WHEN THE FRANCHISE AGREEMENT ENDS BUT THE RELATIONSHIP CONTINUES

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Agenda

1. Expiration v. Termination
2. Rights and Obligations
3. Extension Agreements – express or implied
4. Drafting Considerations
Expiration v. Termination
Expiration v. Termination

• How does the franchise agreement define the terms?
• Any other understanding by the parties?
• Dictionary definitions
• Common usage
• Conduct of the parties
Expiration v. Termination—Hypothetical #1

- Marcus enters into a fifteen-year franchise agreement with “Something’s Fishy Franchising” (“SFF”) to operate a fish supply store.
- Section 9 of Marcus’ franchise agreement, entitled “Rights and Duties of Parties Upon Expiration, Termination or Non-renewal,” contains a post-term non-competition clause operational “[f]or 2 years following the termination of this Agreement.”
- The franchise agreement expires but Marcus continues to operate his fish supply store under the name, “Something’s Fishy.”
Expiration v. Termination—Hypothetical #1

- SFF notifies Marcus about the expiration, and Marcus, the franchisee, advises that he intends to continue operating under the name, “The Fish Bank!”
- In response to Marcus’ advising of his intentions, SFF terminates Marcus’ franchise and threatens to pursue injunctive relief and damages.
- Being a proactive franchisee, Marcus files a declaratory judgment action seeking to hold that the franchise agreement’s non-competition provisions did not bind him.
Expiration v. Termination—Hypothetical #1

• Will Marcus’ declaratory relief claim succeed?
• Did the franchise agreement terminate or expire?
• Would it be different if the terms “expiration” and “termination” were explicitly defined in the franchise agreement?
• What can we learn from these cases about drafting effective franchise agreements?
Rights and Obligations
Post-Expiration
Franchisor's Contractual Rights Post-Expiration

• Purchase franchisee’s assets or inventory
• Takeover franchise location or territory
• Right of first refusal
• Assume franchisee's lease
• Enforce de-identification and restrictive covenants
• Keep telephone number or website
• Renewal agreement? On what terms?
Franchisor's Contractual Obligations Post-Expiration

• Just kidding. There aren't any!
Franchisee's Rights and Obligations Post-Expiration

Renewal right?
Return of property and de-identification
Continuation of business or related business?
Rights and Obligations—Hypothetical #2

Trish and Evan create a company (“Smokey, LLC”) and enter into a franchise agreement with Cigars R’ Us, LLC (“CRU”) for a ten-year period under the brand name “Cigars Unlimited,” with a five-year renewal right.

Marcus was hired as in-house counsel for CRU on Halloween 2017.

The Smokey, LLC franchise agreement expired on June 1, 2017.

CRU did not realize the Smokey, LLC franchise agreement expired until December 1, 2017.
Rights and Obligations—Hypothetical #2

Meanwhile, Smokey, LLC continues to operate its Cigars Unlimited location.

Once CRU realizes the franchise agreement expired, it seeks to renew the agreement pursuant to its terms.

Smokey, LLC declines to renew.

Smokey, LLC continues to operate a cigar store, removing some, but not all, references to Cigars Unlimited from its store and website.

CRU files suit.
Rights and Obligations—Hypothetical #2

- Does CRU have a claim:
  To enforce the existence of a franchise agreement?
  To claim tortious interference?
  To seek relief under the Lanham Act?

What if conflicting evidence as to whether Smokey and CRU had discussed extending the agreement following the expiration, which discussions caused Smokey to stop de-identification in interim?
POST-EXPIRATION CONDUCT
Post-Expiration Conduct

• Conduct Constituting Consent
  • No notice of expiration
  • Continued acceptance of fees
  • Continued allowance of use franchise system and marks

• What are the "new" terms?
Post-Expiration Conduct—Hypothetical #3

- Philadelphia psychiatrist purchases a quick-stop therapy clinic franchise called "Uh-Oh" from a famous friend of his who owns O's Holdings ("Oh") on Oct. 9, 2011.
- The Philly doctor's franchise agreement is for a 5-year term; renewable if not in default, with notice to Oh, and subject to then-current franchise agreement terms. He has a noncompete covenant that extends for one year "from the end of the franchise agreement for whatever reason."
- In 2013, Oh revises its agreement such that all new or renewed franchisees have a mandatory arbitration provision and higher marketing fee, 3%, up from 1%.
- On Oct. 10, 2018, Oh discovers that the Philly Dr turned Uh-Oh into a competing franchise that also does DNA testing back in May 2017.
Post-Expiration Conduct—Hypothetical #3

- The Philly Dr. and Oh never executed a new FA or a renewal.
- Philly Dr. says the FA expired Oct. 9, 2016, and the noncompete ended Oct. 9, 2017.
- Philly Dr. never said he intended not to renew; huge supporter of franchise system; paid all fees, including an increased marketing fee beginning November 2016, which he negotiated to 2%, instead of 3%.
- Oh says FA was renewed for another 5-year term with 3% marketing fee, and it sues for all amounts due under renewed FA through Oct. 2021.
Post-Expiration Conduct—Hypothetical #3

- Can Oh litigate in court or must claims be brought in arbitration?
- If implied contract, for five years, one year, month-to-month, at will?
- What is the term of the noncompete—10/9/16-10/9/17? 5/1/17-5/1/18? 10/10/18-10/10/19? One year from court order?
- If implied contract based on original terms arises, can Philly Dr. get a credit for paying 3% fee.
- Did Oh waive right to renew or use new FA terms because of prior failure to renew or terminate?
- Did Oh waive renewal conditions?
DRAFTING CONSIDERATIONS
Drafting Considerations

Delineate clearly and concisely which terms are binding and which terms are not binding; obligations of each party upon termination, expiration, and/or renewal, as well as the continuing obligations of all parties that survive termination or expiration.

Important considerations regarding de-identification of the facility should include: a) removal of interior/exterior signage; b) changing road and billboard signage; c) no longer identifying the facility by brand name in print, on the phone, or on internet; and d) removal of items bearing the brand name from the facility.
Drafting Considerations

Other Notices

Document franchisee defaults, opportunities to cure, and consequences for failing to cure in a written notice.

Specify in default letters whether termination will automatically follow in the absence of a cure.

Specify post-termination obligations in default letter, if termination will be automatic, and indicate consequences of failure to comply with those post-term obligations.

Consider sending reminders to franchisee of impending expiration deadlines.

Self-help Remedies
Correct This Bad Drafting

Non-compete.

For two years following the termination of this Agreement, Franchisee is prohibited from participating in a Competing Business within its Territory.
Correct This Bad Drafting

Right to Extend Franchise Term.

You have the right to extend your franchise upon the following conditions: (i) written notice received by us at any time before [180 days from expiration], (ii) current in any and all obligations then owed to us, and (iii) you will agree to sign the then-current Franchise Agreement.
Correct This Bad Drafting

Termination Clause in Franchise Agreement

This Franchise Agreement will be terminated if you do not cure any Section 10 default within thirty (30) days from receipt of written notice of the default.

Notice of Default Letter

If Company has not received confirmation that the default has been cured within thirty (30) days, the Company will issue a notice of termination.
CONCLUSION

1. Draft carefully and consistently.
   • Courts may treat expiration and termination (or other terms) differently, especially if you do.

2. Time is of the essence.
   • Act quickly and document any deviations from absolute expiration and immediate enforcement.

3. Know the law.
   • Check state laws on renewals, notice, disclosures, & good faith.
QUESTIONS?

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