ASSESSING THE PRACTICAL ASPECTS OF LITIGATING FRANCHISE DISPUTES

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October 11-13, 2006  
The Westin Copley Place  
Boston, MA
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I. INTRODUCTION

The law. The facts. Applying the law to the facts. That is what we all studied in law school. That is what lawsuits are about, isn't it? Actually, as every experienced litigator knows, the facts and the law sometimes play a peripheral role in the real decision making process that ultimately results in the initiation of a legal action, the manner in which a suit is defended or prosecuted and how the dispute eventually is resolved. In virtually every lawsuit, the parties' motivations, action and strategies are shaped by multiple “other factors” that may have little or nothing to do with the clinical application of the law to the facts in dispute. The goal of this paper is to explore many of those “other factors,” including the often crippling cost of litigation itself and the potential system wide impact of an unfavorable outcome, and to examine how those factors create the framework for much of what eventually becomes the “strategy” for resolving a particular dispute.

The different players in a typical franchise lawsuit (franchisor, franchisor counsel, franchisee and franchisee counsel), often have differing perspectives, goals and motivations in litigation. For example, franchisors and franchisees, neither of whom typically views litigation as a profit center, usually desire to minimize litigation costs and potential exposure while maximizing potential recovery. Outside counsel for franchisors and franchisees, while sharing the goals of their clients, may have additional important motivations and goals, such as ensuring that they receive full payment for their legal services and, if possible, establishing a relationship with the client that opens up the possibility for repeat business. Because examination of the subject matter necessarily demands recognizing and acknowledging the different perspectives of the various participants in a franchise-related litigation, this paper frequently analyzes those perspectives separately.

II. ECONOMIC CONSIDERATIONS AFFECTING THE DECISION TO LITIGATE

A. Costs Of Litigation vs. Cost Of Not Litigating

1. Franchisor Perspectives

   a. Managing The Direct Costs Of Litigation

Some franchisors view their legal departments as cost centers. Others view their legal departments as contributors to the organizations’ overall revenue stream. Regardless, all franchisors’ legal departments necessarily engage in cost containment, including, but not limited to, maintaining budgets and, whenever possible, limiting the fees paid to outside legal counsel. In addition, budget concerns may require a franchisor to be selective when deciding whether to sue. However, franchisors also often are the subject of claims asserted against them. Whether the claim arises from an unhappy franchisee, a vendor, or a third party alleging an incident at a franchised location, the franchisor may have limited control over when it will be required to expend resources to defeat inbound claims. Franchisors also may need to account for the funding of certain anticipated litigation expenses and exposure.

Outside legal fees are a natural direct cost borne by franchisors when they litigate disputes. In order to minimize the direct costs of litigation, franchisors sometimes utilize pre-litigation dispute mechanisms, such as mediation, to avert larger expenditures associated with prosecuting or defending claims. In addition, depending on the circumstances, informal negotiation between the franchisor and the franchisee may be sufficient to avert a full-blown
litigation. Informal negotiations are less intrusive to the parties’ day-to-day business affairs, typically are less adversarial and almost always are less expensive.

b. Managing The Indirect Costs Of Litigation

Less intuitive, though equally important, is analysis of the impact of indirect litigation costs. These are “costs” borne by the franchise system as a result of litigation that do not necessarily result in an immediate expenditure of cash, but, nevertheless, result in an indirect expenditure of resources or a diminution in brand value. For example, litigation in general, and specific issues promoted in a particular litigation, inherently may create strained relationships between the franchisor and other franchisees in the system. The stigma of being labeled a litigious franchisor may hamper a franchisor's ability to grow or maintain business relationships with existing franchisees and to build new relationships with prospective franchisees through the sales process. The avoidance of strained relationships resulting from litigation with franchisees creates incentives for franchisors to attempt to resolve disputes with franchisees in an amicable fashion without resorting to litigation, or to engage in alternative dispute resolution mechanisms to avoid litigation.

i. Impact On Corporate Image

A litigious franchisor may have a strained public relations image with franchisee trade associations, the franchise community in general, the public and the courts which are charged with resolving the franchisor’s disputes. Thus, in deciding whether to litigate a particular matter, the franchisor will have to take into account the likelihood that its litigation position may be perceived negatively by third parties who are not directly engaged in the particular dispute and who have no vested interest in its outcome. In addition, the disclosure of multiple litigations between the franchisor and its franchisees in the franchisor’s UFOC may signal a troubled system and serve as a red flag to potential franchisees evaluating whether to purchase a franchise. This is particularly true when the number of litigations disclosed in Item 3 is excessive in relation to the system’s size and maturity. Thus, an overly litigious franchisor may find that sales of franchises to prospective franchisees diminish as its Item 3 litigation disclosures increase.

ii. Impact On Allocation Of Human Resources

Litigation inevitably creates a strain not only on the in-house legal team, but also on the franchisor’s business personnel whose primary responsibilities are to provide administration, sales, support, training, marketing and other key services aimed to establish, maintain and enhance positive relationships with franchisees. The time spent by business personnel in assisting the legal team with the development of litigation strategy, preparation of written discovery responses, serving as deposition witnesses, participating in alternative dispute resolution, and serving as trial witnesses, often results in a loss of productivity in connection with their primary job responsibilities.

iii. Impact On Relationship With Franchisee

Another indirect cost of litigation entails the strain the litigation necessarily places on the relationship between the franchisor and the franchisee engaged in the dispute. A franchisor needs to consider the future business relationship it may have with a franchisee with whom it has a dispute. Often, the franchisee involved in a dispute with a franchisor also has other sites in the franchise system that are in good standing. The litigation of a dispute with a multi-unit
franchisee over one specific site can create potentially negative consequences for the relationship between the franchisor and the franchisee in connection with the franchisee’s other productive, compliant facilities in the system. On the other hand, a franchisor does not want to set a bad precedent for the system by overlooking or ignoring a non-compliant franchisee’s behavior, even if the pursuit of claims against that franchisee may result in the erosion of other valuable relationships.

c. **Timing Of Initiating Litigation As A Strategic Issue**

The circumstances of a particular dispute can sometimes leave a franchisor or a franchisee with little choice regarding when to sue. If a franchisee’s site has been terminated from the system, the franchisor may need to initiate litigation immediately to resolve claims that, if left to linger, might result in irreparable harm to the system. For example, prompt action must be taken against a terminated franchisee who continues to use, and thus infringe, the system’s proprietary marks since it inevitably becomes more difficult to stop the infringement as time passes. In addition, a franchisor may wish to litigate claims promptly against a terminated franchisee in order to encumber the franchisee’s assets (which often include the real property where the franchise facility is located) and thereby avoid obtaining a judgment against the franchisee that is for practical purposes unenforceable due to the dissipation of the franchisee’s assets. In other instances, the franchisor may make the strategic decision to litigate with an existing franchisee as an alternative to termination. The franchisor may then enforce its rights while maintaining the franchisee’s presence in the system, continuing to avail itself of the franchisee’s revenue stream and avoiding the loss of a unit in a market where replacement opportunities may be limited.

d. **Assessing The Costs Of Not Litigating**

While the direct and indirect costs of litigation frequently are great for a franchisor and routinely factor into the franchisor’s decision concerning whether to litigate, sometimes the impact to the system of not pursuing litigation can be even greater. For instance, a franchisor that does not pursue litigation to enforce its brand standards may be seen as abdicating its responsibility to advocate on behalf of the interests of its compliant franchisees. Franchisee groups and coalitions within the franchise system may be quick to criticize the franchisor if it fails to maintain a stern approach to enforcement of brand standards and protection of the system’s image. In addition, failure to enforce brand standards may result in additional non-compliance by franchisees that view the potential consequences of non-compliance to be insignificant in comparison to the costs of adhering to system standards. Moreover, the failure to litigate flagrant violations of system standards could result in a loss of brand equity and the erosion of the brand’s image in the eyes of the public, which in turn may affect the ability of compliant franchisees to attract and maintain consistent business.

e. **Assessing The Risk Of Counterclaims**

Occasionally, a franchisor may decide to forgo a potentially meritorious claim if it believes that pursuing the claim will precipitate a significant and costly counterclaim from the franchisee. Sometimes, however, a counterclaim catches a franchisor unaware. In addition, franchisors sometimes discover problematic facts during the course of litigation that may undermine the franchisor’s previous evaluation of its own claims. A franchisor must constantly reassess whether to continue to pursue a claim, or defend a counterclaim, at each juncture in the litigation, including when facts are revealed during discovery, when a ruling is issued on a dispositive motion, throughout the immediate pre-trial phase, and even during the course of trial.
f. Cost/Benefit Analysis

A franchisor’s decision whether to sue a franchisee will depend on, among other factors, (a) the cost of litigation versus the upside potential for monetary recovery from a franchisee, (b) whether prosecuting its claims might lead to the exposure of a significant and costly counterclaim, (c) the harm that might be suffered if the franchisor chooses not to litigate and (d) the potential to collect on any judgment that is entered against the franchisee.¹

In determining whether to sue, franchisors typically consider whether the cost of the particular litigation will be greater than the expected monetary recovery if litigation is ultimately successful. In certain instances, the franchisor may simply decide that the litigation cannot pay for itself and thus is not worth pursuing. This consideration may be less important, however, where part of the franchisor motivation for suing is to “send a message.” Sometimes the franchisor’s message is intended to deter other franchisees from engaging in bad behavior. Other times, the franchisor’s message is directed to complaining franchisees that require assurance that the franchisor will take aggressive action to correct wrongs affecting the system. In either event, where the franchisor’s motivations include delivering a message to persons not directly involved in the lawsuit, the cost of the litigation itself may become a secondary consideration.

2. Franchisee Perspectives

Many practical considerations must be taken into account when determining how best to pursue, and eventually resolve, a dispute between a franchisor and a franchisee. Franchisees and franchisors are involved in a special, interdependent relationship with each other. They are “partners” in a business relationship, with both the franchisor and the franchisee possessing an interest in the success of the franchisor and its brand and products. Accordingly, independent decision making is limited in certain circumstances. In the course of their business relationship, the franchisor and the franchisee will typically experience tensions and disputes. While many disputes may be resolved independently by the franchisor and the franchisee throughout the course of their relationship, others will require the intervention of third parties (i.e., attorneys, the court system, mediators, arbitrators, etc.). Where the parties are unable to resolve the dispute informally, a franchisee must answer the question, “how far do I want this to go?” Also of vital importance to the franchisee is whether there is an alternative method to resolve the dispute without resorting to litigation.

As a practical matter, the decision whether to litigate becomes a moot point if the franchisor sues the franchisee. At that instant, the franchisee is a litigant and must respond. However, the franchisee may have the option of asserting a counterclaim against the franchisor.² The action taken by a franchisee, either in response to a complaint or as a plaintiff initiating a claim, will have repercussions on the entire business relationship between the franchisor and the franchisee. It is therefore of vital importance that the franchisee and his


² Some franchise agreements require that issues relating to the franchisor’s marks be brought before the courts while requiring arbitration of all other matters relating to the franchise agreements. If the franchisee has been sued in court for an alleged violation of the franchisor’s marks, the franchisee may not have a viable counterclaim (depending on the language of the franchise agreement). However, the franchisee still has the option of bringing an arbitration against the franchisor.
counsel discuss what the franchisee’s ultimate goals are and how best to achieve those goals, be it through litigation or an alternative form of dispute resolution, whether formal, such as mediation, or informally through negotiations between counsel for the franchisor and the franchisee.

a. Assessing Whether To Stay Within The System Or Leave It

When contemplating a suit against the franchisor, the franchisee and his counsel should consider what end result the franchisee wants to achieve, as this will dictate not only when, but whether, to sue. A primary consideration is whether the franchisee wants to remain part of the franchisor’s system -- a decision that will likely be determined by the status of the relationship at the time that the franchisee is contemplating legal action. Although there are exceptions, in general, the more strained and deteriorated the relationship, the less likely the franchisee (and the franchisor) will want to continue their relationship. If the franchisee wants out because he feels that he is being taken advantage of, that irreconcilable differences exist or that the franchisor has not been treating him fairly, the motivation to litigate may be driven as much by principle, and the desire to teach a lesson or punish, than by economic considerations.

If the relationship between the franchisor and franchisee has not reached the “point of no return,” however, the chances are greater that a franchisee will seek to find a way to remain in the system and continue working with the franchisor. Franchisees devote substantial amounts of time, money, efforts and attention to their franchises. The decision to leave the system, particularly if the franchisee has been involved with the franchisor for a number of years, is a difficult one. Accordingly, the franchisee will have a strong incentive to attempt to work out a resolution with the franchisor and remain in the system. In these situations, whether to litigate takes on greater importance because the franchisee must, before taking any action, consider the impact the litigation will have on the franchisee’s continuing business relationship with the franchisor. The franchisee typically will be best served by seeking to resolve the dispute through negotiation and mediation rather than suing. Once litigation ensues, the relationship between the parties will undoubtedly change, and the willingness to continue as partners in the franchise system may diminish as the litigation progresses.

b. Exploring Alternatives To Litigation

If a franchisee wishes to remain in the franchise system, filing a lawsuit is often a last resort. Many options, other than resort to the courts, are available to franchisors and franchisees unable to resolve disputes on their own. These options include direct communication between the franchisee and the franchisor (often based on the advice of an objective third party mediator may provide the parties with insights into the strengths and weaknesses of their respective positions).

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3 See Section II(A)(2)(d) below for a discussion of the challenges that franchisees face in obtaining and paying for the services of an attorney to represent them in their disputes against the franchisor, as well as the various fee arrangements that have been employed to give franchisees access to counsel and the judicial system.

4 As set forth below, it is the responsibility of the franchisee’s counsel to assess the situation and advise the client accordingly. In the majority of cases, particularly where the franchisees have limited resources or where the franchisees seek to remain a part of the franchisor’s system, engaging in costly litigation merely to prove a point will typically not be in the franchisee’s best interest. In such circumstances, the franchisee’s attorney must advise his client of alternative avenues for resolving the dispute with the franchisor, including mediation. The presence of an objective third party mediator may provide the parties with insights into the strengths and weaknesses of their respective positions.

5 For an interesting alternative perspective, i.e., that in many instances litigation is merely a means of optimizing leverage in the negotiation of the resolution of a particular dispute, see, Edward Wood Dunham and David Geronemus, Franchise "Litigotiation": Understanding The Interplay Of Litigation/Arbitration Outcomes And Settlement Negotiation In The Resolution Of Franchise Disputes, A.B.A. Forum on Franchising, Section W2 (2003).
attorney), negotiation through the parties’ respective counsel, and mediation. Franchisees typically do not favor arbitration because it can be as costly as, if not more costly than, litigating disputes in court. However, arbitration may be the only dispute resolution procedure available to the franchisee since many franchise agreements require waiver of the right of access to the judicial system.

Engaging in alternatives to litigation may actually enhance and improve the relationship between the franchisor and the franchisee if they are able to work through their dispute, reach a mutually agreeable resolution, and maintain a business relationship. Where the parties believe that they have each been provided an opportunity to be heard, the likelihood of achieving a mutually agreeable resolution is enhanced. In addition, in the case of mediation, the presence of a neutral third party may lend the dispute resolution process an air of formality and provide the parties with a greater chance of reaching agreement than would exist if the franchisee were required to engage in direct negotiations with the franchisor. Alternative dispute resolution options may also be attractive to a franchisor who wishes to avoid acquiring a reputation for being unable to resolve disputes with its franchisees.

c. Cost/Benefit Analysis

If the franchisee has already determined that he will leave the franchise system, limitations on the courses of action that he may pursue are fewer because preserving the relationship with the franchisor is no longer a paramount consideration. However, a franchisee’s decision to end the franchise relationship is only a first step in achieving a resolution of his dispute with the franchisor. That there is no interest or desire to preserve the franchise relationship does not mean that the franchisee necessarily should sue the franchisor. The franchisee and his counsel must still engage in a cost/benefit analysis to determine the best course of action to resolve the dispute in a manner beneficial to the franchisee.

Regardless of the perceived strength of the franchisee’s claims or defenses, the franchisee’s ability to obtain redress for a perceived wrong is limited by the expense of resolving the dispute. Cost can present a formidable obstacle to achieving the franchisee’s litigation goals. Engaging in litigation and arbitration typically are the most expensive options for a franchisee. Both litigation and arbitration may require franchisees to pay filing fees, costs, attorneys’ fees, and any travel expenses incurred in pursuing claims.6 As noted above, although frequently touted as a less-costly alternative to litigation, the cost of arbitration often can actually exceed the expense that otherwise would be incurred if the matter were litigated in court.7 It bears repeating: Franchisees and their counsel must always engage in a cost/benefit analysis to determine whether the expense of engaging in litigation/arbitration is worth the potential benefit to the franchisee.8

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6 Many franchise agreements contain choice of law and venue provisions that dictate where a franchisee may bring any claims against the franchisor. If the forum state is not where the franchisee resides, the franchisee will also be responsible for any travel expenses, including those of his counsel, who also might reside somewhere other than the forum state.

7 Organizations such as the American Arbitration Association, which manage and provide administrative support for arbitration actions, charge significant filing fees. Some franchisees, particularly those who have no choice but to pursue a claim (i.e., because of a wrongful termination of their franchise rights) cannot afford to pay those fees.

8 The franchisee and his counsel must also analyze the financial position of the franchisor. Even if the franchisee can expect to win a substantial judgment at the conclusion of litigation/arbitration, the franchisor may not be capable of paying the judgment. It is not necessarily in the franchisee’s best interest to obtain a judgment against a franchisor that it cannot collect because the judgment drives the franchisor into bankruptcy.
d. Assessing How Litigation Expenses Will Be Paid

One of the franchisee’s most important cost considerations will be the expense of hiring counsel to defend him or to prosecute his claims against the franchisor.\(^9\) Ironically, however, attempts to minimize attorney cost at the inception of a dispute by limiting or restricting counsel’s role may actually precipitate much greater costs to the franchisee at a later point in time. This is particularly true if the franchisee initially enters into an agreement to resolve its disputes with the franchisor without any representation by counsel. Many franchisees cannot afford to engage in litigation (or even protracted alternative dispute resolution procedures) if they must pay their attorneys by the hour. Even before a litigation or arbitration starts, a franchise dispute may require a franchisee’s counsel to engage in many hours of negotiation and preparation. Thus, for franchisees with limited resources, any hourly attorney fee arrangement must necessarily be limited in scope and duration, as the franchisee risks being forced to abandon his case mid-stream due to an inability to continue paying counsel’s fees.

Contingent fee arrangements, although not common in commercial disputes, may provide a mechanism for franchisees to engage reputable counsel who might otherwise be too expensive. However, contingent fee arrangements are not without drawbacks. The attorney’s evaluation of the strength of a case will determine whether he agrees to take the case on a contingency. Since an attorney accepting a contingent fee case is essentially funding the lawsuit, he may be less willing to expend resources on weaker cases. Thus, a franchisee whose case is not a sure-fire winner may have difficulty convincing an attorney to accept contingent fee payment. Blended arrangements, where a franchisee pays a portion of the attorneys’ fees up front and also agrees to grant the attorney a percentage of any amounts recovered (typically a smaller percentage than what would be paid with a strict contingent fee) may serve the needs of both the attorney and the franchisee whose case is not initially deemed strong enough to warrant a traditional contingent fee arrangement.\(^10\)

e. Indirect Costs Of Litigation (Franchisee’s Perspective)

Attorneys’ fees, court costs and arbitration fees typically represent the bulk of the direct costs that a franchisee incurs when engaging in litigation/arbitration with a franchisor. However, there are other indirect costs that must be considered when determining which strategy to pursue in attempting to resolve a dispute with the franchisor. Litigation/arbitration can have a severely negative impact on both the franchisee and the franchise. The franchisee can expect to experience a loss of productivity resulting from the shift in the franchisee’s attention from operating the franchise to pursuing his case against the franchisor. The franchisee may also experience undesired changes in his relationships with his employees. The franchisee’s employees may be aware of the dispute and may decide to “abandon ship,” particularly if they believe that their jobs are in jeopardy as a result of the dispute. On the other hand, in some circumstances employees may rally around the franchisee and offer their unqualified support. The response that a franchisee’s employees will have to a dispute between the franchisor and franchisee will depend largely on the quality of the franchisee’s relationships with his employees. On a personal level, being forced to conduct business with the franchisor when the relationship is deteriorating or has been destroyed can cause increased stress for the franchisee.\(^11\) This increased stress can cause personal relationships to break down in the midst

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\(^9\) The costs of litigating a case from the filing of the complaint through a trial can easily exceed $100,000.

\(^10\) There are various other options for funding a lawsuit, including obtaining a third party to invest in the suit in consideration for a percentage of any amounts recovered.

\(^11\) A franchisor engaged in litigation/arbitration with a franchisee may engage in retaliatory conduct such as increasing the frequency of inspections performed at the franchisee’s stores or grading inspections more severely. A franchisee
of the dispute, especially if the franchisees or the guarantors of the franchise agreements are related to, or friends of, the franchisee.

As noted above, the franchisee’s relationship with the franchisor is also likely to change depending on the action that the franchisee takes. The initiation of litigation/arbitration may result in rupturing a relationship that was once merely strained, whereas commencing a dialogue with the franchisor about ways to resolve the dispute may actually improve the parties’ business relationship as they come to understand their respective positions.

f. Winning The Race To The Courthouse

Whether a franchisee enters a lawsuit as a plaintiff or defendant can impact the entire course of the litigation. Typically, a franchisee will prefer to be the plaintiff in the dispute, thereby placing the franchisor on the defensive, affording the franchisee greater control over the pace of litigation, and, at trial, allowing the franchisee to present its side of the story first. In addition, winning the race to the courthouse can embolden a franchisee, who due to the nature of the franchise relationship, often feels that he is at the mercy of the franchisor. A franchisee’s status as a plaintiff may also increase the franchisee’s standing among other franchisees, demonstrating that the franchisee is not afraid of taking aggressive action against the franchisor and asserting his rights. Suing the franchisor may also encourage other franchisees who have been considering taking legal action to either file their own lawsuits against the franchisor, or, if feasible under the applicable rules of procedure, join together in one action against the franchisor. This may also provide the franchisee with increased bargaining power against the franchisor, since the franchisor’s cost of litigation against multiple franchisees is likely to be greater than the cost of litigating against an individual franchisee. Additionally, as discussed more fully below, joinder of claims by numerous franchisees may place the franchisees in a stronger bargaining position vis-à-vis the franchisor, not only by presenting the franchisor with multiple adversaries, but by allowing the franchisees to share the costs of litigation. These considerations are particularly important where the franchisor has superior resources at its disposal.

3. Franchisor Counsel Perspective

It is the job of franchisor counsel to implement the litigation goals and strategy of the client, the franchisor. Thus, on one level, the interests of the franchisor and its counsel always are aligned. However, in every attorney-client relationship an inherent tension exists between the expense of litigation (primarily in the form of the attorneys’ hourly fees) and the benefit or cost avoidance to be derived from engaging in the litigation. For franchisor counsel, managing this inherent tension can be challenging. Franchisor counsel is expected to develop and implement a successful litigation strategy while, at the same time, limiting the litigation effort as necessary and appropriate to maintain a positive risk/benefit ratio. In other words, if the primary issue in the litigation is money and the attorney spends $10,000 in attorney time to recover $9,000 from a franchisee (or to defeat a claim with a $9,000 exposure), that attorney is not going to be greatly valued by the client and probably is not going to receive repeat business

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that is not devoting his full time and best efforts to the franchise (as required by many franchise agreements) due to the demands of the litigation/arbitration may face greater scrutiny and claims of default by the franchisor.


13 The above considerations are also applicable when the franchisee is a defendant in a suit filed by the franchisor and the franchisee is considering asserting a counterclaim. If the franchisor has taken the action of filing an action first, a franchisee’s attorney must also consider whether other franchisees may join as parties in a third-party claim against the franchisor. See Fed.R.Civ.P. 19 and 20.
from that client. In contrast, franchisor counsel who is able accurately to assess the monetary and non-monetary value of a particular litigation to the franchisor, and implement a cost-effective strategy that achieves the franchisor’s goals, will be highly valued.

For franchisor counsel, accurately understanding the franchisor’s goals is paramount. Because of the nature of the franchise business model every franchisor/franchisee dispute potentially resonates on several different levels. At the primary level, the litigation is obviously an actual dispute between the franchisor and that particular franchisee. On a secondary level, the litigation is a potential dispute between the franchisor and every other franchisee in the system similarly situated to the franchisee involved in the litigation. On a third level, because it is likely that the franchisor will have to report the litigation in its UFOC, the litigation is a potential red flag to prospective franchisees that could negatively affect future franchise sales. All of these factors, some monetary and some not, weigh into the franchisor’s evaluation of what it has to benefit or lose in that particular litigation and how much the franchisor is willing to spend to achieve its goals. To develop an appropriate and cost-effective litigation strategy, franchisor counsel, through communications with the client, must thoroughly understand how the franchisor values these issues in that particular litigation.

In addition to achieving a positive and cost-effective result for the client, franchisor counsel, like all attorneys, has the additional consideration of making sure that he is fully compensated for the time and effort expended on behalf of the client. Franchisors come in all shapes and sizes and have differing levels of ability to absorb litigation expense. For small franchisors with limited cash flow, the expense of having to retain and pay outside counsel may make any potential litigation a “bet the business” proposition. Regardless of the degree of risk, or the amount of effort necessary to protect the franchisor’s interests, there may be only so much that a small franchisor can afford to spend on litigation. Larger franchisors, in contrast, may have litigation cost containment mechanisms in place and may attempt to use their size, economic leverage and the carrot of potential repeat or volume business to obtain a reduction in rates or an agreement by outside counsel to “eat” certain litigation expenses. In either event, franchisor counsel needs to be cognizant of, and adept at, juggling the competing interests of cost containment, implementation of effective litigation strategy, collection of fees from the client for the time actually expended on its behalf and, at the same time, maintaining the type of positive relationship with the client that will facilitate future business opportunities.

For most franchisor counsel, the typical billing model remains time based (i.e., time expended on behalf of the client multiplied by the attorney’s hourly rate). However, in the highly competitive market for legal services, variations on this model sometimes emerge. For example, highly commoditized work such as sending out notice to cure letters, may in certain circumstances lend itself to a flat fee (i.e., a fixed fee per letter).

4. Franchisee Counsel Perspective

The franchisee’s counsel must always bear in mind the ultimate goal of the franchisee. The franchisee does not benefit by winning a case against the franchisor if the legal victory results in the franchisee’s bankruptcy, the incursion of excessive debt, or other catastrophic consequences. In other words, a franchisee’s attorney must at all costs avoid a Pyrrhic victory. The typical franchisee’s attorney frequently has to remind the client “it’s not personal, it’s business.” However, the very nature of the franchise relationship often undermines the ability to separate what is personal from what is business. Franchisees often have operated the franchised business themselves and have invested sweat equity and their life savings into their business. The prospect of losing their business or seeing it decimated or destroyed by the
franchisor, his supposed “partner,” becomes unthinkable and can lead the franchisee to adopt a “victory at any cost” approach.

The franchisee’s attorney must be able to guide and advise the franchisee toward actions that will ultimately be beneficial to the franchisee, whether this involves achieving an early settlement or proceeding to trial on the merits. Franchisee counsel must marshal evidence to evaluate the strength of the case (as noted above, this may determine whether litigation/arbitration is even commenced). This process involves both evaluation of the case from the franchisee’s perspective -- through communications with the franchisee regarding his business and the franchise relationship, as well as through review of the documents in the franchisee’s possession -- and evaluation of the case from the perspective of the franchisor, based on the attorney’s experience with and knowledge of the franchisor, its business practices and its financial position.

Franchisee counsel must be able to analyze the facts of the franchisee’s case objectively and advise the franchisee as to the course of action that is most likely to achieve positive results. Franchisee counsel must also gauge the franchisee’s tolerance for risk. In some circumstances, franchisees overestimate the strengths of their claims and defenses. Other times franchisees undervalue their case. The franchisee’s attorney must help the franchisee evaluate how aggressively and how far to pursue the case, and, in addition, must be able to assess the franchisee’s sophistication regarding business and legal matters. Even where a franchisee has strong claims or defenses, litigation/arbitration remains a gamble and some franchisees may be hesitant to pursue claims despite the chance of recovering a substantial judgment. Again, the process by which the dispute is ultimately resolved will often depend on the resources available to the franchisee and his counsel.

B. Insurance Considerations

How a given litigation is ultimately resolved will depend in many respects on who is paying for it. Where insurance coverage exists, it may be possible to shift the expense associated with defending the litigation, and/or ultimate liability, directly to the insurer. Accordingly, one of the very first tasks that litigation counsel should undertake when an action is commenced against his client is to assess whether there is insurance coverage for the claims. The answer will depend upon both the nature of the claims asserted and the nature and scope of coverage under the subject insurance policies. If, after reviewing the policies, there is any possibility of coverage, the complaint should immediately be tendered to the insurer. An insurer’s defense obligations under most insurance policies will not arise until the insurer has received notice of the claim. Accordingly, delay in tendering the complaint may result in the insured’s forfeiture of the right to recover reimbursement for pre-tender litigation expenses.

Care should also be taken that all potentially relevant insurance policies are thoroughly reviewed and evaluated as potential sources of coverage. It is not unusual for a given business to have multiple policies covering multiple types of risk. A single franchisor or franchisee may have separate insurance policies for Error and Omissions (E&O), Officers and Directors liability (O&D), Comprehensive General Liability (CGL), Premises Liability, Business Interruption, Auto, Flood, Worker’s Compensation and industry specific insurance. In addition, some insurance companies even issue policies that cover certain risks peculiarly associated with the franchise business model. Moreover, franchisors and franchisees are frequently named as additional

named insureds on the insurance policies of each other or of third parties. It is important to investigate thoroughly all potential sources of insurance coverage early in the litigation process, and to understand what deductible or self-insured retentions may apply, so that no opportunity to shift the expense of litigation to the insurer is overlooked.

Insurance considerations also may affect the pre-litigation planning of the party asserting claims. That planning should include an assessment of whether the claims to be asserted are likely to trigger insurance coverage for the opposing party and, if so, whether that is desirable. On the one hand, asserting a claim that is likely to trigger the opponent’s insurance coverage may be beneficial because it may substantially increase the pool of funds ultimately available to fund a settlement. On the other hand, insurance coverage may also increase the pool of funds available to the opponent to defend the claims. Accordingly, because different claims may or may not be covered, which claims to assert should always be an informed, strategic choice.

III. STRATEGIC CONSIDERATIONS AFFECTING WHETHER, WHERE AND HOW TO LITIGATE

A. Assessing The Goals Of Litigation

1. Franchisor Perspective

   a. Protecting Brand Equity

   A franchisor may have multiple goals to advance once the decision has been made to litigate a franchise dispute. Typically, first and foremost will be the goal of ensuring that the franchise system’s brand standards are enforced. When franchisees are allowed to erode brand standards, the goodwill associated with the brand diminishes. The consumer is less likely to frequent units in the system because of the lack of quality standards or a lack of consistency among the different franchisees in the system. Furthermore, franchisees who comply with brand standards will become critical when the franchisor fails to enforce the standards against non-compliant franchisees. A brand’s image is directly affected by how closely the franchisor enforces its standards.15

   b. Enforcing The Franchise Agreement

   The franchisor may also need to use litigation as a means to enforce the terms of its franchise agreements (or else risk an epidemic of non-compliance by franchisees). By actively policing and enforcing the terms of the franchise agreement, the franchisor infuses discipline into the system and potentially deters franchisees from engaging in activities in violation of the franchisor’s rights (and the rights of compliant franchisees).

   c. Collecting Fees And Damages

   As with any other contractual obligation, a franchisee’s failure to satisfy its financial obligations to the franchisor often sparks litigation to recover past due fees owed to the franchisor.

In addition to merely collecting past due fees owed by the franchisee, franchisors will often sue terminated franchisees to collect liquidated damages or actual damages as a result of the premature termination of the franchise agreement. Liquidated damages generally are established in the franchise agreement and serve as a measure of damages for the lost revenue associated with the departure of a franchisee from the marketplace until a replacement facility is established. Liquidated damages typically are based upon assumptions made at the commencement of the franchise relationship regarding how long it is estimated to take to replace a facility in a given marketplace and bring it to a point where its revenue stream equals that of an established franchisee. A franchisor’s collection of liquidated damages may dissuade other franchisees from prematurely breaking their contractual obligations to the franchisor. Certain state statutes hold liquidated damages provisions to be invalid, and, therefore, franchisors may choose to pursue actual damages associated with the remaining term left in the contract as a result of the franchisee’s failure to honor its contractual commitment.

d. Enforcing De-Identification

Franchise disputes sometimes involve attempts by the franchisor to get a terminated franchisee to cease utilizing the franchisor’s proprietary marks. These claims are typically pursued by asserting unfair competition and trademark infringement claims under the Lanham Act. A significant portion of the franchise system’s goodwill resides in the franchisor’s trade names, trademarks, service marks and logos. Sometimes terminated franchisees will continue to utilize the franchisor’s marks even though their right to do so has expired. However, trademark infringement results in consumers being confused about whether a franchisee’s product is somehow related to the franchisor whose marks the franchisee displays. In an effort to avoid consumer confusion, and to protect the integrity of the marks, the franchisor may be required to pursue trademark infringement claims in litigation.

2. Franchisee Perspective

a. Multi-Franchisee Litigation

The franchisee’s decision whether to sue a franchisor may be influenced by the likelihood that other similarly situated franchisees will join in the action as co-plaintiffs. Franchisees can band together as plaintiffs through multi-party litigation, through class action lawsuits\(^\text{16}\) or through a suit by a franchisee association. Litigating a case against a franchisor with multiple co-plaintiffs presents a host of benefits and challenges to a franchisee.

Multi-party or group litigation is particularly suitable in franchising, where franchisees already form part of a distinct community and, in the context of the dispute, have a common adversary in the franchisor. Franchisees also may have experienced the same or similar problems with the franchisor and thus have identical bases for claims. A lawsuit by a group of franchisees, all of whom share common disputes with the franchisor, can benefit the system by forcing the franchisor to address and resolve a system-wide problem. Group actions also permit franchisees who lack the financial resources to fund litigation on their own to pool their resources with other franchisees. By sharing the costs of litigation with other franchisees, an individual franchisee can maximize his leverage against the franchisor, minimize expense and increase the likelihood of a satisfactory resolution of the dispute.

\(^\text{16}\) Many franchise agreements contain provisions that purport to forbid franchisees from bringing class actions to resolve their disputes with franchisors.
b. Class Action vs. Multi-Franchisee Litigation

In most cases, franchisees will prefer multi-party litigation to class actions or to the assertion of claims by a franchisee association. Although each type of action allows franchisees to share the cost of the litigation, the procedural requirements for each differ. Generally, in order to maintain a class action, substantial specific requirements must be met regarding the claims and the parties. In addition, once a class has been certified, any proposed settlement will require court approval. Accordingly, a class action may not be the best vehicle for franchisees who are seeking prompt relief or who have initiated a lawsuit for the purpose of increasing pressure on the franchisor to acquiesce promptly to franchisee demands. Similarly, pursuing franchisee claims through an existing franchisee association as a party to the litigation poses its own procedural hurdles, including standing issues. In addition, many associations have cumbersome rules and procedures (i.e., voting requirements) that must be adhered to before action can be authorized on behalf of the association. These cumbersome procedures can cause delays in decision making that may be incompatible with the demands of litigation.

c. Potential Downsides To Multi-Franchisee Litigation

By taking advantage of liberal joinder rules, franchisees may be able to bring their individual claims while simultaneously sharing the costs of the lawsuit. Franchisees and their counsel must always evaluate, however, whether the benefits of joining or initiating a group case outweigh those of litigating individually. In particular, a franchisee with a strong case may not wish to join his claims with those of other plaintiffs for fear that his claims will either be lost in the crowd or diluted by the weaker claims of other franchisees. In a group action, the franchisee with the strongest claim may come to believe that he is being used solely to buttress the claims of others, or that his case is suffering by being joined with less meritorious cases. Disparity in the strengths of individual franchisee’s claims may become more pronounced during settlement negotiation. A franchisor might attempt to reach a settlement with the franchisee with the strongest case, leaving the other franchisees in a weakened position. A franchisor also might offer a global settlement, which, though in the interest of most of the plaintiffs, may not be beneficial to all. A franchisee may not have a choice, however, particularly if he cannot afford to maintain an action as an individual. That franchisee may have to give up some of his autonomy in order to obtain any type of legal redress. Clearly, if a franchisee would not be able to bring a case on his own, becoming one of several plaintiffs confers upon him a benefit because he otherwise would not have had access to such relief.

Another consideration in deciding whether to initiate an action on behalf of several franchisees is franchisee cohesion. The potential always exists that franchisee co-plaintiffs may not be able to agree on which course of action to pursue. Individual opinions differ, and certain franchisees may not want to pursue a course of action that is beneficial to others when it is less than optimum for their particular claims. To avoid this situation, franchisees who intend to pursue claims as co-plaintiffs should agree in advance how such impasses will be resolved. Otherwise, the franchisees may find that they are unable to move forward as a cohesive unit. The attorney for the franchisees must gauge how these considerations affect his ethical duties.

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18 Franchisee’s counsel must then evaluate his ethical responsibilities regarding any potential conflicts that may arise from group representation.
d. Funding Multi-Franchisee Litigation

Given the proliferation of franchise disputes, some franchisees create an advance pool of funds on which they can rely in case litigation with the franchisor ensues. One way of accumulating this “litigation war chest” is through voluntary contributions by the participating franchisees to a “litigation account.” Franchisees may also agree to pay a “litigation tax,” through which they pay a set percentage of certain purchases and use the money to fund any litigation that arises. Each of these approaches can present practical problems, including deciding how the funds should be disbursed, determining who should receive funds, and determining how much money should be distributed in connection with particular activities.

For example, certain franchisees may have, or may believe they have, viable legal claims against the franchisor. However, because only a finite amount will exist in a fund, unless all claims can be grouped together (whether by joinder or through any of the other mechanisms discussed above), it is likely that only a few franchisees will be able to tap the litigation fund. Even then, the costs of a particular litigation/arbitration may exceed the available pool funds. What happens when the funds run out? Will all franchisees receive a “special assessment”, much like condominium homeowners’ associations, or will the franchisees involved in the dispute be required to reach into their own pockets? Should an amount always be left in reserve? Are the merits of the particular dispute strong enough to justify using the entire pool of funds? Who evaluates the strength of the franchisees’ claims? Who determines how much of the pool should be disbursed? How is the disbursement allocated (i.e., the greater the chance of recovery, the more funds a franchisee receives? Who has contributed most? Who has the most franchise outlets?). Should contributing franchisees have a say in the selection of the attorney? Should all franchisees have a say in determining which case is litigated, or should contributing franchisees be required to release all claims to the funds when they are deposited in the pool?

Moreover, franchisees may have competing interests in the fund. For example, a franchisee remaining in the franchise system will have different damages and different goals than a franchisee who has left the system or whose franchise will close. Resolving these concerns before setting up a litigation fund is of paramount importance. A contractual arrangement among the franchisees can set forth the answers to many of these questions. However, the existence of contracts providing for the administration of these litigation war chests could lead to more litigation – among the franchisees themselves – thereby defeating the very purpose for which the pool was created. Indeed, entire franchise systems could be thrown into disarray as franchisees are drawn into litigation among themselves to determine who gets to litigate against the franchisor.19

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19 Additionally, where does the franchisor fit in? The franchisor will likely not want its franchisees getting together to create a pool of funds that will allow its franchisees more opportunities to sue the franchisor, and a franchisor could attempt to prevent these pools from being formed by forbidding such agreements. However, the existence of these funds could serve to rein in franchisors that use the threat of litigation as a strong-arm tactic to force franchisees to acquiesce to their demands.
B. Practical Considerations Affecting Choice Of Venue

1. Federal Or State Court

When a party decides to sue, it must determine where it will file the complaint. Assuming a basis for federal jurisdiction exists, whether to file in federal or state court may have strategic implications. For example, a franchisee suing somewhere other than his home state may wish to file in federal court, as that may reduce any “home-court advantage” that the franchisor may feel is derived from litigating close to home. In contrast, if the franchisee is suing in his home state, he may want the “home-court advantage” of a state court action. Franchisors, in contrast, because the terms of the written franchise agreements typically support their claims and defense, tend to favor federal court over state court because of the general perception that federal court is an easier venue to enforce the terms of the franchise agreement and to obtain summary judgment on contract issues.

2. Arbitration vs. Litigation

Many franchise agreements include arbitration clauses. From the franchisor's perspective, there are many reasons why arbitration may be an attractive alternative to litigation. Arbitrations are private proceedings and may be less open to public scrutiny than litigation. Arbitrations may provide for more limited discovery than that available under the applicable rules of civil procedure. Franchisor-friendly venue provisions may be more likely to be enforced when included in an arbitration provision. And, until recently, arbitration was viewed as an effective mechanism for placing limitations on multi-franchisee claims. In addition, the added expense associated with paying for the services of an arbitrator (typically split between the franchisor and franchisee) potentially serves as a deterrent to spurious franchisee claims.

Franchisors perceive several drawbacks to resolving disputes through arbitration, however. Although historically perceived as less costly than litigation, arbitration is now generally understood to involve costs that approach, if not exceed, the cost of litigating a franchise dispute. In addition, the arbitration process can sometimes take longer to accomplish than litigating a dispute in court. Also, absent exceptional circumstances, arbitration does not afford the losing party the ability to appeal the arbitration award.

Many franchisees prefer litigation to arbitration. As noted above, the additional costs associated with arbitration can be substantial. Also, by engaging in arbitration, franchisees may be giving up many rights guaranteed by the judicial system, including conducting discovery under the broad procedural rules of the federal and state courts, the right to a jury trial and the right to appeal. Those rights are usually severely circumscribed, if not entirely absent, in

20 For a comprehensive examination of jurisdiction, venue and choice of law considerations in franchise litigation, see, Kerry L. Bundy and Kevin M. Kennedy, Procedural Considerations For Filing A Franchise Complaint: Jurisdiction, Venue And Choice Of Law, A.B.A. Forum on Franchising, Section LB-3 (2004).
21 This consideration is more readily applicable to litigation than arbitration because arbitration provisions typically contain specific requirements as to where the arbitration may be brought. Franchise agreements that do not require arbitration may only require that litigation be brought in a particular forum rather than a specific court within such forum.
22 For an in depth analysis of the benefits and detriments of litigation vs. arbitration, see, Edward Wood Dunham and Michael J. Lockerby, Shall We Arbitrate? The Pros and Cons of Arbitrating Franchise Disputes, A.B.A. Forum on Franchising, Section L3 (2005).
23 For an in depth discussion of this topic, see, Robert M. Einhorn, David S. Sager and Maria Walsh, The Shifting Landscape of Class Actions and Class Arbitrations, A.B.A. Forum on Franchising, Section W1 (2006).
arbitration. For franchisees, who often have limited resources, filing an arbitration when they have the option of litigating their dispute frequently makes little sense.

One area in which arbitration remains popular is resolution of international disputes. International arbitration provides parties who may reside in different countries, operate under different legal systems and have widely varied cultural practices a vehicle for resolving their disputes in a neutral, non-culturally biased forum.

3. Franchisor Or Franchisee Home Venue

Additional strategic considerations may exist when proper venue exists in more than one location. As a general rule, franchisors and franchisees typically prefer to litigate or arbitrate in their home venues. The savings in travel, accommodations and meals alone may provide the party litigating in their home venue a distinct advantage. Additional strategic factors include analysis of which venue's laws are more favorable. Regardless of the choice of law the parties may have contractually agreed applies to their disputes, absent clearly discernable differences, judges and arbitrators have a tendency to defer to the substantive and procedural law applicable in the local jurisdiction. The availability of witnesses and documents is another important consideration in deciding where to sue.

4. Is It Cost Effective To Litigate The Venue Issue?

Lawsuits and arbitrations frequently start in a venue different from the one that the franchise agreement requires. When that occurs, a strategic analysis must be undertaken concerning whether the value of enforcing the contractual venue provision outweighs the litigation expense associated with attempting to enforce it. Strategic considerations include the effect a venue transfer motion is likely to have on the timing of consideration of more substantive issues and the impact that litigating the venue issue may have on your opponent’s potentially limited litigation resources (money spent litigating venue issues may be money unavailable later to litigate substantive issues).

C. Assessing Alternatives To Suit

Franchisors often view litigation as the last resort for resolving disputes with their franchisees. Indeed, franchisors often go to great lengths to attempt to resolve disputes before commencing litigation. Franchisors faced with a franchisee who is not complying with the terms of the franchise agreement or with brand standards will often attempt to resolve the issue informally by speaking privately with the franchisee, by offering assistance to correct the problem or by issuing a notice of non-compliance. These steps are often taken in an effort to avoid establishing an acrimonious relationship with the franchisee, and to work with the franchisee to achieve compliance. Franchisors may take these measures in lieu of formally defaulting the franchisee even when circumstances warrant default.

If default and termination is inevitable, however, the franchisor often has many mechanisms in place to resolve disputes between it and the franchisee before resorting to litigation. Some franchise agreements, for instance, may require the franchisor and the franchisee to attempt to negotiate the resolution of a dispute before engaging in a more formal dispute resolution process. Should informal negotiations fail to resolve a dispute, franchisors may demand that the franchisee participate in mediation. Franchisors often find that franchisees are amenable to mediation because it allows them an opportunity to voice their
issues with the franchisor before a third party and allows the parties to have ultimate control over the resolution of the matter.

IV. LEVERAGING SUPPORT FROM NON-PARTIES

A. Leveraging Support Within The Franchise System

For both franchisors and franchisees, strategic advantage can be gained by successfully leveraging the support of other franchisees. Obtaining the vocal support of the system’s franchise advisory committee may be a powerful endorsement for either litigant’s position. From the franchisor’s perspective, the power of having its franchisees line up behind it, for example, in a system standards enforcement action, adds legitimacy to the franchisor’s claims and may isolate the franchisee involved in the litigation and cause him to reassess his position. On the other hand, the endorsement of the franchisee’s litigation position by a franchise advisory committee or by a powerful coalition of franchisees may cause the franchisor to reassess its position and seek compromise rather than face the prospect of a class action or multi-franchisee lawsuit.

B. Leveraging Support Within The Franchise Community Generally

Franchisors and franchisees may consider engaging the assistance of franchise industry trade groups that have an interest in the subject matter of the claims asserted in the dispute or the positions advocated during the course of the dispute. These trade groups may formally endorse certain standards or alternative dispute resolution mechanisms. Depending on the circumstances of a particular dispute, a franchisor or a franchisees may benefit from the trade group’s public endorsement of its position.

In addition, where the judicial determination of the issues involved in a particular litigation potentially affects the franchise relationship generally, it is not unusual for non-parties to become interested in the ultimate resolution of the case. Organizations such as the International Franchise Association have, on occasion, filed amicus briefs on issues that are likely to affect its members.

C. Leveraging Support From The Government

For franchisees in particular, government agencies can be a valuable ally in enforcing their rights. Where a franchisor’s actions have resulted in violations of either the FTC Rule or a state’s franchise laws, it may be possible by reporting the violation to appropriate authorities to facilitate the initiation of a government enforcement action against the franchisor. As a practical matter, the FTC and state government entities charged with enforcing the franchise laws are likely to have limited enforcement capacity and will only bring an enforcement action against a franchisor when the violations in question are blatant and widespread. However, the intervention of a government entity in a dispute between a franchisor and a franchisee is likely to shift the leverage decidedly in favor of the franchisee.

D. Leveraging Support From Special Interest Groups/Minority Organizations

Depending upon the nature of the dispute and the claims asserted it may be possible to obtain the support of groups or organizations unaffiliated with the franchise industry that have a particular interest in the subject matter of the lawsuit. For example, if the lawsuit involves allegations of discrimination, minority organizations seeking to further the goals of particular
interest groups may offer support and assistance. In addition, if the group includes consumers of the franchised product or service, they may exercise their economic power to attempt to influence the resolution of the dispute in a way that benefits the favored party through an organized boycott.

V. MISCELLANEOUS “OTHER FACTORS” AFFECTING FRANCHISE LITIGATION

A. The Cost Of Litigation As A Weapon: The Tail That Wags The Dog

The cost of litigation is not merely a byproduct of the litigation process, but frequently can substantively affect strategic decisions about how a dispute is litigated and/or resolved. The expense required to litigate a particular dispute can vary widely and will depend a great deal on the tactics and level of aggressiveness employed by the litigants. In particular, discovery and motion practice, when aggressively pursued, can drive up the cost of litigation considerably for both parties.

Once litigation is commenced neither party can completely control how much it will cost to bring the dispute to its conclusion. Ultimately, however, a party with superior financial resources is able to bear the burden of litigation expense more easily than the party with inferior resources. Many disputes eventually are resolved solely because one party no longer has the resources to continue fighting. Alternatively, some cases cannot be resolved through settlement because the financial resources expended in the litigation have begun to dwarf the potential exposure or recovery associated with the claims actually asserted. In either case, the expense associated with litigation can play a greater role in strategic decision making than the actual merits, or lack thereof, of the underlying claims.

The impact of “attorney’s fees” provisions in franchise agreements, which permit the prevailing party to the dispute to recover fees from the losing party, while sometimes acting as a deterrent to the assertion of weak claims, can also serve as a deterrent to settlement. When the expense of litigation has exceeded the potential exposure or potential recovery in the claims asserted, the only way that a litigant may be able to achieve a net recovery, after deduction of litigation expense, is to prevail at trial and recover attorney’s fees from the other side. A party’s expectation that attorney’s fees will be recovered upon the conclusion of the litigation can warp the decision making process and cause it to place unrealistic settlement value on its claims.

B. Turning Lack Of Resources Into A Negotiating Asset: The Threat Of Bankruptcy

A party lacking substantial financial resources still has the ability to exert substantial influence over whether litigation is commenced and the manner in which the litigation is resolved. In many franchise disputes, particularly those involving a failing franchisee, the threat of bankruptcy is an ever-present concern for the franchisor and an important point of leverage for the franchisee.

The filing of a bankruptcy petition results in an automatic stay of any pending legal proceedings against the petitioner and precludes third-parties from initiating additional legal actions that could affect the bankrupt estate. All relief against the petitioner must be sought through the bankruptcy proceeding. Accordingly, a strategically filed bankruptcy petition (i.e., filed before a termination of the franchisee has been effectuated) can tie up the franchisor for months because a franchisor cannot terminate a franchisee in bankruptcy without permission of
the bankruptcy judge. A franchisor also cannot sue to collect unpaid royalty or advertising fund payments outside of the bankruptcy.

In addition to potentially checking a franchisor’s attempts to seek affirmative relief against a franchisee, the filing of a bankruptcy petition also diminishes a franchisor’s likelihood of achieving a meaningful monetary recovery against the franchisee. Franchisor’s claims for unpaid royalties and advertising fund payments are frequently unsecured claims and, thus, among the last to be paid, if they are ever paid at all. In contrast, frequently the largest asset of a franchisee’s estate is its claims against the franchisor. Thus, the franchisor can find itself in the undesirable position of being forced to engage the bankrupt franchisee in a forum where there is little upside for the franchisor but plenty of downside in the form of affirmative claims by the franchisee’s estate.

The mere threat of a bankruptcy petition by a franchisee, and the restrictions that this will place on a franchisor’s ability to enforce its rights under the franchise agreement, sometimes is sufficient to dissuade a franchisor from initiating litigation. Instead, a franchisor may be forced to compromise with a franchisee to achieve a financial workout that achieves most, if not all, of its desired goals. In short, one of a financially strapped franchisee’s greatest assets in negotiating with its franchisor may be the franchisee’s precarious financial situation and the imminent threat of bankruptcy.

C. Assessing The Competence of Opposing Counsel.

Another important issue affecting litigation strategy is the party’s assessment of the opposing counsel’s strengths and weaknesses. Counsel necessarily size up one another and, based upon that assessment, make decisions concerning what strategy is most likely to provide positive results for their clients. Is the opposing counsel an experienced franchise litigator? Does he have trial experience with issues similar to those involved in the present dispute? Does opposing counsel have a track record with others in franchising? Does opposing counsel have a reputation for being an “early settler” or for taking cases all of the way through trial? Is opposing counsel a sole practitioner or with a big firm? How deep is opposing counsel’s “bench”? Is opposing counsel being paid by the hour or by a contingent fee?

To maximize the chances of obtaining a positive result, counsel should use every piece of intelligence that can be obtained to better understand the motivations, strengths and weaknesses of the opposing party and opposing counsel. The best litigators are able to use this information to “get inside the head” of their opponents. To do so, counsel must take advantage of every available source. Has opposing counsel written any papers on the subject matter of the dispute? Are there other members of the franchise community who have litigated against this attorney in the past that can provide valuable insights? Is opposing counsel a good writer? Is opposing counsel an effective orator? Is opposing counsel likely to drive up litigation costs unnecessarily or will he lose interest in the case after his retainer has been exhausted?

Knowing your opponent is often the key to defeating your opponent.

D. Which Party Can’t Afford To Lose?

Ultimately, many disputes between franchisors and franchisees are resolved based upon which party most “cannot afford to lose”. For the franchisee the stakes may be the loss of a business in which the franchisee has invested his or her life savings. For the franchisor, the stakes may be exposure to a claim that could threaten the very viability of its system. In either
case, the impetus to resolve the dispute is directly proportional to the risk and repercussions of losing. A successful litigator strategically maximizes the leverage against the other party by emphasizing those aspects of the case that are most likely to have a negative impact on the opponent.

For this reason, most commercial disputes, including franchise disputes, ultimately are resolved by negotiated settlements. The downside risk for one or both parties becomes so great that they cannot afford to submit the claims to a trier of fact and potentially achieve an adverse result. The only reasonable way to mitigate the downside risk is to reach a compromise settlement that achieves some of the litigation goals and foregoes others. The structure of the settlement, and which party achieves more of its litigation goals, is frequently a function of which party faces the greatest downside risk -- which party most “cannot afford to lose”.

VI. CONCLUSIONS

This paper has attempted to focus on many of the factors, other than the law and the facts, that determine whether franchise litigation is initiated, the manner in which a franchise dispute is prosecuted or defended and how franchise disputes are ultimately resolved. These “other factors”, some strategic in nature, some merely monetary, can affect the litigation decision making process to a greater degree than the merits of the subject claims.

These “other factors” can be summarized to include, among others, (1) the cost of litigation, (2) the impact that the claims asserted in litigation have on the franchise system as a whole and participants in that system, (3) the impact of potential claims on third parties’ view of participants in the franchise system and (4) strategic analysis of how best to achieve leverage over one’s opponent.
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