellectual property, reporting of revenue and payment of fees, maintenance of system standards, the termination and renewal of the relationship, and restrictions on competition following termination of the relationship); and the application of similar federal and state regulatory schemes embodied in statutes, administrative regulations, and case law.

Chapter 2, Temporary Restraining Orders and Preliminary Injunctions: Franchisors typically license franchisees to use the franchisors' intellectual property (usually trademarks and trade names) and proprietary business systems. Franchisees typically agree to refrain from using the franchisor's proprietary information or engaging in competitive conduct both during the franchise relationship and for certain periods of time following termination of the franchise relationship. As a result of these aspects of the franchise relationship, applications for interlocutory relief often arise in franchise litigation as part of the termination or nonrenewal of franchise relationships. In order to protect their intellectual property, franchisors frequently seek injunctions to prohibit former franchisees from continuing to use trademarks and trade names and to enforce post-termination restrictive covenants. Likewise, inasmuch as the franchisee's livelihood may depend upon the franchised business, franchisees may vigorously seek to dispute the termination or nonrenewal of their franchise by the franchisor.

Chapter 3, Discovery: In franchise litigation, the typical discovery devices (i.e., interrogatories, document requests, depositions, and requests for admissions) are often focused on obtaining similar categories innate to franchise relationships. Typical categories of information that may be sought include topics such as the formation of the franchise relationship (e.g., was there fraud in connection with the sale of the franchise), the performance and termination/nonrenewal of the franchise relationship (e.g., did the franchisor provide the services that were promised; did the franchisee breach the terms of the franchise agreement), and compliance with post-termination obligations (e.g., did the franchisee breach a post-termination covenant not to compete). Discovery disputes, including ones that may become the subject of motions to compel or for protective orders, are often related to burden and relevance and are a function of the nature of the typical franchise relationship and system. Franchise relationships usually involve a constant exchange of information (e.g., the submission of monthly, weekly, or even daily revenue and expense information), and require frequent contacts between the parties (e.g., periodic communications on franchise services issues, inspections

to monitor compliance with system standards, and revenue or other audits), all of which result in the generation of countless bits of potentially discoverable information in electronic and paper form. Moreover, many different individuals, particularly on the franchisor side, participate in the franchise relationship, and all of them can become the target of depositions. Add to these features the reality that franchise systems often undergo significant changes in electronic information systems due to technological advancements, and the sources and likelihood of significant discovery disputes become apparent.

Chapter 4, Class Actions: Certain aspects of the franchise relationship seem to naturally lend themselves to satisfying the four prerequisites for class certification under Rule 23(a) of the Federal Rules of Civil Procedure and its state law equivalents. Certainly, numerosity should rarely be a problem for franchisee classes. And, given that most franchisors use uniform contracts and engage in system-wide conduct, the commonality and typicality requirements would seem to be easily satisfied by most purported franchisee classes. Finally, aside from the potential for conflicts in classes that purport to include current and former franchisees, adequacy should also rarely be a problem in any franchisee class action. Why then are so few franchisee classes certified? The problem seems to be that franchisees have difficulty in satisfying the superiority and predominance requirements of Rule 23(b)(3), largely because of the remedies that are typically sought (e.g., lost profits) and because of the changes that typically occur within franchise systems (e.g., significant changes in the form of the franchise agreements; periodic renewals of franchise agreements, which are often accompanied by releases; and programs that are rolled out and retired, which often have differing impact on franchisees and often involved providing releases). The result is that, since the Fourth Circuit's reversal of the certification of a franchisee class in *Broussard v. Mieneke Discount Muffler Shops*, very few franchisee classes have been certified.

Chapter 5, Motions for Summary Judgment: Many of the affirmative claims frequently brought by franchisors are often suitable for summary judgment because they tend to be straightforward breach of contract claims (e.g., the franchisee failed to pay fees or the franchisee failed to comply with straightforward system standards) or Lanham Act claims (e.g., the former franchisee has continued to use the franchisor's trademarks and trade names) that do not give rise to disputed fact questions. Summary judgment motions are also frequently directed at franchisees' affirmative claims. That is so because form franchise agreements are typically drafted by experienced franchise lawyers, who realize that some litigation with franchisees is inevitable in most franchise systems. As a result, one of the goals of these lawyer-drafters is to produce agreements that maximize the franchisor's ability to successfully resolve litigation short of trial. For that reason, franchise agreements typically contain a host of provisions that are specifically designed to eliminate or limit franchisors' liability for the claims that are most often brought by franchisees. Thus, for example, franchise agreements typically have clauses in which franchisees disclaim any reliance on statements not

contained in the agreement or the Franchise Disclosure Document, waive any claims arising from the franchise sales process, acknowledge that the franchise agreement is the parties' complete agreement and can be modified only in a writing signed by specified officers of the franchisor, waive various categories of damages, and truncate applicable statute of limitations. These sorts of contractual provisions often lead to summary judgment motions in franchise litigation. Although franchisee motions for summary judgment are much less common, there are at least a few recurring fact patterns that may warrant a summary judgment motion, including the franchisor's failure to comply with its registration or disclosure obligations.

Chapter 6, Trials: Given the well-known statistics that only a tiny fraction of all civil cases are resolved through trial, one may reasonably question the need to devote an entire chapter to trials. While we know of no empirical data comparing the frequency of trials in franchise disputes to other civil actions, our entirely nonquantitative view is that franchise cases are much more likely to be tried than other forms of civil cases because they often (a) are the "right size" to permit trials (i.e., they are not so small that no one can afford to try them and they are not so large that no one can afford to lose them); (b) involve highly emotional parties on both sides; and, (c) present issues of significance to the parties.

Chapter 7, Arbitration: Franchisors generally recognize that disputes with franchisees are inevitable and wish to avoid the risks inherent in jury trials, class actions, and unfriendly forums. While all of those risks can be addressed by contractual provisions such as jury and class action waivers and forum selection clauses, pro-franchisee statutes and judicial decisions limit the effectiveness of such provisions in many states. The impact of these differing state law requirements can be blunted through the use of arbitration clauses, which typically will be enforced, even in the face of conflicting state law requirements, given the preemptive effect of the Federal Arbitration Act. As a result, many franchise agreements mandate that arbitration is the required dispute resolution mechanism. This chapter addresses the unique aspects of arbitration for addressing a franchise dispute.

Chapter 8, Mediation: Franchise disputes are particularly well-suited for mediation, particularly where the parties seek to maintain an ongoing business relationship. Once the passion of whatever caused the dispute has passed, most rational franchisors and franchisees realize that they need each other for their businesses to be successful. Thus, mediators usually have an array of tools at their disposal to develop business solutions that provide value to all sides of a dispute to facilitate a resolution.

In order to address these and other issues raised in the litigation of disputes between franchisees and franchisors, we have been fortunate to obtain the participation of an outstanding group of authors with extensive experience in litigating franchise cases. For the chapters addressing discovery, summary judgment motions, and trials, we asked lawyers who typically represent opposing sides in franchise cases to work together as co-authors, in order to provide the reader with the unique perspectives of franchisee and franchisor lawyers on those topics. In all of the chapters, the authors provide

an impressive combination of scholarly research and practical insights. The authors' legal research will provide the reader with a valuable reference tool when the need arises to research specific legal issues. Their insights will provide the reader with the practical nuances on those legal issues that come from literally decades of prosecuting and defending claims asserted by and against franchisees and franchisors. Your two editors of this book also focus on opposing sides in franchise cases and have strived to ensure that the views of both sides are presented throughout this book.

We should add a few words concerning the book's format. The chapters are written primarily in the context of disputes between franchisors and franchisees relating to the formation and termination of franchise relationships. Obviously, franchisees and franchisors are involved in other types of litigation with third parties such as consumers, employees, or regulatory agencies. Such third-party disputes are outside the scope of this book.

Procedural issues are addressed primarily by reference to the Federal Rules of Civil Procedure. We asked the authors to adopt that approach, in part, because a relatively large number of states have adopted rules of procedure that are modeled on the federal rules and, even where differences exist, state courts often look to the analogous federal rule when interpreting their own civil procedure rules.

In general, citations follow *Blue Book: A Uniform System of Citation*, although we have deviated from "Blue Book form" in a few instances because we felt that strict compliance was unnecessarily cumbersome. For example, we have not provided parallel citations for state court opinions and we have omitted docket numbers in the citations of opinions reported in electronic databases.

Finally, we would like to thank and acknowledge the many people that made this book a reality. First, we would like to acknowledge the extraordinary efforts of the authors. In all instances, they devoted many hours to this project and exhibited noteworthy patience in dealing with the many challenges that accompanied the publication of this book and our editorial comments. Next, we would like to thank the original co-editors of the first edition of this handbook, Dennis LaFiura and C. Griffith Towle. Without their creation of the initial blueprint, this book would have taken much longer to complete. Their work set a high standard for this second edition. We would also like to acknowledge the continuing guidance, support, and editorial assistance of Joseph Goode. The value of his help cannot be overemphasized. Lastly, we would like to thank the ABA Forum on Franchising and its Governing Committee, including the publications officer Gary Batenhorst, for providing us with this incredible opportunity to update an important book that we hope will continue to be a valuable resource for franchise law practitioners for the next decade and beyond.

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