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Strategies to Achieve
The Best Possible Early Settlement

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STRATEGIES TO ACHIEVE THE BEST POSSIBLE EARLY SETTLEMENT

I. INTRODUCTION

“Civil strife often follows a grimly predictable pattern. What at first seems a soluble dispute hardens into conflict, as goals become more radical, bitterness accumulates and the chance to broker a compromise is lost.”¹ While the context of this quotation focused on the escalating conflict in the Ukraine, it also can apply to the franchisor/franchisee relationship.

The focus of this paper is to identify common areas of dispute in the franchise relationship and potential ways to cut off or resolve these disputes before they develop into destructive litigation that distracts the franchise system from its ultimate goal of competing in external markets. While this paper does not identify all the possible disputes that may develop within the franchise relationship, it is intended to assist the practitioner to better understand the dynamic of a franchise relationship under strain and to present possible business and legal solutions to help the parties prevent a dispute from hardening into conflict.

Over the past fifty years franchising has been one of the greatest generators of small business in the United States. As of 2007 it was responsible for the creation of over 9.1 million jobs within the United States and it is responsible for generating 3.4% of the GDP in the United States.²

For the franchisor, the beauty of the franchise model is that it allows for growth of the franchise system through the use of franchisee’s labor and capital. Through a franchisee’s investment into what they perceive to be a proven business system that includes a well-known trademark, a franchisor can earn substantial revenues from a variety of sources including the initial franchise fee, periodic royalties, and sales related to products and supplies. A franchisor’s success in achieving its desired business outcome will depend upon in large measure the nature and quality of the business relationship that exists with the franchise organization, both bilaterally between the franchisor and the individual franchisees, and more holistically within the franchise system generally.³ It cannot be overstated that the ultimate success of the franchisor and the franchise system depends upon the success of the individual franchisees within the franchise system.

A successful franchise relationship is one where the parties recognize and respect the goals of the other party. Through the franchisor’s knowledge of the market place and strategic vision for the chain, together with the practical skills of the franchisee, the parties should be able to attain the twin goals of financial success for the franchisee and growth and prosperity of the franchise system. Conflicts between the parties distract them from focusing on external competition in the ever changing market place.


² See FRANCHISING WORLD, Apr. 2011 (2007 Economic Impact Study conducted by the IFA and PWC).

³ Andrew C. Selden & Victoria Blackwell, Franchise Relationship Management, ABA Franchise Compliance Manual, ch. 4 at 314 (2d ed. 2011) (advocating the importance of maintaining the mutuality of the franchise relationship as a way to avoid conflict within the relationship).
II. WHAT CAUSES FRANCHISE DISPUTES?

The cornerstone of the franchise relationship is the franchise agreement. The purpose of that agreement is to provide a degree of predictability to the relationship between the franchisee and the franchisor. But when a dispute arises, that agreement can become an unwitting accomplice in the pitched battle that can test the boundaries of the symbiotic relationship. Each party will rely on specific language in the franchise agreement to support the basis for the other party’s violation of the franchise relationship.

While the basic tenets of the franchise relationship are to put the franchisee and franchisor on harmonious footing, in practice there is an inherent dynamic tension in that relationship. The franchisor often looks to the gross revenues of the franchisee for the derivation of its revenues, while the franchisee looks to its bottom line for its measure of success. As a result, there are a number of hot-button issues that can create disputes in the franchise relationship.

The franchisee will continually ask itself as it is paying its royalties to the franchisor, what am I receiving in return for the payment of these royalties? If the franchisee believes that it is not receiving good value for the revenue stream that it is providing to the franchisor, it will question or challenge the franchisor on its purported valuation proposition. Any conduct of the franchisor or aspect of the franchise system that the franchisee believes will cut its revenue stream can ferment into a dispute between the franchisor and the franchisee.

A. Presale Disclosures

One issue that is ripe for dispute is what the franchisee believes it was promised when it signed on to the franchise system. More specifically, what representations were made to the franchisee through the Franchise Disclosure Document (“FDD”)? The FDD requires the franchisor to respond to disclosure questions over 21 different sections, including a disclosure of the franchisor’s financial position. Fraud and misrepresentation claims can be predicated on many aspects of the franchise sales process. In one example, a franchisor’s failure to alert one of its distributors of a change in its marketing strategy resulted in a claim by the franchisee that it lost over $100,000 in revenue. Other claims growing out of the FDD focus on the accurateness of the disclosures of the franchisee’s initial investment, opening capital requirements, and financial performance representations.

The most fertile ground for presale misrepresentation claims are based on item 19 representations. If a franchisee’s business does not achieve the results that the franchisor disclosed, the franchisee likely will challenge a franchisor’s financial performance representations. As a general rule a franchisor will provide pro-forma representations in the form of estimates, and not as guarantees. Whether such claim will rise to the level of actionable fraud will more than likely be a matter of fact for a trier of fact to consider.


6 Id. at 8.
It is more likely that a franchisor will see claims for fraud and misrepresentation, either, when a franchisor seeks to enforce a termination of the franchise agreement or when the franchisee believes that its business is in imminent peril of failure. Beyond the issue of whether a franchisee will be successful in its claim of fraud and misrepresentation there remains the question of what can the parties do to avoid protracted litigation, which could leave a franchise system without a franchised unit in that location, and also could result in damage exposure to the franchisor?

B. Encroachment

Another hot button issue in the franchise relationship is the concept of encroachment. Encroachment can occur when a franchisor, through company-owned outlets or by granting other franchises, competes in the same market with an existing franchisee’s business. Often, a key component of a franchisor’s business model is to grow its system through system expansion. From the franchisor’s perspective, growth of the system should also benefit the franchisee, because with a greater number of franchised and company-owned outlets, there will be greater brand presence of the products and services offered by or through the franchise system, which should lead to greater demand for these products and services. While the franchisor might expect that the benefit to the franchise system as a whole is ample justification to continue its expansion efforts, those efforts may ultimately collide with a particular franchisee’s target market of customers. If a new outlet begins to draw business or customers away from the franchisee’s existing outlet, the franchisee will take the position that the placement of the new outlet encroaches on the franchisee’s existing business.\footnote{See Encroachment, Bus. Franchise Guide (CCH) ¶ 830. Even where provisions in a franchise agreement limit a franchisee’s exclusive territorial protection, franchisees have challenged these clauses based on such theories as the covenant of good faith and fair dealing. See \textit{Scheck v. Burger King Corp.}, 756 F. Supp. 543, 549 (S.D. Fla. 1991), where a lower court ruled that the franchisor could not open franchises at will and that an existing franchisee could pursue a claim that the franchisor breached the implied covenant of good faith and fair dealing by opening a nearby franchise.}

Encroachment claims often play out in expensive time consuming litigation, which may provide franchisors or franchisees with paper victories proved to be pyrrhic in nature, as ultimately the parties do little to advance their economic interests in prosecuting or defending these claims.\footnote{For a comprehensive analysis of encroachment issues in the domestic and international context, see Eric H. Karp, Rocio Belda de Mergelina, & Ted Pearce, \textit{Encroachment Issues Around the World}, IBA/IFA Annual Joint Conference, Bright Horizons in International Franchising (Chicago, Ill. May 7, 2014).} These claims come about when a franchisor seeks to place another unit outside or a franchisee protected territory but close enough to the franchisee’s unit where it believes that it will adversely impact its business. Encroachment also can arise when the franchisor offers the same or similar products either in different channels of distribution or offers the same products or services under a different trademark, which is the likely case when a franchisor or its affiliate purchases another franchise system that offers the same or similar products or services. In each of these scenarios, while the franchise agreement may permit the franchisor to expand its system through these options, the franchisee may claim that this discretion cannot be used arbitrarily or without consideration to the effect of this expansion on the franchisee’s business.
C. Operational Issues

Operational issues such as the alleged failure to perform pre-opening obligations like training and site assistance often find their way into a franchise dispute when a franchisor seeks to enforce its contract rights. A franchisee will allege that it should be excused from its defaults or obligations to the franchisor, such as the payment of royalties, because the franchisor did not provide or adequately perform its pre-opening obligations or other alleged obligations to support the franchisee. The franchisor will respond that the payment of franchise fees is not in consideration for those obligations, and the parties’ positions on this issue can harden to a dispute that may put the franchise relationship at risk.

D. System Standards

Closely related to general operating issues is the enforcement of system standards. The franchisor is obligated to enforce its system standards to protect the integrity of its trademarks and trade names and to protect the uniformity of the franchise system, which are the cornerstones of a franchise concept.9 System standards go beyond the protection of the franchisor’s trademarks and support the entire franchise brand. The concept of brand standards include, system upgrades, changes to the franchise system as well as maintaining standards of operations. Certain standards are found in the franchise agreement, but more detailed operational standards usually are contained in the franchise system’s operations manual, which the franchisor reserves the right to amend from time to time.

When the franchisee perceives that the enforcement or enactment of system standards becomes arbitrary, with no underlying business rationale or the standards require a fundamental change to the business system, a franchisor should expect push back from the franchisee. To avoid such pushback and the potential for a dispute, the franchisor is well advised to merchandise changes to the franchise system by including representative franchisees in the decision-making and implementation process. Obtaining franchisee buy-in to changes in the franchise system will go a long way to avoid contentious situations that can easily escalate beyond a mere disagreement.10

From the franchisor’s perspective, there are certain standards that do not warrant discussion. A violation of any standard that goes to the health, welfare, or safety of the customer or the public must result in quick action by the franchisor. While the franchisee may believe that there is good reason for it not to abide by a specific standard, the reputation of the franchise system is at risk if the franchisee violates a specific standard that goes to the safety of the customer. In that situation it behooves the franchisor to explain to the franchisee the reasons behind the basic necessities and requirements of the franchise system.

Surprisingly, in the universe of system standards, more litigation results from franchisees that claim that franchisors are not enforcing system standards for the benefit of the franchise system.11 While franchisees sometimes challenge a franchisor’s right to enforce system

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10 Id. at 31.

11 For example, in Creel Enter., Ltd. v. Mr. Gatti’s, Inc., Bus. Franchise Guide (CCH) ¶ 9825 (N.D. Ala. June 26, 1990), a franchisee sued its franchisor for its failure to enforce system standards based on its allegation that there
standards relative to its location or business, the franchisee typically expects that the franchisor will enforce them against others in the system because they appreciate that the strength of a franchise system lies in the reputation for consistency that the franchisor attempts to establish within its system. A lax franchise system likely will adversely impact the value of the individual franchise unit.

E. Advertising

Franchisees are extremely sensitive to how the franchisor manages the system’s advertising fund. Beyond decisions on the forms of advertising to be used by the franchise system, many franchisees view their contribution to an advertising fund as being their money. Consequently, how the franchisor manages the advertising fund can generate disputes. In one of the seminal cases in franchise legal history, the franchisees in the Meineke system leveled a class action claim against Meineke Discount Muffler Shops, Inc. alleging that the franchisor illegally profited from its management of the advertising fund. While Meineke ultimately prevailed after seven years of litigation, the case all but tore the chain apart and risked a general implosion of the franchise system. Had it not been for the strong leadership of then chief executive officer Ken Walker, the courtroom victory would not have saved the chain from an ongoing angry relationship that developed between the franchisor and the franchisees during the litigation. Had the poor relationship been allowed to fester after the litigation the franchisees and the franchisor would have been distracted from addressing the external competition in the market place, which would not have boded well for the overall health of the franchise system.12

During the Meineke litigation13 there were numerous opportunities to settle the case, which the parties did not undertake because by the time those opportunities arose the emotional vituperation between the parties made it difficult to go beyond the emotions to capitalize on those opportunities. As we will explore later in this paper, the parties, including their attorneys, need to determine when it is time to go beyond principle to seriously discuss an early settlement of a system-wide dispute.

F. Resale and Renewals

The seemingly innocent requirements imposed upon franchisees for resales and renewals are a breeding ground for franchise disputes. Franchisees look at their investment in a franchise with a view of being able to cash-out of that investment and earn a reasonable rate of return. They often view the terms of renewal and resale that include the requirement of the franchisee signing the then-current form of franchise agreement, which may contain materially different changes to that agreement, as an impediment to their ability to recoup what they believe to be their rightful return. A change in the royalty structure or territorial exclusivity may reduce the value of their unit if the result is reduced protection from competition or different unit economics due to higher fees owed to the franchisor.


13 The author, Ted Pearce, was a member of the Meineke management team during the Broussard litigation and can attest to the emotional upheaval to the franchise system that the litigation caused, not to mention the extreme financial costs to both the plaintiffs and the defendants to bring this matter to resolution.
Additionally, if the franchisor blocks a certain resale for a variety of reasons, or no reasons at all, the franchisee may believe that the franchisor is tortiously interfering with its business relationship.

In approving a resale candidate or transaction, the franchisor walks a fine line between protecting its franchise system from permitting less than desirable franchisee candidates from entering the system, and interfering with a franchisee’s ability to monetize its investment into the franchise system. The franchisor views its ability to approve an incoming resale candidate as its right and obligation to protect the integrity of the franchise system. Moreover, it views its right to change the terms of the franchise agreement upon renewal or resale as its only opportunity to modernize a franchise system where a market may have changed since the time that a franchisee first entered into the franchise relationship. In some cases the franchisor may believe that the operations of the seller’s business does not warrant a particular sales price because it does not believe that the purchaser can generate enough revenues to meet its debt service obligations to the seller or a third party creditor, and the general operating expenses of the business, including fees to be paid to the franchisor. While cases tend to support the franchisor’s position, disapproval by a franchisor of a sale may result in a souring of its relationship with the existing franchisee.

G. Who Wins These Claims?

The issues set forth above illustrate how hot button issues within the franchise relationship can ripen from disagreements to hardened disputes that, unless addressed in their nascent stages, can result in all-out war between the franchisor and a franchisee. Neither the franchisor nor the franchisee is likely to win that war. From the franchisor’s perspective a large money judgment against the franchisee might result in numerous trips to the bankruptcy court where it must try to recover as much of its unsecured debt from the debtor’s pool of marshalled assets, which are never enough to cover the outstanding judgment, not to mention expended attorneys’ fees. From the franchisee perspective, a likely result from a judicial victory against the franchisor may still result in the loss of its unit and more often than not a less than full recovery of its out-of-pocket investment. While an early settlement may not grant each party everything it wants, it may well save the relationship, or at least be less disruptive to the parties’ business interests.

14 For example, in *R.A. Inc. v. Anheuser-Busch, Inc.*, Bus. Franchise Guide (CCH) ¶ 11,072 (Minn. 4th Judicial Dist. Ct. Dec. 3, 1995), a court held that a franchisor was not liable to a distributor for tortious interference for refusal to approve a transfer of a distributorship. In this case the court held that the manufacturer, under the terms of its distributorship agreement, had the right to approve or disapprove a transfer of the distributorship within 30 days of receiving the final requested information regarding the proposed purchasers.
III. EXHAUST OPERATIONAL REMEDIES BEFORE ALLOWING A DISAGREEMENT OR BREACH TO RISE TO THE LEVEL OF A DISPUTE OR TERMINATION

A. How Can the Franchisor Work with the Franchisee?

The franchise agreement serves as the core document defining the relationship between the franchisor and franchisee. Most agreements however, are short on remedies available to both parties to the agreement when there is an alleged breach. For the franchisor, the usual enforcement mechanism consists of sending a notice of default and, if there is no cure, terminating the franchise agreement. Few franchise agreements contain progressive remedies or penalties, and even if they do, those options can cripple the franchisee’s ability to conduct its business. For example if the penalty for the failure to meet certain sales quotas is the loss of exclusivity in a protected territory, the loss of that exclusivity may exacerbate the problem of the franchisee’s inability to generate more sales from its business. Similarly, loss of certain advertising placements for failure to pay continuing advertising contributions can result in further loss of sales opportunities.

By the same token, a franchisee’s remedies are limited if the franchisor does not perform its obligations under the franchise agreement. In most cases the franchisee does not possess the right to terminate its franchise agreement so it is left to sue the franchisor for specific performance, damages, or rescission of their franchise agreement. Between the franchisor’s nuclear option of terminating the franchise agreement, and the franchisee’s option of suing its franchisor, when disagreements arise the playing field is weighed heavily toward conflict.

Once the franchisor sends a notice of default to a franchisee for an alleged breach, the goodwill that heretofore existed between the franchisee and the franchisor likely will have abated. Before reaching this trigger point the franchisor should examine the underlying issue and review its arsenal of operational remedies to address a shortcoming in the franchise relationship. Like most people, franchisees react to reason and incentives better than they react to repressive conduct on the part of the franchisor. In most systems the days of the franchisee following the franchisor’s edicts "just because it said so" are a vestige of the past. Franchisees and their counsel have become more sophisticated in navigating both the legal and business dynamic between the franchisor and the franchisee. Since each franchised unit in a system constitutes an asset of the franchisor, it is better served trying to find an operational remedy before having to resort to termination.

The most obvious and likely problem a franchisor might have with its franchisees is the franchisee’s payment of continuing royalties. The franchisee’s failure to pay royalties is not an uncommon occurrence and can be triggered by a number of different issues. It is the franchisor’s responsibility to determine why the franchisee is not paying its fees. There are a number of warning signs that a franchisor might see to better anticipate the possibility of an interruption of its royalty stream. Franchisors should closely monitor a franchisee’s progress from the time it begins its operations to identify potential warning signs. Did the franchisee open its unit with sufficient working capital? Are there any impediments to its operations such as lack of signage, poor traffic patterns etc.? Is the franchisee following the system, and if not what parts is it not doing well? A franchisor should remember that just because a franchisee attends and completes the franchisor’s initial training course does not mean that it is ready to tackle all

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15 The term nuclear option refers to the franchisor's sole remedy of terminating the franchisee's franchise agreement upon default. This term, coined by Mike Carlet from Driven Brands, was an option that the franchisor used only as a last resort.
of the challenges of the marketplace. Often a franchisee will need additional one-on-one assistance before it is able to operate a well-oiled franchised unit.

Along those same lines, what is the ramp-up time for a franchisee before it can expect to run a successful operation? The franchisor should know from the history of its other unit openings how long it will take a franchisee to generate a profit in its operations. If a franchisor believes that it will take longer than three months for a franchisee to be able to ramp up its business, that time frame should be taken into consideration when deciding the working capital needs for the franchisee when it purchases the franchise.

Addressing the immediate non-payment issue is perhaps the easiest part of a problem for the franchisor to solve. Financial workouts are common, and most franchisors resort to promissory notes or other deferred payment plans to rectify these immediate issues. The trickier problem is to how to ensure that the franchisee will be able to avoid these problems in the future. On this point the franchisor will need to be creative. It will need to determine what caused the franchisee to default in its payments in the first place. Are the reasons centered on the franchisee’s inability to follow the franchise system, or are there more fundamental problems such as the viability of the unit’s location? In many cases a franchisee that purchases a unit at a high price from an existing, strongly performing franchisee may not possess the same managerial capabilities as its predecessor, and thus cannot maintain the same sales performance, making it more difficult to meet both its obligations to the franchisor as well as its debt service obligations. Also, market conditions of the original location might have changed necessitating the relocation of a franchisee’s unit. There may be a variety of reasons causing the default and it is up to the franchisor to recognize these problems and address them. Employing operational creativity from recommending a change in managers to a recapitalization of the franchise by the franchisee taking on new partners can prevent the franchisee from repeating the same behavior that caused the previous defaults.

**B. Beyond Operational Remedies to Keep the Franchisee in the Franchise System**

Even when a franchisor optimally uses its operational remedies, there may come a time with some franchisees when the relationship cannot be saved, and both the franchisor and the franchisee recognize that the best remedy is for the franchisee to exit the chain. Accomplishing that without the parties crossing swords can be a tricky proposition. The first thought of the franchisor will be to assist the franchisee in selling its franchise to a third party. The most immediate difficulty with this solution is that the franchisee’s sales price may not be realistic for a prospective purchaser. There are many permutations in establishing a sales price including, taking a percentage of the franchisee’s annual sales or taking a multiple of its earnings before interest, taxes, depreciation, and amortization (“EBITDA”). While each of these formulas can work, a franchisee likely will have problems if it needs to sell in a hurry or if it owes more to its creditors than a well-constructed sales price may command.

Where it becomes obvious that a franchisee will not be able to obtain a sales price sufficient to satisfy creditors, the franchisor should consider contacting all of the creditors, including the landlord, the bank that holds the purchase money mortgage, any equipment lessors and other creditors, to explore a global workout. A franchisor is limited only by its own imagination in finding workable solutions. Out of court settlements are always preferable to bankruptcy or other legally imposed restructuring, but such settlements are not always possible. To accomplish an out of court workout all of the creditors will need to be on board because creditors usually will only agree to a workout if all of the other creditors do also.
As a work around to recalcitrant creditors it may be a better alternative for the franchisor with the cooperation of the franchisee and some of the key creditors, to arrange for a pre-negotiated or pre-packaged bankruptcy. "A pre-negotiated bankruptcy, which is similar to a prepackaged bankruptcy, is a restructuring in which the company and key creditors agree upon the terms of a restructuring and contractually bind themselves to such terms though a lockup agreement without yet having engaged in the voting process mandated by Section 1126 of the Bankruptcy Code." It is only after the lockup agreement is signed by the parties that the company initiates a Chapter 11 case to implement the restructuring. The advantage of the pre-negotiated or prepackaged bankruptcy is that a company through this process can impose a treatment of claims on dissenting creditors so long as the company satisfies the confirmation standards of the Bankruptcy Code. It is important to note that using a prepackaged or pre-negotiated bankruptcy takes some time to implement, so it is important that the franchisee have sufficient staying power before engaging in this strategy. If the franchisee does not have sufficient staying power, a conventional bankruptcy filing that will provide a franchise with automatic stay rights under sections 362 and 105 of the Bankruptcy Code. One risk of prepackaged bankruptcies is that during the negotiation stage a debtor receives no protection from the automatic stay provisions of the Bankruptcy Code, so there is a risk that secured creditor may obtain a judgment or pre-judgment order of attachment of a debtor’s assets. It may also seek the support of other creditors to institute involuntary bankruptcy proceeding against the debtor franchisee.

If a franchisee is unable to find a buyer for its unit, the franchisor may decide to purchase the unit directly from the franchisee. While the franchisor may purchase the unit at a loss, there may be value in preserving a franchised location that the franchisor deems necessary to its overall franchise development. Particularly where the unit would be hard to re-franchise or is in an area where there are no franchises or company stores to service a franchisor’s warranties, it may be better for the franchisor to retain that unit and try to resell it at a later date than to lose its developmental momentum or presence in a particular market.

Where a franchisee has entered into a multi-unit development agreement with the franchisor, the franchisee may fall behind in the development of its units under the terms of the agreement’s development schedule. In many cases, a franchisee’s failure to uphold the development schedule may be grounds for the franchisor to terminate those development rights and perhaps the actual development agreement. The underlying reasons for the franchisee’s inability to meet that development schedule may form the basis for claims running both ways between the franchisor and franchisee. The franchisor may be within its rights to take a hardline position under the area development agreement, but doing so may result in protracted litigation that will undermine the entire development relationship with the franchisee and possibly the franchisor’s position in the development of the market.

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17 Id. at 1.
18 Id. at 1.
19 Section 362(a) of the Bankruptcy Code provides in relevant part that the filing of a bankruptcy petition "operates as a stay . . . of — (1) the commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title." Additionally, section 105(a) of the Bankruptcy Code provides in relevant part that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."
This recipe for disaster sometimes can be avoided if the franchisor is willing to be flexible in its development expectations. Often a franchisee’s inability to meet its development schedule is a function of a shortage of working capital. The franchisor should determine whether, as an alternative to termination of the development rights, a postponement or deferral of development with the particular franchisee makes sense, and whether it believes that the franchisee in the not so distant future will be able to meet its development schedule. Likewise, if the franchisee finds it difficult to operate multiple units, the franchisor should consider what assistance it can provide to the franchisee to better enable it to operate multiple units. While there are certain economies of scales that a franchisee can realize in the operation of multiple units, there are certain additional costs, such as managers, that a franchisee will need to undertake.

Other alternatives to termination of the agreement might include a reduction or abatement of the territorial exclusivity granted in the franchise, or requiring the franchisee to take on another partner in the future development of the multi-unit development rights. In the end, however, the franchisor must decide, likely in consultation with the area development franchisee, if in fact the franchisee is the best candidate to develop the particular market covered by the development rights. If the answer is no, the franchisor and the franchisee should consider a buyout or transfer of the area development rights of the franchisee to a third party. This is especially true in international cases. At almost all costs, the franchisor will want to avoid litigation with a foreign franchisee. Often litigation can take place in the franchisee’s country thus possibly subjecting a franchisor to the confines of an unfriendly court. Even if the dispute resolution is in front of a neutral party with the franchisor receiving a favorable outcome, it will still need to enforce any favorable order in the franchisee’s jurisdiction, which could be both costly and unpredictable. Consequently, arranging for a third-party assignment or purchase is a far better outcome, and one where both the existing area development franchisee and the franchisor will ultimately benefit.

When franchisors and franchisees cannot come to an agreement on how to end amicably the franchise relationship, the franchisor might have no choice but to resort to its nuclear option and terminate the franchise previously awarded to the franchisee. The franchisor should weigh carefully the costs and disruption to the franchise system that may arise when terminating a franchise and enforcing the post-termination rights contained in the franchise agreement.

IV. NOTICES OF TERMINATION

A. Fire for Effect

Franchisors may use notices of termination for a variety of reasons. In some cases, the notice will be used if a franchisee has been unresponsive to notices of default. The franchisor might think that a notice of termination will get the franchisee’s attention and it will understand that the franchisor was serious about the defaults that the franchisor alleges have occurred. Often, however, a notice of termination can have an unintended effect on the franchise relationship. In some cases, the franchisee may take that notice literally and merely take down its sign and start operating independently, necessitating that the franchisor launch an enforcement proceeding. In other cases, the franchisee may goad the franchisor into terminating the franchise, so when the termination notice comes the franchisee has gotten what it wanted, which is an excuse to take down its sign, and perhaps limit its damages from an
exposure to future damages to the franchisor. Moreover, if there were any hope to salvage the franchise relationship with the franchisee, it is likely that this window will close upon the issuance of a termination notice.

B. The Real Deal

If the termination notice was sent in earnest, then it behooves the franchisor to do it correctly. The first thing that a seasoned franchisee attorney will do is to review the termination notice against the terms of the franchise agreement and the various state relationship acts. In drafting a termination notice a franchisor must make sure that the notice strictly complies with the requirements of the franchise agreement and any applicable laws. If the franchise agreement states that a notice of termination is effective three days after sending it, then the franchisor must make sure that the effective date in the termination notice states just that. If the franchise agreement states that a notice of termination must be sent by certified mail, then the franchisor must be true to the language in the franchise agreement. Failure to follow the language in the franchise agreement, or failure to comply with applicable franchise relationship laws, may abrogate the notice of termination and can result in a claim by the franchisee for damages resulting from the wrongful termination.

C. What Should Be Contained in a Notice of Termination?

There are two purposes of the notice of termination. The first purpose is to state the reason for the default or breach and how to address it. Depending upon the termination procedure in the franchise agreement, a notice of termination could serve the same purpose as a default notice in that the notice can state that unless the franchisee cures the default within the period of time set forth in the franchise agreement, or in accordance with applicable state franchise relationship laws, the agreement will terminate automatically and without further communication at the end of the notice period. Alternatively, the notice can state that the termination of the franchise is effective upon the receipt of this notice, with the items of default being set forth in a previous notice of default.

Will the notice of termination be self-executing? In some cases the termination notice will state that termination becomes effective on a certain date. In other notices the franchisor may want to leave the door open for the franchisee so it may “reserve the right” to terminate the franchisee’s franchise so termination will not become effective until the franchisor actually sends out another notice announcing to the franchisee that the termination of its franchise becomes effective on the date or receipt of the follow-up notice. It is critical that the franchisor maintain a well-organized and complete paper trail. Because termination of a franchise is a draconian remedy, any ambivalence about the effectiveness of the termination notice will come back to

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20 Where a franchisor elects to terminate a franchise agreement then it may give up its rights to the recovery of “futures.” See Postal Instant Press v. Sealy, 51 Cal Repr. 2nd 365, 371 (Cal. Ct. App. 1996). In that case, the court held that it was the franchisor’s termination of the franchise agreement rather than the franchisee’s failure to pay past-due royalties and advertising contributions that cut off the franchisor’s ability to receive future payments.

21 Certain states have franchise relationship acts that codify the requirements of an effective and enforceable notice of termination. These termination notice requirements typically range from 30-90 days depending upon the state in question.

22 See, e.g., Hamnil v. Rickel Mfg. Corp., 719 F.2d 252 (7th Cir. 1983) where the court found that a franchisors failure to provide a franchisee with an opportunity to cure its financial default constituted a violation of the Wisconsin Fair Dealership law.
haunt the franchisor when it comes time to enforce the franchisor’s post-termination contract rights.

The second purpose of the notice of termination is to set forth for the franchisee its post-termination obligations upon the termination of its franchise. A franchisor should not assume that a franchisee is conversant with the post-termination obligations contained in the franchise agreement, so it should lay them out in the termination notice. The post-termination obligations typically include the franchisee’s obligation to de-identify the franchised unit and not make any further use of the franchisor’s trademarks or any part of its business system. If the franchisee is using a telephone number that is tied to the franchisor’s trademark, for example in the Yellow Pages, the franchisor typically will require the franchisee to assign that telephone listing to the franchisor. Likewise, the franchisor will typically require the franchisee to dissociate itself from the franchise system and not hold itself out as being part of the franchise system. If the franchisee owes the franchisor any fees or other monetary obligations, the franchisor will expect that the franchisee immediately pay the outstanding balance.

The franchise agreement may provide the franchisor with the right to purchase the equipment and inventory of the franchisee as well as the right to assume its lease. The franchisor should act promptly to invoke those rights. If the franchisor chooses not to take advantage of these remedies but later seeks to enforce its non-compete covenants or close down the franchisee’s business, the franchisor may claim that the franchisor is not serious about wishing to protect the franchisee’s location from unwarranted competition because it did not feel strongly enough to take possession of the premises.

Once the termination notice has been sent, the next steps will depend upon the reaction of the franchisee once it receives the notice. From the franchisor’s perspective the notice of termination is its nuclear option, and outside of operational remedies, a termination is the only true legal option available to the franchisor. Therefore, a termination notice should be a last resort because it is hard to predict how a franchisee will react to it. While the franchisor hopes that the franchisee will fold its tent and comply with the post-termination obligations in the franchise agreement, the franchisee is at risk of losing its entire investment into the franchise, thus, it may use any remedy available to it to protect or salvage any portion of that investment. Consequently, it is hard to predict what will happen post termination. So once the notice is put into motion, the parties have come closer to losing control of the dispute and have moved further down the road to hardened conflict.

V. IS THERE LIFE TO THE FRANCHISE RELATIONSHIP AFTER A NOTICE OF TERMINATION HAS RUN?

A. Extending the Relationship

While it is true the termination may produce unintended consequences for both the franchisor and franchisee, and it may end the franchise relationship, there are also opportunities to maintain or resurrect the franchise relationship. The termination notice may be the springboard to find a non-judicial resolution to a fractured franchise relationship.

As noted before, sometimes a notice of termination has the effect of waking up the franchisee to the reality that it may lose its franchise. At that moment the franchisee may decide that while it does not want to remain in the franchise system, it wishes to exit without protracted bloodletting. If the franchisor and franchisee can continue to communicate at this point in the relationship, they may jointly find a solution either to amicably end the term of the relationship or possibly to resurrect that relationship. Doing so may require the assistance of a third-party
mediator or ombudsman to bring the parties together. If there is bad blood between the franchisor and the franchisee, this cooling off period and the ability to put the dispute in front of a disinterested third party may assist the parties in acting reasonably instead of out of emotion.

At this point in the relationship it behooves the parties to consider the true endgame of each party, and what type of compromise the parties are capable of crafting. Again, the parties must consider the risks, including cost and disruption to the franchise system or the franchisee’s life by continuing down the path of post-termination enforcement of the contract. From the franchisor’s perspective what can it do to both preserve the integrity of the franchise system without at the same time spending countless dollars to enforce every provision of the contract? Perhaps the better course will be to buy-out the franchisee in order to preserve the franchisor's presence in a particular location. A franchisor should use its operations representatives, which have had ongoing contact with the franchisee during the relationship to float this possibility. If the franchisor is considering buying out its interest in the franchise, the franchisee must be realistic in what it expects to receive from a sale. From a legal standpoint the franchisee may have nothing to sell upon termination, so that it needs to keep this in mind when negotiating with the franchisor.

B. The Standstill Agreement

If the parties believe that there is any hope of coming to a negotiated resolution short of protracted litigation, they may enter into a standstill agreement that will guide the parties during this interim period. The standstill agreement can contain a host of different provisions, but it should address issues such as the term of the standstill agreement, the undertakings that need to be accomplished on the side of both the franchisor and the franchisee, and what it means to maintain the status quo of the franchise relationship. Common provisions in a standstill agreement may include:

- Whether the franchisees pay fees during the standstill term
- What happens to unpaid fees during the standstill term
- The consequences of not complying with standstill provisions
- Upon breach of the standstill agreement, must additional notice of termination be provided
- Preservation or tolling of the statute of limitations during standstill term
- Neither party can file any claims or invoke legal proceedings during standstill term
- Preservation of all claims of each of the parties to the agreement
- What services is the franchisor required to provide during standstill term.

The hope is that in part the standstill agreement can defuse what otherwise can be a very emotional period in the franchise relationship. However, the standstill agreement should maintain some third-party mechanism to resolve disputes should they occur during the standstill agreement. Also, to satisfy each of the party’s urge to be able to pull the conflict trigger if necessary, the standstill agreement should contain a reservation of rights for both the franchisor and the franchisee to terminate the agreement under specified circumstances and continue either enforcing the franchisor’s termination rights or the franchisee’s claims against the franchisor, respectively.

23 For example, § 17.15 of the Meineke Franchise and Trademark Agreement where the parties agree after receiving a formal notice of default or notice of termination a franchisee has 10 days to seek the assistance of an ombudsman before Meineke can act on its termination of its franchise agreement.
C. Early Termination Rights

There are times when a franchisee may wish to leave the franchise system even if there is no conflict between the parties. In some cases, the franchisee may seek to retire from the business, and the location is not suitable for resale. If it is apparent that the franchisee is not well suited for this particular franchise opportunity, it may be in the best interests to both parties to end the franchise agreement before the end of the stated term. In other cases the market or location where the franchisee is operating no longer is considered a viable location at which to operate the franchise and relocation is not a viable option. Where there is not an early termination provision provided for in the franchise agreement, a franchisor may wish to permit the franchisee to make an early exit from the franchise system either through a buyout of the agreement, e.g., paying some form of liquidated damages, just allowing the franchisee to leave the system without payment if the franchisor believes that an early exit will set a precedent for others in the franchise system. In either case, the franchisor should seek a release from the franchisee and should ensure that the franchisee has no plans to operate a competing business. A post-termination inspection of the facility, as would be necessary upon other forms of termination, is also advisable.

With all of these resolution vehicles, the franchisor and franchisee are seeking alternatives to protracted expensive and distracting litigation, which in the end likely will benefit only the attorneys on both sides.
ONE FRANCHISEE LAWYER’S PERSPECTIVE ON EARLY SETTLEMENT PROTOCOLS THAT WORK\textsuperscript{24, 25}

VI. BEGIN AT THE BEGINNING

A. What is the Franchise Lawyer’s Proper Role When Asked to Handle a Franchise Dispute?

To identify and effectively implement strategies that work to achieve the best possible early settlements, franchisee counsel should first reflect upon their proper role as lawyers, when they are called upon to resolve a dispute.

One of the great civil trial lawyers in this country, who achieved many quite dramatic successes in trial, answered that question this way: “I am a trial lawyer. If a client asks me to resolve a disputed matter, my role is to try that case for him. If he wants to settle the case, he can do that.”\textsuperscript{26}

However, when lawyers—particularly franchise lawyers who are frequently involved in seeking to resolve disputes between parties who are in ongoing franchise relationships together—are asked to resolve disputes, the first, and most appropriate, role is to figure out how to most effectively and most efficiently maximize the clients’ opportunities to resolve their disputes consistent with their principal business objectives. While that may mean commencing a lawsuit, that should typically be the case only if other more effective and more efficient strategies to effect an early negotiated resolution that is consistent with the clients’ principal business objectives have failed.

\textsuperscript{24} For an affirmation of many of the settlement strategies spelled out in this section, see generally Negotiation Briefings (formerly Negotiation), Program on Negotiation, Harvard Law School (publishing monthly “briefings” on the theory and practice of dispute resolution).

\textsuperscript{25} J. Michael Dady and his law firm represented the franchisees or dealers in each of the following cases discussed in this article (cited in the order they appear):

- \textit{Lano Equip., Inc. v. Clark Equip. Co., Inc.}, 399 N.W.2d 694 (Minn. Ct. App. 1987)
- \textit{Randall v. Lady of Am. Franchise Corp.}, 532 F. Supp. 2d 1071, 1081 (D. Minn. 2007)
- \textit{In re Patrick Nickleson Enter., LLC}, Case No. 12-32710, Doc. No. 89 (Bankr. D. Minn. Nov. 12, 2013)
- \textit{Blaske v. Burger King Corp.}, Bus. Franchise Guide (CCH) ¶ 10,767 (D. Minn. Sept. 25, 1995)
- \textit{Furlev Sales & Assoc., Inc. v. N. Am. Auto. Warehouse, Inc.}, 325 N.W.2d 20 (Minn. 1982)

\textsuperscript{26} This lawyer was the author’s first trial lawyer mentor. While the author learned many great and lasting lessons from this terrific mentor, he disagrees with his answer to this important professional question.
B. **Help Define the Client’s “Goldilocks Objectives”**

Consistent with the proper role as lawyers, doubly so as franchise lawyers, counsel must “begin at the beginning,” which means that they need to first ask clients what are their principal business objectives in connection with resolving their disputes. Franchisee counsel needs to help them define their objectives in a way that, first of all, makes sure that they are indeed concrete “business objectives” and not “strategies”—like “we need to sue them for every dollar they have.” Franchisee counsel also needs to help them get to what they, and counsel, believe are “Goldilocks objectives”—i.e., not unreasonably aggressive objectives, on the one hand, and not unreasonably soft objectives on the other hand.

Once franchisee counsel has these “Goldilocks objectives” defined, it is good practice to put them in writing to the client, and ask the client to confirm that they have accurately defined these business objectives. Counsel also should let the client know that they have the right to change their principal business objectives as the matter progresses, but, if they do, they need to clearly communicate that to counsel, as what they do, and how they do it, will be affected by the principal business objectives counsel has jointly defined. In the same vein, if as the facts develop, and as circumstances change, what had earlier appeared to be reasonable business objectives no longer appear to be so, counsel is duty bound to let their clients know that, and to consider whether the clients’ business objectives do indeed need to be revised.

On a macro level, franchisee objectives in a dispute typically fall into one of two broad categories: (1) “I want to stay in my relationship with my franchisor, but I need to address my franchisor’s concerns about my performance to date and/or my concerns about my franchisor’s performance to date, in ways that will improve this relationship going forward”; or (2) “I want to end my relationship with my franchisor prior to the termination date set forth in my franchise agreement, and/or recover the substantial amounts I have lost and/or be allowed to continue to operate my business as an independent operator or with a different flag.”

Examples of this first broad category of disputes would include the following:

- Seeking to persuade the franchisor to impose more reasonable upgrade requirements, perhaps limited in both dollar amount and frequency;
- Convincing the franchisor to improve protection against unreasonable same brand competition, by both the franchisor and by other same brand franchisees;\(^\text{27}\)
- Persuading the franchisor to be more transparent in the ways it is obtaining cash and non-cash consideration from vendors of products franchisee clients are required to purchase, and limiting how the consideration received is being spent (hopefully, for the benefit of the entire system, rather than to simply improve the franchisor’s bottom line cash flow);
- Seeking to rein in the franchisor’s “too-quick trigger” on the types and the frequency of the default notices it is issuing and seeking to also negotiate more specifics as to the

notice of the “cure” that the franchisor may be imposing, with reasonable limitations on
the types of cures required, and with reasonable time frames for effecting the required
cures;  

- Seeking to obtain specific rights to add additional franchise locations provided the
  franchisee client is capably performing in its existing locations; and

- Seeking assurances that, if the franchisee client continues to capably perform, he will be
  able to successively renew his franchise agreements, on terms that are not materially
  different than the terms of the franchise agreement currently in place.

Examples of disputes in this second broad category include helping franchisees who
have lost substantial amounts in a franchise investment, with continuing operational losses, with
no realistic hope of reversal, and with no express right to end the franchise relationship prior to
the end of the term thereof, promptly end the relationship and recover the substantial amounts
they have lost.

Once the appropriate business objectives are defined, the franchisee lawyer’s job is not
to simply commit to “try this lawsuit,” but rather is to use all of the gifts the franchisee counsel
has been given, and all of the available tools at his or her disposal, to maximize their clients’
opportunities to achieve those principal business objectives, just as effectively and as efficiently
as possible. That does not typically mean “we will try this lawsuit,” as that is likely the least
efficient, and the most expensive and stressful, way to proceed. However, not being afraid to
try the lawsuit, if that is what is called for, helps counsel to successfully use other, more
efficient, strategies for maximizing the clients’ opportunities to achieve their principal business
objectives.

the termination for alleged market share deficiency, because the notice of default did not allow a reasonable amount
of time to cure the alleged deficiency and because the proposed cure was unreasonable).

denied franchisor’s summary judgment motion, finding that the franchisor departing from its typical process for
allowing additional franchises to existing franchisees to deny expansion to leader of franchisee association may
violate the implied covenant of good faith and fair dealing).

granted an injunction preventing the manufacturer from unilaterally forcing its authorized dealer to sign a renewal
agreement substantially modifying the dealer’s assigned geographic territory, based on the dealer’s substantial
likelihood of succeeding on its claim that the parties’ long time course of dealing, evidencing successive renewals on
substantially the same terms, on which the dealer reasonably relied, will estop the manufacturer from being able to
now impose substantially different terms as a condition of renewal).

23, 2013) (three arbitrator panel entered an interim order allowing the franchisee to seek to mitigate its damages by
switching flags, and held, after a hearing on its merits, that this franchise opportunity was sold in violation of
applicable franchise disclosure laws with the making of false financial performance representations, and awarded in
2d 1004, 1015-17 (W.D. Ky. 2013), citing *Randall v. Lady of Am. Franchise Corp.*, 532 F. Supp. 2d 1071, 1081 (D.
Minn. 2007) (franchisor’s general disclaimers and integration clauses cannot negate franchisee reliance on alleged
illegal earnings claims, for purposes of claims under the Minnesota Franchise Act, as franchisee reliance is a fact
question not suitably resolved on a motion for summary judgment); *In re Patrick Nickleson Enter., LLC*, Case No. 12-
32710, Doc. No. 89 (Bankr. D. Minn. Nov. 12, 2013) (approving settlement of franchisee’s statutory pre-sale fraud
claims against franchisor).
Accordingly, franchisee counsel should pursue appropriate settlement possibilities as soon as that can feasibly and effectively be done. To be able to effectively do that, however, certain important pre-settlement discussion preparations must be completed.

VII. FACT FINDING

A. Obtain Key Facts and Key Documents

As a pre-condition to being able to effectively engage in appropriate settlement negotiations early on, franchisee counsel first needs to gather, and confirm, the key facts and key documents necessary to initially evaluate the client’s, and its adversary’s, likely legal rights and responsibilities, and whether they have been honored or breached.

In doing this initial fact-finding, franchisee counsel should have a good general sense of the likely legal principles in play, in order to quickly zero in on the range of potential key facts and key agreement provisions. Interestingly, the likely most fertile factual topics to be addressed are not the topics that are intuitively known by franchisees to be important. Rather, franchisees typically want to provide a soliloquy (often a too long soliloquy) about why they are so angry that their franchisor is not supplying more operational support. To get franchisee clients on track for the most fertile topics to explore, franchisee counsel should conduct what the author refers to as “Category One” and “Category Two” inquiries.

B. Do a “Category One” Analysis

Category One inquiries focus on the circumstances pursuant to which the franchise opportunity was sold. There, franchisee counsel should try and find a potential statutory and/or common law violation—e.g., was there some type of material misstatement or material omission. The first, and typically most fertile, such inquiry is the search for an illegal written or oral earnings claim made by the franchisor’s representative or affirmed by the franchisor’s representative.

C. Do a “Category Two” Analysis

Category Two inquiries relate to whether the franchisor has materially performed all of its express contractual obligations (as set forth in their written agreements), all of its implied obligations (as found in the contract-in-law principle of good faith and fair dealing), and whether the franchisor might have violated a statutory or common law duty (e.g., taking money from vendors without properly disclosing it in Item 8; or interfering with the franchisee’s existing and prospective contractual relations with their customers or their proposed transferees).

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32 See, e.g., Rogers Hospitality, LLC v. Choice Hotels, Int’l, Inc., Bus. Franchise Guide (CCH) ¶ 15,245 (A.A.A. Dec. 23, 2013) (the three arbitrator panel found that the franchisor’s sales director’s affirmation of projections made by a franchise consultant and provided to the franchisee constituted an illegal earnings claim in violation of applicable franchise disclosure laws).

33 In Blaske v. Burger King Corp., Bus. Franchise Guide (CCH) ¶ 10,767 (D. Minn. Sept. 25, 1995) a federal jury found that Burger King breached the implied covenant of the good faith and fair dealing by denying the Blaskes’ expansion rights.

34 For example, in Furlev Sales & Assoc., Inc. v. N. Am. Auto. Warehouse, Inc., 325 N.W.2d 20 (Minn. 1982), the Minnesota Supreme Court affirmed a jury verdict awarding compensatory and punitive damages against an attorney for the plaintiffs’ employer, for interfering with the plaintiffs’ employment contracts with their employer.
At the outset of this initial fact-finding, franchisee counsel also should perform an initial damages analysis to assess whether the objectionable conduct by the adversary has caused, or will cause, significant damage to the client's business. Whether significant damage is likely provable is an important fact to know in advising the client, whether he (and his lawyers) should meaningfully invest in addressing the problem to be solved or the objective to be achieved and, if so, on what basis. Surprisingly, more than a few clients initially ask to help them address issues that are troubling to them, but which, from the franchisee counsel's perspective, are not the type of macro issues which are causing, or are likely to cause, significant damage. As either the existence of, or the potential for, significant damage is likely a key factor in advising clients whether they should make a meaningful investment in seeking a franchisee counsel's help in addressing the problem to be solved or not, it is important to address, early on, this “step 3” of the “three-legged stool,” which will need to stand upright in order to be successful – i.e., proving (1) legal duty owed; (2) breach thereof; and (3) significant damage caused thereby. Accordingly, unless counsel has the likelihood of being able to prove significant “damages caused thereby” to date or in the future, they most likely will want to advise their clients to otherwise direct both of their resources.

VIII. DO A SIX-STEP ANALYSIS

In addition to gathering, analyzing and confirming the key facts and key documents, franchisee counsel may find it helpful, as a pre-condition to engaging in effective early settlement negotiations, to engage in a six-step analysis. Doing this six-step analysis makes it unlikely that counsel will miss a key legal point—i.e., one which, if missed, will cause them to incorrectly analyze the strengths and weaknesses of their, or their adversary’s, positions on the merits. Indeed, overlooking one or more of these six key steps can create unrealistic settlement expectations or sell short a legitimate claim. For example, a major agricultural equipment manufacturer acquired another major equipment manufacturer, and, in the process, announced the “withdrawal” of its tractors from the U.S. market, and thereafter began re-marketing those tractors under the flag of the manufacturer it has acquired, believing that strategy would insulate it from any liability for wrongful termination. In coming to that erroneous conclusion, it likely overlooked the existence of several state dealer protection statutes imposing successor manufacturer liability for such conduct.

Here are the six steps we typically follow:

A. Assess the Franchisor’s Announced Reasons and Potential Other Reasons for the Objectionable Conduct in Question

Counsel for a franchisee should have a healthy degree of skepticism as to the franchisor's announced reasons for proposing a particular change that will likely damage his or her franchisee client. Franchisors have been known to propose changes “for the benefit of the

35 For a detailed presentation of the specifics of this six-step process, see J. Michael Dady, Chapter 3: Evaluating the Termination Decision, in 1 Corp. Counsel's Guide to Distribution Counseling (Thomson Reuters 2014).

36 See Coelho & Bachetti, Inc. v. Ford New Holland, Inc., Bus. Franchise Guide (CCH) ¶ 10,923 (A.A.A. May 9, 1996) (Former New York federal judge Marvin Frankel found that, where the manufacturer and successor dealers of the renamed products were “continuing in business and reaping the benefits of the former . . . . dealers’ . . . . business,” it was unlawful to cause the former dealers alone to bear “by their own extinction the decline in . . . business.”) For an analysis of this case, and related cases, see J. Michael Dady, The Olds Market Withdrawal: Is What’s Past, Prologue?, 21 FRANCHISE L.J. 65 (Fall 2001).
system” which, in fact, improve the franchisors’ bottom line at the expense of their franchisees’ bottom line.

Over the years, many franchisors have changed their practices in how they announce significant system changes. Whereas, in the past, franchisors thought that providing no reason for their proposed changes in their franchise relationships was a good strategy, they have come to realize that, if no purported good reason is announced, it is quite likely that a bad reason will be inferred. Accordingly, in recent years, franchisors typically do provide a reason for the conduct in question, but looking for other plausible reasons for the changes is sometimes fruitful. Finding a “bad reason” that may be contrary to the principle of good faith and fair dealing can cause a fact-finder to conclude that unreasonable changes to a relationship are in fact unlawful changes.\(^\text{37}\)

If the franchisee’s counsel can find a factual basis for challenging the reasonableness of the proposed change, or if the franchisor’s announced reason is “because we can,” as opposed to the franchisor communicating the likely bona fide return on investment to both franchisor and franchisee for the announced change, the franchisee’s likelihood of success on the merits goes up. This also enhances the franchisee’s chances for an early settlement.

B. **Study the Relevant Provisions of All Applicable Written Agreements and Franchise Disclosure Documents**

While franchise agreements typically are not drafted to be favorable to franchisees, the franchisee’s counsel needs to know what the key substantive and procedural provisions say about the issues to be addressed. Counsel needs to look at the applicable franchise disclosure documents for the same purpose. As to the latter, besides providing a general overview of the franchise system involved, Item 19 and Item 8 are typically of most interest.

As to Item 19, oddly enough, franchisee counsel may like to see “we do not make any earnings claims” set forth therein. While some day that may prove to be true for a particular franchise system and its franchise sales people, commonly, the opposite is in fact true.

As to Item 8, franchisee counsel should be very interested in whether the franchisor commits therein to use its system-wide bargaining power to benefit its franchisees, which can provide the basis for a claim – i.e., if that in fact is not the case. Franchisee counsel should also look to see whether the franchisor is taking payments from vendors, and, if so, (1) whether it adequately discloses the receipt of such payments and the use to which the payments are put; and (2) whether these announced practices are in fact being followed – e.g., if these funds are announced to be invested “for the benefit of the system” but instead are being used to enhance the franchisor’s bottom line profitability, that is likely actionable.

C. **Study the Relevant Provisions of All Potentially Applicable State and Federal Statutes**

Counsel should analyze whether any of the franchise disclosure or franchise relationship statutes in place in approximately eighteen states each might be applicable to the particular

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\(^{37}\) See, e.g., *Dunafon v. Taco Bell*, Bus. Franchise Guide (CCH) ¶ 10,919 (W.D. Mo. Mar. 13, 1996), (chief executive officer of the franchisor announced a change in the criteria franchisor would consider for allowing franchisees to add new stores, which the court found was, instead, likely an effort to sanction the franchisee leader of the franchisee association by not allowing him to grow).
dispute. Counsel also should assess whether any other state or federal statutes apply that might provide certain legal rights and responsibilities relevant to the parties' relationship. The potential for applying a particular state’s disclosure, or relationship, or deceptive trade practices, statute outside the boundaries of the particular state that has enacted the statute is always something to consider.

D. Do an Antitrust Analysis

Because the federal and state antitrust statutes have such extraordinary remedies available to victims of violations, including treble damages, and because the potential sanctions to violators may include criminal sanctions, franchisee counsel always should take a separate look for potential federal and state antitrust statute violations. Among the array of potential franchisor conduct worthy of an antitrust challenge is resale price maintenance activity; franchisors taking payments from vendors based on franchisees’ purchase of required products; and discrimination in pricing of the products or services provided by franchisors to their franchisees who are competing with one another, including by announcing quantity discounts that are not functionally available to different sized and competing same brand franchisees.

E. Do a Common Law Analysis

While the comprehensive summary of potential common law duties is beyond the scope of this paper, there are several common law duties franchisee counsel should consider. For example, courts and arbitrators will commonly accept the traditional jury instruction that the contract may be established from express statements and conduct by the franchisor, even when they are not reflected in their writing. For instance, in Dunafon v. Taco Bell Corp., the court acknowledged that, even in the absence of a writing, the plaintiffs could establish that an expansion agreement existed, based upon the express statements and conduct of the defendant.

In addition to the contract in fact, a “reasonableness” term may be imputed, as a matter of law, pursuant to the doctrine of good faith and fair dealing recognized in essentially every jurisdiction in this country. For example, in the first published “Internet encroachment” decision, Emporium Drug Mart, Inc. v. Drug Emporium, Inc., a panel of arbitrators issued a preliminary injunction, based in part on the covenant of good faith of fair dealing. In Emporium, the franchisees were given the exclusive right to operate “drug stores” within their territories using the name Drug Emporium. The franchisees claimed that operation of the drugemporium.com Internet store encroached on their exclusive territories. The arbitration panel rejected the franchisor’s claim that the exclusive territory provisions in the franchise agreement extend only to “brick and mortar” stores and, instead, found that the franchisor’s establishment of an Internet

38 For a comprehensive overview of federal and state business opportunity laws, see Keith J. Kanouse, An Overview of State of Business Opportunity Laws, 23 FRANCHISE L.J. 102 (Fall 2003). Several states also have deceptive trade practices acts, which are typically modeled after the FTC Franchise Rule, but, which, unlike the FTC Franchise Rule, commonly provide for a private right of action. See, e.g., TEX. BUS. & COM. CODE ANN. § 17.50 (West 2005).

39 See, e.g., Tractor & Farm Supply v. Ford New Holland, Inc., 898 F. Supp. 1198 (W.D. Ky. 1998) (Kentucky court applied the Michigan Franchise Investment Law to provide protection against termination to a Kentucky agricultural equipment dealer, holding that, as the manufacturer had provided in the agreement that Michigan law, without exception, would apply to this relationship, Michigan law applied).


store, selling to customers within the franchisees' exclusive territory, breached both the franchise agreement and the covenant of good faith and fair dealing.

Further, the Uniform Commercial Code provides that “every contract or duty within this chapter imposes an obligation of good faith in its performance and enforcement.” U.C.C. § 1-102(3). U.C.C. § 2-103 states that between merchants, “good faith” means “honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.”

Additionally, promissory or equitable estoppel may prevent a franchisor from invoking a clause in its written contract where the franchisor has, by its conduct, led its franchisee to believe it would not rely on the clause against the franchisee.42

Further, the statutory claims related to material omissions or material misstatements made in connection with the sale of a franchise may also be asserted as common-law claims for misrepresentation, which is particularly important where the applicable state’s law does not include a franchise disclosure statute.43

Another potential common law claim is whether the conduct in question may satisfy the elements of tortious interference with contracts and prospective contractual relationships. By introducing a tort theory of liability into termination litigation, punitive damages become possible. This often substantially affects the franchisor’s potential exposure and the terminated franchisee’s potential recovery. One particular type of interference that may be alleged is interference between the franchisee and his current and prospective contractual relationships with his customers.44 This same type of claim can also potentially be asserted against franchisors who unreasonably refuse to consent to the transfer of the franchisee’s business to a reasonably qualified buyer.

F. **Do a Damages Analysis**

As noted earlier, finding significant current or prospective damages is a key to success on the merits and to gaining leverage in early negotiations. Franchisors often underestimate the damages their conduct has caused or will cause. They may erroneously conclude, for example, that, if their conduct in question causes a reduction in revenues of 20 percent, it will have a corresponding reduction in the profits of our franchisee clients by only that same percentage. In fact, as business people know, the first dollars in cover the overhead and the last dollars in may

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42 See, e.g., *Lano Equip., Inc. v. Clark Equip. Co., Inc.*, 399 N.W.2d 694 (Minn. Ct. App. 1987) (holding that a manufacturer may be estopped to deny the existence of a long-term dealer relationship despite the existence of eighteen successive one-year contracts with integration clauses).

43 See, e.g., *Rodopoulos v. Sam Piki Enter., Inc.*, 570 So. 2d 661 (Ala. 1990) (the Federal Trade Commission regulations regulating the sale of franchises are admissible in a common law fraud action with regard to the franchise seller’s duty to disclose).

44 See, *Dunafon v. Taco Bell Corp.*, Bus. Franchise Guide (CCH) ¶ 10,919 (W.D. Mo. Mar. 13, 1996) (rejecting defendant's argument that plaintiffs' claim for tortious interference with prospective customers was flawed because plaintiff's relationship with prospective customers was too attenuated, and holding that (1) in Missouri the tort of interference with a business expectancy applies to mere expectancies; and (2) a regular course of prior similar dealings may create a valid business expectancy).
be all, or nearly all, of the bottom line cash flow. Thus, diminishing revenues by 20 percent could in fact eliminate profitability entirely.  

IX. SHARE THE RESULTS OF THE SIX-STEP ANALYSIS WITH THE CLIENT, AND IDENTIFY AND PRIORITIZE BEST NEXT STEPS

A. Share the Results of the Six-Step Analysis With the Client

Once the franchisee’s counsel has completed the fact-finding and six-step analysis, he is in a position to assess whether that analysis provides a strong, modest, weak or non-existent opportunity to achieve the client’s objectives through early settlement negotiations. Franchisee counsel should share the results of this analysis with the clients and discuss with them whether revising their principal objectives is then appropriate.

B. Do a Creative Problem Solving Analysis

As a next step in preparing for early settlement negotiations, franchisee counsel should likely engage in what folks who make their living engaging in creative problem-solving call “creative problem solving.” This process includes the following: (1) Identify the objectives to be accomplished (or the problems to be solved); (2) Consider the array of potential strategies to employ; (3) Evaluate the likely positive and negative consequences for each potential strategy; and (4) Prioritize strategies and pursue next steps. This analysis is designed to minimize the likelihood that counsel will forget something that is important to maximizing our clients’ opportunities to accomplish their principal objectives as effectively and efficiently as possible.

X. CONSIDER AT LEAST THE FOLLOWING POTENTIAL STRATEGIES FOR EFFECTING AN EARLY SETTLEMENT

In considering potential strategies to employ to maximize our franchisees’ opportunities to be successful in accomplishing their principal objectives, it is helpful to work off a checklist of potential strategies. Engaging in this process sometimes stimulates thinking about, and employing, other strategies as well.

A. What Has Been Tried Already, and What If Any Follow-up Thereon Might Be Most Appropriate?

Having a good sense of history is generally important in any negotiation, and that is certainly the case in assessing the potential strategies that might work for early settlement discussions in franchise disputes. Gaining a clear understanding of what has been tried already, either by the clients or by their other representatives, and what type of responses they have received, is always in order. Assessing what in the historical settlement negotiation process has worked or not worked, and why, is quite valuable.

45 See Buono Sales, Inc. v. Chrysler Motors Corp., 449 F.2d 715, 719-720 (3d Cir. 1971) (where plaintiff’s overhead or fixed expenses are not affected by the defendant’s breach, no deductions should be made in calculating the profits which the plaintiff would have made had it not been for the breach; in that event, only the variable expenses attributable to the lost unit sales are to be considered).
Developing an understanding of who the decision-makers are, and who might be of influence with those decision-makers, is helpful, as is understanding any offers made by each side, and the flexibility demonstrated, and the exchange that has taken place to date with respect to duties, likely breaches thereof, and damages caused thereby, so that franchisee counsel has some foundation for assessing potential follow-up strategies that might be most appropriate.

B. What do We Need to Do, and When, to Preserve Our BATNA Options?

Evaluating, and discussing with the client, early on, what if any “bad things” could happen if appropriate steps are not taken to preserve franchisee counsel’s best alternatives to a negotiated agreement, is very important. For example, certain franchisors are very quick to commence an action in the venue of their choice, rather than the likely venue of the franchisee’s choice, to gain a “first to file” advantage that may adversely affect the franchisee’s bargaining power. Franchisee counsel should evaluate the array of potential venue options, and if there is a significant disparity between a potentially favorable venue and a potentially unfavorable venue, franchisee counsel needs to do what can be done to maximize the opportunity to go forward in the venue of the franchisee’s choice, rather than in the likely venue of the franchisor’s choice, if an early settlement cannot be successfully negotiated. To maximize this opportunity, one option is to immediately file an action in the venue of franchisee’s choice. One negative in proceeding with this course of action is that some franchisors are understandably more willing to settle claims that have not yet been filed, since actions which have been commenced likely need to be disclosed in the franchise disclosure document, whereas disputes settled prior to any filing likely would not need to be disclosed, so these countervailing factors have to be weighed.

Another option in this situation is to have an action ready to be filed, but first reach out to franchisor counsel to see if they are willing to immediately enter into a standstill and tolling agreement in a form that would preserve our right to be first to file. This alternative, like immediately commencing an action, would stop the running of any applicable statutes of limitation – an issue which must always be immediately examined and considered, by looking at not only potentially applicable statutory statutes of limitation, but also whether the franchise agreements in effect contain potentially enforceable contractual shortening of the otherwise applicable statutes of limitation.

From the franchisee’s perspective, there might be a need to proceed to commence an action immediately – e.g., to obtain a temporary restraining order against an imminent termination. There may also be other business reasons for needing to do so. Accordingly, franchisee counsel should typically ask their clients to consider, as counsel does along with them, whether the passage of time without taking any formal, or informal, action is their “friend” or their “enemy”, with counsel’s going forward actions being significantly influenced by the answer to this important question.

46 Best Alternative To a Negotiated Agreement. In assessing whether and when we have reached the best potential early settlement agreement we can achieve early on, and evaluating it and making recommendations to our client as to whether that proposed early settlement agreement should be accepted or not, we need to evaluate it against what we believe is the likely best alternative to a negotiated agreement – e.g., how likely are we to succeed in any subsequent formal proceeding, and what might we likely achieve if we are successful.

47 See, e.g., Motorscope, Inc. v. Precision Tune, Inc., CIV. 12-1296 SRN/AJB 2012 WL 4742278 (D. Minn. Oct. 4, 2012) (in cases of concurrent jurisdiction, the first court in which jurisdiction attaches has priority to consider the case, and the fact that the plaintiff filed this Minnesota action one minute after the expiration of the parties’ standstill agreement in an attempt to pre-empt Precision Tune’s choice of forum does not evidence bad faith, as both parties filed suit as quickly as possible upon termination of the standstill agreement).
C. **Who is the Best Possible Third-party Intervenor Available, and How Might that Be Effected?**

Franchisee counsel should typically ask their client, and think themselves, about whether there might be some individual or entity who might have tremendous influence over a key decision-maker of the franchisor, and who might be willing to use that influence to help counsel’s client maximize his opportunity to achieve his principal business objective. Interestingly, about ten percent of the time the client will suggest such a person.48

D. **Is There Strength in Numbers?**

Clients frequently ask whether it would make sense to get other similarly-situated franchisees involved with them in seeking to accomplish their principal objectives. Like every potential strategy, there are positives and negatives to consider. A likely positive is that the cost of going forward could be, on a per franchisee basis, reduced, and having a significant number of franchisees voicing similar concerns may be more likely to get the decision-makers at the franchisor involved, and lead to a more swift resolution.

On the other hand, a likely negative is that managing a larger group could be cumbersome, and different perspectives could make moving together quickly more difficult. In addition, the assertion of claims by multiple franchisees could harden the franchisor’s resolve to view the claims as “system threatening” and, therefore, not able to be settled.

With increasing frequency, franchisee associations are taking an interest in helping their franchisees assert and resolve claims that are of common interest to their association’s members, by commencing an action themselves,49 by helping to fund franchisee litigation, by seeking to publicize and seek broad support for their members, and increasingly by their working together with other associations to seek positive legislative enactments.

E. **Might Franchisee to Franchisor Direct Communication Be Productive, and If So, How Might that Best Be Facilitated?**

Getting a sense of what has been tried already will help assess this potential strategy. Sometimes franchisee clients have good relationships with senior executives of the franchisor,

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48 For example, one of the author’s clients who was a large construction equipment dealer and had been terminated “effective immediately” at all seven of his locations responded to that question: “The CEO of my manufacturer has his job because I recommended him.” As expected, the client immediately reached out to that individual, and the matter was swiftly, and successfully, resolved.

49 As franchisee associations typically are not parties to contracts with their franchisors of their franchisee members, associational standing is a common issue franchisors like to raise to try and prevent these franchisee associations from bringing claims on behalf of their members. The law of associational standing has been evolving in favor of their ability to assert claims, on behalf of their members, provided “(1) its members would otherwise have standing to sue in their own right; (2) the interests it seeks to protect are germane to the organization’s purpose; and (3) neither the claim asserted nor the relief requested requires the participation in the lawsuit of each of the individual members.” *Hunt v. Wash. State Apple Adver. Comm’n*, 432 U.S. 333 (1977). One strategy to consider in seeking to blunt the effectiveness of a franchisor challenge to associational standing is to commence an action on behalf of both the association itself and some representative individual members who would have indisputable standing to assert the claims at issue. For an excellent discussion of association standing, see Edward Wood Dunham & Erika L. Amarante, *In DAI v. Downey: Associational Standing and Arbitration*, 27 FRANCHISE L.J. 16 (Summer 2007), and Jon S. Swierczewski, *Standing in Franchise Disputes: Check the Invitations, Not Every Party Gets Inside*, 26 FRANCHISE L.J. 107 (Winter 2007).
who clients might assume know about and have endorsed the objectionable conduct in question when, in fact, the opposite is the case.

On other occasions, more powerful same brand franchisee acquaintances of the franchisee client might be in the best position to positively influence a senior decision-maker at the franchisor and be willing to do so. With increasing frequency, leaders of the franchisee’s association or franchisee advisory council have a good relationship with the senior executives of the franchisor, and are willing to intervene on our client’s behalf.

In assessing this potential strategy, in addition to considering the “who, what, where, and when questions,” franchisee counsel should typically consider helping those who will be participating in this direct negotiation with Talking Points (business, legal or a combination of the two). These Talking Points should be prepared in a non-pejorative fashion, and in a format that makes it easy for the folks referencing them to speak about them, and, when appropriate, to share them with the franchisor representatives they are speaking with. These Talking Points have been successfully utilized to facilitate joint ongoing negotiations between one or more senior executives and their franchisor lawyer with one or more of our client representatives and one of us to facilitate a reciprocal communication of the respective parties’ principal objectives, and the joint development of a “settlement menu” for discussing the array of options that might work to address these respective principal objectives, as well as a discussion of the costs and benefits of pursuing the alternatives identified in ways that have led to a successful settlement agreement, early on.

F. Might Direct Communication with Franchisor Counsel Be in Order, and How Might that Likely Be Made Most Productive?

In the initial interview with franchisee clients, franchisee counsel should always inquire as to whom the franchisor might be using as its franchise counsel, both in-house and outside. If they are experienced franchise lawyers, perhaps franchisee counsel will know them and, hopefully, will have had some good experiences with them resolving other similar disputes on which they might build in seeking to resolve this dispute.

1. Who Communicates First?

In assessing whether reaching out to opposing counsel might be appropriate, franchisee counsel should think about the answers to the when, where and what questions. As to the when question, franchisee counsel should not view reaching out first to discuss settlement as a sign of weakness. If franchisee counsel has demonstrated a willingness to try cases that cannot be appropriately settled, the hope is that reaching out to discuss settlement early on will not be mistaken as a sign of weakness, but rather as evidencing a sincere desire to find a resolution to the dispute that works for everyone involved.

As to the where, franchisee counsel should do so with in-person or telephone contact, and should stay away from making that initial substantive contact by email or letter. Typically in those situations where franchisee counsel knows the lawyer with whom he is dealing, having an initial visit, which typically includes inviting them to tell “the rest of the story,” from their franchisor client’s perspective, including what their franchisor would like to achieve in its relationship with the franchisee client, and what types of settlement possibilities might be worth pursuing, is far more helpful, and far more productive, than a one-way communication, whether by email or letter.
As to the what, franchisee counsel should be driven by the exigencies of the situation. If, as is sometimes the case, we are contacted on the 29th day of a 30-day notice period of a termination absent a cure, counsel should reach out to opposing counsel on the same day that he is hired, absent some very good reason not to, to see if the attorney on the other side is open to allowing some reasonable time to get up to speed and to be back in touch, hopefully with a “standstill” commitment during this brief interim.

2. **Might We Work Together to Develop a Settlement Menu?**

Having “good settlers” on the other side dramatically increases franchisee counsel’s ability to work with franchisor counsel to develop, early on, a list of potential ways the matter might be resolved. The author has taken to writing down this array of potential ways to resolve the dispute on what his firm hopes has become an initial jointly developed “settlement menu.” Attached, at the back of this paper, is a sample settlement menu related to a dispute in which the franchisee wanted to leave the system and go independent or switch flags, whereas the franchisor’s preference was for the franchisee to stay in the system and was willing to make some concessions to increase the likelihood that the franchisee would be willing to do that. Reviewing this jointly prepared settlement menu might offer an idea or two to help deserving clients achieve a satisfactory early settlement.

G. **Consider the Array of Cash and Non-cash Consideration Options**

In reflecting on early settlement possibilities that might work, franchisee counsel should think about both “cash” and “non-cash” consideration options, including, in particular, any potential consideration where the benefit to the client is greater than the cost to the franchisor. Additionally, sometimes desirable franchisor payments might, in fact, benefit both the franchisee client and the franchisor alike. For example, in the *Collins v. Int’l Dairy Queen* antitrust litigation,\(^50\) Int’l Dairy Queen made a substantial commitment to increase the funding of national advertising as an investment which, hopefully, benefitted both sides to the dispute.

Types of non-cash consideration that a franchisee might be able to put on the negotiating table, to make settling more desirable for one or both parties, include confidentiality, negotiating the settlement before any action is filed, structuring the transaction as a quit claim sale of franchise rights (which typically makes the franchisor’s compliance with its FDD disclosure obligation more palatable), accepting payments over time (with adequate security), accepting reduced royalty rates on a going-forward basis, obtaining increased and more comprehensive development rights, increased protection against encroachment, better renewal rights, improved dispute resolution protocols, and reciprocal non-disparagement commitments.

H. **Consider When and How Best to Utilize a “Demand Letter,” If Ever**

Sending the traditional “demand letter” to commence early settlement negotiations is typically not an effective “door opener.” Rather, the naked “demand letter,” without other forms of communication accompanying it, is likely to draw a strong counter-demand letter, with this exchange likely promoting, rather than reducing, the likelihood of formal litigation or arbitration proceedings going forward vigorously (and expensively).

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\(^{50}\) *Collins v. Int’l Dairy Queen*, No. 94-95-4-MAC (M.D. Ga. Apr. 14, 1994) (The settlement agreement required defendants to pay $30 million in advertising, $250,000 to each of the suit’s five original Central Georgia plaintiffs and $11.3 million in legal fees. Defendants also agreed to make concessions on supply and other franchise issues.)
At the same time, providing to the decision-makers and counsel on the other side and our adversary a written presentation of the franchisee’s position as to likely duties, breaches thereof, and damages caused thereby, accompanied by an invitation to negotiate a mutually-acceptable settlement or to engage in some type of facilitated negotiation involving third-parties, can be helpful. This is particularly true if it is preceded by an in-person or telephonic communication, ideally with a franchisor lawyer on the other side who franchisee counsel knows and respects. Then the “demand letter” instead can be written as a polite, but firm, “confirming letter.”

I. Anticipate, and Be Prepared to Attempt to Leap, Likely Hurdles to Settlement

Hurdles to a successful early settlement do often arise. They must be successfully leaped, if an early mutually-acceptable settlement is to be achieved. Common hurdles (followed by a thought or two as to what might work to be able to leap them) include the following:

- “Because we can,” rather than “because this makes good business sense”

Franchisors seeking to impose change most effectively do so by first testing the proposed change and demonstrating that an investment in the cost of implementing the change will be returned to the franchisees with a good bottom line return on that investment. In those cases, franchisees are more likely to work cooperatively with their franchisor to make the change happen. On the other hand, franchisors that do not demonstrate a solid prospect for a bona fide positive return on the investment, but simply seek to impose a change “because we can—read your contract,” are likely to create a dispute. Persuading franchisors to move from “because we can” to “because this makes good business sense” typically benefits not only the particular franchisee in the dispute but the franchise system as a whole. Franchisee advisory councils and franchisee associations willing to speak up on this issue have been of significant, and rather frequent, help in leaping this particular hurdle.

- Dealing with message carriers rather than decision-makers

A principal reason early settlement efforts fail is because the franchisee is unable to engage either a decision-maker or a person who can and will positively influence the decision-makers involved. While franchisee lawyers are duty bound to deal with only the franchisor lawyers, absent franchisor permission to do more than that, proposing a meeting with mutual decision-makers in attendance sometimes works, as does getting third-parties willing to get involved engaged in communicating with decision-makers.

- “We can’t settle with you because your claims threaten our entire system”

Franchisors often take this position, but franchisees can try to turn this claim around. If this claim is right, trying the case and losing would be a far more significant threat to “the entire system” than would be settling with this one franchisee. Offering confidentiality with reasonable commitments that the confidentiality will be maintained, and with significant sanctions if it is not, is an additional help in leaping this hurdle.

- “We have no money”

“We trust you, but we would like to cut the cards” comes to mind when faced with this hurdle. Franchisee counsel should request complete, up-to-date financial documentation of the
current and likely future prospects of the franchisor that makes this claim. Outside assistance in assessing the financial statements and the franchisor’s future prospects may also be appropriate, either to confirm what has been said or to obtain and communicate to franchisor counsel why the “no money” representation may not be true long term. Additionally, offering to structure the settlement terms in ways that take into account the current and the future performance of the franchisor is another option. For example, having an “earn out” provision in the settlement terms, providing that the franchisor will pay a certain percentage of future annual revenues (subject to a minimum and maximum payment), can help to facilitate settlement where the future financial ability of the franchise system is in doubt. Obtaining guarantees of performance by the franchisor’s control person can also help achieve an acceptable settlement.

- “We have to treat all our franchisees the same”

While clients often hear this claim, it is typically not precisely accurate. While there are some statutes that prohibit discrimination among franchisees, that discrimination issue only comes into play as to “similarly-situated” franchisees. Franchisee counsel should demonstrate that this client is in fact not “similarly-situated”—e.g., because a settlement of this potential litigation separates our franchisee client from all other franchisees—to help leap this real or imagined hurdle.

- The franchisee needs to move “North” from a prior settlement proposal, instead of “South”

If the franchisee, or its former representatives, have been too gracious in proposing a settlement, such that counsel now needs to increase the cost of a settlement to the franchisor from the cost previously proposed to get the case settled, that typically makes settlement more difficult than if additional concessions by our franchisee may be made to make a deal. Demonstrating why certain factual or legal factors, not previously known or properly communicated, or evaluated, make this move “North” now appropriate, will help to leap this hurdle.

- A dislike/distrust of counsel is getting in the way of effecting good settlement options

Sometimes prior bad experiences, overly aggressive contested litigation, or outside influences can create an unfortunate distrust or dislike of lawyers on our side or on the other side. In those situations, and likely for other reasons as well, it sometimes makes sense to suggest that different folks, lawyers and non-lawyers alike, be designated as settlement representatives for each side. The use of different lawyers, acting as “settlement counsel only,” can be an effective way of leaping this impasse hurdle in settlement negotiations.

- Clients are reluctant to accept their lawyer’s “good advice”

While developing good and mutual respect and trust between lawyer and client is very important, sometimes there are breakdowns or outside influences that cause clients to be unwilling to accept what their counsel believes is good advice in the context of settlement negotiations. While this reluctance could be influenced by the form of the arrangement in place (e.g., contingent fee clients often want to meet and discuss and debate issues with us in far greater frequency, and in far greater detail, than do pay-as-you-go clients), other factors can influence this as well. In those situations, an affirmation by someone that the client trusts—e.g., a spouse, sibling, financial advisor, or business partner—can allow us to leap this hurdle.
J. Engage in Mediation?

One arrow in the settlement quiver that can work extremely well is mediation. While there are other understandable, and frequently appropriate, thoughts by counsel on both sides that the time to conduct a mediation must be the “just right” time – i.e., mediations can be subject to fail if they are engaged in too early or too late in the dispute resolution process – there is a process counsel can engage in, at the same time as they are communicating with one another directly to see if the matter can be settled early on, that can move forward the “just right” time for mediating.

To lay the groundwork for engaging in a successful mediation, if other alternative forms of early dispute resolution prove to be unsuccessful, counsel for both sides should first communicate directly, ideally in person or by telephone, and confirm those early settlement communications with follow-up confirming written communications, in a manner that allows each side to understand (1) the other side’s key objectives, (2) the other side’s key fact and legal arguments as to the parties’ respective legal rights and responsibilities, (3) how the other side is principally claiming that their legal rights, if any, have been violated and the likely damage caused, or to be caused, (4) what the parties’ collective “settlement menu” for a negotiated resolution might look like, and, finally, (5) what each sides’ best early settlement offer might be. Sometimes, but not always, parties should also be invited to “put some meat on the bones” of these key factual and legal issues – e.g., by engaging in a limited “key documents” exchange, and perhaps by also answering some informal, and reciprocal, exchanges of questions about key issues.

This exchange between counsel can lay the foundation for a good and effective early direct communication between franchisor and the franchisee and their respective counsel that may well lead to a directly negotiated early settlement. Failing that, however, this same exchange can lay the groundwork for introducing into the settlement efforts the participation by some mutually respected third party, for a mediation.

Once this factual and legal foundation has been laid, an early mediation can work very well, with the chances for mediation effecting a successful early settlement going up rather dramatically if three factors are present.

First, it is important to have a skilled mediator suitable for the type of dispute and the type of parties involved. Interestingly, having a mediator who is held in particularly high regard, and trusted, by the franchisor and its counsel may be more important to the franchisee than the opposite, such that franchisee counsel should solicit franchisor counsel’s input as to who such mediators might be, from their perspective. Those mediators who are trusted by the folks on the other side, and by franchisee counsel, to give their honest evaluation of the strengths and weaknesses of each side’s position on the merits, and to help the parties brainstorm about the types of settlement that might make the most sense, in an empathetic, graceful, persuasive, and persistent way, are the most effective mediators.

Second, it is crucial to make sure that the decision-makers are, in fact, in attendance and engaged for the entire mediation process. The absence of a bona fide decision-maker may

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51 For an excellent discussion on mediation, see Layn R. Phillips, Deborah L. Taylor, & Morton H. Aronson, Mediation: When To Do It, How To Do It, What To Do With The Results, ABA 18th Annual Forum on Franchising at B (1995).
be the reason that mediations are unsuccessful. Accordingly, addressing this “a bona fide decision-maker must be in attendance” issue, up front, as a condition of agreeing to going forward with the mediation, is essential to avoid wasted time and other resources.

Third, having both sides motivated to actually reach a settlement is very important. Conducting that mediation only if there is the requisite minimum sense of urgency, and doing what can reasonably be done to create that urgency, is very helpful. If, however, it appears that the opposing party is only interested in conducting mediation to engage in some pre-litigation informal discovery, and to try and intimidate the franchisee into unwise concessions, leaving the mediation arrow in the quiver, and saving it for another day, when the requisite bona fide minimum sense of urgency is present on both sides, is likely the best decision to then be made.

K. Consider Commencing Formal Proceedings

It is sometimes the case that certain franchisors will not take the claims of our franchisee client seriously unless franchisee counsel commences formal proceedings. In those instances, with the permission of their clients, franchisee counsel should do so. At that point, some franchisee counsel advises against again seeking to initiate settlement discussions, as their opinion is that to do so might suggest an unwillingness to go forward with formal proceedings. However, is that then reaching out to opposing counsel may not be a sign of weakness, but rather a sign of intelligence – i.e., it is a sign that counsel recognizes that working harder to achieve a potentially acceptable settlement is likely a good investment on the part of all concerned.

L. Is a “Bad Cop”/“Good Cop” Approach Advisable?

Rather frequently, franchisor representatives, sometimes from the same person, and sometimes from different persons, employ a “bad cop”/“good cop” approach. The “bad cop” typically creates additional stressors for the franchisee and for counsel, by implementing the formal dispute resolution protocol in some particularly aggressive way. At the same time, the “good cop” is reaching out to the franchisee to achieve a reasonable, mutually satisfactory settlement, and also lends an empathetic ear to the franchisee’s concerns about the antics by the “bad cop”.

The effectiveness of this rather schizophrenic approach to settlement negotiations is subject to debate, but sometimes utilizing a strident approach, and at other times utilizing a conciliatory approach, can be helpful in getting the attention and the cooperation of folks on the

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52 The author’s firm has had some recent very bad experiences at mediations in which the franchisor attorney has promised that bona fide decision-makers will be in attendance when, in fact, it became very clear to the author, and to the mediator, this was not the case. Rather, what appears to have occurred is that the franchisor sent folks to the mediation with minimal authority, with the sole purpose of trying to utilize the mediator and the mediation process to get the franchisee client to accept an extremely modest settlement well below the bona fide settlement value of the claims in question.

53 While mediator retention agreements commonly require the parties to bring decision-makers “with full authority” to the mediation, and while some of these retention provisions even allow the opposing party to receive written notice as to who the purported decision-makers are and to raise a pre-mediation objection to the mediator if their authority is in question, the author has unfortunately had bad experiences with only “token” authority decision-makers apparently attending, causing a substantial waste of everyone’s time and money. Cooperation among the franchise bar, to make reciprocal assurances that bona fide decision-makers will be in attendance at all mediations would help make this good mediation option even better.
other side who might otherwise be reluctant to engage in bona fide, meaningful settlement negotiations.

M. Consider Employing Separate “Settlement Counsel” For Each Side

A particularly effective alternative approach to settlement negotiations, which is often particularly underutilized, is for each side to designate one or more lawyers to be their “settlement counsel only.” The settlement counsel does not participate in the formal dispute resolution process at all, except to appear at any settlement conferences that may be scheduled by the court.\(^{54}\)

The use of “settlement counsel only” should be tried more often, particularly in those situations where both parties desire to improve ongoing relationships and seek a swift, and informed, method of resolving disputes.

One suggestion on this topic is for large franchisor entities to allow their in-house counsel to function as “settlement counsel only,” and to negotiate directly with the franchisee lawyer on the other side of the dispute, whether that franchisee lawyer is himself or herself is “settlement counsel only” or is also involved in the litigation. Instead, what is often the case is that the in-house franchisor counsel remove themselves from the dispute resolution process entirely, whether it be litigation, arbitration, or settlement discussions, and they are then unable to either share their unique perspective on the costs and benefits of going forward or their ideas to creatively search for mutually acceptable accommodations.

On the franchisee side of this equation, franchisees and their trial lawyers should consider employing experienced franchisee counsel as their “settlement counsel only,” with the single mission of trying to engage directly with opposing in-house counsel or outside counsel, given the mutually satisfactory nature of this settlement vehicle for dispute resolution.

XI. SUCCESSFULLY CONCLUDING THE EARLY SETTLEMENT

A. When and How Best to Document

As the parties move forward in early settlement negotiations, exchanging draft Terms Sheets is helpful, as these Terms Sheets can reduce the likelihood of an unintended difference of opinion later between lawyers and their clients. Terms Sheets should include both dispute resolution provisions and a “subject to subsequent consistent documentation” clause.

\(^{54}\) The most successful, and the most rewarding, settlement experience the author has had in his career to date, is the result of the franchisor’s CEO, in hotly contested, bitter litigation between approximately 20 percent of its United States franchisees and the franchisor, proposing, after months of settlement negotiations that had done nowhere, that each side select new lawyers and new business people to engage in settlement discussions. The author was selected by the franchisees to be their settlement counsel in these negotiations, which resulted in a long-term, restructured relationship of the franchisor/franchisee system for those involved in this litigation. At least as importantly, this negotiation laid the groundwork for over 20 years’ of follow-up settlement negotiations between the lead lawyer for the franchisor’s settlement team and the author, in which the two of of them, with the help of their respective clients’ decision-makers, were able to negotiate to a mutually satisfactory resolution essentially every significant issue that has arisen between their respective clients over the past 20 years.
B. **Put Your Best Foot Forward in Your Concluding Communication with Opposing Counsel**

After the settlement has been fully documented and signed, counsel should do their best to conclude on a positive note the settlement negotiations, with a sincere, complimentary communication to the lawyers on the other side, including, in particular, identifying and affirming the significant benefits the adversary’s counsel has obtained for their client in this settlement.

C. **Calendar Future Key Dates**

In addition, even when the subsequent events making up a part of the settlement have been precisely documented, calendaring subsequent action dates, and communicating with the clients when those follow-up action dates are about to arrive, provides a real service and avoids likely unintended breaches of settlement terms and unintended missed opportunities (e.g., rights to renew).

D. **Consider What Else Might Be Done, Why and When**

Finally, later following up with the settling client to find out how the settlement terms are being effected is appreciated, and frequently leads to identifying other ways counsel can be of assistance to these clients, on this or related other matters, often in ways that would not have been possible had they not achieved this early settlement.
SAMPLE SETTLEMENT MENU

1. Franchisee is allowed to go independent, or switch flags, with an exchange of mutual releases.

2. Franchisee is allowed to go independent, with certain reduced non-compete terms, with an exchange of mutual releases.

3. Franchisee is allowed to mitigate his continuing damages by going independent, or by switching flags, with a waiver of liquidated damages and the post termination non-compete, but leaving open the franchisor’s lost future profits claims and the franchisee’s rescission/restitution/out-of-pocket damages claims.

4. Franchisee agrees to stay in the system long term, with significant concessions in royalty rate, the frequency and extent of upgrade requirements, increased operational flexibility, increased development rights and encroachment protection, improved dispute resolution and transfer provisions, and a right to successive renewals of the existing franchise agreement or something similar so long as the franchisee capably performs.

5. Franchisor, or its designated and franchisor-supported third party purchaser, buys out the franchisee.

6. Franchisee is allowed to sell to a third-party buyer, without any requirement that the buyer stay in the franchisor’s system.

7. Franchisor provides the franchisee with adequate consideration—cash and/or non-cash—to compensate the franchisee for the damages caused by having been oversold on the franchise opportunity and for not having received the promised level of franchisor support.

8. The parties agree to a Standstill Agreement in the relationship, with the franchisor putting on hold any claimed right to terminate (provided the franchisee stays current on its ongoing obligations), until or unless a court or arbitrator declares that the franchisor has the legal right to end the relationship.
Michael Dady is widely regarded as one of the most prominent franchisee attorneys in America. He and the other lawyers in his firm, Dady & Gardner, P.A. of Minneapolis, Minnesota, limit their nationwide practice to helping franchisees and dealers preserve and enhance the value of their businesses as effectively and as efficiently as possible. He and his colleagues at Dady & Gardner have made new law for franchisees, and together they are credited with having tried and won more cases on behalf of franchisees and dealers than any other firm in America. He and his partners have successfully represented franchisees and dealers in more than 350 different franchise and supplier organizations, and they currently represent 35 different national franchisee and dealer associations. Again in 2014 Chambers USA ranked Dady & Gardner as the top franchisee law firm in America, and it ranked Michael Dady and his partner, Ron Gardner, as two of the top three franchisee lawyers in America.

Michael is a frequent national speaker and writer on franchise law topics, and was an adjunct professor at the University of St. Thomas Institute for Franchise Management. Michael is listed in the Best Lawyers in America, is a member of the Million Dollar Advocates Forum (having obtained several results in excess of one million dollars for franchisee victims of unfair treatment), was selected by the Minnesota Lawyer as one of its ten “Attorneys of the Year” for the year 2000, has been consistently recognized by his Minnesota lawyer peers as one of Minnesota’s Top 100 Super Lawyers from among its more than 29,000 lawyers, and he, along with four of his partners at Dady & Gardner, has been consistently recognized by Franchise Times as one of the top 100 franchise lawyers in America.

Michael is active in supporting several service organizations. He formerly served as both the Chair of the Board of Directors of Catholic Charities of St. Paul and Minneapolis and the Chair of the Board of Regents of St. John’s University. He has been honored by both his university, Saint John’s University, and his high school, Sisseton High School, as their Alumnus of the Year. He is currently a member of both the National Advisory Council of the American Creativity Association and the Board of Directors of the C.M. Russell Museum of Western Art. A native of Sisseton, South Dakota, Michael is a rancher in his spare time, and considers “doing cowboy work” his favorite recreational pursuit.

To learn more about Michael and his firm, you can consult their Web site at www.dadygardner.com. You can reach Michael Dady at jmdady@dadygardner.com or by calling 612-359-9000.

To see Michael Dady answer frequently asked franchisee questions on video, please go to this link: http://www.reellawyers.com/michael.dady.
Ted Pearce Biography

Ted Pearce is Special Counsel for the Law firm of Nexsen Pruet located in Charlotte, North Carolina. He is the co-chair of the firm’s franchise and distribution group.

He joined Nexsen Pruet after a 30 year tenure as General Counsel for Meineke Discount Muffler Shops and then its parent Driven Brands, Inc., which is the holding company for 5 separate franchised automotive repair brands including, and MAACO Collision and Auto Painting. At Meineke and Driven Brands he worked with management and the company owners during the many phases of franchise system development.

His franchise legal experience includes: litigating enforcement of non-competition and intellectual property rights for franchisors in Federal and State courts, and through arbitration; management of the defense of franchisee class action against its franchisor; drafting of a broad range of transactional documents including franchise agreements, franchise disclosure documents, stock purchase and asset purchase agreements, financial instruments, settlement agreements, cooperation agreements; advise management on a broad range of franchise relationship issues including encroachment and effectuating changes to the franchise system (v) management of the legal aspects of the franchise sales process; working with independent franchisee associations for each of the Driven Brands’ franchise systems relative to numerous relationship issues; and, participating in multiple corporate transactions involving the purchase and sale of franchise systems to and from both strategic buyers and private equity groups.

He is a written and spoken frequently on issues relating to franchising over the past twenty-five years.