FRANCHISEE REPRESENTATION AND RECURSE BEYOND THE FRANCHISE AGREEMENT

Michael S. Levitz
The Häagen-Dazs Shoppe Company, Inc.

Kenneth P. Milner
Kraut Harris, P.C.

Robert L. Purvin, Jr.
American Association of Franchisees and Dealers

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I. INTRODUCTION

Franchising has changed over the past thirty years. However, during the same three decades, representation of franchisees has remained fundamentally the same. As a result, despite the diligent efforts of their attorneys, clients are often unprepared when becoming franchisees, under-funded when opening for business, unable to cope with problems during the terms of their franchise relationships, unsuccessful in resolving disputes with the franchisor, and unprotected when exiting the franchise system.

Whether assisting the potential franchisee in his or her due diligence, advising the new franchisee as he or she prepares to open for business, counseling the established franchisee when problems arise, or representing the franchisee who is leaving the system, attorneys use the basic techniques and strategies upon which they have relied since franchisee representation became a recognized field of practice.

The purpose of this paper is to briefly review the standard techniques which franchisee counsel have used to assist their clients, explain why those techniques may be lacking, and suggest several fresh approaches for counsel to employ. If franchisee attorneys employ innovative processes throughout the franchise relationship, both franchisees and franchisors will benefit: Franchisees will understand their dual roles as business owners and franchisees, be more effective in addressing matters which arise during the franchise relationship, and have the opportunity to resolve disagreements with less harm to their financial security.

Attorneys for franchisors may also find the information in this paper useful. By recognizing the new approaches and techniques of franchisee attorneys, franchisors and their counsel will be able to work in harmony with a well-represented and knowledgeable franchisee. Instead of being concerned about negotiating a franchise agreement, deflecting in-term concession demands and posturing for litigation, franchisor counsel will be able to concentrate on making the client's system more attractive to potential franchisees, recognize new ideas to enhance the value of the franchisor's system, and lessen the amount of cost and time consumption spent on adversary proceedings.

II. PRE-SALE AND PRE-OPENING REPRESENTATION

A. Standard Practices and Techniques

When an attorney is retained to represent an individual or a few individuals who are interested in becoming franchisees (who, for purposes of this paper, will be called "franchisees" or "clients"), the attorney will typically perform at least a few of the following tasks:
1. **Review the Uniform Franchise Offering Circular / Franchise Disclosure Document (“FDD”)**

After meeting with his or her client, counsel will generally scan the narrative of the FDD to determine if the client understands the business opportunity presented, the risks of the venture and whether there are hidden costs--start-up or continuing--for which the client has accounted. Experienced counsel will also look for "familiar" names among the disclosed franchisor executives, litigation patterns, unusually harsh termination, renewal or renovation provisions, and trademark security. The attorney will double-check the narrative provisions against the actual franchise agreement, and review software licenses, financing documents and other contracts for cross-default provisions and to determine if the cumulative effect of the various contracts will make it difficult for the client to succeed.

Financially astute counsel will also review the financial statements to determine if the franchisor appears to have the resources to provide operational assistance and promote growth. Some attorneys will simply determine if the franchisor must escrow all or a portion of the franchisor's initial franchise fee as a means of determining whether the franchisor is fiscally sound.

2. **Contact Existing Franchisees and Counsel**

Many attorneys will urge their clients to call several of the existing franchisees listed in the FDD, and even provide a list of questions the client can ask. Experienced counsel will also advise the client to call some of the people who are no longer franchisees. In addition, the attorney will request authorization to contact some of the counsel involved in the disclosed litigation, or who have had experience with the subject franchisor.

3. **The Follow-Up Meeting**

After the attorney and client have reviewed the FDD and made their respective phone calls, the attorney and client will most likely meet to discuss what they have discovered. There is rarely a surprise, and it is even rarer that the client will want to abandon the opportunity. Most objectionable provisions to the franchise agreement are explained away (by the client or attorney) as being "no worse than any other franchise agreement," or "something the franchisor won't change anyway." Others are dismissed by the attorney or client by pointing out that "It can't be that bad if all of the other franchisees are living with it."

4. **Negotiations**

Instead of determining whether the opportunity is one which truly makes sense for the client, the client will request that the attorney try to get the franchisor to change one or two of the most troubling provisions of the franchise agreement, bargain for a larger territory, obtain a right of first refusal for adjacent territories or obtain a financial concession.

5. **Entity Formation**

Either just prior to or just after the client executes a franchise agreement, the attorney will form a corporation or limited liability company to operate the franchised business. Unlike large or sophisticated franchisees, the individual or "mom and pop" client will usually not
authorize more than a minimal approach to entity formation. The attorney has already advised the client that forming the entity will not protect the client from being personally liable to the client's major creditors, i.e., the franchisor, the financing company and the landlord.

6. **Lease Review**

Experienced franchisee counsel understand that the three party relationship between a landlord, the franchisee client and the franchisor can be problematic for their clients. Counsel will attempt to obtain a copy of the lease (or sublease) for the expected location of the franchised business, and make certain that the client's compliance with the lease will not conflict with the terms of the franchise agreement, and vice-versa. Counsel will also attempt to provide to the franchisee/tenant term extension or renewal options for the premises lease which will approach the term of the franchise agreement. In many instances, counsel will enlist the assistance of well-established franchisors to obtain exclusivity clauses and other use protection clauses.

7. **Loan/Financing Document Review**

Most individual or small entity franchisees will require financing to establish their franchised business. Their attorneys will usually review the loan documents and explain them to their clients. However, attempting to negotiate the terms of those documents with the lender is often viewed as a nugatory act. Accordingly, seasoned counsel will simply remind their clients of the enhanced danger of personally guaranteeing the payment obligations to the lender, the franchisor and the landlord.

In some cases, astute counsel will attempt to use the obligations owed by the client to one major creditor as a means of minimizing the client's obligations to the other. For example, landlords will often have little choice but to subordinate their landlord liens in favor of the lending institution or even the franchisor. (Conversely, many years ago, the SBA abandoned its position that the franchise agreement was a franchisee asset upon which the SBA lender could invoke a security interest.)

B. **Challenges and Limitations of Standard Practices**

Despite the diligent efforts of the attorney to find and warn the client about hidden costs and harsh provisions, many clients will execute the franchise agreement, spend a great deal of money to open the franchised business--and, a few years later, wonder why things went wrong. The problem is not that the attorney has been lax in his or her review, or that the attorney has failed to properly advise the franchisee. The problem is that the standard practices recited above have limitations which cannot be overcome.

1. **Financial and Time Limitations**

The attorney's review is inhibited by the financial limitations and time pressure which the client brings to the relationship. A potential franchisee simply does not want to spend thousands of dollars for an attorney to tell him or her about potential problems regarding what the client believes is a terrific opportunity, or documents which the client believes "can't be changed anyway." Further, the client is in a hurry: "If I take too long, I might lose the territory I want, or I might not get any territory at all." The potential franchisee is also concerned about
making a good impression upon the franchisor, and does not want to be viewed as a "troublemaker."

2. **Perceived Lack of Bargaining Power**

For many franchisees, knowledge does not equal power. Whether real, self-imposed or perceived, the franchisee and counsel believe they have little or no power to change the franchisor's position or documents. As a result of the attorney's efforts, a client may learn about difficult provisions or risks of which he or she was not otherwise aware. But the client also believes (often correctly) that the franchisor's position will not change, the franchisor will rarely "negotiate," and that, by signing the agreement as it stands, the client will be in no worse position than the other franchisees--all of whom probably signed the same agreement and many of whom are succeeding.

3. **Unreliable Information**

The attorney and client must also realize that the empirical information obtained from existing and departed franchisees must be viewed with a jaundiced eye: Often, the sampling is small. Many contacted franchisees have "grudges"; others may provide overly optimistic or pessimistic views, depending upon that franchisee's current situation, rather than the overall status of the franchisee's relationship with the franchisor. Some franchisees will mistake the client for a franchisor "plant"; others may want to discourage the client because the franchisee believes the client may be opening an outlet close to the existing franchisee's territory.

4. **Misconceptions Regarding Territory**

The concept of territorial protection is frequently misunderstood or overrated. An "exclusive territory" does not protect against encroachment from internet and mail order transactions. Franchisors typically reserve the right to sell the same product with the same brand name in an alternative outlet, such as supermarkets and wholesale outlets. Franchisors may also reserve the right to sell the same goods and services at a discount under a different name. Moreover, during the lengthy period of the franchise agreement, there can be dramatic demographic shifts which will change the nature of the selected territory of the franchisee, and significantly alter--for better or worse--the business dynamic at the franchisee location.

Similarly, there is dubious value in obtaining options or rights of first refusal for additional territories or units. It is, of course, worthwhile for a successful franchisee to have a second or third outlet available for opening. Moreover, if having multiple units is part of the client's overall plan, attempting to obtain options or rights of first refusal would be good practice. However, unless the franchisee's first outlet succeeds, there is little likelihood that the franchisee will be able to open a second outlet. Even if the franchisee is able to open an additional unit, it is unlikely that doing so will magically transform the first one from a losing or mediocre business into a profitable operation.¹

¹ This is less of a challenge if having multiple units is part of the client's plan and the franchisor is offering an area development agreement. See Section II.C.1., supra.
5. Minimum Value of Negotiation

Attempting to "negotiate" terms of a franchise agreement is often a destructive, rather than constructive, attorney technique: Franchisors and their counsel often view dealing with requested changes at best as a necessary cost of doing business, and at worst as a nuisance to be remembered if the franchisee has a future issue or problem. Further, often for valid reasons (e.g., avoiding charges of discrimination or minimizing the risk of having to amend the FDD), many franchisors simply will not negotiate, causing the franchisee counsel to lose credibility with both the client and the franchisor. In some instances, the franchisor will negotiate, but will not make any change of substance. On the infrequent occasions when a franchisor actually agrees to a significant change, the client (and even the attorney) become willing to ignore the other concerns which have been raised, choosing to instead focus upon the "success" they have had in obtaining a "good result" for the franchisee. Further, by negotiating and obtaining some minimal benefit, the franchisee and counsel may lose an opportunity to argue as to the adhesive nature of the contract if problems arise in the future.

Another problem with negotiating the franchise agreement is that the focus of such negotiations is often upon specific "deal" matters, e.g., term, territory, fees, renewals and renovations. The client and counsel will typically ignore the "boilerplate" provisions, which can become the most troublesome during the term and termination phases of the franchise relationship.

6. Limited Post-Sale Assistance

Entity formation and lease reviews, though necessary, provide modest benefit for the franchisee client. Franchisees usually remain personally liable for the obligations under the franchise contracts and the lease. Further, though some franchisors will provide actual "assistance" in finding a location and negotiating lease terms (See Section II.A.6., above), many simply reserve for themselves a right of "approval" or "acceptance" of the site and lease terms. Often, such rights are predicated upon the franchisee and landlord agreeing to a conditional premises lease assignment clause, a franchise agreement cross-default provision, or both. Those provisions, if accepted, will virtually assure that a franchisee who is in trouble with either the franchisor or landlord will be in trouble with both, and the franchisee who loses his or her franchised business will not be able to remain in the location to compete with the franchisor.

In summary, despite the good faith efforts of their counsel, the advantage gained by a potential franchisee from the attorney's utilization of standard techniques during the due diligence and pre-opening process is often insufficient to protect the client or increase the client's chances of success. Though a client may become somewhat more knowledgeable about the risks of owning and operating a franchised business, the client still enters into the venture with a sense that the franchisor is the franchisee's optimistic teammate, while the attorney has done little more than be an overly cautious or pessimistic outside presence.

C. Pre-Sale and Pre-Opening Innovative Techniques and Approaches

How can the franchisee attorney provide greater assistance to the client, taking into account the limited resources and time the majority of clients are willing to commit to due diligence and the pre-opening process?
1. **Focus Upon the Client**

The first thing the attorney can do is approach the due diligence process differently. Rather than focus upon the FDD, perhaps it would make more sense to focus upon the client. The attorney should ascertain the client's priorities and concerns. The attorney should determine the reason the client has chosen the particular franchise opportunity, and try to understand the client's strengths and weaknesses. Is the client simply buying a job for himself, herself or a child? Will the client want to personally operate the business? Does the client have the will, financial strength and support system to be a multiple unit or area franchisee? Once the attorney has a deeper understanding of the client, the attorney can concentrate upon those items in the FDD and contracts which will acutely affect that particular client.

2. **FDD Comparison**

Another method of reviewing FDDs is to compare the FDD of the client's chosen franchisor with the FDD of a competitor. The fact that a franchisor charges a five percent continuing royalty will no doubt be of interest to the client. However, it would mean even more to the client to know that a similar franchisor charges only three percent. On the other hand, if the franchisor charging only three percent has management, accounting and procurement fees which add an additional six percent bite into the franchisee's gross, the franchisor charging the five percent royalty and nothing else now appears in a more favorable light.²

3. **Database Formation**

Focusing upon specific client concerns and comparing different FDDs and contract provisions does not mean that the attorney can simply ignore the other parts of the disclosure documents. Therefore, it could be argued that the techniques described directly above will add to the amount of due diligence time and cost spent by the attorney. This is something many clients cannot afford and something of which almost no clients will approve, regardless of the added value to the client. Is there a resource which could provide focused information to the attorney and client without undue cost?

There can be: The attorney can start a personal database. Each time the attorney recognizes something unusual--good or bad--about a particular franchise or contract, the attorney can put the information into the database. The database can be organized by FDD items, specific topics, franchise types or other categories the attorney desires. Before long, the attorney will have a fairly large information resource upon which the attorney may draw for comparing franchises and identifying favorable or unfavorable things about a franchisor and its contracts.

To take this idea one step further, imagine the fantastic resource which franchisee attorneys would have if all of their personal database information could be shared. With a network including scores of attorneys, dozens of different franchises and continuing updates regarding provisions of franchise and other agreements, the franchisee attorney will be able to provide to his or her clients a great deal of useful information without spending a great deal of the clients' money.

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² The California Department of Corporations' Cal-EASI database makes such document comparison easy and effective. [http://www.corp.ca.gov/caleasi/caleasi.htm](http://www.corp.ca.gov/caleasi/caleasi.htm)
4. **The Franchisee Team**

Many franchisors have benefited by setting up and coordinating the efforts of real estate, marketing, accounting, research, operations and legal departments. Their franchisee counterparts have not learned to do the same. Instead, the franchisee's attorney will often try to advise the client about many business matters in addition to providing legal advice. Would it not make more sense for franchisees and their counsel to take a "team" approach, with the attorney taking the role of manager or team captain? For example, while the attorney is reviewing other parts of the FDD, the team CPA could be reviewing the financial statements of the franchisor. The accountant could also determine which business entity or structure would be most favorable for the client's overall financial picture. If the client is purchasing an existing unit, the CPA could also critically review the existing franchisee's financial information.

A local real estate broker could be retained to offer insight into an area's demographic characteristics, growth potential and economic trend. A public relations professional could not only critique a franchisor's current marketing efforts, but could also make suggestions as to what steps a franchisee could independently take to promote the franchise name and business (with franchisor approval to be obtained, of course). The public relations team member could provide grand opening suggestions, and would have local knowledge regarding the best way to obtain the maximum amount of publicity for each advertising dollar spent, or community event attended. This would be helpful to the franchisee and franchisor, particularly if the franchisee is considering being the first franchisee to open in a given region.

It could well be argued--and should at least be observed--that the cost of utilizing a team approach would subject the technique to the same spending obstacles noted in Section B.1., above. However, while the franchisee would most likely face additional costs, it does not follow that the technique would be unsuccessful or even nixed by the franchisee: The franchisee's objections are often specifically targeted at legal fees for due diligence, i.e., spending money for an attorney who points out a lot of negative things, but who would not be able to do much about them. Spending money on people who can give business advice--not only about whether to invest, but how to invest--would be far more palatable to the budding franchisee business owner/business operator. Moreover, the franchisee will have the value of team members who are available to be business advisors throughout the term of business ownership.

5. **Location and Site Assistance**

When a franchisee will be operating from a fixed location, the site of the business will often be a critical factor in the franchisee's ultimate success. Unfortunately, the role of the franchisee's attorney regarding this important matter is often limited to negotiating some terms in the lease, and making certain that the covenants of the lease and franchise agreement do not conflict. Many franchisees and their counsel assume that the franchisor will have the experience and expertise required to find a favorable location. However, the fact is that most franchisors simply reserve for themselves a right of approval over a location, and do not wish to actively participate in selecting a site for fear of a claim being raised against the franchisor at a later date if the location turns out to be a bust.

At the very least, an attorney can assist the client in selecting a real estate professional in the franchisee's chosen locale. The real estate member of the team, who would be paid a flat
or hourly fee by the franchisee, would assist the franchisee in choosing a location and advising the attorney and franchisee about general lease costs, customary provisions and negotiating points, and other real estate issues prevalent in the area. The real estate team member would also be able to critique, confirm or augment any franchisor suggestions, or assist the franchisee in satisfying any franchisor directives. If the client cannot afford the cost of engaging a real estate professional, another option would be to contact the franchisor’s real estate department or local agent, and obtain preliminary information upon which the client would independently follow up.

The attorney can also assist the franchisee by negotiating a limited contract with a “location intelligence” agency. Depending upon the amount of demographic and trending detail the franchisee requires, and by limiting the depth of the written report, the attorney should be able to help the franchisee obtain invaluable information for short- and long-term planning, at a reasonable fee.

6. Franchise Business Valuations

If the client is purchasing an existing franchised unit, a review of the seller’s financials is often misleading. The existing franchisee may well be operating under a different contract (with different fee structure) than the client/buyer. Moreover, the existing franchisee may be paying off loans of different amounts and interest than the buyer will face, and will have other variables which make it difficult to accurately assess the value of the business to the client. Conversely, the attorney who recommends a limited franchise business valuation would be providing significant assistance to the client. Unlike standard business valuations, franchise business valuations take into account factors such as a) the fact that the client will only obtain a limited (both in time and scope) use of the names and marks accounting for much of the goodwill of the business, b) the fact that the business requires two strong levels of management (i.e., the franchisor overseeing the entire chain and the franchisee or manager operating the actual franchised unit), and c) the difficulty in effecting change if necessary. When combined with the real estate intelligence obtained as part of the team approach, the franchise business valuation will provide a more realistic view of the worth of the existing franchised business to the specific client.

7. Franchisee Associations as a Resource

The recent amendments to the FTC’s Franchise Rule4 (“Amended FTC Rule”) now mandate that franchisors disclose the identification of their franchise advisory councils (“FACs”) and, upon timely request, independent franchise owner associations (“FOAs”). FACs and FOAs (together as “associations”) can also provide a wealth of information for the potential and budding franchisee. Franchisee counsel can contact attorneys for the associations and learn about the contract enforcement patterns of the franchisor, the franchisor’s litigation priorities and the willingness of a franchisor to assist troubled franchisees. The client can contact franchisee representatives of the associations directly. In addition to obtaining the personal information


from a franchisee who is a member of an association, the potential franchisee may obtain a more global view of the franchisor. The client will learn more about system-wide advertising, training, growth prospects and intra-franchisee relations. While there is no guarantee of objectivity coming from a member of an association, there is at least less risk of a solitary "grudge" being the overriding factor in the information provided to the client.

[This resource may also be of significant value to franchisors and their counsel. As one seasoned observer noted, "If ... an association adopts a position paper establishing certain key objectives, prospective franchisees ... should be able to obtain copies of any such position paper and information as to what progress has been made in resolving those issues. A favorable report from the franchisees should certainly help recruit the prospects."^^5]

The client will also be able to follow up with the association members after he or she becomes a franchisee. The new franchisee can obtain tips regarding successful (or unsuccessful) grand opening strategies, ordering inventory, supplies and equipment, and learning which franchisor representatives can and will provide effective assistance.

In addition to FACs and FOAs, attorneys should contact--and encourage their clients to contact--national franchisee associations. By contacting representatives of associations such as the American Association of Franchisees and Dealers ("AAFD"), the attorney or client can learn about the franchisor's efforts, if any, to develop agreements and programs which eschew some of the harsh provisions found in many franchise agreements. They can also find out if the national association members who are current franchisees are or have been having problems with the franchisor, or are in the habit or midst of developing positive programs with the franchisor.

8. **Develop Franchisor and Franchisee Checklists**

Franchisors have developed personality tests and questionnaires to determine who would be best suited to become a franchisee. There are many franchisor "consultants" who will assist the new--and established--franchisors in producing their training programs, manuals, fee structures and marketing strategies. Perhaps franchisees should have similar assistance.

For example, the AAFD has developed its Fair Franchising Standards, and offers an accreditation program for franchise systems that embrace the Standards.\(^6\) Attorneys for franchisees could develop their own checklist and questionnaires for completion. The questions would cover topics from advertising to zoning requirements. Each topic in the checklist could be judged on a range of one to five. Extra weight could be given to factors which are of particular importance to the client. The answers would not only be obtained through the various techniques set forth throughout this paper, but would also be submitted directly to the franchisor for answers. [Of course, if the attorney wants the questions to be answered, they must be written so that the responses would not be deemed promises, and could only augment or clarify, rather than contradict or conflict with, provisions of the agreements or the disclosures in the subject franchisor's FDD.]

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6 Chapter 1. AAFD Fair Franchising Standards, CCH Business Franchise Guide §§4600, see infra Section III.C.6.
Attorneys should also have a checklist relating to a client’s ability to become a franchisee. The attorney should be prepared to discourage from a franchise relationship a client who is unable or unwilling to follow someone else’s directives, or is too distracted to pay attention to detail, or is too willing to bend or break rules for sake of expedience.

9. Franchisee Training

Attorneys could also develop a potential franchisee training program. Clients considering entering into a franchise relationship could attend classes covering topics such as the nature of the franchisor/franchisee relationship, relationships with other franchisees, principal-agent and vicarious liability issues, questions to raise at “Discovery Day,” the importance of an exit strategy, entity selection and document retention.

It is not uncommon for franchisee counsel to provide some of that training as part of their representation. However, many potential franchisees do not have the financial resources to spend an entire day or a few days on education. By having several attendees share the cost of the training session, expense would no longer be a deterrent to providing valuable education to a potential franchisee. A similar training session could be arranged for new franchisees. However, it would have to be coordinated with franchisor training programs, and would focus more upon maintaining entity formality and controls, establishing filing and updating systems, landlord/tenant issues, employment law and government regulations.

10. Franchisee Brokers

Many franchisors rely upon business brokers to assist in the sale of franchised units. The broker will typically include several franchise companies in the broker’s inventory of available businesses. When an interested buyer contacts the broker, the broker will attempt to match the buyer with a franchise company the broker (hopefully) believes will best suit both the needs of the franchisor and the buyer. If the buyer is opening a new unit, the broker is paid a commission by the franchisor. If the broker sells an existing franchised business, the broker is paid from the purchase price—a purchase price which is often raised to account for the broker’s fee.

Perhaps potential franchisees would be better served by hiring and paying independent brokers to work for them. As of the writing of this paper, there are over 3,000 different franchised business offerings, most with both new units and existing units for sale. Why should a potential franchisee’s search be limited to the relatively few franchisor horses in the particular broker’s stable? A client might pay a flat or hourly fee to the broker who works for him or her and will independently look at all existing opportunities. Though paying the broker would be a significant expense, the expense would to some degree be offset by the money and time saved as a result of the client not investigating opportunities about, or having an attorney review FDDs of, franchises ill-suited to the client. Of course, by paying the fee, the client would also have the benefit of knowing that the broker has a fiduciary duty to the client.

11. Pre-Opening Sales

Franchise agreements are typically signed several weeks or months before a franchisee actually opens for business. However, the fact that a franchisee may not have moved into a location or may not have all of the required furniture or equipment should not necessarily
prevent the franchisee from making actual sales. Franchisee counsel should assist the franchisee who wishes to begin operations before the actual opening of his or her location, or before he or she has everything in place. For example, a carpet cleaning service franchisee whose van does not contain special canine stain cleaning solutions might still have the necessary equipment and materials to clean carpets stained by mud or paint. In many cases (e.g., a transmission repair), the new franchisee will require the assistance of an established franchisee. In those situations, the new franchisee should be able to obtain a referral fee or make other fee sharing arrangements with the established franchisee. Naturally, franchisor approval of such an arrangement would have to be obtained in advance; however, counsel could facilitate such approval by pointing out that the franchisor would still receive its royalty, the new franchisee would be able to start earning money right away and the established franchisee would obtain additional revenue.

12. Exit Strategy

Like marriage and other intended long-term relationships, becoming a franchised business owner is relatively easy to get into, but difficult to leave. Attorneys should make it a practice to have their clients recognize and understand in advance concepts such as restrictive covenants, limited use (as opposed to ownership) of goodwill, transfer fees, rights of approval and rights of first refusal. Attorneys should use the educational techniques and team members to establish a plan for the client's leaving the franchised business. The attorney should also make certain that the client's long term and estate planning documents dovetail with the client's nascent business venture, as well as the client's ultimate exit strategy.

13. Cultivate Relationship with Franchisor Counsel

Many of the fresh approaches and strategies described above will be easier to carry out—and more effective—if counsel for the potential franchisee establishes and nurtures a positive relationship with franchisor's counsel. Whether franchisor utilizes independent or in-house counsel, a call to the franchisor counsel will almost always benefit the client: The franchisor counsel will be prepared for whatever ideas and approaches the client is considering. There will be less chance of misunderstanding. There will be less likelihood of implementing a strategy which would polarize the parties, or having the client spend time and money on something which will have no chance of success. Franchisor counsel may even suggest some ideas to help the potential or new franchisee.

Of course, the positive effect of establishing a personal relationship with franchisor counsel is not limited to the due diligence and pre-opening process. As will be discussed in the following sections of this paper, a positive relationship between counsel can benefit the client throughout the franchise term and when the parties are in dispute.

III. IN-TERM RELATIONSHIPS

Perhaps the greatest need for a paradigm shift in the way attorneys think about representing franchisees arises during the franchise relationship. Attorneys are trained to be advocates and adversaries, but virtually every franchisee that comes to counsel during the franchise term is likely to admit that his or her ultimate goal is to fix the problem in a way that repairs and improves the “marriage.” This suggests a different strategic approach to the typical course of sending a demand letter and threatening action if the alleged wrong or default is not
The purpose of this section is to compare the typical approach to issue resolution by franchisee counsel to some new ways of thinking which are designed to solve immediate problems and to enhance franchise relationships. At the core of this “new way of thinking” by counsel is the ultimate goal of achieving and fostering a successful business and a happy relationship for the clients.

If a solid foundation has been laid from the outset of the relationship (perhaps by following some of the suggestions in Section II), and the parties respect each other’s needs from the brand, the system and the business enterprise, counsel’s ability to help resolve issues as they arise is likely enhanced. With a solid foundation of mutual respect, the parties’ willingness and intentions to collaborate to seek truly win-win solutions will be much easier to advocate and orchestrate.

A. Standard Practices and Techniques

For many franchisee attorneys, advocacy tends to focus only on the client’s immediate needs and goals—the impact of a neighboring outlet, the excessive cost of the new remodel or POS system, the perceived unfair application of advertising dollars, or the response to a notice of default. Typically counsel will address the client’s concern or defense with affirmative demands addressing the client’s needs, when empathy for the franchisor’s goals and purposes that led to the ‘objectionable behavior’ may well serve a better path to long term resolution.

1. Advise When Questions Arise

In the typical scenario, when an issue arises in a franchise relationship that sends a franchisee to counsel it is likely that there is already infliction of significant pain, or the threat of pain. Some action has either been taken or threatened that causes a client to ask, “Can they do this to me, or can I stop them from doing this to me?” The client will tell his or her story, describe the pain and prospective consequences, and will normally ask for help to stop or prevent the objectionable action, to defend the client’s actions or rights, or perhaps to gain compensation for a claimed loss.

2. Review Franchise Agreement and FDD

Usually counsel will commence his or her evaluation by reviewing the franchise agreement and FDD (and perhaps collateral agreements) to determine if the franchisee’s legal rights have been abridged or violated. While not always the case, most of the time the franchise agreement is written in the franchisor’s favor and there is a lack of direct protection for the franchisee’s position.

In the absence of favorable contractual protections, with the lack of financial resources to take or defend action, and usually faced with a franchisor with substantial resources and a team of able counsel, franchisee counsel will seek to “level the playing field” by utilizing one or more of a variety of strategies.

Often, counsel will simply advise that the client has little effective leverage, and will
counsel the client to essentially seek the franchisor’s mercy to resolve the problem.

3. **Seek Support of Similarly Situated Franchisees**

Counsel may also advise clients to seek common cause from similarly situated franchisees. Counsel may seek to identify a group of franchisees to join the client in litigation or other activity. In some instances, the objectionable behavior arises from a franchisor's decision which affects an entire class of franchisees. There may be an existing or forming franchisee association which may have resources to pursue the action the attorney or client believes to be viable.

4. **Threaten Legal Action / Discourage Mediation**

If the case is perceived to be strong on the merits, counsel may well advise some form of legal action. Perhaps counsel is able to identify contractual grounds, or extra-contractual grounds such as bad faith, the breach of the implied warranty of good faith, misrepresentation, breach of fiduciary duty, the adhesive nature of the agreements, or some statutory duty.

Counsel may seek to threaten legal action to achieve a negotiated result, knowing that all material legal actions against the franchisor must be disclosed in its future FDD and therefore may actually increase the client’s perceived leverage to demand a desired result.

Some attorneys will seek to mediate the dispute, recognizing that the client simply cannot afford to “go the distance” with a lawsuit or arbitration of claims. Other attorneys will discourage mediation as an “up front” strategy, believing that mediation will waste scarce resources, will show weakness, will provide free discovery to the franchisor, or is simply not timely until the parties are in a settlement frame of mind.

If the client is defending a claim, counsel may advise affirmative action on the premise that the “best defense is a good offense.” Counsel may threaten or commence offensive actions for prior breach, failure to support the franchisee or the system, breach of covenant of good faith—all as justification of a client’s defective performance.

An increasingly popular defense being raised by franchisee counsel is that the franchise agreement is a contract of adhesion that is being enforced in an unconscionable manner. Unconscionability as a defense has been effective in some states, especially California, but has fared poorly in the large majority of states.7

Procedurally, counsel may forum shop to seek protection of local law, if local law is deemed more favorable than the choice of law and venue established in the franchise agreement.

5. **Public Airing of Complaints**

Counsel may consider taking (or threatening to take) the issue to the press in hopes that a concern for adverse publicity will motivate the franchisor to reverse course and accommodate

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the client’s needs and concerns. Going public with an issue is often treated as a tactic of last resort, because the results are, at best, uncertain. Even in current practice techniques, counsel usually understands that the effort may backfire, because the client’s cause may not be embraced by the press or the public, or the effort may actually cause the franchisor’s position to harden. Further, once the press card is played, there is no way to recall it, and any damage done may be much harder to remedy. Nevertheless, there are times when “going public,” either as a tactic or a threatened option, is perceived to be the best available remedy.

B. Challenges and Limitations of Standard Practices

1. Focus Upon Winning is Unrealistic

The essential failing of traditional approaches to representing franchisees during the franchise term is that the focus is on winning the case and not on saving the relationship. Even when cases are won, very often the quality of the relationship suffers—often in an irreparable fashion. But how often is legal advocacy focused on fixing the problem and repairing the relationship? If the focus is on winning, or defeating a claim, how likely will the defeated party wish to simply end the relationship all together?

Many attorneys believe that winning is the best result for the client; however, most franchisees, whether seeking counsel individually or in groups, are seeking to solve their problems in a way that maintains or improves the franchise relationship. Enlightened counsel might try to assist their clients by helping them establish realistic, relationship-building goals, and develop the strategies to achieve those goals.

Most legal representation is, at its core, based upon an “I win and you lose” resolution of disputes. Such an orientation often fails to incorporate strategic thinking toward a desired and achievable goal of getting the parties back on track. In fact, a litigative approach to franchisee representation provides limited prospects for success. Even if one can overcome a contractual and resource disadvantage and gain a monetary victory, if the goal is to get the benefit of the franchise investment bargain, a relationship tarnished by a legal victory will not likely deliver the desired result.

In ongoing franchise relationships, an “I win, you lose” result will often defeat the goal of the desired long term result⁸ and a great relationship. While we pay lip-service to the notion of win-win relationships, few really have learned the art of promoting win-win cultures. The phrase win-win is often invoked to improve the lot of the suffering party, who perceives oneself to be in a disadvantaged or ‘losing’ state. While the client may argue that the deal needs to be fair to both sides to be win-win, the focus is really only on correcting the disadvantage being suffered by the client, as opposed to trying to address both parties’ needs and goals.

Indeed, very often a win-lose strategy results in a lose-lose expectation. How often has it been said that only the attorneys win in litigation? All too often, those franchisees who “won” in court are defeated by the financial and emotional cost of their victory. And how often does the client ultimately capitulate as a result of the mismatch of client resources?

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⁸ For an interesting discussion of this subject, see Malhotra, “The Perils of Negotiating to Win” Harvard Law School Program on Negotiation publication, Negotiation. Volume 10, Number 3, March 2007.
2. **Lack of Resources**

In most instances, franchisee clients lack sufficient resources to fully pursue their claims (or defenses). Counsel will usually be aware of the client’s lack of ability to finance legal action, and will also be acutely aware of the franchisor’s far more substantial resources. This not only hinders the client's chance of prevailing, but can create conflict between the client and counsel. The attorney begins to base strategy not on what is best, but what the client can afford. In the client's mind, counsel represents another problem, i.e., a financial obstacle to overcome.

3. **Risk of Bad Publicity**

As noted above, the option of going public with a dispute can be fraught with the risk of achieving a *lose-lose* result. Bad press for the brand will negatively impact both the franchisor and the entire franchise network. Moreover, the franchisee’s seemingly valid claim is not always embraced by public opinion, such as may be the case when the franchisee desires to set his or her pricing, while the franchisor is seeking to enforce some form of value pricing, including maximum resale price requirements.

C. **Innovative Approaches and Techniques**

There may be times when traditional advocacy is warranted, such as when the business has already failed, the investment is procured by fraud, or if the parties simply no longer wish to be in business together. But for the many instances in which the parties would like to make a success of the enterprise, there are better ways to represent clients to achieve their more positive goals. A key to a ‘new paradigm’ of franchisee advocacy is *marketing the value of the client to serve his franchisor’s needs goals in a manner that enhances the willingness of the franchisor to value and reward the client’s goals and requirements.*

Despite the anger, frustration and concern franchisees exhibit when they seek counsel during the franchise relationship, these business owners usually are not seeking to surrender their businesses, or looking to terminate their franchise relationship. Their long term goal is to fix their immediate problem, ideally through negotiation, and then earn a great *win-win* relationship fueling a successful business and brand.

1. **Change Client’s Approach to Problem Solving**

Counsel might pose a series of questions that are designed to identify and focus on long term goals, and also to manage expectations. The most important of these questions would be as follows:

Would you be completely satisfied if we could waive a magic wand and have your relationship with your franchisor be as you imagined it on the day you purchased your franchise?

Almost invariably, franchisees will respond affirmatively to this question. No matter what the complaint or the short term goal, the long term goal is to have a successful franchise business and relationship.

In this context, there is a second telling question that might be posed to all franchisees
(and groups of franchisees) who seek aid of counsel:

   I’d like to know something about how you conduct your business. When someone walks into your store for the very first time, or if you call on a prospective customer, do you stare the customer square in the eye and proclaim, “I demand that you do business with me, and if you don’t I will sue you?”

   Prospective clients will probably laugh at the suggestion that they would adopt a business marketing strategy based upon threats and coercion, which prompts this follow-up query:

   Of course, you would never try to attract new business by employing threats. Why then do you think this would be a successful strategy with your franchisor which already has you bound to an agreement written in its favor?

   This line of questioning is designed to change the paradigm of groups of franchisees to appreciate that their perceived strategy to storm the castle and demand their rights is not calculated to achieve their true goal, i.e., to be embraced by their franchisor with respect and compassion and appreciation that the franchisee network is likely the franchise system’s most precious asset. The first step for the franchisee and counsel is to realize that a strategy based upon threats of legal action and other forms of coercion is not designed to evoke trust and compassion. The next step is to conceive a strategy aimed at the true goal of achieving a franchise system which matches the client’s vision on the day the franchise agreement was first signed.

   2. **Adopt a Marketing Approach to Franchisee Representation**

   The goal of every attorney who represents clients should be to effectively assist clients in achieving their goals. For franchisee counsel, this may be a negotiated business deal, a resolved dispute, effecting or avoiding termination on favorable terms, negotiating favorable terms for a store remodeling, or other examples. In each instance, counsel is seeking to enhance his or her client’s ability (or opportunity) to succeed. In other words, counsel’s goal is to increase his or her client’s leverage to achieve a desired result.

   Traditional advocacy involves the use of dispute resolution strategies to build a client’s leverage. If the matter involves negotiation, the attorney is nevertheless seeking to increase the client’s negotiating leverage to achieve a better deal.

   Here is the paradigm shift: Rather than the attorney viewing himself or herself as engaging in combat (as legal action is often perceived), the attorney might view his or her role to be one of "marketing consultant.

   Think about the question posed above, “Why do you think a strategy of threats and coercion would be effective to attract or entice a franchisor to solve your client’s needs?” Fundamentally, is not the client essentially seeking to attract his or her franchisor ‘to do business’ in a manner profitable to the client? To do this, the attorney might employ the
following techniques, which are similar to those commonly taught by sales and marketing consultants:

- Seek to establish the client’s knowledge of and interest in the prospective customer’s (franchisor’s) needs and goals.
- Build customer confidence by listening intently to the customer, and making the customer know that the client understands and can expertly articulate the customer’s needs.
- Demonstrate the client’s empathy for the customer’s needs and desires, and demonstrate how the client is the best person on the planet to deliver what the customer is seeking. In other words, make the client as attractive as possible so the customer will prize the value of the client’s ability to achieve the customer’s goals.
- Articulate what the client wants (the “price”) for fulfilling the customer’s needs.

These fundamental steps of selling and marketing can be effectively applied in franchisor-franchisee relationships. Imagine the leverage a franchisee might enjoy if the franchisor believes that the particular franchisee is a top producer and a model citizen within the franchise community during the franchise term.

Imagine the leverage that Alex Rodriguez (for baseball fans) and Peyton Manning (in football) enjoy when they go to negotiate a new contract. Their market value will allow them to “write their own ticket” in their negotiations. Is the concept applicable in franchising? Suppose the client is Marriott Corporation and Marriott decides to open pizza franchises in its hotels. Would not most pizza chains be likely to “cut special deals” with a mega-corporation that can put hundreds of new units on line?

While few attorneys can boast a client stable with the negotiating clout of Marriott (or Rodriguez or Manning, each of whom would have most franchisors salivating over the prospects of landing either superstar as a franchisee), the art of enhancing negotiating leverage is a valuable skill that will well serve franchisee clients, especially when applied during the franchise term. The component parts of this skill set forth above are explained in detail below:

a. **Seek to Establish Knowledge of Franchisor’s Needs**

Franchisees, and perhaps counsel, are frequently surprised when the franchisor is described as “the customer.” They see the relationship in opposite terms—the franchisee sees himself or herself as the customer who should be served by the franchisor. But franchising is a bilateral enterprise—franchisors need a distribution system and franchisees are looking for a product or service to represent. At its core, franchisors and franchisees are each others’ customers, but all too often they (and their counsel) fail to recognize this fact. In this regard, the first order of business is building the case and image that the client is the best person on the planet (or among the best persons) to satisfy the franchisor’s needs.

9 There are many resources for steps to successful selling. These steps are gleaned generally from Covey, Stephen. The Seven Habits of Highly Effective People, New York: Simon & Schuster, 1986. (Hereafter cited as “Covey”) See also, other citations.
This effort of image building is done by careful planning:

- Start with an evaluation of the franchisor’s needs and goals.
- Evaluate and embolden the client’s capabilities and qualities to fulfill the franchisor’s needs.
- Develop a plan to “publicize” the client’s knowledge, skills and capabilities.

b. **Build Franchisor’s Confidence**

Astute counsel listens well, reserving judgment and strategic advice until he or she has heard the franchisor’s side of the facts, recognizing there are almost always two sides to every story. Counsel will also advise and assist the client to empathically listen and understand the franchisor’s goals, objectives and rationale for the design and requirements of the franchise system. By listening intently to the franchisor, and by aiding the client to do the same, counsel is also helping to build the franchisor’s (customer’s) confidence in the client, by convincing the customer that the client understands and can expertly articulate the franchisor’s purposes and goals. It has been said that the most critical step in sales and marketing is listening intently to the customer and articulating a clear understanding of the customer’s goals.\(^\text{10}\) There is nothing more powerful in sales (and advocacy for that matter) than gaining the confidence of the customer (or, in the case of counsel, the client, the opposite party, the judge or jury) that the client is a valuable asset on his or her team. This maxim is true in franchising. In every franchise system, there are certain to be favored franchise owners whose success is built upon gaining the confidence of the franchisor through good work and a strong showing of empathy. Schooling the franchisee client in these skills will lay the groundwork for successful future projects.

A critical element of gaining confidence is to be a good listener. There is likely no greater attractant for any customer, franchisors included, than to believe “I have been heard and understood.” Good listening and communicating skills alone can dramatically improve the client’s negotiating leverage. Equally powerful confidence builders are expressions of compliments and gratitude for good deeds and behavior. The advice to "catch your employee doing something right and reward it" is equally applicable with franchisors, and it has been said that the most powerful words in the English language are “thank you.”

c. **Demonstrate Empathy for Franchisor’s Needs**

By making the franchisee as attractive as possible, the franchisor/customer will usually prize the franchisee’s value to achieve the franchisor’s goals. After counsel has packaged the client with an aura of competence and value, and have thoroughly researched the franchisor’s goals with respect to any issue at hand (primarily by listening and evaluating what has been communicated), step three is to thoughtfully and cogently articulate and demonstrate the client’s solution to the franchisor’s goal, and the ability to deliver. A key to any negotiation is the one side’s perception of the value of the other side’s offer, and the willingness to pay a price for the performance the client is offering. Rather than presenting the client’s demand, focus on the

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10 Covey, pp 236-260 “Seek First to Understand, Then to Be Understood: The Principles of Empathetic Communication.”
value to the franchisor customer. The goal is to make the franchisor hungry for the client’s service, and for the franchisor to be fearful of losing a valued asset to the franchise system if the client is not amply rewarded for his or her service. The client’s goal, with counsel’s strategic help, should ideally be to demonstrate that he or she is the best person on the planet to deliver what the franchisor is seeking in a franchisee.

d. Articulate the Client’s "Price"

If the first three steps are followed successfully, the articulated "price" to be paid to the client will be perceived as offered in trade, and the ultimate negotiation will be haggling over amount and terms--exactly where the client and counsel would like the discussion to center. The client’s goal is a quid pro quo negotiation aimed at both parties needs being served.

Adopting a marketing strategy of advocacy can work in virtually any situation in which the client is hopeful of preserving the franchise relationship. A real life example will exemplify how the strategy is applied:

A group of clients of a fast food business were obligated to remodel at stated intervals during the franchise term. The franchisees believed the franchisor’s requirements were excessive.

The franchisees first determined their goals from the negotiations they hoped to engage with their franchisor. To this end they met with counsel and their design and construction team to determine with a fair degree of certainty what they would propose to meet the remodeling obligations. Next, the franchisees discussed the franchisor’s proposals with their counsel and construction team, the goal being to evaluate the franchisor’s goals and objectives before they ever met with management.

Next the franchisees met with the franchisor representatives to discuss the franchisor’s requirements. The purpose of this first meeting was not to negotiate, but merely to learn. Their sole purpose was to completely understand their franchisor’s goal and vision underlying the remodel requirements. The franchisees confirmed their understanding of each component of the design requirement, and did their best (including the application of their earlier deliberations with counsel) to impart their understanding of what was being required and why.

The next step was to privately revisit with counsel to determine what the franchisees could propose to meet the franchisor’s goals within the franchisee’s budget. Counsel’s goal and task was to craft a proposal intended to satisfy the franchisor and still be consistent with the clients’ needs.

11 Franchisor counsel have advised that even small steps that demonstrate a franchisee’s goodwill toward resolving issues can be very helpful, such as “immediately doing small things for coming into compliance that don’t cost the franchisee big bucks, that builds up lots of goodwill that a franchisor attorney would usually be inclined to reciprocate.”
The next meeting was critical. The franchisees and counsel made their proposal to management. They took care to stress their commitment to meet the franchisor’s goals, but they sought to demonstrate the economic hardships of the original requirements. They took pains demonstrate the sincerity of their own offer to meet the franchisor’s needs on a reasonable budget.

The franchisor did not accept the franchisees’ proposal, but a foundation of mutual respect had been achieved, and the parties began to negotiate a compromise. Ultimately, counsel suggested that the parties engage a mediator, in this instance a restaurant authority. It was agreed that if the mediation reached an impasse, each party would submit a final offer to the mediator, whose role would switch to arbitrator to select one of the two offers, or what is known as baseball arbitration. The mediation was successful and the parties agreed on a remodeling plan that all the parties could endorse.

3. **Seek the Win-Win Result that Will Repair and Foster an Improved Relationship**

As noted, a key component to adopting a marketing strategy (as opposed to a strategy based upon confrontation) is to focus on solving the franchisor’s evaluated needs in consideration for achieving the client’s goal or objective. A result that serves both parties delivers a win-win resolution, inspires future negotiation and collaboration and lays a foundation for a mutually satisfactory relationship.

Astute counsel will ask a critical question of the client, “What result are you looking for in this situation?” As will be seen, careful probing of the client’s true goals may well yield solutions that would entice a great result from the franchisor. However, too often counsel fails to ask this critical question, and rather focuses on the alleged ‘wrongful conduct,’ giving primary attention on a calculated ‘damages’ valuation of the franchisee’s complaint.

Clients often claim that they are seeking a win-win relationship, but their behavior, though cordial, is really focused on their own interests. For example, here is a typical statement one might hear from a client group’s view of a win-win effort:

We tried to approach our franchisor with a win-win attitude. We explained that we wanted a solution that works for everyone, and we were very considerate in our discussions. We told [our franchisor] why the existing marketing campaign was not working, and why it was too expensive for its results, and we explained what we thought would be a more effective use of our marketing funds. [Our franchisor] defended his program, and merely chided us for not getting behind it and following the rules. Essentially, he simply said we weren’t following the correct processes, and the failures of the plan were our fault. I guess win-win just doesn’t work.

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What these clients viewed as a *win-win* effort was really no more than pleading their case in a cordial fashion. It was not focusing on the franchisor’s needs, only the needs and desires of the client group. Consider the following (abbreviated) approach:

We approached our franchisor with a plan to analyze the current marketing program. We reviewed the goals of the program, and the budget. We agreed that if our advertising budget is 5% of sales, then we should be targeting that every dollar we spend on advertising should generate $20 in revenue. Noting that we aren’t achieving our desired results, we brainstormed with our franchisor to develop various approaches and options that might more efficiently achieve our common goal of more revenues generated by our advertising fund. At the end of the day [our franchisor] endorsed our recommended program, and we committed to focus our resources collaboratively for our marketing program to be more effective.

The difference between these two approaches is that a true *win-win* approach articulates value to both sides of the negotiation, as well as common value. It has been said that the goal of the parties in a *win-win* negotiation is a result that is superior to the goals of either party coming into the negotiation. The result is superior in that it builds the common value to the enterprise, as well as meeting the needs of each party to the negotiation.

4. **Importance of Collaboration and Negotiation in Issue Resolution**

If building a great and long lasting relationship is a core goal of advocacy during the franchise relationship, then the importance of negotiated solutions achieved through a collaborative process cannot be stressed enough. Franchise systems that have adopted a collaborative culture report a significant improvement in franchisee satisfaction.

Collaborative business cultures have been extensively studied, evaluated and analyzed. A system of business management known as Total Quality Management (TQM) has been described and developed based upon a collaborative business model in which employees are empowered to contribute to their own corporate cultures. The advantages of collaborative

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13 Covey, pp 262-284. ‘Principles of Creative Cooperation.’


A survey of AAFD Fair Franchising Seal recipients conducted by Lexington Insurance Company (a subsidiary of AIG Insurance) revealed a visible improvement in franchisee relations—including trust, satisfaction, a sense of franchisee empowerment and performance among franchisees in the accredited systems. This survey led to an offer of steeply discounted franchisor E&O insurance to companies that had earned the AAFD Seal.

business cultures are many, and have been documented to include a sense of investment and buy-in into corporate and management decisions.\textsuperscript{16}

Franchisee counsel may find it advantageous to promote the advantages of TQM to improve franchisee satisfaction, to promote system and contract uniformity and to provide a process for system-wide amendment of the franchise agreement with a super majority ratification of negotiated changes.\textsuperscript{17}

5. **Utilize Franchisee Associations**

Increasingly, independent franchisee associations (FOAs), and to a lesser extent franchise advisory councils (FACs), are evolving to be effective tools for franchisee counsel.\textsuperscript{18} Whether the issue at hand is a grievance or other dispute, a response to a crisis or catastrophe, or a petition for approval of a new idea, often issues raised by one franchisee are common to others, or are of concern to others who may wish to avoid a personal confrontation in the future. Franchisee associations by their very nature are usually organized to address and resolve such common issues.

FOAs come in many shapes and sizes. They may be new or mature, timid or aggressive, collaborative or adversarial, mediative or combative, ministerial or provocative. The FOA may or may not be recognized by the franchisor. Some associations will take up the cause of individual franchisees; others will only entertain system wide issues. Some have engaged legal counsel and others shun all issues legal. Still others are actively engaged in marketing, purchasing, impact resolution and/or remodeling issues, while their counterparts in other systems may exist solely to offer mentoring programs for fellow owners or to serve as a think tank for the franchise system.

FACs, and individual FAC representatives (whether elected or appointed), are often empowered and chartered as the proper channel to filter grievances, disputes and suggestions on behalf of individual owners and licensees. Other times, a FAC’s function may be limited to the franchisor’s agenda, or otherwise may be limited to advising the franchisor on matters in which the franchisor asks for advice, such as the current state of franchise relations or a new business program that the franchisor is considering.

Counsel should evaluate what kind (if any) FOA and/or FAC the franchise system has in place, and determine if there is an opportunity and resource available to address a client’s issues and concerns. Such an evaluation may reveal significant (or negligible) opportunities for leverage, and if there exists a pool of similarly situated franchisees, counsel may discover and construct a viable “client” with sufficient resources to enable the attorney to provide effective representation. Increasingly, franchisee counsel are learning to leverage client claims by

\footnotesize{\textsuperscript{16} Id.}
\footnotesize{\textsuperscript{17} The essential principles of TQM have been mirrored and adopted by the AAFD in the enunciation of its model for franchisee management that has been given the moniker of Total Quality Franchising (TQF). The AAFD defines TQF as a franchise system that is built upon a collaborative franchise relationship that respects the legitimate business interests of the franchisor and the franchisees of the system. The AAFD offers an accreditation program for franchise systems that embrace the principles of TQF with its Fair Franchising Seal. Chapter 1, AAFD Standards, supra, footnote 6. See infra Section III(C)(6).}
\footnotesize{\textsuperscript{18} See Note 4, supra.}
aggregating those with similar claims, or gaining financial support (formal or informal) from an FOA that determines to embrace the challenge at hand. Franchisee counsel might consider supporting existing franchisee associations, and to encourage their formation where none exists.

Consistent with the theme of this section to incorporate marketing skills into client advocacy, counsel may consider promoting FOAs as valuable assets of a successful franchise system. For example, uniformity is universally endorsed as a desired attribute of franchising, but few franchise systems can boast having all of their franchisees working off the same agreement. Indeed, it is probable that most franchise systems are administering at least one version of their franchise agreement for every year they have been in business. A collective agreement that has been collaboratively negotiated with an association may well result in all system franchisees being on a truly uniform agreement. Moreover, a negotiated agreement might also include a provision to allow for system wide amendments to the franchise agreement, provided there is some form of super majority ratification by the franchisee population.

FOAs offer other benefits to a franchise system, beyond the opportunity to foster negotiated system uniformity. FOAs often play a significant and beneficial role in site approval, marketing, purchasing (both with respect to standards and buying power), remodeling standards, impact policies and the handling of grievances. In many, if not most, instances, franchise systems that have endured the establishment and growth of an independent FOA have come to appreciate these institutions as valuable (even if sometimes trying) assets of the franchise system as a whole.

An FOA can be valuable to counsel in many ways, from providing factual and financial resources to the possibility of direct representation. The FOA may have a direct process to champion a cause, petition for change, or handle a grievance. The association may wish to take up the cause on a group-wide basis. Examples of situations in which franchisee associations have supported legal representation include the following:

a. Negotiation of new supplier contracts introduced by an individual franchisee, embraced by the FOA purchasing cooperative, and ultimately approved and embraced by the franchisor.

b. Challenge to a franchisor’s efforts to dictate a new point of sale system for all franchisees in the system.\(^\text{19}\)

c. Providing of direct financial support to effect a challenge to group arbitration of common claims by asserting that the franchise agreement’s ban on group arbitration was unconscionable.\(^\text{20}\)

d. Supporting a franchisor’s efforts to secure an exemption from various state licensing requirements.

e. Developing and supporting an impact policy for a franchise system.

\(^{19}\) Bores v. Domino’s Pizza LLC, 489 F.Supp.2d 940 (D. Minn. 2007).

f. Collaborating with the franchisor to develop and implement a system for approving remodeling plans and requirements in a mid-size fast food system.

g. Engaging research of competing franchise systems to support a challenge to the amount of a national advertising fund that was diverted to administration of the fund.

Undoubtedly, there will be issues that call for dispute resolution institutions. The FOA may provide litigation support, witness support, and/or financial support. Many associations have established legal funds that can be accessed to finance projects that require legal services. Increasingly, associations have been held to have standing in group-wide disputes where the courts have found the association is in a better position to represent the interests of franchisees, even though the association may not have a direct contractual relationship with the franchisor (or even be recognized by the franchisor).21

As a practical matter, there may also be times when counsel may better assist a client by standing a part from an existing FOA, and advising the client to act on his or her own. For example, if a client’s position can be improved by not aligning with a more adversarial owner’s association, or if there is an opportunity to gain leverage by siding with the franchisor, such options need to be evaluated. Whether seeking supporting, opposing, or avoiding involvement with an FOA, counsel is wise to use strategic long term thinking, and not impetuously act to a tactical advantage. The client’s long term interests are likely to be best satisfied if the client has not alienated himself from the franchisor, or the franchisees, or the FOA, so careful evaluation of whether to use, or avoid involvement is advised.

6. Seek Assistance from Outside Trade Organizations

By reading this paper, counsel is to some degree reaping the resources of the American Bar Association Forum on Franchising (“the Forum”) to advance his or her lawyering skills and client representation. In fact, for many members the Forum ListServ network has become an invaluable tool and resource. The Forum is also a resource for scholarly research on issues of relevance to the practice of franchise and distribution law, a resource to identify counsel, mediators, arbitrators, and even the quality of judges. All of these are valuable tools for practicing attorneys.22

Similarly, the International Franchise Association (“IFA”) and the American Association of Franchisees and Dealers (“AAFD”) both seek to provide support and resources to counsel. While the AAFD is more directly focused on support for franchisee counsel, both organizations have valuable tools available to counsel on both sides of the franchising equation.


22 The Forum is not the only ABA Resource for franchise attorneys. The General Practice Section has two committees focused on franchising and dealership issues. The Dispute Resolution Section, Corporate Law Section, Anti-Trust Section and Intellectual Property Sections all provide resources of value to franchise counsel.
The IFA has produced an aspirational Code of Ethics which can support a franchisee’s claims.23 The IFA also offers an ombudsman program to help resolve franchisee disputes, and has placed great emphasis on supporting self-regulation of franchising, including a process to hold franchisors accountable for violations of the IFA’s ethics code.24 The IFA offers a popular Annual Legal Symposium, and offers many publications and studies that are resources to counsel. The IFA sponsors and supports the Society of Franchising which advances academic research of the franchising community, and has served as the major stimulus for academic study of franchising. The IFA’s Annual Conference is a place where best practices in franchising are discussed, evaluated and promoted.

All of these resources may be utilized by franchisee counsel during the course of the franchise term. The information can be used in negotiations as well as in the "marketing" of the franchisee client.

The AAFD also provides resources that can be tapped by franchisee counsel to advance client causes, including assistance in organizing and funding franchisee associations. The Franchisee LegaLine network is a resource of nationwide counsel who focus their practices on the representation of franchisees. The LegaLine has its own email list serve network designed for shared communication between such franchisee counsel.

Perhaps the AAFD’s most significant contributions to franchisee advocacy have been the development of its Fair Franchising Standards ("Standards") and an accreditation program for franchisors, the AAFD Fair Franchising Seal ("Seal").25 As of this writing, the AAFD has adopted 140 standards touching every aspect of the franchise relationship. In addition to using the Standards and Seal as a means of evaluating franchise business opportunities (see Section II.C.7.), counsel can use the Standards during the franchise term to help determine the reasonableness of the client’s (or franchisor’s) position on an issue, or to suggest a fresh approach to resolve a problem.

There are other resources offered by both the IFA and the AAFD that can be tapped by counsel in appropriate circumstances. For example, both organizations support amicus brief programs and take positions on issues of concern to their members in appropriate circumstances. Also, both organizations support efforts to promote the mediation of franchise disputes, which leads to the next topic.

There are also many industry specific trade associations that may be of value to client interests. Such associations may be franchise related, such as the National Association of Automobile Dealers, or the Service Station Dealers of America; or may be industry related, such as the National Education Association. Such organizations may have both business and legal resources. For example, gaining independent accreditation for your client in his or her industry

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23 The IFA’s Code of Ethics specifically disclaims that it should be used as evidence of franchisor misconduct, or otherwise be cited in legal disputes. This statement does not preclude counsel from citing and quote the IFA Code in its legal arguments.

24 It should be noted that there are no reported or published accounts of the IFA ever disciplining a member or taking action regarding an ethics code violation.

may help influence a franchisor as to the client’s value when dealing with issues of contract enforcement.

7. Use Mediation To Resolve Disputes and Build Value for Franchisees

Obviously, mediation is not a tool that is unknown to franchisee counsel. And yet mediation, like declaratory relief actions that are dealt with in the next section, is often not used to its fullest potential. Mediation is often the only process that the client can afford, and a good mediator will often pursue a remedy that will benefit both parties.

Most attorneys already recognize mediation as a valuable tool to resolve disputes, and many courts now make mediation of disputes mandatory even if the franchise agreement has not done so. Nevertheless, many attorneys are leery of mediation as wasteful of scarce resources, a waste of time, a sign of weakness, or will serve to give away discovery that counsel (often in poor judgment) wants to hold close to his or her vest.

However, during the franchise relationship, if the parties wish to continue in business with each other and are looking to resolve a specific issue or repair and restore their relationship, use of mediation at an early time can be a miracle salve to heal wounds and even save the relationship. In the hands of a skilled mediator, mediation can go beyond dispute resolution. Often mediation can create value for franchisors and franchisees by creating a new perspective on the disputed subject, where perhaps the parties have dug in and are incapable of looking at different perspectives.

Some years ago a franchise system was embroiled in a difficult debate during a contract negotiation over its impact policies and the protected territory it provided in the franchise agreement. The company offered a territory with a two-mile radius; the franchisees wanted 6 miles. The parties dug in and were at an impasse and mediation ensued. The mediator was first able to get the parties to agree that they shared the goal of system growth to meet and beat their largest competitor, and the mediator urged the parties to focus as businesspersons on how to grow their system in a manner which would avoid undue impact. With this different focus the parties went to work, and with the mediator’s influence, ended up with a two-mile protected territory, but with a new impact policy that included encroachment insurance that could provide protection up to six miles. The encroachment policy of this company is now a major selling point for franchise development, and the franchisees have some of the best impact protection offered in the franchising community.

This example demonstrates the creation of value in a non-litigative context. Mediation can be most valuable in building great franchise agreements. A good mediator can keep the parties focused and be help create value. A skilled mediator is more likely to look at the combined interests of the parties and help create a sense of empathy on both sides that is valuable to most successful business deals. A mediator with specific knowledge and understanding of franchising and franchise relationships can be a significant asset in franchise related mediations.

Even employed in dispute resolution, mediation can help resolve issues, create value and repair the relationships. Another brief example will help illustrate: In a dispute regarding the alleged misapplication of advertising funds, the mediator convinced the franchisor to replenish the fund by a substantial amount (although not 100% of the claim). The money, of
course, was spent on marketing the brand (and almost half the stores in this system were company owned), which in turn generated sales and additional royalties that nearly made up the monies paid by the franchisor to replenish the fund. Truly, this solution resulted in a win-win in which both parties got exactly what they wanted.

8. **Utilize Ombudsman Services**

A close cousin of mediation is the use of ombudsman programs where they are offered by a franchise system. While ombudsman programs are perhaps seen as a tool that would be used before counsel gets involved, very often the client has not considered accessing the ombudsman, and sometimes is not even aware that such a program exists (and shame on the franchisor that fails to adequately promote the tool!). Counsel can serve his or her clients by finding out what kind of ombudsman services might be available, and by directly accessing the ombudsman in the client’s service.\(^{26}\) Not all ombudsmen, just like not all mediators, are created equal, but such programs should be explored, and are especially of value in situations regarding adherence to system standards.\(^ {27}\)

Example: A nearby mall construction has resulted in significantly decreased sales, as a result of which the franchisee client is having trouble paying the bills, including royalties.

This example is well suited for the services of either an ombudsman or a mediator. If the franchisee has a strong history, the parties will likely work together to meet the competitive challenge. If the existing location is still viable, but no longer attractive, a mediator or ombudsman might suggest some form of aid, perhaps a loan or grant, or a franchisor subsidized second store in a new location. This would likely achieve a win-win result. If the existing store is no longer viable, relocation might be suggested. If the relationship is worth saving, and the parties recognize the impact of an outside influence, the value of a winning relationship will normally trump the current difficulty when the parties have objective assistance coaxing the negotiation process.

9. **Collective Contract Negotiations and Renewals**

[Contract negotiations from the franchisee’s perspective was the subject of a specific program at the 2000 ABA Forum on Franchising Program \(^ {28}\), and the authors make no effort to retrace that ground in this effort. Although contract negotiations, including renewal terms, are beyond the scope of this paper, the strategies suggested in this section would apply to any negotiation effort.]

It is predictable that most franchisors eschew efforts to negotiate the franchise agreement, especially on the basis that individual negotiations impair the uniformity of the

\(^{26}\) As noted supra, the IFA sponsors an Ombudsman program that can be accessed by any franchisor member of the IFA.

\(^{27}\) There have been many excellent articles that focus on mediation and ombudsmen programs, including “A New Era for Ombuds,” Dispute Resolution Magazine (Winter 2005).

\(^{28}\) “Negotiating Franchise Agreements: The Franchisee Perspective” written by Lawrence Ashe and Harris Chernow for the 2000 ABA Forum’s Program in New Orleans.
franchise system. Franchisors will also argue that administration of multiple contract versions would be a nightmare. These arguments may actually yield negotiating leverage for franchisee associations that can offer improved uniformity as well as the potential for system wide amendments without requiring each individual franchisee’s approval.29

There is a growing trend of franchisee associations, and franchisee counsel, to advocate collectively negotiated franchise agreements. While it is appropriate to observe that most franchise systems resist negotiated agreements, it may well be that negotiated agreements have benefits for both franchisees and franchisors. Franchisee counsel may wish to evaluate these benefits in advancing the strategies recommended in this section.30

It should be stressed that it is rarely too late to initiate these new approaches. Even in circumstances in which a long history of disfavor has existed, new attitudes and strong empathy may breed confidence and compassion. The simple gesture of complimenting the franchisor for doing something right, or thanking its executives for a good deed or behavior, can immediately shift a negative attitude towards a more positive and receptive mood. How often have disputants been seen to “kiss and make up” and seen just days later playing golf together, never seeming to have been in conflict just a short time earlier?

During the franchise relationship, every effort of counsel should be made with a purpose to preserve, restore and even enhance the relationship. The suggested approaches are all aimed at that goal. Sadly, not all franchise relationships are capable of being saved. In the next section, focus turns to representing franchisees when the relationship is facing litigation or termination.

IV. DISPUTE / TERMINATION

A. Standard Practices

As noted above, franchisors generally resist negotiating the terms of their franchise agreements. This is an understandable dynamic. While a franchisee may have one or several franchise agreements, franchisors often have hundreds of franchise agreements, and it would not be very practical if every one of those franchise agreements differed from all the others. While there may be dozens or even thousands of franchisees in a particular system, there is but one system, and each of the franchise agreements needs to address compliance with that system’s standards. Also, because a franchise agreement is a form of trademark license, the franchisor, as licensor, will necessarily include provisions directed at protecting the licensed mark.

29 See Section III.C.5., supra.

30 There are a growing number of franchise systems with negotiated agreements, including KFC, Meineke, Burger King, Pizza Hut, Taco Bell, among many. These systems often report that better relationships emerge through the respect gained through negotiation. As a practical matter, the AAFD’s Fair Franchising Seal is awarded to franchise systems that have embraced collectively negotiated franchise agreements and relationships. AAFD Fair Franchising Standards, Chapter 1, CCH citation.
Understandable, perhaps, but the end result is the same. The typical franchise agreement, in exchange for granting the franchisee a license to use the marks and system, creates a litany of obligations in favor of the franchisor, but very few in favor of the franchisee. Not surprisingly, when a franchise dispute arises, the franchise agreement is likely to be both a sword and shield in the hands of the franchisor, while providing to the franchisee little in the way of offense or defense. When one considers that the majority of litigated franchise disputes are not resolved in favor of the aggrieved franchisee, one must conclude that the typical litigation path ought to be the path of last resort.

Franchisors, too, are not necessarily well-served by the typical dispute resolution process. Winning a lawsuit may be better than losing a lawsuit, but that is not why franchisors are in business. While there may be times when a franchisor feels compelled to end a franchise relationship, the loss of a royalty stream and market presence is a very high price to pay.

Below are several techniques and strategies used by franchisee counsel over the past quarter century.

1. **Written Communications after Problem Recognized**

When a franchisee engages counsel, it is not atypical for the lawyer to interview the franchisee, review the franchise agreement, review any other pertinent documents, and draft a letter to the franchisor, detailing the franchisee's claims, and demanding relief. Not surprisingly, given the nature of the issue, the aggrieved franchisee will most likely have selected a litigation attorney.

2. **Posturing and Finger-Pointing**

The letter will probably read a bit like a complaint, and a bit like a summary judgment brief. In some ways this will be the lawyer's opportunity to see how the franchisor will respond, so there is no point leaving anything off the table. More likely than not, in order to justify the relief sought by the franchisee, the letter will at best suggest some failing on the part of the franchisor, and at worst accuse the franchisor of serious misconduct.

3. **Seek to Enlist Aid of Franchisee Association**

Recognizing that there is strength in numbers, the aggrieved franchisee, perhaps at the urging of counsel, may seek to encourage others franchisees to join the cause. If the particular system has a franchisee association, the franchisee may seek the association's support.

4. **Commence Litigation / Arbitration**

All too often, what begins as an accusatory letter, instead of leading to an early resolution, leads to litigation. Typically, franchisee-initiated litigation pursues one or several of the following causes of action:

   a. **Good Faith and Fair Dealing**

   In essence, a franchisee alleging a breach of the implied covenant of good faith and fair dealing is seeking to establish that the franchisor, while not breaching an express provision of
the franchise agreement, has acted in a manner that has unreasonably deprived the franchisee of expected rights and benefits under the franchise agreement.

Claims alleging a breach of the implied covenant of good faith and fair dealing are often made in encroachment\textsuperscript{31} and wrongful termination\textsuperscript{32} cases.

b. **Fraud and Misrepresentation**

The essence of a fraud or misrepresentation claim is that the franchisor made a material statement that the franchisor knew or should have known to be false, intending that the franchisee rely upon such statement, and upon which the franchisee actually and reasonably relied, resulting in the franchisee being damaged.

c. **Breach of Contract**

As noted above, typically a franchisor does not have many express obligations under its franchise agreement. Indeed, in some instances a franchise agreement will contain several pages of text dealing with the right of the franchisor to terminate the franchise agreement, while containing little, if any provisions, addressing the rights and obligations of the parties in the case of a breach by the franchisor. That is not to say that a franchisor cannot engage in conduct properly characterized as a breach of contract, such as establishing another franchised outlet within the exclusive territory granted to another franchisee.

d. **Lack of Support / Lack of Competence**

Occasionally franchisees allege either, or both, lack of support and lack of competence claims. A lack of support claim is essentially a claim, by the franchisee, that the franchisor failed to provide a minimum or requisite level of assistance. A lack of competence claim, on the other hand, is a claim asserting that the franchisor did not have the necessary background and skills to provide those services reasonably expected by the franchisee.

5. **Sale, Closure or Takeover**

Typically the dispute will result in the sale of the franchised business, its closure, or its reacquisition by the franchisor, often with negative financial impact to one or both parties.

B. **Challenges and Limitations of Standard Practices**

These standard practices often result in disputes taking on a life of their own. Instead of the franchisee and franchisor dealing with an issue that is capable of being resolved, with little damage to the underlying relationship, too often the manner in which the issue is addressed results in irreparable damage to the franchisee-franchisor relationship.

\textsuperscript{31} See, Scheck v. Burger King Corp., 756 F. Supp. 543 (S.D. Fla. 1991) (claim that establishment of a competing restaurant violated covenant of good faith and fair dealing, even though there was no exclusive territory under the franchise agreement).

\textsuperscript{32} See, Dunkin’ Donuts of America, Inc. v. Minerva, Inc., 956 F2d 1566 (9th Cir. 1992) (claim that franchisor used inaccurate audit method in order to establish grounds for termination).
1. **May Become Entrenched in Communicated Positions**

An asserted position is not unlike a moving object, in that it has mass and momentum. Once asserted, a lot of energy can be spent trying to prove or disprove the correctness of the position initially asserted. Instead of two parties working together to resolve an issue, each party is trying to prove that party is right, and the other party is wrong.

2. **Litigation Expense and Time Commitments Can Quickly Exhaust Resources**

Litigation is both expensive and time consuming. More often than not, the franchisor can more easily afford the financial burdens of litigation, although every hour spent dealing with litigation is one hour taken away from something else. In some instances the money spent starts to be viewed as an “investment,” making it hard for a party that has paid a lot of legal fees to accept what might otherwise be a reasonable settlement proposal.

3. **Franchise Association Sympathy Limited**

Section II of this paper described how franchise associations can be useful information resources for a potential franchisee considering the respective franchise system, Section III described how franchise associations can positively influence the way a franchisor approaches issues impacting many of its franchisee-members. However, in the context of a typical dispute involving just one franchisee and its franchisor, the system franchise association is unlikely to come to the aid of the franchisee.

In the case of a terminated or soon to be terminated franchisee, the franchisee association may not be particularly sympathetic, if the reason for the termination is a failure of the franchisee to comply with the same rules with which other system franchisees are complying. Even when the franchisee association is sympathetic to the franchisee’s situation, it may not be willing to assist the affected franchisee. Unless a majority of franchisees believe the franchisor to be systematically engaging in inappropriate conduct, the franchisee association will probably avoid becoming involved, in part because the system does not benefit from resources spent by the franchisor to defend litigation.

4. **Litigating Enforceability of the Arbitration Clause, and Other Distractions**

Too often a lot of money can be spent dealing with tangential issues, which will also delay the ultimate resolution of the dispute.

Arbitration clauses are often attacked by one of the parties.\(^{33}\) Similarly, it is not unusual for a party to challenge a franchise agreement’s venue provisions, or a court’s personal jurisdiction over a defendant.\(^{34}\) The ultimate decision in the case may not be impacted by these skirmishes; but the time and money spent will move the franchisee and franchisor further away from reconciliation.

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\(^{33}\) See, *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006)

5. Agreement Language Will Usually Favor Franchisor

As noted above, the franchisor typically has very few obligations under its franchise agreements. Moreover, in those instances where the franchisor has a contractual obligation, it probably has that same obligation to most, if not all, of its franchisees, and therefore is most likely intimately familiar with what it must do to meet those obligations.

Most franchisee claims, therefore, to have any chance of being successful, must allege conduct that is outside the four corners of the franchise agreement, including conduct occurring prior to the point at which the franchise agreement was signed.

6. Success Rate Low

Not surprisingly, considering that the typical franchise relationship is defined by a written franchise agreement, a franchisee asserting claims other than the garden variety breach of contract, has an uphill battle, and more often than not will ultimately not be successful. Consider the following:

a. Good Faith and Fair Dealing

While not all jurisdictions construe the implied covenant of good faith and fair dealing in an identical manner, most courts will not allow a franchisee to use the implied covenant of good faith and fair dealing to alter any express contractual provision. As a result, the covenant of good faith and fair dealing is of limited value to a franchisee, because the typical franchisee agreement is unlikely to be silent with regard to any issue that is of real significance between the parties.

b. Integration Clauses

Similarly, most claims of fraud or misrepresentation asserted by franchisees are not successful, because, typically, to sustain such a claim, the court would need to ignore an integration or merger clause in the franchise agreement. While some franchisees have successfully defeated an integration clause by establishing fraud in the inducement, most franchisees are not successful. Indeed, it is not unusual for a fraud in the inducement claim to be dismissed by a court on the basis that the franchisee’s reliance on the alleged misrepresentation would have been unreasonable in light of express statements in the FDD.

c. No Duty of Competence

Similarly, while a court will enforce specific contractual provisions in a franchise agreement, a court will ordinarily not find a franchisor to lack a minimum required level of competence, if that lack of competence does not manifest in a failure to satisfy a specific measurable contractual obligation.

36 See, Id.
7. **Franchisor Obligation to Disclose Action Compels Vigorous Defense**

Further complicating matters is the franchisor’s obligation to include pending litigation, as well as completed litigation under certain circumstances, including in the case of a settlement. This reporting obligation, as a practical matter, can compel a vigorous defense.

Bad precedent is damaging to the franchisor in two significant ways: First, prospective franchisees may be less inclined to join the system if concerned about the way in which the franchisor deals with its franchisees. Second, if the claim is of a nature that is not unique to the particular franchisee, then the franchisor will need to consider the potential for similar claims to be asserted by other franchisees.

The franchisor, forced to report the nature of the franchisee’s allegations, is not in a position to simply pay some money to make the matter go away. Accordingly, the franchisor has a significantly greater interest in prevailing.

8. **Litigation Counsel May Have Limited View of Potential Resolutions**

When each party is represented by litigation counsel, the respective lawyers will focus on the way to best handle the case. Unfortunately, litigation strategies, discovery, and pre-trial motions, while important in the context of litigation, are not geared toward mending relationships. While the end result may be monetary damages, monetary damages may not be the ideal end result for either party. And often a franchisee is left with nothing more than expensive legal bills.

Although there may be business-oriented resolutions that both parties would find relatively attractive, even the best-intentioned litigation counsel may not be sufficiently familiar with the client’s business to suggest such an approach.

The next section will explore alternatives to typical franchise litigation, and will suggest that, once a complaint or demand for arbitration has been filed, better opportunities for conflict resolution may have been lost.

C. **Innovative Techniques and Approaches**

The previous sections described the typical approaches to conflict resolution, and why those approaches may not result in an optimal resolution for either the franchisee or the franchisor. This section explores some alternative techniques that may result in better outcomes for all involved.

While these same techniques can play a part even after a lawsuit is commenced, this paper is premised on the notion that franchisees, and franchisors, can achieve better results through early dispute management, and, in particular, before litigation is commenced. Resolving a potentially adversarial situation at the early stages can allow the parties to focus on their entire relationship, as opposed to simply focusing on their disagreement.

1. **Call In-House Counsel Before Problem Gets Out of Hand**

Many franchisors employ in-house counsel. An in-house lawyer is uniquely positioned,
and may have knowledge and tools that can be used to proactively resolve a potential dispute at the early stages.

Let’s say, by way of example, that it is fairly clear that a franchisee is about to be terminated, and following that termination would be inclined to bring a wrongful termination action, contending that the franchisor’s area manager unfairly targeted the franchisee by conducting system compliance audits more frequently than those conducted of other area franchisees. The options available to the parties before the termination are going to be very different than those available to them afterward. On one end of the spectrum, franchisee counsel may be able to convince the in-house lawyer that the impending termination would truly be wrongful, in which case the in-house lawyer would be in a position to rectify the underlying situation. In-house counsel may even be aware of similar previous situations involving the same area manager. On the other end of the spectrum, in-house counsel may be in a position to demonstrate why the franchisee’s perceptions were misplaced, but, in view of the dialogue taking place, may be able to offer an exit strategy that would be far more attractive to the franchisee than an outright termination.

Consider that termination on the grounds of non-compliance with system standards would probably be upheld by a court, even if compliance audits were conducted on an unusually frequent business. However, in-house counsel would still have an interest in avoiding litigation, fully aware that litigation would be an unwanted distraction for the franchisor’s management team, and the costs of litigation would impact the in-house counsel’s litigation budget.

Calling the franchisor’s in-house counsel will in many instances lead to a quicker, less painful resolution. If the particular franchisor does not have in-house counsel, reach out to upper level management.

To be clear, this paper suggests a telephone call. In this day of email and fax machines, written communications are not only easy, they are in some instances too easy. Once the send button has been hit, going back becomes very difficult. Moreover, a written communication is likely to result in a written response, and the fray will have begun.

In contrast, a phone call gives each party a chance to feel out the situation, and respond accordingly. In some instances, things that might have been communicated in writing will never need to be said. In other instances, although still said, the party at the receiving end may feel less compelled to formally assert its position on the matter.

2. Seek Face-to-Face Meeting

A face-to-face meeting can go a long way toward fixing a problematic situation. It is hard to think of someone or something as simply the “franchisee” or “franchisor” when people are sitting across the table from each other. A franchisee’s efforts to meet with a franchisor at the franchisor’s principal place of business may itself be perceived as a significant gesture toward reaching an amicable resolution.

A face-to-face meeting will also provide each party with an opportunity to explain its perspective, and, if appropriate, validate the other’s perspective.

Here is a real example: A national quick service restaurant franchisor terminated a
franchisee on account of the failure to report gross sales. While the reporting failure was easily identified, and hence solid grounds for termination, the franchisor understood the reporting failure to be symptomatic of a more significant problem, being the franchisee’s failure to pay attention to the franchised business on a day-to-day basis. The franchisee made considerable efforts to convince the franchisor to give the franchisee “another chance.” Among other things, the franchisee sought to meet with the franchisor’s management team. Ultimately the franchisor would not rescind the termination, but was willing to enter into a new franchise agreement (without payment of a franchise fee) for the unexpired term of the terminated franchise agreement, conditioned upon the franchisee correcting a number of operational deficiencies. The new franchise agreement required the franchisee to pay a greater royalty than the terminated agreement, which the franchisee happily agreed to pay for the right to remain in business. More importantly, the franchisee resumed paying attention to the franchised business, resulting in a continued operation of benefit to both the franchisee and franchisor.

3. **Acknowledge Problems / Validate Concerns**

As noted above, a face to face meeting provides a good opportunity to validate the other party’s concerns. Even in the absence of a face to face meeting, it is important to acknowledge real problems and make the other party understand that it is being heard. While the franchisee lawyer may need to be careful about making an “admission” in some situations, there are ways to be respectful of another party’s perspective without necessarily agreeing that it is correct.

The important thing to remember is that recognizing the problem is an important first step to correcting that problem. Conversely, if a franchisee ignores a problem, or pretends that it does not exist, realistically the franchisor is not going to perceive the franchisee as being able to correct the problem.

4. **Strategically Use Franchisor’s Desire to Avoid Litigation Disclosure**

As noted above, a franchisor is required to disclose, in its FDD, litigation initiated against it by its franchisee. Once disclosed, the case is going to be reported as long as it is pending. Short of a dismissal in favor of the franchisor, the case is going to be reported for ten years from its being concluded.

Once a lawsuit is initiated, the franchisor is legally obligated to amend its FDD, irrespective of whether the lawsuit is believed to be meritorious. This will necessarily entail time and effort on the part of the franchisor, as well as the incurring of costs associated with reprinting and amendment filings. Once a lawsuit is initiated, the franchisee has lost any leverage associated with the franchisor’s desire to avoid being saddled with the lawsuit disclosure obligation.

It logically follows, therefore, that franchisee counsel can strategically use the threat of litigation as negotiating leverage. That is not to say that the leverage would enable a franchisee to extort an unreasonable resolution. However, the desire to avoid making a litigation disclosure can motivate the franchisor to look for a solution sooner, rather than later.
5. Consider Ex-Contractual Alternative Dispute Resolution / Declaratory Judgment Action

The typical franchise agreement contains various dispute resolution provisions, the enforceability of which will in some instances depend upon applicable state franchise laws. While these provisions may enable a party to force resolution in a particular state, or a particular forum (e.g. arbitration), these provisions do not preclude the parties from mutually agreeing to an alternative dispute mechanism.

Where a dispute arises in the context of an ongoing franchise relationship that neither party wants to end, mediation may help the parties come to a mutually agreeable resolution. A franchisor who feels strongly about its position, but still does not desire to find itself making a litigation disclosure, may be willing to agree to a one-day mock trial, where each party gets to put on an abbreviated presentation of its case.

In some instances the parties may even be able to resort to a judicial determination, without implicating the disclosure that would be necessary in the case of franchisee-initiated litigation. Specifically, if the parties are mutually interested in an interpretation of their rights, or obligations, the franchisor may be able to initiate a declaratory judgment action. Of course, a franchisor is unlikely to do so if there is a significant likelihood of establishing bad precedent. The parties would also need to understand any other ramifications of a declaratory judgment action, such as whether, under the applicable laws and court rules, the defendant would be required to assert any compulsory counterclaims.

6. Look for Business-Oriented Solutions

The typical franchisor is interested in expanding the reach of its franchise system, and increasing its revenue base in the process. A franchisee who has invested heavily in building its franchised business does not necessarily want to end the relationship with its franchisor over a dispute. While a dispute can define a franchise relationship, it need not be permitted to do so. Often disputes can be resolved through business resolutions; that is to say, resolutions crafted on the basis of the business interests of the parties, rather than on the potential for an award of damages.

If a franchisee is financially forced to abandon an outlet, and by doing so technically breaches the franchise agreement, then the franchisee may be answerable in damages. However, if the franchisee had complied with the franchisor’s operational requirements, and made a good faith effort to achieve success, then it may be in the mutual best interest of the parties to permit the franchisee to develop another franchised outlet in a different location.

If a franchisee is an excellent operator from a systems-standards perspective, but consistently delinquent when it comes to submitting required reports, rather than terminate the franchisee with immediate effect, the franchisor can provide a period of time during which the franchisee could sell the franchised business to a suitable transferee. In this type of situation the franchisor has little to gain if the business closes, and permitting the franchisee to sell the business will significantly reduce the likelihood of litigation.

Here is a real example of a business-oriented resolution: A franchisee established a second franchise location in the same mall where the franchisee’s original outlet existed.
According to the franchisee, the franchisee would not have done so, and would not have been permitted by the mall to do so, but for the franchisor’s promise to permit the franchisee to participate in a new program involving a line extension. The franchisor, on the other hand, took the position that it had not committed to permit the franchisee to participate in the new program. After a short period of operation the mall required the franchisee to cease operating the second location, because the line extension was an important element under the lease use clause.

While the franchisee and franchisor never came to an agreed-upon understanding of the facts, the parties did agree that the costs incurred by the franchisee, and the franchisee’s expectation damages, could be compensated for by a business-oriented resolution. The parties settled by agreeing to an extension of the initial franchise, and a grant of an additional franchise, for a location to be determined and developed in accordance with the terms of the franchising documents, both without payment of a franchise fee. The practical cost to the franchisor was at most the waiver of franchise fees totaling about $50,000, and less if the franchisee failed to establish the additional location. However, if the location were established, then the franchisor and franchisee would both benefit. More importantly, the grant of the additional franchise communicated a very positive message to the franchisee; i.e., despite the disagreement, the franchisor continued to see the franchisee as an important part of the system. Ultimately the franchisee established what has turned out to be the highest grossing location in a system of more than 200 outlets, with the franchisor realizing annually about what it cost the franchisor in waived franchise fees.

7. Give the Franchisee a Job as Part of Reacquisition

Troubled businesses generally fall into several categories. There are good operators in bad locations, bad operators in good locations, and bad operators in bad locations. There are also franchisees with good operational skills, who may not have the abilities to handle some of the responsibilities that come with owning a business.

When a franchisor feels compelled to reacquire a franchised location being operated by a franchisee who is generally a good operator, but is troubled financially or who is good at managing some aspects of the business on a day to day level, but not others, the reacquisition of the franchised business need not leave the former franchisee without an income. In appropriate instances the parties can enter into an employment arrangement, to mutually exploit the strengths that the respective party can bring to the table.

V. CONCLUSION

There is an adage that a bad contract won’t hurt a good relationship, and a good contract won’t save a bad one. While the franchise agreement may form the “legal” basis of the franchise relationship, it does not determine whether that relationship will be mutually successful. The franchise agreement may be the backbone, but it is not the nervous system.

Lawyers have a natural tendency to look to the contract. But relationships that are often measured in decades cannot be encapsulated on a few dozen sheets of paper. To be effective counsel must understand the needs their respective clients, not just their contractual rights. Indeed, to be truly effective, franchisee counsel must not only understand the needs of their franchisee clients, but must be able to understand the legitimate business interests of their
clients’ franchisors.

If counsel accepts, intellectually, that the franchise relationship consists of more than the franchise agreement, then, while counsel cannot ignore its terms, counsel must do more than analyze the facts in light of those terms. While it is often an attorney’s role to be an adversary, attorneys must not lose sight of their roles as advocates. To be effective advocates we must be able to be persuasive. People, including those making up a franchisor’s management team, respond better to logical persuasion than to threats and demands.

Persuasion can make a difference at every stage of the relationship. It is unreasonable to expect a franchisor active in 20 states to agree that the franchise agreement should be interpreted in accordance with the law of the state in which the respective franchise outlet is located. That does not mean, however, that a franchisor cannot be persuaded to modify some provisions of its franchise agreement, if the requested modification is truly related to the unique circumstances of the particular franchisee.

More often than not, what begins as a relatively minor issue or problem can become a full-fledged dispute. If the client’s ultimate goal is to preserve the franchisor-franchisee relationship, or to exit that relationship on the best terms possible under the circumstances, then in many instances the interests of the clients will be better-served by approaching the situation based upon the parties’ respective interests, as opposed to focusing on the language of an agreement.

Consider that most franchise agreements will favor the position of the franchisor most of the time. Yet the right of the franchisor to enforce the terms of its franchise agreement does not compel a franchisor to do so. The fact that termination may be immediate does not preclude a franchisor from giving a franchisee a reasonable opportunity to sell the franchise, but whether the franchisor is willing to do so may be influenced by the first contact from franchisee-counsel.

At the end of the day, the agreement is the agreement, and the facts are the facts. How counsel approaches the situation with which counsel is asked to deal is the only real variable counsel has to work with. Effective advocacy requires that attorneys use that variable as best as possible to achieve the end result that is most important to the client.
MICHAEL S. LEVITZ

Michael S. Levitz is Associate General Counsel to The Häagen-Dazs Shoppe Company, Inc. ("Shoppe Company"), franchisor of Häagen-Dazs ice cream shops in the United States, headquartered in Minneapolis, Minnesota. Mr. Levitz, who has been with Shoppe Company for more than a decade (under several different corporate structures), is also Corporate Counsel to Dreyer’s Grand Ice Cream, Inc. ("Dreyer’s"), the largest ice cream company in the United States, and corporate parent of Shoppe Company. In the United States, Dreyer’s, which is an indirect wholly-owned subsidiary of Nestlé, S.A., the largest food company in the world, manufactures and distributes Häagen-Dazs, Dreyer’s, Edy’s, Nestlé, The Skinny Cow, Eskimo Pie, Chipwich, Starbucks and other brand ice cream products. Mr. Levitz graduated from New England School of Law in 1988, and before joining Häagen-Dazs practiced primarily in the area of construction litigation.
KENNETH P. MILNER, ESQUIRE

Ken Milner is Special Counsel to the Blue Bell, Pennsylvania firm of Kraut Harris, P.C. He concentrates his practice in the fields of franchise, real estate, corporate and commercial law. While General Counsel of Cottman Transmission Systems, Inc. and Cottman Transmission Canada Limited, Ken practiced throughout the United States and Canada. During that time, he was also an advisor to the office of the Consumer Advocate of Dade County, Florida, and the Better Business Bureau of the State of Maryland. Ken was appointed the first Chairman of the Franchise Law Committee of the Montgomery Bar Association, and served in that capacity for five years. He was reappointed to that position in 2004 and 2007. Ken also served four terms as Chair of the Montgomery County Realtor Attorney Liaison Committee.

From 1984 through 1995, Ken was an instructor of franchise, real estate and business law at The Institute for Paralegal Training in Philadelphia. His articles on the relationship between franchising and real estate leases have been published in Focus Magazine and The Philadelphia Business Journal. Ken is a certified mediator and arbitrator for the Davenport Dispute Resolution Center, in Montgomery County, Pennsylvania. He received his B.A. from the University of Pennsylvania and his J.D. from the Boston University School of Law.
ROBERT L. PURVIN, JR.
Chairman, Board of Trustees AAFD
American Association of Franchisees & Dealers

Professional Experience
Mr. Purvin is the Chairman of the Board of Trustees of the American Association of Franchisees and Dealers (AAFD), a national nonprofit trade association promoting fair franchising practices and the concept of Total Quality Franchising. Mr. Purvin is the author of The Franchise Fraud: How to Protect Yourself Before and After You Invest, (John Wiley and Sons, 1994), an expose’ on the franchising in the 1990’s, which advocates franchisees joining together for greater market power in the negotiation of franchise agreements and the resolution of disputes as a favored method of addressing problems in franchising. Mr. Purvin served as co-chair of the AAFD’s Fair Franchising Standards Committee, which has authored the AAFD’s Fair Franchising Standards, which provide a basis for negotiating franchise relationships and offering AAFD accreditation to franchising companies whose programs meet the standards. Prior to assuming the duties of Chief Executive Officer of the AAFD, Mr. Purvin practiced franchise law for 24 years. Although he has substantial experience representing the interests of both franchisors and franchisees, Mr. Purvin has gained the reputation as a pre-eminent authority relating the representation of franchisees.

Mr. Purvin engages in contract and dispute mediation and is an approved mediator of the National Franchise Mediation Program. Recently served as mediator in the national contract negotiations for Meineke Discount Mufflers. Mr. Purvin has completed formal Mediation Training from JAMS.

Selected Honors, Awards, Publications, and Professional Affiliations
Mr. Purvin has testified several times before Congressional and state legislative committees on issues relating to franchising from the franchisee's perspective. Mr. Purvin has three times been a plenary speaker at the American Bar Association Forum of Franchising. Mr. Purvin has served as the Vice-Chair of the Franchise Law, Business Opportunities and Licensing Law Committee, and Chair of the Franchisee and Dealer Subcommittee, of the General Practice Section of the American Bar Association. Mr. Purvin is a member of the ABA Forum on Franchising and has served several terms as a member of the State Bar of California Franchise Law Committee. Mr. Purvin has written or contributed to numerous articles on franchising, and he and the AAFD have been featured, profiled, and/or quoted in scores of publications which have focused on franchising. Mr. Purvin was co-author of several papers published by the American Bar Association Forum on Franchising, two of which (“Androcles and the Franchising Industry: Pulling out Thorns from the Franchise Relationship,” and “Speaking to be Heard: Effective Communication in Franchise Relationships”) which have since been republished as part of the American Bar Association’s Best of the Best series.

Education
Mr. Purvin received his Bachelor of Arts Degree with high honors in Political Science from the University of California, Santa Barbara in 1969. Mr. Purvin received his Juris Doctor degree from Georgetown University Law Center in June, 1972.