CLAIM EVALUATION FOR THE FRANCHISEE ATTORNEY

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CLAIM EVALUATION FOR THE FRANCHISEE ATTORNEY

Introduction. A franchisee approaches you with concerns with the performance of a franchised business. The back story is typical: the franchise was selected after careful study of several franchise opportunities and genres, consultation with friends and family, diligence with existing franchisees, and plenty of time spent with the accountant and banker, and possibly even another lawyer. The life savings went into the business, the 401(k) account was leveraged and the rest of the capital needed borrowed from the local bank. Business assets, home equity, and personal guarantees provide collateral and additional security.

The business started out like gangbusters, with strong sales, positive cash flow and a great reception in the market. Lately, the franchise isn't performing as expected, and something just isn't right. The situation is headed downhill, and the franchisee needs some advice from you about what to do next. The franchisee never expected to be facing tough sledding after buying a franchise. What can you do as counsel to the franchisee at this stage of the franchised business life cycle? Does the franchisee have any recourse?

I. INTAKE PROCESS

A. Primary Concern of the Franchisee – What is the Objective?

The first step in the evaluation of a franchisee's potential claim is to understand what the franchisee wants to accomplish. Understanding a client’s goals will inform all aspects of your representation: Your strategies, tactics and the time you spend pursuing them.

The typical franchisee seeking legal advice where some aspect of the franchise relationship is going wrong or is beyond redemption knows there is a problem but doesn't know how to fix it. With the advice of knowledgeable counsel, that franchisee may be able to assert claims that achieve the goal of terminating the franchise relationship and recovering the money they have invested in the enterprise, may stop a franchisor from engaging in practices that make operation of the franchise unnecessarily difficult or unprofitable, or may obtain from the franchisor royalty relief or more in terms of support services that will assist the franchisee in the short term while they turn the business into a more profitable venture. This paper addresses how to evaluate the problem presented by the franchisee and how to achieve these goals.

There is an important distinction between franchisees who want to remain in the franchise system and those that wish to terminate the franchise relationship completely. Franchisees who want to continue operating within the franchise system will generally want to retain a cooperative relationship with the franchisor, which could mean early settlement negotiations or willingness to compromise, while franchisees who want to terminate the franchise relationship may be more willing to engage in a protracted, possibly acrimonious battle. An attorney will need to tailor his or her strategy to the franchisees' long-term goals. Once the attorney understands what the franchisee wants to get out of the representation, the attorney can begin the process of achieving those goals.

Clients, and particularly franchisees, often do not have a clear goal they can articulate in the initial meeting. Therefore, it is essential for counsel to effectively communicate various potential strategies, including thorough assessments of possible end results of the representation and how those outcomes may affect the client's relationship with the franchisor and future business prospects. This can be particularly effective where a client has not previously thought deeply about potential outcomes.
B. What Should the Franchisee’s Primary Concern Be?

Franchisees often focus initially on non-actionable information, telling some version of the following story: “The franchisor told me that it would be my partner and provide a robust support system to make sure that my business succeeded, but since opening, the franchisor has not done any of what it promised during negotiations. My business is losing money and I want out.” Or: “The franchisor set up a competing store three miles away and it’s killing my business. They told me they wouldn’t do that and how can I stop them. Many franchisees do not realize that what they were told about the deal in the sale process is not part of the franchise agreement or that franchisor’s obligations to the franchisee may be limited. Attorneys representing franchisees must probe deeper into what was said to a franchisee during the negotiation process and review the agreement and relevant law in depth in order to set a strategy to reach the client’s goals.

As the franchisee’s attorney, you will not be able to do anything about most of what a franchisee tells you at the beginning of the representation. At the outset, a franchisee’s primary concern needs to be finding some facts that an attorney can use to help achieve the franchisee’s objective. In order to focus the franchisee on what is important or possibly actionable, you can give examples of what types of cases have been successful in the past, including violations of franchise sales laws (improper financial performance representations, failure to provide essential documents for review prior to entering into the franchise agreement, etc.), franchise relationship laws (wrongful termination, etc.), and breach of contract. With a clear understanding of what can be used for the franchisee’s benefit, he or she will be able to provide better information that may help you strategize an avenue for recovery.

Once a franchisee and his or her attorney determine that a claim can be asserted, a franchisee’s primary concern will look different depending on the relief the franchisee seeks, though most if not all franchisees’ primary concern is maximizing their personal financial situation. For example, if a franchisee wants to be relieved of her obligations under the franchise agreement and sell her franchise back to the franchisor, then the primary concern would likely be getting the best price for terminating the franchise agreement and giving up her rights to operate the franchise. Such a concern would likely include minimizing legal costs, as any financial arrangement with the franchisor would be tempered by the costs incurred procuring the arrangement. Likewise, if a franchisee has already closed his business because it was too financially burdensome to continue operations, his primary concern might be getting compensated by any means possible. Conversely, franchisees who wish to remain in business and are only looking for some sort of modification to the operation of the franchise system will likely have different primary concerns, such as getting concessions while not permanently souring their relationship with the franchisor.

A franchisee who wants to terminate the franchise relationship will generally be looking for the best financial outcome so that she can be made as whole as possible—as if she never entered into the franchise agreement in the first place. A franchisee who wants to remain in the franchise system will also be looking for a positive financial result, but this result may come in different forms, as franchisees who remain in business will generally be more open to creative solutions and concessions from the franchisor. The job of the attorney is to help the client understand the different strategies that might satisfy the client’s goals and the potential outcomes that may occur when using such strategies.

An important consideration for every client is the cost of an attorney’s services. Whether a franchise agreement specifies litigation or arbitration as the proper dispute resolution mechanism, clients must understand the potential costs. While some franchisees are large,
sophisticated entities with experience litigating or arbitrating disputes, many franchisees will not have a clear understanding of the costs associated with litigation or arbitration. At the first meeting with a franchisee client, an attorney should discuss the potential costs of pursuing a claim, as well as other strategies such as demand letters and mediation, to make sure the client makes a cost effective choice about how to achieve its goals.

C. **Evaluate the Financial Condition of the Client and the Franchise System**

A client’s financial condition goes hand-in-hand with his or her objectives—and the attorney’s strategy. A client that is in strong financial position is able to fund a long, drawn-out dispute, which means attorneys have more strategic options. Many times, though not always, a franchisee who is in a strong financial position will be looking for modifications of their arrangement with the franchisor rather than to terminate the franchise relationship. This is particularly true when the franchise is making money, but certain behaviors of the franchisor make doing business more difficult or less profitable for the franchisee. A franchisee looking to terminate its franchise relationship is often in a weak financial position because all of the available money has been spent opening and supporting the franchise business that has been underperforming. It is important to have a frank conversation at the outset of your representation of any client, but in particular a franchisee, about the burden that legal action imposes. While this burden encompasses a client’s time and emotional energy, the most concrete burden on a client will be on her finances. If a franchisee cannot afford to pay legal bills, you must be honest at the beginning of the potential representation as to whether or not you can represent the client. If the client’s potential recovery is large enough, contingency arrangements are a good option, but if not, it is better to refer the client to attorneys that the client can afford, as withdrawing as counsel in the middle of a representation is a result that is best avoided at the outset.

An honest assessment of a client’s finances does not necessarily mean that an attorney should demand substantiation of what a client tells her. The attorney-client relationship is ideally built on honest, open communication. You must evaluate if the client has the willingness and resources to see the litigation through to the end or if you as the attorney may be in a position to foot the bill until the end of the case. Again, litigation is expensive, and it is better to deal with this problem at the beginning of the representation.

Similarly, the franchisee and counsel must have a sense of the current financial condition of the franchisor. No matter a franchisor’s financial situation, it can be used for the benefit of a client. For example, if a franchisor is in a strong financial condition, it is in a better position to meet the demands of the franchisee, and if a franchisor is in a weak financial condition it is in a worse position to fight a franchisee. Of course the opposite is true as well: A financially stable company can spend more on legal fees, and a financially weak company will have less to give at the end of a case. Where a franchisee wants to continue operating within the franchise system, there will likely be a variety of options that can alleviate the franchisee’s concerns, such as reductions in royalty payments or additional training programs. The financial resources of the franchisor are disclosed as of the end of its last fiscal year in Item 21 of the latest edition of its Franchise Disclosure Document ("FDD")\(^1\). Does the franchisor have any financial assurance risk factors disclosed in the Risk Factors section of the FDD?\(^2\) Have any of the states that review the FDD imposed requirements for initial fee escrow, deferral, surety bond or security that appear in

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\(^1\) 16 CFR §436.5(u).
\(^2\) NASAA Franchise Registration and Disclosure Guidelines (2008), III.B.
the State Addenda section of the FDD?\(^3\) Is there a year to date interim financial statements disclosure that appears in Item 21 with more recent information? The franchisor may publish current financial information if it is a reporting company under the Securities and Exchange Act of 1934, as amended,\(^4\) with more than $10 million in assets and more than 500 equity holders. Does an on-line search reveal any information about the financial condition of the franchisor, such as pending collection suits or other indicia of non-payment or financial distress?

The financial condition of the franchisor is important information when developing a legal strategy and setting the goals for the representation. For the representation to be worthwhile for the franchisee, the franchisor must have the ability to satisfy the client’s goals. Spending time and money going after a franchisor that cannot give the franchisee what it is looking for is a waste, and should be addressed as early in the representation as possible.

D. **Timeline - How Fast Does This Need to Resolve?**

The franchisee consults counsel when the franchised business is not generating sufficient cash to sustain itself. The earlier the consultation, the more likely remedial action can avert disaster or limit the losses of the franchisee. If Remedial Support\(^5\) cannot slow or reverse the losses and restore profitability, then the hard question about selecting from a few tough choices remains. Cold, clear eyed analysis of capital resources and cash "burn rate," the amount by which weekly or monthly cash outflows exceeds collected cash revenues, provide a schedule for action. Candor with the franchisor about the challenges faced, together with sharing of cash projections, invites the opportunity to request a royalty holiday, reduction or abatement. That relief, coupled with Remedial Support and tight expense management, may be sufficient to reverse the course of the business and save it. Any such plan should be in writing as an amendment to the franchise agreement or a separate agreement with the force of an amendment. The franchisor will likely ask for a release of claims as a condition to any forbearance or payment modification. Before signing a release, the franchisee and counsel should assess the merits of claims against the franchisor, recognizing the release is likely enforceable by the franchisor against the franchisee.

Three significant elements of cash flow calculus include paying: a) employees their wages, salaries and benefits, and the related employer share of payroll taxes and contributions; b) trade creditors on a current basis for inputs necessary to continue operation; and c) rent, mortgage and secured debt that will result in eviction, foreclosure and forfeiture of assets if not paid, although the instruments of indebtedness may have notice and grace periods to use if necessary.

E. **Options for the Franchised Business**

If the franchisee has the resources to sustain the business for a modest time period, the franchisee may wish to sell the business. The franchisor may assist by referring prospects for purchasing the business. However, the value of a troubled franchise may not exceed the debts of the business. The personal guarantees of the franchisee and its financial resource partners may not be released by a sale without lender cooperation. The selling price calculation should involve several defined levels:

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\(^5\) As defined in more detail in Section III(B)(3), but, generally, services that assist the franchisee to rectify performance and service issues with the operation of the unit.
1. The price range of the franchise system units sold in the last two years, including leased and owned real estate which defines the secondary market for these franchises. There may be a multiple of gross sales or earnings before interest, taxes, depreciation and amortization ("EBITDA", which is a surrogate for cash flow), around which prices coalesce, or form a range of multiples. For example, three times EBITDA or 1.3 times gross sales.

2. The payoff amounts of the principal of and accrued interest on debt secured by the franchised business assets to third party lenders, necessary to release mortgages, security interests and personal guarantees.

3. The net equity invested and loans to the franchised business, net of capital distributions and debt repayment. Loans to the business by its owners are considered equity contributions by creditors.

4. Third party obligations that may be assumable on sale, such as equipment leases and real estate leases, but that may carry personal guarantees from the franchisee and its owners or financial partners.

5. Unpaid debts, particularly taxes, of the franchised business that must be paid at sale or otherwise discharged to sell the business.

Any sale must account for payment of all categories except the net equity invested and loaned to the franchised business. If the selling price, net of broker commissions, cannot pay off all categories except net equity, then a bankruptcy liquidation may be in order.

Another alternative is relocation, if the current location has been adversely affected by changes in the market, or is just not ideal for the franchise. For example, a franchise with a stronger morning business that depends on traffic flow but locates on the evening drive side of a busy street can turn around with simply moving to the other side of the street. That the franchisee made such a business error, if not the subject of a communication from the franchisor cautioning or prohibiting the choice of the wrong side of the street, is itself the basis of a failure to support claim.

F. Crafting Your Client’s Story

Once you decide to accept the representation, the attorney must craft a story of how the situation between the franchisor and the franchisee came to pass and why the franchisee deserves relief.

The franchisor may contend that the franchisee didn’t work hard enough or faced unexpected circumstances for whatever reason and couldn’t build a successful business. The franchisor will also point to the franchise agreement (which usually imposes minimal burdens on franchisors) to build its story that it did everything it was supposed to do to help the franchisee succeed. To counter these narratives, the franchisee’s attorney must be able to develop a version of events that properly contextualizes the relationship between the parties.

For example, franchisee attorneys can portray the franchisee as a trusting individual looking to support her family and achieve the American Dream who got taken advantage of by a sophisticated company looking to make a buck. Many franchisees are one-person or family-run operations with no experience in the business or franchise world. As such, they think of franchisors as their partners that will be there to help them succeed. The franchisee is often
encouraged in this thinking by the franchisor's statements during the disclosure and selling process, which can be useful in crafting the narrative for the client. In reality, many franchisors see the franchisee as a low-risk source of passive income, which can be emphasized to draw a starker comparison in motives and expectations of the parties.

Crafting a proper narrative is an essential component of the attorney's job. Your story will offer the relevant facts and make your legal arguments stronger. A well-constructed narrative can turn an otherwise borderline claim into a recovery or provide the leverage to make a beneficial deal to continue in operation.

G. Assess Witness Potential and Veracity (Trust but Verify)

After properly assessing what the client hopes to achieve by hiring an attorney and the franchisor's ability to meet those goals and crafting your client's story, you as the attorney should begin evaluating the available evidence you will use to support the franchisee's claims. Witnesses who can corroborate your client's version of events can be vital to the success of your case when the nature of a claim makes documentary evidence of secondary importance. Typical witnesses will include the franchisee's principal(s) and its employees and former employees.

Other franchisees may also be valuable witnesses. Often franchisors will employ similar tactics during negotiations of a franchise agreement, or engage in similar behaviors across the franchise system after the franchise agreement is signed. Statements from other franchisees may help to show that you are on the right path with your strategy for recovery, but these statements may not be admissible. Generally, evidence of a franchisor acting a certain way in its relations with other franchisees will be subject to challenge based on the rules against admission of propensity character evidence. There are exceptions to the general rule that propensity character evidence is inadmissible, but these are fact-specific inquiries determined on a case-by-case basis. Franchisors may also challenge the admissibility of statements from other franchisees on relevance grounds. In Ponderosa System, Inc. v. Brandt, the Tenth Circuit rejected a franchisor's appeal that evidence from other franchisees regarding meat quality should have been excluded at trial because, among other reasons, it was not relevant. The court found that the evidence was relevant and probative to several issues in the lawsuit. However, not all courts have found such evidence admissible, including the Third Circuit which excluded evidence of a financial performance representation ("FPR") made to a number of former franchisees because it was not relevant. The relevance of evidence from other franchisees will turn on the elements at issue in each individual case, and must be analyzed on a case-by-case basis.

When representing franchisees, many witnesses who have information about the buying process or operation of the business will be family members and employees of your client. While such people are often reliable, they are also more likely to be partial or try to help their family member/boss by offering what they believe are more helpful versions of events. For this reason, it is critical for an attorney to be able to properly evaluate potential witnesses. Many attorneys

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6 See Fed. R. Evid. 404(a)(1).
7 767 F.2d 668 (10th Cir. 1985); see also Am. Dairy Queen Corp. v. Universal Inv. Corp., No. 16-cv-323-wmc, 2017 WL 4083595 (W.D. Wis. Sept. 15, 2017) (denying in part and reserving in part motion in limine to exclude evidence relating to other franchisees on the grounds that the evidence is relevant).
8 Ponderosa, 767 F.2d at 670.
9 Id. at 671.
have relied on a witness’ version of events only to be presented with a contradictory document or other “smoking gun” later in the case that requires a different explanation for the state of affairs than the witness had posited. To some extent, those situations are unavoidable, but often taking the time to verify witness accounts can prevent needless headaches later in a case.

H. Obtain and Review Relevant Documents

Documentary evidence can be essential to prove a franchisee’s claims. You should obtain and review documents kept by your client as early as possible to identify the material that corresponds and supports witness statements and your theory of your case in general. Some important documents are: 1) the FDD actually received by the franchisee; 2) The FDD Item 23 receipt; 3) Franchise agreement and related agreements between the franchisor and franchisee; 4) Financial information (P&L reports, bank statements, earnings reports); 5) Construction documents and documents that the franchisor relied in making estimates for certain items in the FDD, including Item 7; 6) Loan applications; 7) Emails, letters and other records of communications; and 8) Business plans used for various purposes, particularly if shown or approved by the franchisor. Some of these documents are discussed in more detail in this section.

1. FDD. The most important document to review in any franchise case is the FDD received by the client. The FDD contains 23 “Items” that are required to be disclosed to potential franchisees. In the FDD, the franchisor discloses information about itself and the franchise system. The FDD also provides prospective franchisees information about the franchise agreement. The FDD is particularly relevant if the franchisee’s attorney is developing a case that is tied to a franchisor misrepresentations in the pre-sale contract period or other violations of franchise disclosure laws. An analysis of whether the FDD is materially misleading or inaccurate appears in Section II.C. of this paper.

2. Franchise Agreement and Related Agreements with Franchisor and Affiliates. In every franchise case, you should look at the franchise agreement and any related agreements with the franchisor and its affiliates (addendums, purchase agreements, sublease, etc.). Not only does the franchise agreement govern the terms of the business relationship between the parties, it also provides for when and how disputes between the parties can be settled.

You will likely notice that most of the terms in the franchise agreement discuss duties your client owes to the franchisor, and very few terms provide for duties the franchisor owed to your client. Despite the one-sided nature of most franchise agreements, it is necessary and can be very useful to review the agreements for any potential breaches by the franchisor. Special care should be taken in reviewing provisions related to support obligations, territorial grants, training and transfer provisions.

It is just as important to find out any weaknesses in your own case. The franchisor may be able to assert counterclaims or otherwise use your client’s breaches of the franchise agreement against you. Openly and thoroughly discussing your client’s performance under the franchise agreement should be done at the beginning of the representation and revisited frequently throughout the course of the attorney-client relationship, so that you can properly advise your client on how to deal with any breaches. Section II of this paper describes in more detail the franchisor’s duties under the franchise agreement and some of the limitations on these duties.
3. **Spreadsheet Summary of Start-Up Costs and Profit and Loss Statements.** Generally, the amount of damages a franchisee will want to recover is the aggregate amount of the start-up costs and the cumulative losses suffered in the operation of the franchise business. Therefore, you should have your client prepare a spreadsheet of the costs she incurred to get the business off the ground. These costs include the franchise fee, equipment purchases, loans taken, personal investment in the business, and other costs. You should also obtain information on the operating losses in the business. Hopefully, the client has a full set of profit and loss statements for the time she has been in business. Other important financial documents include balance sheets, annual financial statements and tax returns. One word of caution is that the less sophisticated the client is the less likely the financial books and records will be accurate. We recommend that you take time to analyze the information given to you to make sure it covers all of the financial issues about which you need information. This information is critical to your representation of your client as it is likely to be the basis (or at least a starting point) of a damage claim in any lawsuit or arbitration and a basis for negotiations with the franchisor.

4. **Correspondence and Communications with Franchisor.** Your initial evaluation of your client's claims must also include relevant communications with the franchisor. Communications may include letters, emails, texts, contemporaneous notes of phone conversations and/or data from internal messaging applications such as Slack or proprietary communications systems. Such communications can substantiate your client’s position as to, for example, representations made by the franchisor, or they can reveal facts that are detrimental to your client’s case. Either way, reviewing the relevant communications early on will serve you well in crafting your case. This is especially helpful for claims based on earnings claims or misrepresentations made by the franchisor during the pre-sale negotiations phase. Review attachments to emails that may include proposed profit and loss statements, financial information from other stores or units that weren’t in the FDD and other documents that can corroborate or support your client’s claims.

Asking your client to create a timeline of events, including important communications with the franchisor, can be very useful for understanding and conceptualizing your case. Once your client prepares the basic timeline, you can use other documents that you review to supplement the timeline with information that your client may not have understood to be important. Once you have completed the timeline, you can attach the relevant documents as a way to have all relevant information in one place.

Typically, however, franchisors keep more detailed and complete records than franchisees. When reviewing documents provided by your client, it is important to be aware that you are likely not reviewing all relevant documents and that the franchisor is likely to provide additional relevant documents during discovery.

5. **Evaluative Material and Operational Feedback.** Any documentation that the franchisee can provide regarding his performance since the beginning of operations is useful background information that can establish compliance with the franchise agreement and good faith operation of the franchise. Even if the evaluations have not been stellar, any comparative evaluations that show similar performance to other franchisees, upward trends in evaluative marks, or positive comments by the evaluator can be helpful in establishing your client as the “good guy” in the dispute. It is important to remember that the franchisor may not have provided every report to your client, particularly reports obtained from secret shoppers and other unannounced or clandestine inspections. (Any reports that your client does not have can be obtained during discovery.)
6. **Lease and Financing Documents.** A review of a franchisee's lease and financing documents is important to understand the obligations the franchisee has incurred as part of his operation of the franchise. Unless the franchisee has a lease or loan directly with the franchisor, there may not be much to gain from your review of the documents, but it is nevertheless necessary to know what your client is obligated to pay. The debts your client is obligated to pay are a major factor in his financial health, and may also be a factor in your damage calculations. You may be able to use these obligations as negotiating chips as well, for example, by accepting a reduction in rent or help with your client's loan obligations as part of a settlement agreement.

7. **Business Plans.** A franchisee's business plans will can give insight into where his business is falling short. The more detailed the business plans and other financial information you receive from your client, the better understanding you will have as to what numbers are not matching up with his projections. Business plans can also be important evidence supporting claims of improper financial performance representations. A business plan that included financial projections made by the franchisor is some of the best evidence that your client relied on those projections. It can also serve as corroboration of your client's statements that the franchisor made financial performance representations that were not included in the FDD.

8. **Default and Non-Compliance Notices.** Default and non-compliance notices can be sent either by the franchisee or franchisor. In either case, you should review any such notices – even if the notices do not directly involve the dispute at issue in your representation. If, however, the notices of default do directly relate to the dispute, then they will contain valuable information regarding the sender's position and will alert you to potential arguments the other side will make. Occasionally, a franchise agreement requires a party to send non-compliance notices prior to any formal dispute resolution procedure. It is therefore vital for you as the attorney to thoroughly review the dispute resolution terms contained in the franchise agreement.

II. EVALUATION OF FRANCHISEE'S CLAIM

A. **Disclosure Law Compliance Testing.**

Disclosure law compliance testing is a priority for franchisee counsel. Failure of the initial transaction to comply may provide remedies or the threat of remedies for the franchisee that will obviate the need to prove damages or causation of loss for the franchisee.

Initially, you should determine if either the franchise or the franchisee is located in a "registration state,"\(^\text{11}\) that is one with a franchise registration and disclosure law, or a "filing state,"\(^\text{12}\) where a franchisor is required to file a notice with the state agency to perfect an exemption from the state’s business opportunity law, either once or on an annual basis. If not, the franchise and franchisee are in an "FTC State" where compliance with the FTC Franchise Rule is required but no private right of action may be recognized for its violation. You should also determine:

\(^{11}\) California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. Oregon is not a registration state but provides a private right of action for violation of the FTC Franchise Rule.

\(^{12}\) Connecticut, Florida, Kentucky, Nebraska, Texas and Utah.
1. Did the franchisee receive the franchisor’s FDD that was current at the time of delivery, and did the franchisee sign and date the Item 23 receipt?

2. Did at least fifteen days elapse between the date of the Item 23 receipt and the date that the franchisee signed the franchise agreement and paid the initial franchise fee or any other consideration to the franchisor or an affiliate?

3. Did at least eight days elapse between the date the franchisor delivered to the franchisee a completed franchise agreement and the date the franchisee signed the franchise agreement if the franchisor made any material insertion of transactional terms?¹³

4. Did the franchise agreement signed match the version of the franchise agreement in the FDD received by the franchisee? If the franchisee is in a registration state, did the franchisee sign the state addendum disclosed in the FDD as part of the franchise agreement?

5. Did the franchisor countersign and return a completed, executed franchise agreement to the franchisee?

If the answer to any of these inquiries is "no," then counsel should explore claims based on a defective disclosure and contract formation process. There may be other conditions attached to contract formation that are detailed in a transmittal letter from the franchisor. There also is likely some form of closing certificate or acknowledgement that is intended to be an estoppel against certain claims that the franchisee may want to assert against the franchisor.

The next inquiry is to determine whether the franchisor was registered in the registration state, or filed the notice in the notice state, for the period of time when the franchise was offered and sold. That determination requires checking with the registration authority, some of which may be accomplished on line or through state level freedom of information requests. If the franchisor is exempt from registration in the registration or notice state, there may be certain requirements to file an annual notice to perfect the exemption. The failure to file the notice on a timely basis is jurisdictional — the offer and sale of a franchise before the notice is properly filed violates the registration state statute.

If counsel can identify a violation of a registration or notice state disclosure statute, the law will supply a rescission remedy and the opportunity to claim damages resulting from the violation. This is a powerful weapon for franchisees. The statutes in some states are strict liability — no causation between loss and violation need be shown.

In addition to the private right of action, the leverage of a formal complaint lodged with the state franchise regulatory authority, or the FTC, can be a powerful tool. In the case of substantial misconduct, the state enforcement arms will be actively promoting resolution that is beneficial to

¹³ The F.T.C. Rule Compliance Guide provides this guidance: “The mandatory seven calendar day review period does not apply where the only differences between the standard agreements and the completed agreements are non-substantive “fill-in-the-blank” provisions, such as the date, name, and address of the franchisee. The addition of substantive terms such as a specific radius or geographic area comprising a protected territory, the actual number of stores to be opened pursuant to an area development agreement, the specific interest rate payable by the franchisee, or other contractual terms that were not previously disclosed in the basic disclosure document or its attachments will trigger the seven calendar day review period.” Federal Trade Commission: Franchise Rule Compliance Guide 22 (2008), http://business.ftc.gov/documents/franchise-rule-compliance-guide (then follow “Franchise Rule Compliance Guide” PDF hyperlink).
the aggrieved franchisee. No franchisor wants to feel the wrath of the state and report in Item 3 for ten years about an adverse state administrative or civil action.

B. **State Law Assistance**

Franchise agreements have a choice of law selection that will be enforced except in rare circumstances. The exceptions will be in "registration" states that mandate their state's law governs the franchise agreement as a condition to registration.\(^{14}\) Franchisors will usually select either their home state or the state of incorporation such as Delaware or Nevada. Unless the franchisor qualifies as exempt from registration, the registration states' disclosure statutes condition registration on the use of a state addendum that incorporates provisions of state law that supersedes the franchise agreement, generally in favor of the franchisee.\(^{15}\)

A franchisee in these registration states, and the twenty-four states and territories\(^{16}\) with franchise relationship laws,\(^{17}\) is protected against franchisor conduct that may be permitted by the franchise agreement but prohibited, limited or modified by the relationship law statute. Some states have inventory and logo item repurchase requirements.\(^{18}\) Failure to follow these state specific requirements produces a claim against the franchisor for violating the statute.

C. **Was the FDD Materially Misleading or Inaccurate?**

1. **Items 3, 7, 8, 19 are key focal points.** Item 3 requires franchisors to disclose any pending or recently completed litigation (i.e. litigation that has ended within the past ten years). Item 3 disclosure includes the settlement terms of any litigation that settled. If a franchisor fails to disclose a lawsuit in which it was involved, there may be a basis for rescinding the franchise agreement and any ancillary agreements that the franchisee entered into. Federal courts in both California and Tennessee have granted rescission based on Item 3 disclosure violations.\(^{19}\) Similarly, if the franchisor misrepresented the nature of the litigation, the FDD could be materially misleading. It is good practice to contact attorneys or parties involved in any litigation listed on an FDD to check whether the franchisor has accurately disclosed the nature of the litigation. Reviewing court filings can also be helpful.

\(^{14}\) See, e.g., Wimsatt v. Beverly Hills Weight Loss Clinics Int'l, Inc., 32 Cal. App. 4th 1511, 38 Cal. Rptr. 2d 612, 613 (1995) ("Yet a critical feature of California's Franchise Investment Law is an antiwaiver statute voiding any provision of a franchise agreement which forces a franchisee to give up any of the protections afforded by the law."); Luling v. Barnaby's Family Inns, Inc., 482 F. Supp. 318, 320 n. (E.D. Wis. 1980) ("The Wisconsin Franchise Investment Law prohibits any attempt by parties to contract out from under Wisconsin law, and thus renders void the clauses requiring the application of Illinois law.").

\(^{15}\) Alaska; California has obfuscated this issue; Illinois requires Illinois choice of law.

\(^{16}\) Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Puerto Rico, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. See Appendix A for citations and a summary of good cause, notice requirements, and inventory repurchase requirements.

\(^{17}\) See Appendix A.


\(^{19}\) See Altrust, LLC v. Medex Patient Transp., LLC, No. 3:17-cv-01179, 2018 WL 1704111 (M.D. Tenn. Apr. 9, 2018) (confirming an arbitral award of rescission based on, inter alia, Item 3 disclosure violations); Dollar Sys., Inc. v. Avcar Leasing Sys., Inc., 673 F. Supp. 1493 (C.D. Cal. 1987) (ordering rescission of the franchise agreement for various disclosure violations, including Item 3 violations).
Item 7 is a chart which contains information relating to start-up costs and costs for the initial three months of operating. The numbers on the chart represent both fixed costs (such as the franchise fee) and estimated costs that are generally given as a range. It is essential to compare the costs that your client identifies with the estimates provided by the franchisor in the FDD (e.g. construction costs vs. estimates in Item 7), as well as any representations made by the franchisor in communications that you have reviewed. Having evidence of start-up costs greater than the information indicated or projected in Item 7 does not mean you have proof of fraud or that the franchisor misrepresented the start-up costs. Estimates can be materially misleading if the franchisor knew or should have known that the actual cost would be significantly different than the estimate. When requesting documents from the franchisor during discovery, it is important to ask for documents that the franchisor relied on in calculating the estimates included in the FDD, as such documents may show that the franchisor's estimates were not reasonable (for example, if the franchisor used the same cost estimates for the past twenty years). There may also be documentation exculpating the franchisor, such as letters from the franchisor during construction advising the franchisee that he is spending too much money.

The supply chain disclosures in Item 8 require franchisors to disclose any restrictions (or lack thereof) on vendors from whom the franchisee may be required to buy goods or services. Additionally, the franchisor must disclose whether it is entitled to receive rebates or allowances, including the future right to rebates or allowances, from such required purchases. The existence (or lack thereof) of vendor rebates is frequently litigated.

Item 19 is fertile ground for litigation because franchisors are allowed to make financial performance representations in Item 19. Note that the franchisor is not required to make any such representations, but it may make them if it so chooses. These representations may be information about past performance or projections of future performance. Franchisors that make financial performance representations must have a reasonable basis for making such claims. Franchisors also must disclose a variety of other information, such as to which outlets the representation regarding past performance applies and the material bases for making projections about future performance. If franchisors make representations that are not included in Item 19, they must follow additional FTC guidelines regarding supplemental financial performance representations.20 Many franchise disputes relate to supplemental financial performance representations that were not included in Item 19 and which the franchisee relied on in purchasing the franchise.21 Reviewing Item 19 with your client and discussing any additional representations made by the franchisor is a critical step in analyzing potential claims. However, the fact that your client's business did not perform up to the financial performance representations made in Item 19 alone does not necessarily mean there is a claim to be made: The key question is whether the information given to your client was accurate or representative.

D. Was training adequate to open the business and run it?

Usually, one of the few absolute duties franchisors have under franchise agreements is the duty to provide training to franchisees so the franchisees will have the requisite knowledge and skill to successfully operate the franchise. The franchisor also has an incentive to properly train its franchisees so that they will successfully represent the franchisor's brand. However,


franchisors often qualify their obligations by requiring themselves to provide services that are “reasonable” or discretionary.

Nevertheless, disputes often arise when franchisees feel they were not adequately trained. Whether or not the training provided to a franchisee complied with the terms of the franchise agreement is a fact-specific inquiry that must be evaluated on a case-by-case basis. Some useful strategies in evaluating such claims are to compare the training your client received to other franchisees, both within the franchise system and those that operate similar franchises in the same industry and the same marketplace. You should also closely review the franchise agreement and Item 11 of the FDD to see if the franchisor failed to provide any service that it was specifically obligated to provide.

E. **Did the franchisor deliver on Item 11 pre-opening and post-opening services and other promises in the documents?**

Franchisors sell franchisees on the prospect of running a franchised business in part by promising a strong support system to which franchisees will have access. The franchise system consists of not only the franchisor’s brand and trademarks, but also marketing, advertising, training and consulting services that the franchisor developed for the benefit of all corporate and franchised stores. During the sales process, many franchisors make promises to the franchisee regarding their franchise systems and the services they provide. Many disputes arise because franchisees are dissatisfied with the services actually provided by the franchisor, and feel they were lied to during the negotiations.

Item 11 of the FDD is where franchisors are required to state their obligations under the franchise agreement. This Item requires a franchisor to disclose what training as well as marketing and various other support services it is obligated to provide for franchisees under the franchise agreement. A common complaint from franchisees is that they feel they do not receive enough help from the franchisor to justify the fees they pay. Franchisees who begin disputes over failure to deliver on Item 11 services often want to continue to operate in the franchise system, albeit with some additional support from the franchisor. Item 11 disputes are also fact-specific, so it is important to analyze the franchise agreement and FDD as well as understand industry standards regarding what franchisors are required to provide to franchisees in similar circumstances. Because franchisors generally limit their obligations, attorneys for franchisees should be prepared to think creatively about how to frame a franchisor’s failure to provide the services that the franchisee was expecting.

Franchisees typically see themselves as business partners with the franchisor, and expect the franchisor to do everything within its power to help the franchisee succeed. When the franchisor inevitably falls short of that expectation, the franchisee may seek legal counsel to resolve the differing opinions on what exactly the franchisor is required to do to support the franchisee. As the franchisee’s attorney, it is your job to analyze the pre-sale promises made by the franchisor, the terms of the franchise agreement and the representations in the FDD about these support services, and the post-sale service delivery actually made by the franchisor. Discrepancies between pre-sale promises and post-sale delivery often sound in breach of contract, but may also rise to the level of fraud.

F. **Are there any pre-sale or post-sale writings that contradict the FDD?**

As noted above in this Section II, franchisors are bound by certain information they provide in the FDD. If a franchisor provides information that contradicts the FDD, it could be liable to the
franchisee under various state laws governing the sale of franchises. As the franchisee's attorney, you should review any public material published by the franchisor as well as communications between your client and the franchisor for any discrepancies between what is in the FDD and what is written by the franchisor elsewhere.

The franchisor's website will often contain information about franchising and is a good place to look for information that conflicts with the information provided to your client in the FDD. When looking for pre-sale writings, the Internet archive, which can be found by performing a Google search for "the wayback machine," backs up and saves public webpages at various times. Often franchisors' webpages from the relevant time period can be found and explored via the wayback machine.

Discussing writings that your client may remember reading can help focus your search for contradictory information, though searching the franchisor's website and communications is generally not very time-consuming and can uncover information that your client may not remember or understand the significance of.

G. Was a material fact misstated or omitted, or was a promise or prediction of a future event or circumstance unfulfilled or unrealized?

The classic disputes between a franchisee and a franchisor involve either a claim that franchisor misstated or omitted a material fact during the negotiation of the franchise agreement, or a claim that franchisor represented that a future event would take place, which induced the franchisee into entering into the franchise agreement, and that future event did not occur as advertised.

Your client will feel wronged by the franchisor and will want to tell you everything that crosses his mind that could possibly demonstrate how the franchisor took advantage of him and lied to him in order to induce him into buying the franchise. As the attorney, your job is to sift through all the information that your client throws at you and pick out the actionable statements, representations and omissions that were made by the franchisor.

Even when a franchisor promises or predicts future events, such statements can be actionable. Promises or predictions regarding the future financial performance of the franchised business may be actionable if they are made outside the FDD or if they do not include the proper descriptions and disclaimers required by Item 19. Other promises and predictions regarding prospective financial performance can be actionable as well. For example, if the franchisor makes a promise of a future outcome which it has no reasonable basis for making, and your client relied on that promise, the franchisor may be liable for making an improper FPR or violation of various state laws.

All questions about which statements, representations or omissions made by the franchisor are actionable depend on the law governing the parties' relationship. As the franchisee's attorney, you should review the franchise agreement and the relevant facts about the parties' relationship to determine what law applies to the dispute before advising your client about which statements, representations and omissions of the franchisor are actionable.

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H. Encroachment and Oversaturation Claims

Franchisors may enter a protected market in violation of the franchise agreement. This scenario can occur where the franchisee has tapped a particularly lucrative market and the franchisor wants to open a corporate store in order to make additional profits. Though opening a corporate store near a franchised store likely decreases both stores' profits in the short-term, the franchisor has deeper pockets and may be able to drive a franchisee out of business, thereby capturing the entire market for itself. Even if the franchisee is able to stay in business, opening a competing store could make sense for a franchisor where the company-owned store is able to make a profit and the franchisor collects royalty fees from the franchisee.

Claims may be available when the franchisee has been granted a protected territory in the franchise agreement. Additionally, franchisees may be able to bring claims based on the implied covenant of good faith and fair dealing even when the franchisor does not violate an express term of the franchise agreement. Such claims are possible in certain jurisdictions where a franchisor’s actions serve to deprive the franchisee of the benefit of its bargain by oversaturating a market with the intent of driving the franchisee out of business or cannibalizing a market by opening more than store.23 In Handlers-Bryman vs. El Pollo Loco, Inc., El Pollo Loco was found to have violated the implied covenant of good faith and fair dealing by opening two corporate stores in close proximity (2.2 and 4.4 miles away, respectively) to the franchisee’s successful restaurant. The franchisee did not have an exclusive territory and El Pollo Loco had an express contractual right to open a competing restaurant “in the immediate vicinity of or adjacent to” the franchisee’s location; however, the court found that provision unconscionable and unenforceable under California law.

I. Evaluation of Integration Clause and Waiver Clauses

Not only do franchisors draft franchise agreements and FDDs to limit their obligations to the franchisee, they also include various mechanisms to limit their liability for any misrepresentations they may have made during the sales process. Two typical provisions in franchise agreements designed for this purpose are integration clauses (sometimes called merger clauses) and waiver clauses.

A typical integration clause will state that the franchise agreement is the entire agreement between the parties and that all other conversations, drafts, statements or agreements regarding the subject matter of the franchise agreement are superseded by the franchise agreement. The clause is designed to eliminate any potential liability for failure to comply with terms that may have been discussed with or even promised to the franchisee but were ultimately left out of the franchise agreement. Integration clauses should be familiar to every lawyer, and it should come as no surprise that franchisors utilize these clauses to protect themselves from liability. Franchisee attorneys should note that in many jurisdictions, when a plaintiff pleads fraud, she may not be bound by merger clauses.24

Franchisors also typically require franchisees to waive certain rights as part of the franchise agreement. Franchisees often waive their right to a jury trial, punitive or multiple

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damages, class action relief, and other rights. Waiver clauses will affect the relief a franchisee can claim from a franchisor and must be analyzed by the franchisee’s attorney early in the representation to properly advise the client about what she can expect both in terms of the dispute resolution process as well as any ultimate recovery. Waiver clauses are not enforceable, or at least not dispositive, to defeat claims brought under franchise-specific state statutes, though it depends on your jurisdiction.25 In Coraud LLC v. Kidville Franchise Co., LLC,26 the U.S. District Court for the Southern District of New York dismissed common law fraud claims based on the franchisee’s disclaimer of reliance on financial representations made outside of the FDD, but refused to dismiss similar claims based on the New York State Franchise Sales Act27 because of the statutory anti-waiver provision28. It is also crucial to review a waiver clause carefully and compare it with the representations made to your client. General waiver clauses (e.g. “the franchisee disclaims reliance on any representations not included in this agreement”) may not be specific enough to defeat claims made pursuant to state franchise laws, and even specific waivers may be inapplicable to the representations made to your client (e.g. a waiver of reliance on any representations made regarding revenue does not mean your client disclaimed reliance on a representation about breaking even within two years).29 In both Hardee’s and Steak n Shake, the specific disclaimer provisions were analyzed and found to specifically bar the claims, while the Colorado Coffee Bean court held that the general language of the exculpatory provisions signed by the franchisee was not specific enough to disclaim reliance on the franchisor’s statements. Franchisee attorneys should also remember that there is no disclaimer for projections made in Item 7.

J. Evaluate Parol Evidence Rule Potential

The parol evidence rule generally limits the introduction of evidence regarding prior or contemporaneous agreements or negotiations that would serve to change the terms of a contract. The rule is particularly strong when the terms are unambiguous on their face. Merger clauses are employed to further bolster the presumption against introducing outside evidence to assist in contractual interpretation. Franchisors are eager to limit any evidence of additional promises or representations that are not included in the express terms of the franchise agreement or the FDD, and generally include such language in the merger clause. Franchisees, on the other hand, will often have received additional representations throughout the negotiation process and will seek to introduce evidence of those representations even though they were not included in the franchise agreement or FDD.

When the terms of the franchise agreement are ambiguous, franchisees may be able to introduce additional evidence regarding the parties’ intent. Additionally, if the franchisee was fraudulently (or illegally) induced into entering into the franchise agreement, she may be able to

25 See, e.g., Randall v. Lady of Am. Franchise Corp., 532 F. Supp. 2d 1071 (D. Minn. 2007); see discussion infra Section IV(C) along with several other cases on the same subject.

26 109 F. Supp. 3d 615 (S.D.N.Y. 2015); see also discussion infra Section IV(C).


introduce evidence of additional or contradictory representations, though it depends on the jurisdiction.  

K. **Understand notice provisions, dispute resolution, jury trial waiver, arbitration, venue provisions, limitations on class actions, statutes of limitations and contractual limitations provisions**

Franchise agreements tightly control when, where and how claims are asserted. It is standard practice for franchisors to include various restrictive provisions in the franchise agreement. Such provisions include: notice provisions whereby the franchisee must give notice of an alleged breach within a certain time period; dispute resolution provisions that specify procedures which must be complied with prior to a formal proceeding; waivers of the right to a jury trial; arbitration clauses or venue provisions whereby the franchisee exclusively agrees to arbitration or litigation in front of a specific tribunal or court which is governed by specific law; waivers of a franchisee’s right to engage in class or group action litigation or arbitration against the franchisor; and contractual limitations provisions which modify the relevant statute of limitations. These are provisions that any attorney representing a franchisee should immediately look out for when reviewing a franchise agreement as they may affect where and how your client will be able to bring claims against the franchisor.

Many franchise agreements include notice provisions that specify the manner and time within which a franchisee must allege a breach by the franchisor. For example, a franchise agreement may specify that a franchisee must allege a breach in writing mailed to a specified address within sixty days of discovering the alleged breach. Notice provisions are often coupled with mandatory dispute resolution procedures such as mediation. Complying with notice and dispute resolution provisions (or obtaining a waiver from the franchisor) is critical, as non-compliance may bar a franchisee’s claim.

Waiver of a franchisee’s right to a trial by jury is another common provision in franchise agreements. These waivers are generally enforceable, though not in California or Georgia pursuant to California Code of Civil Procedure § 631 and Georgia Code of Civil Practice § 9-11-39(a), respectively. Limitations of the right to bring claims as part of a class are similarly enforceable. The Supreme Court held that class action waivers are enforceable with respect to arbitration notwithstanding any finding of unconscionability. The Supreme Court’s reasoning is that the Federal Arbitration Act (“FAA”) sets forth a policy favoring arbitration and requires courts to enforce arbitration agreements according to their terms. Class action waivers that are not part

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of arbitration clauses would be subject to state contract law rules and may be void as unconscionable or against public policy.

Franchise agreements almost invariably contain some type of venue provision, be it a forum selection clause or an arbitration clause. Both venue clauses that select a specific court and arbitration clauses are broadly enforceable. The Supreme Court has held venue provisions in franchise agreements control where the suit is brought "in all but the most exceptional cases."\textsuperscript{32} This principle is true even if the franchisor were to bring an action in a forum that is more convenient for the franchisee, as the plaintiff's choice of venue carries no weight in such circumstances and courts may not consider the private interests of the parties when deciding the proper forum.\textsuperscript{33} Likewise, arbitration provisions are generally enforceable. Even where a franchisee has been fraudulently induced to enter into the franchise agreement, unless he can prove he was specifically induced to enter into the arbitration clause, the dispute will be arbitrable.\textsuperscript{34} In *Buckeye Check Cashing*, Justice Scalia reiterated long-standing precedent that "if the claim is fraud in the inducement of the arbitration clause itself—an issue that goes to the making of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language [in § 4 of the FAA] does not permit the federal court to consider claims of fraud in the inducement of the contract generally."\textsuperscript{35}

Finally, reviewing contractual limitations periods and applicable statutes of limitations is crucial. In general contractual limitations periods that shorten the otherwise applicable statutes of limitations are enforceable; however, certain states have non-waiver provisions in their franchise laws that may preclude contractual limitations periods that are shorter than the statutory provisions under the theory that a shorter contractual period would vitiate statutory protections for franchisees. Therefore, contractual limitations provisions cannot shorten the limitations period for statutory claims in those states, as they are considered an illegal waiver of the statutory rights granted to franchisees.\textsuperscript{36} On the other hand, New York courts have found that contractual limitations periods in franchise agreements are valid notwithstanding the New York State Franchise Sales Act.\textsuperscript{37} Breach of contract claims will usually be subject to contractual limitations periods, even in the states with statutory anti-waiver provisions.

III. EVALUATION OF FRANCHISOR'S PERFORMANCE OF SUPPORT OBLIGATIONS

A. Disclosure of Franchisor Support Obligations.

Counsel should refer back to the FDD and the franchise agreement for a catalog of the franchisor's support obligations to the franchisee. Under the FTC Franchise Rule and the NASAA Disclosure Guidelines, in Item 11 of the FDD, the franchisor must disclose certain assistance obligations to the franchisee to be provided before the franchise opens, which we summarize: (a)


\textsuperscript{34} Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440 (2006).

\textsuperscript{35} Id. at 444–45 (internal quotation marks and citations omitted).

\textsuperscript{36} See Randall, 532 F. Supp. 2d at 1071.


whether the franchisor generally owns the premises and leases it to the franchisee; (b) whether the franchisor selects the site or approves a franchisee-selected area or site; (c) disclosure of the factors that the franchisor considers in selecting or approving sites; (d) the time line, process and consequences for site selection or failure to agree; (e) code compliance and permitting; (f) constructing, remodeling, or decorating the premises; (g) hiring and training employees; and (h) providing for necessary equipment, signs, fixtures, opening inventory, and supplies.

The FDD must also detail the support to be provided to the franchisee during the operation of the franchise, which we summarize: (a) developing products or services for customers; (b) hiring and training employees; (c) improving and developing the franchised business; (d) pricing strategies; (e) establishing and using administrative, bookkeeping, accounting, and inventory control procedures; and (f) resolving operating problems encountered by the franchisee.

If the FDD or the franchise agreement does not specifically address these categories, they provide a meaningful basis for questioning whether support was promised by some other means, such as the collateral franchise recruitment advertising and the promotional communications of the franchisor and its sales representatives.

B. **Franchisor support activities may be organized into four broad categories:**

1. **Initial Support** - pre-opening support in selecting the location, developing the site or the business, training of the franchisee, the managers and the staff, and pre-opening marketing so the start-up period is as short as possible. A franchisee is willing to pay the initial franchise fee(s), rather than start its own business, because the Initial Support gives the franchised business an advantage, presumably at a cost/benefit that justifies the fees. Otherwise, the franchisee could invest the same resources in its own start-up business.

2. **Essential Support** - mission critical goods and services essential to the operation of the franchise and compliance with operating standards. These may include transactional data flow such as hotel reservations, or order processing, or sales lead referrals from the brand website or social media. It also includes participation in marketing activities funded by franchisee or vendor contributions to the brand marketing fund, and participation in supply chain programs and benefits intended to foster efficient, cost effective procurement of inventory and supplies necessary to operate the franchised business.

3. **Remedial Support** - services that assist the franchisee to rectify performance and service issues with the operation of the unit, conformance to system or industry standards, or correcting issues that have been the subject of third party identification such as health code violations, customer service reviews or other means. Without this support, the franchise would be at risk of default and termination or failure from the legal or practical inability to sustain cash flow and meet obligations.

4. **Additional Training/Evolutionary Support** - services that are intended either to achieve better financial results or expand product and service offerings, or to evolve the franchised business as its dynamic market changes, such as the introduction of new technology, product lines or services that respond to customer needs and opportunities. This type of support may start as voluntary or additive, but may become more significant to franchised business survival or profitability.
The genesis of a claim for non-support starts with a complete list of franchisor support functions and questioning the franchisee, buttressed by documentary proof, regarding what support was received and what was not received. To the extent the franchisee communicated requests for support and received no response or an inadequate response in reply, a timeline will be very useful. The timeline allows assessment of responsiveness and frequency of requests for support or assistance.

Counsel should also inquire about conventions, regional meetings and similar events where the curriculum may have included performance of support functions. In particular, conventions and gatherings may include program materials, speeches or other form of communication in which the senior leadership of the franchisor makes commitments and promises to the franchise community at large about support and brand services.

Some franchises are doomed to failure when the doors open for the first time. There is folklore in the franchise world, particularly in mid-sized and smaller capital expenditure franchise programs, that costs to open the unit in excess of one year's gross revenues will likely result in a low margin or money losing franchise. The franchise system or industry of the affected franchisee may have similar metrics that are imprecise but useful measures. An early analysis of whether the initial capital investment cannot be sustained, and the related debt serviced, by the cash flow of the stabilized unit must be a critical element of the claim evaluation. If the unit opening costs are not outside the realm of a serviceable level, then analysis should move to support or possible lack of support issues.

C. **Breach or Tort - The Economic Loss Doctrine**

An important distinction should be addressed at the outset of the evaluation. Did the franchisor simply breach the franchise agreement, which supports only a breach of contract claim, or did the franchisor misrepresent its support capabilities to induce the franchisee to enter into the franchise agreement, either intentionally or negligently? If there is evidence only of the former, then any claim would be circumscribed by the economic loss doctrine. Damages are limited to breach of contract damages, equating to return of some or all of the fees paid. If there is evidence of the latter, then an independent cause of action in tort, with the prospect of tort damages, such as consequential and punitive damages, may be sustainable.

For a successful claim for breach, the franchisee must prove (1) the existence of the contract, (2) the performance of its conditions by the franchisee, (3) a breach by the franchisor, and (4) damages as a result of the breach. Only a duty imposed by the contract can give rise to a breach.\(^{39}\) The *Appliance Alliance* case is an example of a breach of contract case where franchises get behind their finance curve and never catch up, despite cooperation between franchisor and franchisee.

Sears Hometown and Outlet Stores, ("SHO") granted Appliance Alliance four franchises to operate certain Dallas area home appliance stores, using the Sears branding and inventory sourcing channels. There was some discussion about the unit economics, particularly commission rates on appliance sales and marketing support, but the franchisee received the brand FDD and the agreements were consistent with FDD. Oral representations about potential commission rates in excess of the contract minimum were not included, and the closing documentation included an estoppel stating that the franchisee did not rely on any oral

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representations in deciding to buy the franchise. The franchisee later purchased franchises for two additional locations.40

The four original stores were initially profitable, but their economics eroded, hurt by the larger issues at Sears and competition from other Sears outlets. The performance wobbled, corners were cut on operations to save on expenses and the franchisee fell behind on rent and other obligations. One location was turned over to Sears, which provided a substantial loan for working capital. Default notices were issued serially, while the franchisee was unable to meet payroll and did not provide financial reports or cure operational deficiencies identified in the notices. There was evidence that the franchisor's area training and support representative took on supervision of the franchisee's employees. The franchisee could not provide the requested financial information, in part because the franchisor allegedly did not provide certain data necessary and in part because the franchisor had never previously asked about some of the information. SHO terminated all six franchises and the matter moved to litigation.

The franchisor sued to enforce termination, and the franchisee counterclaimed for breach of contract, failing to deal with the franchisee in good faith, and interference with contractual relations. All of the counterclaims for breach were dismissed on summary judgment.41 The franchisee's claim for failing to provide marketing support unraveled because the support in the form of the two percent allowance was conditioned on submission of a marketing plan. The franchisee never submitted the plan, all of the requested financial information or cured its financial defaults. Franchisee counterclaims for conversion, trespass, defamation and business disparagement, and fraud were also dismissed by the court on summary judgment, as were its claims for tortious interference with its store leases, and existing business relations, unfair competition and economic duress. Whatever merit the franchisee's claims may have had, such claims were fatally undercut by the franchisee's unwillingness or inability to perform simple self-help tasks required as conditions to franchisor assistance.

D. Economic Duress

Economic duress is an interesting theory for a claim by a franchisee suffering from financial difficulties. The court in Appliance Alliance evaluated the franchisee's claim:

Under Texas law, a plaintiff that seeks to prevail on a claim for economic duress must prove: (1) "a threat to do something beyond the legal right of the party making the threat," (2) accompanied by an "illegal exaction or some fraud or deception," such that (3) the threatened party is imminently restrained and its free agency is destroyed without a present means of protecting itself. Schlotzsky's, Ltd. v. Sterling Purchasing & Nat'l Distrib. Co., 520 F.3d 393, 404 (5th Cir. 2008) (quoting Beijing Metals & Minerals Imp./Exp. Corp. v. Am. Bus. Ctr., Inc., 993 F.2d 1178, 1184-85 (5th Cir. 1993)) . . . .

But even if Texas were to recognize an economic duress claim based upon contractually permitted threats, Defendants have not pointed to any specific threats, nor identified how such threats were accompanied by an illegal exaction, fraud, or deception. See generally [reference to briefing omitted]. The Court therefore concludes that no reasonable factfinder could find that Plaintiffs

40 Id. at *2-*4.
41 Id. at *18.
committed economic duress and grants summary judgment to Plaintiffs on Count V of Defendants' counterclaim.\textsuperscript{42}

The text of most Item 11 support disclosures, and the related provisions of the franchise agreement, usually have very vague and minimal support obligations for the period after unit opening. The general approach covers: 1) access to the operations manual and other brand management tools; 2) telephone consultation; 3) access to supply chain support and participation; 4) access to marketing fund-paid products and services for franchisees, and listings in marketing fund-support media content; and 5) field support at the discretion of the franchisor. None of these support functions is difficult to perform.

Many franchisors offer optional support services, sometimes for additional fees. A claim for failure to support may arise if the franchisee has requested and not received such services, or if the franchisee has requested and received such services, but the work product didn't match the promise or the description, either in the FDD, the franchise agreement or the operations manual.

To understand and evaluate the most fruitful avenue for inquiry, counsel can focus on which support category may be identified by the franchisee as deficient or inconsistent with either the FDD, the franchise agreement, operations manual or collateral materials used in the franchise sales process. The franchisee should demonstrate that its performance, submissions and interaction have all met any obligations, conditions and thresholds needed to obtain support. In particular, the franchisor may have adopted customs or informal conditions on providing support that do not conform to the franchise agreement, which most likely has a clause specifying that the agreement is not amended except by a writing signed by both parties, and that no custom or usage or course of dealing operates as amendment to the franchise agreement. Over time, franchise organizations and systems adopt their own methods of interaction that may not be supported by their documentation.

E. \textbf{Consumer Injury Theory}

If a franchise system allegedly engages in a business practice that is harmful to its retail customers, does the franchisee have recourse against the franchisor? The answer is, possibly, provided that claims are pled specifically as to their contractual basis. The UPS Store terminated eleven New York area franchisees owned by two brothers and related entities for breach of certain contract terms regarding the retail pricing of delivery services. UPS filed suit to enforce termination in \textit{The UPS Store, Inc. v. Hagan}.\textsuperscript{43} The franchisees and their affiliates counterclaimed for a variety of causes and added other franchisees as third party defendants. There was a flurry of procedural activity that earned the ire of the judge for violations of Federal Rule of Civil Procedure 8 and filing of a "larded" complaint with 175 paragraphs, which spawned a retaliatory answer with 1,020 paragraphs in 210 pages plus exhibits. The case spotlighted sales practices in New York UPS Store locations owned by the franchisee Hagans and others to overcharge for parcel shipping. Applying California law, as chosen in the franchise agreements, the court decided motions to dismiss under Federal Rule of Civil Procedure 12(b)(6), noting that the franchisees failed to plead their own performance or any specific breach of the franchise agreement by franchisor UPS. The court dismissed franchisee claims for breach of contract, breach of the covenant of good faith and fair dealing, fraud, tortious interference with contract, violation of the New York Franchise Sales Act; violation of the California Unfair Competition Law

\textsuperscript{42} \textit{Id.} at *19.

\textsuperscript{43} 99 F. Supp. 3d 426 (S.D.N.Y. 2015) (ruling on motions to dismiss).
and unjust enrichment. The only counterclaim to survive early motions was the New York State Consumer Protection Act claim that related to the overcharging of consumers by the New York area UPS Stores. The allegations relating to use of the UPS technology and standard practices as the cause of the deceptive trade practice also survived the motions to dismiss.44

_Hagan_ is mandatory reading for counsel seeking to pursue or defend claims that a failure of Essential Support, as described in Section III.B of this paper, has contributed to a franchise failure or distress. Critical to such analysis is whether the practices complained about harmed consumers of the services of the franchised business, as well as the franchisee affected.

But _Hagan_ wasn’t over – another published opinion followed the first ruling. Unfortunately, the issues of proof were insurmountable to the Hagans. When the Hagans amended their complaint following the court’s first ruling, they added a Lanham Act claim for false advertising to their surviving New York General Business Law (“GBL”) claim. The court dismissed some of the claims based on preemption by the Federal Aviation Administration Authorization Act. However, the court found that the franchisees had stated a claim under the Lanham Act by pleading that their businesses’ reputation was harmed by defendants’ statements regarding UPS’s “ground guarantee,” resulting in customers losing confidence in their businesses.45 More of the franchisees’ claims were dismissed at summary judgment despite evidence from a secret shopper hired by them, most of which was inadmissible.46

F. Franchisee Needs

Counsel must evaluate the relative independence of the franchised business – is the franchisee receiving in a timely manner the Essential Services promised by the franchisor, in the promised quality and quantity? If struggling, is the franchisee receiving the Remedial Services that have been promised as available to a struggling franchisee? Would the additional training promised as available be of assistance to the franchisee in facing and overcoming its challenges? Does the adage of a franchise as “being in business for yourself but not by yourself,” ring true or hollow under the circumstances?

While this analysis may seem simplistic, consider whether the nature of the franchise, particularly in the business format genre, is one where the franchise has greater latitude of operation and selection of sources of supply, or is a tightly controlled business where the franchisor specifies virtually every detail of the operation and allows the franchisee little latitude to operate and make decisions about the operation of the business, except perhaps pricing the goods and services, whom to hire and what to pay them.

If the franchise system includes a referral network, such as a hotel reservation system, how does the performance of the referral network compare to what the FDD disclosed about its historical performance, particularly in Item 19, or to published industry reports that may not qualify as financial performance representations47 but that were provided by the franchisor and are not

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44 Id. at 442.


47 16 C.F.R. § 436.1(e) (2007) (states “Financial performance representation means any representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.”); see also 16 C.F.R. §436.5(s) (2007).
circumscribed by an integration clause? In *Hotels of Key Largo, Inc. v. RHI Hotels*, the hotel franchisee alleged that the franchisee was promised that forty percent of a Key West hotel’s room reservations would be generated by the Radisson hotel reservation system, in addition to the hotel being the sole beneficiary of the hotel reservation system in the Florida Keys. The performance of the reservation system disappointed, as did the speed of activation on the reservation system. There was no contractual provision that specified an obligation of the franchisor that matched the alleged promises. The franchisee’s claims for fraudulent inducement and misrepresentation were dismissed by the trial court, which found that economic loss rule and the parol evidence rule barred the claims. The separate causes of action alleging breach of the implied covenant of good faith and fair dealing, violation of the Florida Franchise Act and for rescission were dismissed with prejudice. The appellate court affirmed the trial court’s conclusion that the complaint failed to state a cause of action. Unless the franchisee can plead that the alleged fraudulent conduct on the part of the franchisor is not intertwined with the terms of the contract, allegations that the fraud related to the contract terms are barred by the economic loss rule. The *Key Largo* court offers this guidance:

> It makes sense that a truly independent cause of action for fraudulent misrepresentation, where the ability of one party to negotiate fair terms is undermined by the other’s fraudulent behavior, is not barred by the economic loss rule. However, where the only alleged misrepresentation concerns the heart of the parties’ agreement, simply applying the label of “fraudulent inducement” to a cause of action will not suffice to subvert the sound policy rationales underlying the economic loss doctrine.

As noted above, the economic loss doctrine will be applied to prevent tort claims and the potential recovery of tort damages for purely economic losses. Even in Florida, tort claims are not eliminated if the torts are truly independent of the contractual breach, but the cause must be based on proof of facts that are separate and distinct from the breach of contract. The distinction, articulated in an opinion involving franchising indirectly, is that fraud in the inducement is a promise never intended to be performed, while a promise intended to be performed but which ultimately is not is a breach of contract. The fraudulent promise is made before a contract forms, and thus is independent of the contract. A contracting party has a duty to not fraudulently induce another party into a contract. The duty exists separate from the contract itself.

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48 694 So. 2d 74 (Fla. Dist. App. 1997), rev. denied, 700 So. 2d 685 (Fla. 1997).

49 Id. at 78.

50 Id. at 77.

51 *Tiara Condo. Ass’n, Inc. v. Marsh & McLennan Companies, Inc.*, 110 So. 3d 399, 409 (Fla. 2013) (Pariente, J., concurring) (noting that while Florida limits economic loss rule to product liability cases, “in order to bring a valid tort claim, a party still must demonstrate that all of the required elements for the cause of action are satisfied, including that the tort is independent of any breach of contract claim.”).

52 *Budgetel Inns, Inc. v. Micros Sys., Inc.*, 8 F. Supp. 2d 1137, 1149 (E.D. Wis. 1998) (other courts have declined to follow this reasoning); see *Irwin Seating Co. v. IBM*, 306 F. App’x 239 (6th Cir. 2009); *Rich Prod. Corp. v. Kemetec, Inc.*, 66 F. Supp. 2d 937, 977 (E.D. Wis. 1999), aff’d, 241 F.3d 915 (7th Cir. 2001).

53 *See Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc.*, 41 Tex. Sup. Ct. J. 289, 960 S.W.2d 41 (Tex. 1998) (“Moreover, it is well established that the legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself.”).
G. Information Needs

What if the franchisee needs information from the franchisor about the brand or the marketing program of the brand in order to conform its strategy to the expectations of the brand? A distribution case holds some promise for a claim based on the failure to disclose a change in marketing strategy. The Wisconsin Supreme Court held in *Kaloti Enterprises, Inc. v. Kellogg Sales Company*, 54 that a change in distribution strategy for a product line of an acquired manufacturer carried a duty of disclosure for material facts to the distributors of the affected product line. The distributor had placed an order on May 14 for a three month supply of products without having received any disclosure about the change in strategy for dual distribution, in that the manufacturer and its representative would be selling directly to the distributor’s customers. The order was delivered on June 1 and the distributor paid for the order. The distributor’s major customers notified it on June 14 that they were now buying directly from the manufacturer. They would no longer be buying from the distributor. The next day the distributor contacted the manufacturer and the sales representative to rescind the order and recover the payment to the manufacturer and its sales representative. The trial court dismissed the complaint of the distributor. The Wisconsin Supreme Court reversed the dismissal, and held that the distributor's intentional misrepresentation claim was not barred by the economic loss doctrine.

The *Kaloti* Court examined whether under Wisconsin law, a party in a business deal is under a duty to disclose a material fact. When such a duty exists, the failure to disclose is equivalent to a representation of the nonexistence of the fact. Citing the *Restatement (Second) of Torts*, §551 and its comments, the court identified the elements to review as whether:

(1) the non-disclosing party knew that the other party was not aware of the fact; (2) the mistaken party could not discover the fact by ordinary investigation or inspection, or he or she could not otherwise reasonably be expected to discover the fact; and (3) the mistaken party would not have entered into the transaction if he or she knew the fact. 55

The court dismissed the argument from the manufacturer that the two sophisticated parties engaged in an arms’ length transaction had no duty of disclosure material facts to each other. Because the manufacturer knew the distributor was buying the inventory to resell to the manufacturer’s new direct sales customers, and that such information could be material to both the distributor and the manufacturer, the duty to disclose arose and the case was remanded for proof of the elements at trial. 56

The *Kaloti* claims vividly demonstrate the need to document the communications between franchisee and franchisor, so that any delay in disclosure or incomplete disclosure of information material to the franchise may be the source of a claim based in tort, not contract.

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54 283 Wis. 2d 555, 699 N.W.2d 205 (2008).
55 283 Wis. 2d at 572, 699 N.W.2d at 213.
56 283 Wis. 2d at 589, 699 N.W.2d at 221.
H. Franchisor Performance Standards

What if the franchisor has undertaken more definitive obligations to the franchisee, or to the franchise system as a whole? In Holiday Hospitality Franchising, LLC v. CPTS Hotel Lessee, LLC\textsuperscript{57} the franchisor undertook the obligation to:

conscientiously seek to maintain high standards of quality, cleanliness, appearance and service at all hotels using the System so as to promote, protect and enhance the public image and reputation of the Crowne Plaza name and to increase the demand for services offered by the System. Licensor's judgment in such matters shall be controlling in all respects, and it shall have wide latitude in making such judgments.\textsuperscript{58}

The license agreement also provided for notice and opportunity to cure if the franchisee alleged a default by the franchisor. Dissatisfied with the support of the Crowne Plaza brand by the franchisor, the franchisee gave notice of breach and initiated the default and termination procedures. The franchisor contested the default and commenced litigation to save the franchise on its self-identified flagship hotel. The franchisee alleged that the brand lagged behind the performance of similar quality hotels in key industry metrics, including lower room rates because of a perceived lesser value on the part of consumers, and that the reservation system was inadequate and antiquated. In its general indictment of the brand's management, the franchisee pointed to deficiencies in the growth pipeline of the brand, corporate instability because of frequent changes in the brand executive group, lack of presence in the U.S. hotel market as a whole and poor public perception of the brand. The franchisee also complained that the brand initiatives would likely not result in brand performance improvement. The franchisee claimed breach of contract, sought declarative relief confirming that its default and termination complied with the franchise agreement, and alleged franchisor breaches of its obligations under agency and personal services theories. The franchisee also alleged that the franchisor used its reserved discretionary power in an arbitrary and capricious manner, in violation of the implied covenant of good faith and fair dealing. Finally, the franchisee contended that notwithstanding certain express language in the franchise agreement to the contrary, the agreement was a personal services agreement that gave the franchisee the right to terminate at will as a matter of law.\textsuperscript{59}

The franchisor disagreed and counterclaimed for fraud on the part of the franchisee, breach of contract, and declaratory relief rejecting the franchisee's theories of agency and personal services.

In deciding a motion to dismiss by the franchisor, the court expressed some support for the position of the franchisor, but denied the motion because there were genuine issues of fact to be developed in discovery. The court held that the arbitrary and capricious standard of review for the franchisor's decisions applied, but the agreement supplied its own standard and reserved to the franchisor the right to define its own performance. The court also rejected the personal services argument of the franchisee, as the franchise agreement was the product of extensive negotiation and settlement of a prior dispute over the management of the hotel, and the services provided by the franchisor to the franchisee were not of the same type as would fall within the

\textsuperscript{57} No. 652996/2016, Bus. Franchise Guide (CCH) ¶16,185 (N.Y. Sup. Ct. May 1, 2018).

\textsuperscript{58} Id. at 3.

\textsuperscript{59} Id.
notion of personal services. The court was reluctant to invade and rewrite the heavily negotiated agreement agreed between sophisticated parties represented by experienced counsel.60

I. Evaluation of Franchisee Compliance with Franchise System Norms and Standards

Most franchisors have a reporting and early warning system in place to measure franchisee performance and identify areas of concern. These are rarely included in Item 19 of the FDD, so they are most often a part of the Operations Manual or related documentation.

For example, franchisors often share system average monthly profit and loss statements that are anonymized, but condition such sharing on submission of the franchised business’s monthly financial reports. These reports typically encompass what the franchisor describes as "Key Performance Indicators" or KPI's. If the franchisor doesn't designate any metrics as KPI's, then resorting to an industry resource would be appropriate. The absence of meaningful data analysis, particularly in a more esoteric genre of franchise, speaks volumes about the support level of the franchise system, the sophistication of its management, and the likely ability to respond to a franchisee in need of Remedial Support.

Counsel and the franchisee should compile a schedule and timeline of all system reports generated by the franchisor and delivered to the franchisee, and those delivered by the franchisee to the franchisor. Any reports that are missing from the expected sequence should be noted and requested from the franchisor, or produced and filed by the franchisee. If any reports point to the issues to be addressed or areas of concern, based on deviation from expected or standard performance levels, what did the franchisee do in reaction, and how quickly? Did the franchisor provide the guidance toward resolution and the Remedial Services with the level of detail and applicability that solves the issues evident in the reports, and as the franchise agreement and operations manual obligate? The franchisee should consult franchisee communication resources for other franchisees who share the same or similar issues, and those who have done so in the recent past, with a view toward understanding what resources were devoted by the franchisor toward resolution. The franchisee and perhaps the franchisee's accountant or financial advisor, or a training resource, should evaluate and set appropriate targets for KPI's, map out a critical pathway to achieve the objective, and formulate a request for the franchisor to supply Remedial Support when and as needed to resolve the performance issues.

Franchisees communicate directly and indirectly through franchisee only groups and other means on social media. Information about the assistance provided to franchisees with challenged businesses can be exchanged so the franchisee is informed with appropriate questions that can be asked of the franchisor about Remedial Support. Another source of contacts is the list of recently terminated franchisees in Item 20 of the franchisor's FDD, who can supply information about steps taken for Remedial Support that may be at variance or conformance with the franchise agreement and the operations manual of the system. Once that actual process is understood, that information can be compared to the franchise agreement and operations manual, so that any course of dealing that varies from the intended methodology would be the basis of a demand to adhere to the new course of dealing.

J. Course of Dealing Changes to Franchise Agreements

In LaGuardia Associates and Field Hotel Associates v. Holiday Hospitality Franchising, Inc., a hotel franchisor that accepted franchise fee payments that were generally sixty days late for a considerable period of time could not abruptly default and terminate the franchisee when new management at the franchisor decided to enforce the time period in the franchise agreement as written. This opinion from the U.S. District Court for the Eastern District of New York demonstrates the lengths to which a court may decide to go if it is convinced that the strict application of the franchise agreement's terms will be offensive to an already imbalanced franchise relationship. Even without a franchise relationship law in New York, the court remarked that New York franchise law in "its general tenor bespeaks a state policy to prevent overreaching in the franchise relationship."62

The franchisor noticed the franchisee about the financial defaults but chose not to terminate for ten months. The franchisee brought its account current after receiving the default notice. The franchisor then gave its notice of termination. After rejecting the implied amendment and oral course of conduct arguments advanced by the franchisee, under statutory prohibitions, the court held that the delay in terminating combined with the franchisee's payments effectively waived the franchisor's termination right under the original default notice. "Having permitted the [franchisee] to become addicted to payment delays, [the franchisor] could not simply cut them off. Cold turkey."63 The court went on to grant equitable relief but allowed the franchisor to reset the payment terms to those specified in the franchise agreement.

IV. LEGAL STATUS AND JURISDICTIONAL ASSESSMENT

A. What are the 10 cases every lawyer representing a franchisee in a franchise dispute should consider in the evaluation of franchisee claims against franchisors?

1. Emfore Corp. v. Blimpie Associates, Ltd.64 A franchisee sued Blimpie for fraud under New York’s Franchise Sales Act (“NYFSA”), common law fraud and breach of contract. The franchisee claimed a Blimpie salesperson made false representations about franchisee earnings, telling the franchisee that the average store generated $33,000 a month in revenue, a nearby location averaged $20,000 per week, and another store “just like you guys” cleared $12,000 per week. The store underperformed and closed within six months of opening, leading the franchisee to sue. Blimpie’s Uniform Franchise Offering Circular (“UFOC”)65 contained a questionnaire asking whether a Blimpie representative made statements about the franchisee’s earning potential. The franchisee answered that no such representations were made. The franchisee also signed a letter acknowledging that no Blimpie representative had made a representation about earning potential. Blimpie argued that these documents precluded the franchisee's fraud claims. The trial court agreed and dismissed the franchisee’s claims. A New York appellate court affirmed in part and reversed in part. The court affirmed the dismissal of the breach of contract claim because the franchisee failed to provide notice as required by the

62 Id. at 126–27.
63 Id. at 130.
65 The UFOC was the precursor to the FDD under the FTC Franchise Rule and NASAA UFOC Guidelines in effect prior to 2008.
franchise agreement. As to the fraud claims, the court found that the disclaimers were enough to bar the common law fraud claim. However, the NYFSA barred waiver of fraud claims brought under the statute. The court also decided that whether the franchisee reasonably relied on the Blimpie representative's representation given the disclaimers was a question of fact for the jury to resolve.66

2. **EV Scarsdale Corp. v. Engel & Voelkers North East LLC.**67 Three real estate franchisees sued a franchisor, alleging that the franchisor fraudulently induced them to open property shops and the franchisees received deficient support from the franchisor after the stores opened. The franchisees' fraud claims rested on two allegations: (1) the franchisor failed to provide the FDD to the franchisees before their first personal meeting; and (2) the franchisor misrepresented the earning potential of the franchisees. The franchisor moved for summary judgment. The court granted the franchisor's motion for summary judgment on the late disclosure claims, finding that whether the franchisees received the FDD before their first meeting with the franchisor was immaterial because it was undisputed that the franchisees received the documents before signing their license agreements. Thus, the franchisees could not show that their investment decisions would have been different or that later losses could have been avoided if they had possessed the disclosure documents earlier. The first personal meeting rule was dispatched by the 2007 amendments to the FTC Franchise Rule68, and retained only by New York and Iowa, may indeed be a legal antique. The court also granted summary judgment on the misrepresentation claims. The only evidence submitted by the franchisees of their losses was that but-for the alleged misrepresentations, they never would have invested. The court assumed that fact to be true, but still granted summary judgment because the franchisees failed to offer any expert evidence that their particular losses could be separated from the general market forces of the financial crisis.

3. **Randall v. Lady of Am. Franchise Corp.**69 A group of Minnesota women's fitness franchisees sued Lady of America ("LOA"), alleging that the franchisor violated both Minnesota and Florida franchising statutes, violated Florida's deceptive practices statute, and was liable for common law fraud. During the sales process, the plaintiff franchisees were shown financial statements from other locations. The plaintiffs also toured other franchisee locations and alleged that a LOA representative made false representations about the franchisee's potential profitability. LOA moved for summary judgment, arguing that franchisees signed disclaimers that precluded their claims. The UFour provided to the franchisees said that LOA did not provide information about franchise financial performance to salespersons and that the profitability of franchises varied. The franchise agreement contained an integration clause stating that no representation not contained in the agreement had been made to induce execution. The agreement also contained a provision requiring the franchisees to list any promises made to them or the franchisor would not be bound by them. It also required the franchisee to certify that he or she had undertaken an independent investigation into the business opportunity. The court denied LOA's motion for summary judgment. LOA argued that the disclaimer provisions meant that the franchisees could not have reasonably relied on oral representations. But the court found that reasonable reliance was not an element of a fraud claim under the Minnesota Franchise Act

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("MFA"). LOA also argued that the disclaimer provisions precluded any fraud claim. But the court held that the MFA nullified any provision that had the effect of waiving fraud claims and that the provision at issue fell within that category. Randall has its judicial fans and detractors, so its value as precedent is not assured.70

4. **Kieland v. Rocky Mountain Chocolate Factory Inc.**71 Franchisees sued Rocky Mountain, a Colorado chocolate and confectionary retailer, alleging that the franchisor violated the Minnesota Franchise Act ("MFA") by failing to disclose material information in its UFOC and that, by trying to terminate the franchisees’ franchise agreement, breached an implied duty of good faith and fair dealing. Rocky Mountain moved for summary judgment. The court granted Rocky Mountain’s motion. The franchisees argued that Rocky Mountain’s UFOC was materially deficient because it did not disclose that Rocky Mountain waived some franchisees’ royalty fees, did not contain accurate information about the point-of-sale system required by the agreement, and did not mention an earnings claim made to the franchisees. The franchisees also argued that Rocky Mountain violated the MFA by making misrepresentations about the same topics. The court rejected the franchisees’ argument. That Rocky Mountain waived royalty fees was immaterial because it had only done so for less than two percent of franchisees. The UFOC mentioned the franchisees obligation to purchase the point-of-sale system, and contained the price of that obligation. Finally, the UFOC was not misleading for failure to include the alleged earnings representation because the document explicitly disclaimed any oral representations. The court found that the franchisees’ misrepresentation claims failed for the same reasons and granted summary judgment to Rocky Mountain.

5. **Burgo v. Lady of Am. Franchise Corp.**72 A group of California franchisees sued LOA, claiming that the UFOC misrepresented the cost of opening a franchise. The franchise agreement contained a choice of law provision electing Florida law, but a “California Addendum” stated that the choice of law provision may be unenforceable if it required application of any state other than California’s law. The court found that California law applied because California had a “materially greater interest” in the litigation than Florida. The Florida statute conflicted with the California law because it afforded less protection to franchisees, rendering application of the choice of law provision electing Florida law contrary to California public policy.

6. **Postal Instant Press, Inc. v. Sealy.**73 A franchisor sued a franchisee for breach of contract for failure to pay royalty fees. The complaint sought damages for both past unpaid royalties and future royalties for the remaining term of the contract. The court held that the franchisor could not recover for future lost profits under the franchise agreement for two independent reasons. First, the court found that a franchisee’s failure to pay was not the proximate cause of a franchisor’s loss of future royalties. The franchisor had terminated the franchise agreement, and the court found that this decision rather than the franchisee’s failure to pay was the cause of any loss of future royalties. Second, the court held that awarding lost profits damages would violate California’s prohibition on “unreasonable, unconscionable and grossly


71 No. 05-0518 DOC DWF/SRN, 2006 WL 2990336 (D. Minn. Oct. 18, 2006).

72 No. SA CV 05-0518 DOC (RNBx), 2006 WL 6642172 (C.D. Cal. May 4, 2006).

oppressive damages.\textsuperscript{74} The court reasoned that permitting such damages would give a franchisor unfair leverage over a franchisee, allowing franchisors to threaten to terminate franchise agreements over minor disagreements and seek large lost profits damages. However, the court did emphasize the limits of its holding. It clarified that it did not intend to hold that lost profits can never be awarded to a franchisor. But, for an award to be proper, the lost profits must result directly from the franchisee’s breach and cannot be disproportionate to the franchisor’s loss. Like \textit{Randall, Sealy} has not been followed widely.\textsuperscript{75}

7. \textit{Zounds Hearing Franchising, LLC v. Bower.}\textsuperscript{76} Hearing aid center franchisees sued in Ohio state court alleging that the franchisor violated the Ohio Business Opportunity Purchasers Protection Act by failing to provide a five day cancellation right and by making false and misleading statements. The franchise agreement contained provisions electing Arizona law and venue for resolution of any dispute. Because Arizona does not have a franchisee protection statute, the choice of law issue was dispositive. If Ohio law governed, the franchisee would prevail. If Arizona law applied, the franchisor would prevail. The court held that Ohio law applied despite the choice of law provision in the franchise agreement. Because both the franchisees and the franchised locations were in Ohio, the court found that Ohio had a more substantial interest in the case than Arizona. The court noted that Ohio also had a more substantial interest than Arizona because its laws offered more protection to franchisees. Finally, Ohio law explicitly says that its franchise statute is a fundamental public policy. Because Ohio had a greater interest in the case than Arizona, the court applied Ohio law, denied the franchisor’s motion to dismiss, invalidated the venue clause and choice of law clauses in the franchise agreement, and transferred the case back to Ohio.

8. \textit{KC Leisure, Inc. v. Haber.}\textsuperscript{77} This case involved the sale of an electric vehicle franchise in central Florida. The purchaser alleged that the corporate officers of the seller conspired to sell a “license agreement” rather than a franchise agreement so that they could obtain a license fee before providing a UFOC and franchise agreement. The purchaser sued the officers alleging that the failure to provide the requisite disclosures under the federal Franchise Rule constituted a deceptive trade practice. The trial court held that the Florida Deceptive and Unfair Trade Practices Act (“FDUTPA”) did not permit a claim against shareholders of a seller corporation or individuals who merely represented the seller. Thus, the trial court dismissed the purchaser’s FDUTPA claim against the seller’s officers. The Fifth District Court of Appeals reversed the trial court. The appellate court found that the purchaser had clearly pled a cause of action against the corporation, and had also pled a claim against the officers by alleging that they had actual knowledge of the FTC Franchise Rule violation.

9. \textit{Nagrampa v. MailCoups, Inc.}\textsuperscript{78} A one-woman franchisee had been unprofitable for two years when she unilaterally terminated the franchise agreement. MailCoups

\textsuperscript{74} 43 Cal. App. 4th at 1719, 51 Cal. Rptr. at 375.


\textsuperscript{77} 972 So. 2d 1069 (Fla. Dist. Ct. App. 2008).

\textsuperscript{78} 469 F.3d 1257 (9th Cir. 2006).
filed a demand for arbitration against the franchisee, claiming that she owed over $80,000 in fees. The franchisee countered that rather than making the forty-one percent profit she was promised, she incurred substantial personal debt and made significant payments to MailCoups. Throughout the arbitration proceeding, the franchisee objected to the validity of the arbitration clause. When the franchisee failed to obtain a fee waiver from the American Arbitration Association, she sued in California state court, alleging that the franchisor engaged in unfair business practices and fraud. MailCoups removed the action to federal court and moved to compel arbitration based on an arbitration clause in the franchise agreement requiring any dispute to be resolved by binding arbitration in Boston. The Ninth Circuit, sitting en banc, held the arbitration provision was unenforceable and unconscionable because it lacked mutuality on two key provisions. First, the provision allowed MailCoups to seek relief in either arbitration or the courts to remedy infringement of its intellectual property. Second, the forum selection provision allowed MailCoups to litigate claims miles from its corporate headquarters but required the franchisee to travel across the country. Based on these facts, the court held that the arbitration provision was both procedurally and substantively unconscionable.

10. **Cycle City, Ltd. v. Harley-Davidson Motor Co., Inc.**

    Plaintiff Cycle City was the exclusive distributor for Harley-Davidson products in Hawaii for nearly fifty years. Cycle City alleged that it had invested substantial resources in building a customer base, accumulating good will, and growing Harley-Davidson’s reputation in Hawaii. Cycle City also had a license agreement with Harley-Davidson permitting it to manufacture certain products with the Harley-Davidson logo. Harley-Davidson elected not to renew Cycle City’s distributor or license agreement. Cycle City sued alleging that Harley-Davidson’s actions violated the Hawaii Motor Vehicle Industry Licensing Act (“HMVILA”) and for breach of the distributorship agreement based on an implied covenant of good faith and fair dealing. Cycle City’s theory was that Harley-Davidson was seeking to capture unfairly the benefits of its efforts to build the brand in Hawaii. Harley-Davidson moved to transfer the case to Wisconsin based on a forum selection clause in the distributorship agreement. The forum selection clause provided that “[a]ny applicable state motor vehicle statute governing the relationship . . . shall be controlling in the event of a conflict between any provision of this Agreement and the state statute.” The court found that HMVILA conflicted with the forum selection clause. Thus, based on the plain language of the clause, the court held that the parties’ agreement contemplated Hawaii as a proper forum for resolving the dispute, as the HMVILA was incorporated into the clause. What is most remarkable about the court’s decision, however, is the court’s comment that even if Wisconsin were the contractually agreed upon forum, a forum non conveniens analysis weighed against dismissing the Hawaii case based on the strong public policy exhibited by the HMVILA in favor of resolving these sorts of disputes in Hawaii.

B. **Other Successful Franchisee Actions for Franchisor Breach of Contract**

    **Sir Speedy, Inc. v. L & P Graphics, Inc.**

    Printing and document production franchisee sued franchisor for breach of the franchise agreement, alleging that the franchisor failed to provide it with a proprietary printing system and a continuing assistance program, and had also engaged in unfair and deceptive trade practices. After trial, the jury awarded the franchisee $35,000 in lost profit damages. The trial court granted the franchisor’s motion for judgment notwithstanding the verdict, finding that the evidence the franchisee used to establish its damages was insufficient.

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80 957 F.2d 1033 (2d Cir. 1992).
The Second Circuit reversed, directing the trial court to reinstate the jury award and award the franchisee attorneys' fees under the franchise agreement.

7-Eleven Owners for Fair Franchising v. Southland Corp. Convinence store franchisees sued franchisor in class action, alleging that it breached their franchise agreements by failing to ratably share in certain "returns, discounts, and allowances." The parties reached a settlement, with over 5,000 franchisees joining in. The franchisor agreed to pay $37 million to settle the case. The court affirmed the reasonableness of the settlement.

Vylene Enterprises, Inc. v. Naugles, Inc. Restaurant franchisee going through bankruptcy brought adversary proceeding against franchisor for breach of the franchise agreement. Under the agreement, the franchisee had the option to extend the franchise upon expiration "on terms and conditions to be negotiated." The franchisee became delinquent on its fees and rent and went through bankruptcy. As part of that process, the franchisee made a $38,121 payment to the franchisor for unpaid fees and rent. Two years later, the franchisee sought to extend its franchise, but the franchisor rejected its offer outright. The franchisor also opened a company-owned store less than a mile-and-half from the franchisee's location. The Ninth Circuit found that the franchisee's payment cured its default and affirmed the bankruptcy court's finding that the franchisor had failed to negotiate in good faith.

Mathis v. Exxon Corp. Fifty-four gas station franchisees sued franchisor, alleging that it breached franchise agreements by failing to act in good faith in applying an open price provision in the contract regarding the sale of gasoline. The franchisor claimed that the mechanism it used to set the price it charged was industry standard, but the franchisees alleged it was designed to render them uncompetitive. The Fifth Circuit affirmed a trial court's judgment that the franchisor breached the contract by requiring the franchisees to purchase gas at a price that put them at a competitive disadvantage. The franchisees were awarded over five million dollars in damages and two million dollars in attorneys' fees.

G.M. Garrett Realty, Inc. v. Century 21 Real Estate Corp. Realty franchisee sued franchisor for wrongful termination and breach of the franchise agreement. The jury found that the franchisor was liable and awarded over $50,000 in damages. The franchisor appealed, arguing that it could not have inappropriately terminated the franchisee when the franchisee owed it money. The franchisee admitted it owed money, but the court found that the mere fact that money was owed did not preclude a finding that the termination was unreasonable. The Fourth Circuit affirmed the district court's judgment, commenting that the franchisor's argument conflated "reasonable cause" with "any cause."

Little Caesar Enterprises, Inc. v. OPPCO, LLC. Franchisor sued for breach of franchise agreement, and franchisee counterclaimed for fraud and breach of contract. The district court found (and the Sixth Circuit affirmed) that the franchisor violated the South Dakota Franchising Act by failing to register to sell franchisees in the state. Because of the franchisor's violation of the statute, the franchisees were entitled to rescind their franchise agreements.

82 90 F.3d 1472 (9th Cir. 1996).
83 302 F.3d 448 (5th Cir. 2002).
84 17 F. App’x 169 (4th Cir. 2001).
85 219 F.3d 547 (6th Cir. 2000).
Century 21 Real Estate Corp. v. CLTM Associates, Ltd.\textsuperscript{66} Franchisor sued real estate franchisee to recover money allegedly owed. The franchisee counterclaimed for breach of the franchise agreement. The franchisee claimed that the franchisor failed to provide the services required by the franchise agreement. Specifically, the franchisee claimed that the franchisor failed to list it in its system directory, preventing it from receiving referrals. The franchisor moved for summary judgment on its claim, but the court denied its motion, finding that a genuine issue of fact existed as to whether it had performed its obligations under the contract.

C. \textbf{State Franchise Rescission Rights & Deceptive Trade Practices Acts}

The FTC Franchise Rule has no private right of action.\textsuperscript{67} All of the "registration states" plus Oregon have a private right of action for violation of the state registration and disclosure statute. Some states require proof of causation between the violation and the loss suffered by the franchisee. Others are strict liability by definition, so a violation produces a rescission right whether or not there is a causal connection. Appendix B lists in detail the citations to those statutes and assesses whether proof of causation is required for the franchisee to obtain a recovery from the franchisor.

State deceptive trade practice acts, better known as "Little FTC Acts," may offer a cause of action against the franchisor for violation of the FTC Franchise Rule, or under the standards of the Little FTC Act itself. But not every Little FTC Act applies to commercial relationships by its terms, and courts are reluctant to extend consumer protection statutes to commercial relationships without express direction from the state legislature. The primary benefits of the Little FTC Act claims are ancillary – they provide for treble damages, attorneys' fees, or both.\textsuperscript{68}

1. \textbf{State Act Likely Does Not Extend to Commercial Relationships—No Specific Franchise Case Law from that State}

a. California. California's Consumer Legal Remedies Act only applies to contracts "undertaken by any person in a transaction intended to result or which results in the sale or lease of goods or services to any consumer."\textsuperscript{69} A consumer is a person "who seeks or acquires, by purchase or lease, any goods or services for personal, family, or household purposes."\textsuperscript{70}

\textsuperscript{66} No. 02 C 1735, 2003 WL 288951 (N.D. Ill. Feb. 10, 2003).


\textsuperscript{68} See, e.g., FLA. STAT. § 501.2105 (2018); TEX. BUS. & COM. CODE ANN. §17.50(b) (2018).

\textsuperscript{69} CAL. CIV. CODE § 1770(a) (2018) (emphasis added); Ting v. AT&T, 319 F.3d 1126, 1148 (9th Cir. 2003) ("Accordingly, the CLRA does not apply to commercial or government contracts, or to contracts formed by nonprofit organizations and other non-commercial groups.").

\textsuperscript{70} CAL. CIV. CODE § 1761 (2018).
b. **Georgia.** Georgia’s Unfair Trade Practices Act applies only to “consumer transactions,” which are defined as “the sale, purchase, lease, or rental of goods, services, or property, real or personal, primarily for personal, family, or household purposes.”


2. **State Act Does Not Extend to Commercial Relationships—Specific Franchise case law**

   a. **Kentucky.** *859 Boutique Fitness LLC v. Cyclebar Franchising, LLC.*, 99 Boutique Fitness negotiated with Cyclebar to be its franchise in the St. Louis area. Boutique Fitness thought the parties had struck a deal, and it signed the franchise agreement. Two days later, however, Cyclebar informed Boutique Fitness it would not be executing the agreement. Boutique Fitness sued Cyclebar, alleging it had said it had signed the agreement, and that such a false statement violated the Kentucky Consumer Protection Act ("KCPA"). The court dismissed the KCPA claim because it found that Boutique Fitness' transaction was not made for personal purposes and thus did not fall under KCPA's private right of action.

   *St. Martin v. KFC Corp.*, 100 Fast-food franchisee sued franchisor claiming that it violated the KCPA by failing to make disclosures required by the FTC Act. The court noted that the legislative purposes of the two statutes were markedly different. While the KCPA was intended to be liberally construed, the FTC Act provided the Federal Trade Commission the exclusive authority to enforce the statute. Because Congress did not intend the FTC Act to contain a private right of action, the franchisee could not invoke a state statute to create a de facto private right of action. Otherwise, the FTC Act's administrative scheme would be undermined.

   b. **Pennsylvania.** Pennsylvania's Unfair Trade Practices and Consumer Protection Law (PUTPCPL) limits its private right of action to "[a]ny person who purchases or leases goods or services primarily for personal, family or household purposes." 101 In *Family Wireless #1, LLC v. Auto. Techs., Inc.*, 102 a group of franchisees sued their franchisor, alleging breach of contract, fraud, and claims under their respective states consumer protection statutes. The franchisor was an agent of Verizon and was permitted to contract with other entities to serve as subagents for Verizon. The franchisor elected to create a franchise and sell the franchises to operate as Verizon's subagents through it. The franchisees' state law deceptive practices claims were based on the franchisor's alleged failure to disclose that it intended to withhold a ten percent royalty on what was known as the "installment offset." Some customers purchased their devices on installment plans. In such cases, Verizon reimbursed the agent for the retail cost of the device. Verizon also paid the agent a commission on the sale. As the master agent, the franchisor had always applied a royalty to the commission payment but had not done so for the installment payment in the past. The franchisor did not update its Franchise Disclosure Document or otherwise provide notice to the franchisees that it would begin taking a royalty from installment offsets. The court dismissed the franchisees' claims under the PUTPCPL and the West Virginia Consumer Credit and Protection Act because those statutes "do not apply to the sale of franchises, but only to the sale of goods or service." 103 However, the court permitted the claim made under the Connecticut Unfair Trade Practices Act to proceed.

3. **State Unfair Practices Act Apply (in Some Fashion) to Franchises**

   a. **Florida.** Florida's Deceptive and Unfair Trade Practices Act explicitly makes a violation of the FTC Act a violation of the state statute as the statute states

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103 *Id.* at n.17.
"Violation of this part' means any violation of this act or . . . [a]ny rules promulgated pursuant to the Federal Trade Commission Act . . . [t]he standards of unfairness and deception set forth and interpreted by the Federal Trade Commission or the federal courts . . . [or] [a]ny law, statute, rule, regulation, or ordinance which procribes unfair methods of competition, or unfair, deceptive, or unconscionable acts or practices."104

However, liability under the FTC Act, and consequently under FDUTPA, requires more than a technical violation of FTC rules. Instead, the challenged conduct must be likely to mislead a consumer acting reasonably under the circumstances. In Hetrick v. Ideal Image Dev. Corp., a Florida federal court held that the plaintiff franchisee had failed to meet that standard. In a previous trial, the jury had found that a franchisor's representative made statements regarding the expected earnings of the franchise. The franchisee argued that this finding meant that the franchisor had violated FDUTPA because the FTC Franchise Rule prohibits representations regarding earnings, and FDUTPA incorporates any violation of FTC rules to be a FDUTPA violation. The court rejected the franchisee's argument, holding that to recover under FDUTPA, a plaintiff must show that a violation of an FTC rule would mislead a reasonable consumer for the conduct to be actionable under the state statute.

Another FDUTPA case reminds that the failure to deliver a FDD is not only a potential violation of FDUTPA; a corporate officer can be held personally liable if he or she has knowledge of the violation and participates in the alleged deceptive acts and practices under the Florida franchise statute.105

b. **New Jersey.** In Morgan v. Air Brook Limousine, Inc.,106 a limousine franchisee sued the franchisor alleging several causes of actions, including a claim under New Jersey's Consumer Fraud Act ("NJCFBA"). Prior to the franchisee executing the franchise agreement, he alleged that the franchisor provided him a deceptive brochure and sample earning program, claiming that the figures represented in those documents were a "minimum." Relying on those representations, the franchisee agreed to accept rides only from the franchisor's dispatcher. But those rides eventually proved insufficient to cover the franchisee's fixed obligation to the franchisor.

The franchisor moved for summary judgment, arguing that the NJCFA only applied to consumer retail sales and advertising, and that a franchise was not "merchandise" within the meaning of the act. The court rejected both arguments, holding that NJCFA applied not only to consumer purchases but also when a person such as the franchisee makes an investment. The court found a franchise to be a "commodity" and thus to fall under the statute's scope to regulate the sale of merchandise in the state.

Finally, the court found that the franchisor's failure to comply with the FTC Franchise Rule prohibiting representations about specific earning potentials and requiring disclosure of certain information constituted a per se violation of the NJCFA. The court did not require the franchisee to demonstrate that he had relied on any of the franchisor's misrepresentations to his detriment.

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104 **Fla. Stat.** § 501.203 (2018); *see* Nieman v. Dryclean USA Franchise Co., 178 F.3d 1126, 1128–29 (11th Cir. 1999) ("The Florida DUPTA defines a violation of that law to include violations of rules promulgated pursuant to the Federal Trade Commission Act."); *see also* Hetrick v. Ideal Image Dev. Corp., 758 F. Supp. 2d 1220, 1231 (M.D. Fla. 2010).

105 **Fla. Stat.** § 817.416 (2018); **KC Leisure**, 972 So. 2d at 1073.

The application of the NJCPA to franchises was rejected in *J & R Ice Cream Corp. v. Calif. Smoothie Licensing Corp.* A smoothie franchisee sued its franchisor, alleging fraud, negligence, and a violation of the NJCFA. The franchisor argued that the NJCFA did not apply to the sale of a franchise because the transaction did not involve an ordinary consumer. The trial court rejected the franchisor's argument, holding that the NJCFA applied. The Third Circuit reversed. The court considered *Morgan* but found its reasoning unpersuasive. The court reasoned that the NJCFA's objective to protect "ordinary" consumers did not apply to franchise purchasers because the purchase was not a "consumer oriented situation." Even though franchises may be offered to the public, the court said they were not "merchandise" because they were not purchased for consumption.

After *J & R Ice Cream*, New Jersey state courts have reaffirmed that the NJCFA applies to franchise sales. In *Kavky v. Herbalife Int'l of Am.* a nutrition supplement franchisee sued its franchisor alleging common law fraud claims and violations of NJCFA. The franchisor moved to dismiss the complaint, claiming that the NJCFA did not apply to investments. The trial court agreed and dismissed the complaint.

The appellate court reversed, reaffirming that franchise sales fell under the NJCFA. The court analyzed *J & R Ice Cream*, finding it unpersuasive. The court found the sale of a franchise in this instance to be "in essence, a consumer transaction," because the business opportunity was marketed to the public.

c. **Alabama.** In *Rodopoulos v. Sam Piki Enters., Inc.*, the Alabama Supreme Court held that the FTC Franchise Rule sets the duty for state law fraud claims, creating a backdoor private right of action. The franchisee plaintiffs purchased a pizza franchise from the franchisor defendants. Before the sale, defendants allegedly provided plaintiffs a written projection stating that the franchise could expect to clear $12,000 a week and that it would need to gross $7,000 a week to break even. However, plaintiffs alleged that only two of defendants' stores grossed between $4,000 and $5,000 a week. Plaintiffs argued that the FTC Franchise Rule created a duty for defendants to disclose those earning figures. At trial, the judge permitted the FTC Franchise Rule to be introduced into evidence and instructed the jury it could consider the FTC Franchise Rule in determining the duty owed by defendants to plaintiffs. The jury returned a $170,000 verdict for plaintiffs, which the Alabama Supreme Court affirmed.

d. **Connecticut.** In *Bailey Emp't Sys., Inc. v. Hahn*, an employment agency franchisor sued franchisee to obtain payment of $10,000 loan. The franchisee filed a counterclaim, alleging that the franchisor violated Connecticut's Unfair Trade Practices Act ("CUTPA") by making false representations to induce him to invest in the franchise. The franchisor represented that the average counselor in the franchise generated $36,000. However, the $36,000 average only counted "tenured" counselors who had operated their business for at least six months and, consequently, had higher earnings. The franchisor had more than four times the number of untenured counselors in its system as tenured counselors. The court held that the statement was misleading and thus a violation of CUTPA, even if the franchisee did not rely on it. The court also considered other statements of the franchisor. In a written communication to the franchisee, the franchisor had represented that many franchisees had

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107 31 F.3d 1259 (3d Cir. 1994).
109 570 So. 2d 661 (Ala. 1990).
earned $500-$700 a week (enough to wholly support the owner) during the recession and that those figures had doubled in some instances when the market improved. The franchisor also promulgated a brochure that implied that the average franchisee earned double what the actual figures showed. The court found these statements violated the FTC Act, and were "equally unlawful under CUTPA." The franchisee also claimed that franchisor violated the FTC Franchise Rule and FTC Act and CUTPA by failing to disclose the attrition rate for its franchisees and its litigation against other franchisees. The court agreed, holding that the attrition rate was material information and that the franchisee had a duty to disclose its litigation with franchisees involving alleged breach of contract, fraud, misrepresentation, or unfair and deceptive trade practices. The court also concluded that while the FTC Act did not give the franchisee a private right of action, CUTPA did.

In Aurigemma v. Arco Petroleum Prods. Co.,\textsuperscript{111} a convenience store franchisee sued its franchisor after it terminated its franchise, alleging that the franchisor violated CUTPA by failing to disclose a series of facts related to the franchisor’s decision to withdraw from the regional market. The court found that the franchisor’s failure to disclose the number of franchisees cancelled or terminated by the franchisor—a figure required to be in the disclosure document (then a Uniform Franchise Offering Circular) was an unfair trade practice under CUTPA. The franchisees leased property from the franchisor under a separate agreement, but the franchise agreement contained a provision stating that the agreement was also terminated in the event the lease was terminated. The court also found the UFOC violated CUTPA by failing to disclose that termination of the premises lease could result in termination of the franchise.

e. Illinois. In Bixby’s Food Sys., Inc. v. McKay,\textsuperscript{112} a bagel bakery franchisor sued its franchisee under the Lanham Act alleging that the franchisee had violated the franchise agreement and was infringing their intellectual property. The franchisee filed various counterclams, including one under the Illinois Consumer Fraud and Deceptive Business Practices Act. The court held that the franchisee was a “consumer” within the meaning of the statute and had standing to bring a claim. Further, the court found that the franchisor falsely represented that the franchisor had 340 development agreements when it in fact only had sixteen. The court granted summary judgment on the franchisee’s Deceptive Business Act claim against the franchisor.

f. Louisiana. In LeBlanc v. Belt Ctr. Inc.,\textsuperscript{113} an industrial belt franchisee sued a franchisor alleging unfair trade practices and breach of contract. The franchisee claimed that the franchisor’s failure to include the information required to be disclosed by the FTC Franchise Rule constituted an unfair trade practice. The franchisor only provided the master franchise agreement and a list of properties and services the franchisee would receive once the agreement was executed. The court held that the mere failure to abide by the FTC Franchise Rule was insufficient to constitute an unfair trade practice under the Louisiana Unfair Trade Practices Act. Because the franchisee had failed to show any “fraud, misrepresentation, deception, or unethical conduct,” the court concluded that the trial court properly entered summary judgment on the franchisee’s unfair trade practices claim.

\textsuperscript{111} 734 F. Supp. 1025 (D. Conn. 1990).
\textsuperscript{112} 193 F. Supp. 2d 1053, 1064 (N.D. Ill. 2002).
\textsuperscript{113} 509 So. 2d 134 (La. Ct. App. 1987).
More recently, in *Cooper v. Primary Care Sols., Inc.*,¹¹⁴ the plaintiffs entered into "Site Director Consulting Agreements" with Primary Care Solutions ("PCS"). Under these contracts, one plaintiff was to serve as Site Director for one facility and one plaintiff for another facility. The plaintiffs would then set up and run satellite PCS offices. Plaintiffs alleged a claim under the Louisiana Unfair Trade Practices Act ("LUTPA") because defendants solicited them to invest in a purported franchise without following the Louisiana Business Opportunity Law or the FTC Franchise Rule. Plaintiffs also argued that the defendants engaged in a deceptive business practice by "coercing" them into signing non-compete clauses and investing in PCS, and then selling the plaintiff's locations to a third party. Specifically, plaintiffs complained that PCS promised to give them forty percent of the profits from their respective offices after a $25,000 "sweat equity" investment. PCS sold the offices and did not pay plaintiffs anything. The court rejected those arguments. The court held that a violation of the FTC Franchise Rule, without more, was insufficient to state a cause of action under LUTPA. Instead, the plaintiff must also plead fraud, deception, or some other unethical conduct to survive a motion to dismiss. As to the specific conduct that the plaintiffs did point to, the court found that it was essentially a repackaged breach of contract claim, which is not cognizable under LUTPA.

**g. Tennessee.** The Tennessee Consumer Protection Act ("TCPA")¹¹⁵ applies to any natural person to whom is offered for sale a franchise or distributorship agreement or any similar type of business opportunity. "Goods" covered by the TCPA include a franchise, distributorship agreement or a similar business opportunity. The TCPA was originally held to apply only to natural persons,¹¹⁶ but the Tennessee Supreme Court ruled that the TCPA applied to business entities.¹¹⁷ Tennessee case law suggests that the TCPA is available for redress of disclosure procedural and accuracy violations, if claims are timely filed and there is a causal connection established between the violation and the damages suffered by the franchisee.¹¹⁸

**h. Texas.** The Texas Deceptive Trade Practices Act¹¹⁹ applies to the offer and sale of franchises, but the franchisee must prove that the franchisor's deceptive conduct is the producing cause of the franchisee's losses.¹²⁰ The franchisee must also prove that it acted diligently so that its reliance on the bad acts of the franchisor is reasonable.¹²¹

The only claims of merit for the franchisee in *Appliance Alliance*, discussed earlier in this paper, were its claims that the selling process representations made to the franchisee by the franchisor violated the Texas Business Opportunity Act¹²² and the Texas Deceptive Trade Practices Act.¹²³

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¹¹⁷ *ATSCs, Inc. v. Carrier Corp.*, 18 S.W.3d 626 (Tenn. 2000).


¹²⁰ *In Re Carroll*, 464 B.R. 293 (Bankr. N.D. Tex. 2011).


Practices Act. The Illinois federal court, applying Texas law, did not dismiss the claims but held that the statute of limitations on both claims had run one year before the suit was filed.\footnote{\textit{Tex. Bus. & Com. Code Ann. §§ 17.46, 17.50 (2018).}}

4. **What cases are reported against franchisor in the FDD or on electronic search?**

Counsel for the franchisee should review Item 3 of the franchisor’s current FDD carefully, and perform an electronic Pacer search, as well as a search of the state court dockets in the preferred jurisdiction and venue of the franchisor to identify pending and resolved cases between the franchisor and its franchisees. Those cases provide a big picture view of the problems and solutions affecting the franchise system, allowing a careful assessment of vulnerabilities, approaches and facts that may be similar to those associated with counsel’s client.

5. **Is your client an ad hoc situation or indicative of a broader issue?**

Analysis of the pending and resolved cases will assist in examining whether the circumstances of the client franchisee are unique or part of a pattern or broader issue affecting others, as will previously discussed social media exchange review. The franchisor will be more interested in solving a larger problem with an efficient result for franchisees than to engage one franchisee in a protracted fight.

6. **What remedies does the franchisor have in the franchise agreement for franchisee defaults—e.g., recovery of future lost royalties?**

Before taking on a claim, counsel may wish to consider what is at stake. Franchisors will claim or counterclaim for damages from early termination of the franchise agreement. These claims may include liquidated damages at a formula specified in the franchise agreement, or various formulations of contract damages either for lost revenues or lost profits. For most franchisors, the incremental cost of servicing an additional franchise is minimal, so the lost profits claim may well be close to the full value of the franchise fees. Depending on the amount of capital investment required to replace a franchise, most experienced franchisors have a good sense of how much time it will take to recruit, develop, open and achieve full performance of the franchise by a replacement franchisee. That time frame is the relevant measure of damages and a defensible period for enforcing liquidated damages.

In one recent case, a Texas federal court declined to enforce the franchise agreement’s liquidated damage clause. The hotel franchise terminated as a result of the franchisee’s failure to cure the breach after two notices of default. The franchisee continued to operate the location under the franchisor’s marks and provided misleading information to the franchisor about the status of performing the post termination obligations in the franchise agreement. Instead of liquidated damages, the court used the intentional infringement damage calculation under the Lanham Act to award the franchisor $252,582, based on the profits of the unit during its post-termination period of identification, which it trebled to $757,746. The court added actual damages

\footnote{\textit{Appliance Alliance, LLC, 2018 WL 3208514, at *18.}}
for unpaid royalties and fees in the amount of $120,996, plus attorneys' fees of $33,395 for a total award of $912,137.  

V. COMMUNICATION WITH THE FRANCHISOR AND ITS COUNSEL

A. What should be said in the first communication

1. Fee reduction/holiday/refund. When your franchisee client wants to stay in the system, there are numerous options for an agreement with the franchisor. Commonly, franchisees who are making money but are not getting the support they expect or desire from the franchisor will seek a reduction of fees or royalties, a partial refund of start-up costs, or royalty holidays. Your first communication with the franchisor should tell your client’s version of the story, and include references to documents that you have reviewed, including communications between the franchisee and the franchisor as well as the franchise agreement and the FDD. Your demand letter or other initial communication will be strengthened by pointing to concrete examples of how your client was wronged and it can be used in any future formal dispute if your initial communications fail. The demand letter should clearly state what your client aims to achieve through the communications with the franchisor, including specific concessions. When your client wishes to stay in the franchise system, a good tactic is to make specific demands such as a reduction in royalty payments or other fees, but state that the franchisee is open to reasonable solutions to optimize the business going forward.

2. Financing assistance. Another common demand that franchisees make is assistance with loan repayments or rent. If your client is struggling to become profitable, a reduction in loan or rent payments can give the franchisee enough breathing room to make improvements to the business that have a compounded effect over time. Working with a franchisor to get even temporary relief (either by the franchisor stepping in to help negotiate with a bank or landlord or by the franchisor offering direct relief) can be an effective, quick solution for your client that can be accomplished through constructive letters and meetings with the franchisor rather than drawn-out expensive litigation or arbitration. Franchisors can offer assistance when dealing with an approved lender or a bank or landlord that the franchisor does a lot of business with, and can offer rent reductions if the franchisee entered into a sublease directly with the franchisor.

3. Training. As noted above in Sections II.B and III.B, the franchisor typically trains the franchisee and certain employees after the franchise agreement is signed and before the franchised business becomes operational. When franchisees are struggling, a common solution is for the franchisor to provide additional training, either more in-depth training for the principals, or broader training for additional employees of the franchisee. When a franchisee seeks additional training, it is important for the attorney to negotiate with the franchisor, as franchisors often charge exorbitant prices for additional training sessions that franchisees feel entitled to.

4. Territory. Franchisees who run successful businesses but who have claims against the franchisor may seek to expand their territory. Successful franchisees will want to expand their businesses by acquiring other locations or expanding a territory in which they have the exclusive right to operate. In situations of oversaturation where a franchisor has breached a territorial agreement by opening a competing store or allowing another franchise to

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open close to your client's business, a common avenue for relief is to demand that the franchisee take over the competing establishment or open the second franchise so the franchisee does not lose market share. Territorial expansion is usually a positive outcome for both parties, as the franchisee will get more locations from which the franchisor will receive royalty payments and other fees from an established, successful franchisee.

5. **Operational issues.** Franchisees, particularly first-time franchisees who are essentially one-person operations, often want assistance from the franchisor in operating the franchised business. The franchisor has expertise in the operation of its brand, and is in the unique position of being able to offer assistance in operating its franchised stores. Franchisors may be willing to help new franchisees get their business off the ground by offering additional operational assistance, such as sending employees to the franchised store to suggest improvements. Franchisees may seek to change certain aspects of how the franchised business is operated. This can occur when a franchisee is dissatisfied with the results of the business and the franchisor is unresponsive to the franchisee's suggestions. Franchisors require franchisees to strictly follow the prescribed elements of their franchise system, and are usually hesitant to allow changes by franchisees, often for good reason, as the franchise system would cease to exist if every franchisee were permitted to operate differently. When this happens franchisees can feel betrayed or think that the franchisor has reneged on its promises of support. A demand letter outlining the promises made by the franchisor compared to the obstinate refusals to implement operational changes suggested by the franchisee can be used to negotiate changes to the system (or at least exceptions for your client) that would increase profitability for the franchisee.

6. **Marketing assistance.** Inadequate revenue is a common issue, particularly for new franchisees. Franchise agreements typically provide for a common advertising fund into which the franchisee may be required to pay. Franchisees may see shortfalls in marketing and advertising as the significant reasons for the lack of revenue as compared to what they expected prior to beginning operations. Parties to a franchise agreement may agree to increased marketing in the franchisees local market, or additional assistance in developing marketing plans including discounts, coupons and other ways of attracting new customers to the business.

7. **Assistance with sale or new equity/financing.** When a franchisee wants to terminate the franchise relationship, your job as the attorney is to negotiate the most favorable terms for leaving the system. Franchisors may be amenable to assisting with the sale of the franchise business, as they have an interest in the business remaining operational. Franchisors may not be interested in helping a franchisee sell the franchise, but if the franchisor would rather have the franchise keep operating rather than shuttering its doors, it may help. Finding a buyer that is acceptable to both the franchisee and the franchisor is easier when both parties work together constructively.

Similarly, a franchisee that seeks to remain in operation but needs an injection of cash into the business should seek assistance from the franchisor, who may have favorable relationships with lenders. Apart from unusual circumstances involving a particularly acrimonious relationship between the parties, franchisors favor franchised businesses continuing to operate. Franchisors do not have many obligations towards franchisees, and franchises provide consistent income to the franchisor. Moreover, the sales and start-up processes are what takes the most time and money from the franchisor, so franchisors prefer existing franchises to new ones. Understanding this dynamic will help you as an attorney representing franchisees to enlist the help of franchisors to assist your clients in getting what they need to continue operations.
8. **Store relocation or territory revision.** Finally, your client may want to relocate or revise her territory. While the franchisor will have other considerations such as corporate-owned stores, other franchises, and the potential for new franchises, there should be room to negotiate a relocation or modification of your client’s territory. This is particularly true if your client has leverage stemming from breaches of the franchise agreement or potentially fraudulent representations made during the sales process. However, even when neither party has wronged the other, franchisors have an interest in maximizing the profitability of their franchisees, so long as it doesn’t cost too much or take away other opportunities of the franchisor.

VI. **CONCLUSION**

To open a franchise, a franchisee must sign a franchise agreement that was drafted by the franchisor’s attorneys and intended to protect the interests of the franchisor, with minimal consideration of the interests of the franchisee. When a franchisee’s business struggles financially, the franchisee is not without means to obtain redress from a franchisor if the financial problems or the sale of the underlying franchise are the result of the franchisor’s misconduct. The franchised business can be salvaged and economic value preserved even when a franchisee takes adversarial action to assert its rights against the franchisor. Asserting these rights does not mean the asset cannot be salvaged or economic value preserved. However, a carefully researched and phased plan of assistance, leveraging the legal rights and remedies that may be available or actionable, is essential to a successful outcome for the franchisee. In too many cases cited above, the franchisee and its counsel brought claims that did not survive early stage motions, wasting time and resources on claims that have a slim chance of success. Clear-eyed, realistic assessment of what are most likely to be valid and triable claims is the most effective way to serve the interests of the troubled franchisee client.\(^{126}\)

\(^{126}\) The authors wish to thank and recognize Charles Welcome of Einbinder & Dunn and John Hundscheid of Baker, Donelson, Bearman, Caldwell & Berkowitz, P.C. for their contributions to and assistance with the writing of this paper.
## APPENDIX A

### STATES WITH GENERAL FRANCHISE RELATIONSHIP LAWS

<table>
<thead>
<tr>
<th>STATE</th>
<th>STATUTE</th>
<th>GOOD CAUSE TO TERMINATE/NOT RENEW</th>
<th>DAYS NOTICE TO TERMINATE/RIGHT TO CURE(^{127})</th>
<th>DAYS/NOTICE ON RENEWAL ACTION</th>
<th>INVENTORY REPURCHASE REQUIREMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>(Alaska Stat. §§ 45.45.700 to 45.45.790)</td>
<td>No/No</td>
<td>N/S(^{128})</td>
<td>N/S</td>
<td>Yes</td>
</tr>
<tr>
<td>Arkansas(^{129})</td>
<td>(Ark. Code Ann. §§ 4-72-201 to 4-72-210)</td>
<td>Yes/Yes</td>
<td>90/30</td>
<td>90</td>
<td>No</td>
</tr>
<tr>
<td>California</td>
<td>(Cal. Bus. &amp; Prof. Code §§ 20000 to 20043)</td>
<td>Yes/No</td>
<td>60/60</td>
<td>180</td>
<td>Yes</td>
</tr>
<tr>
<td>Connecticut</td>
<td>(Conn. Gen. Stat. Ann. §§ 42-133e to 42-133h)</td>
<td>Yes/Yes</td>
<td>60/0</td>
<td>60</td>
<td>Yes</td>
</tr>
<tr>
<td>Delaware</td>
<td>(Del. Code Ann. Tit. 6 §§ 2551 to 2556)</td>
<td>Yes/Yes</td>
<td>90/0</td>
<td>90</td>
<td>No</td>
</tr>
<tr>
<td>Hawaii</td>
<td>(Haw. Rev. Stat. §§ 482E-2 &amp; 482E-6 to 482E-12)</td>
<td>Yes/Yes</td>
<td>N/S</td>
<td>N/S</td>
<td>Yes</td>
</tr>
<tr>
<td>Idaho(^{130})</td>
<td>(Id. Code § 29-110)</td>
<td>No/No</td>
<td>N/S</td>
<td>N/S</td>
<td>No</td>
</tr>
<tr>
<td>Illinois</td>
<td>(Ill. Rev. Comp. Stat. Ch. 815, §§ 705/18 to 705/20 &amp; 705/26)</td>
<td>Yes/No</td>
<td>30/30</td>
<td>180</td>
<td>No</td>
</tr>
<tr>
<td>Indiana</td>
<td>(Ind. Code Ann. §§ 23-2-2.7-1 to 23-2-2.7-7)</td>
<td>Yes/Yes</td>
<td>90/0</td>
<td>90</td>
<td>No</td>
</tr>
<tr>
<td>Iowa</td>
<td>(Iowa Code, Ch. 523H, §§ 523H.1 to 523H.17 and § 537A.10)</td>
<td>Yes/Yes</td>
<td>30/30</td>
<td>180</td>
<td>No</td>
</tr>
<tr>
<td>Louisiana</td>
<td>(La. Rev. Stat. Ann. Tit. 23, § 921(F) and Tit. 12, § 1042)</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>No</td>
</tr>
<tr>
<td>Michigan</td>
<td>(Mich. Comp. Laws §§ 445.1527 &amp; 445.1535)</td>
<td>Yes/No</td>
<td>30/30</td>
<td>180(^{131})</td>
<td>No</td>
</tr>
<tr>
<td>Minnesota</td>
<td>(Minn. Stat. § 80C.14)</td>
<td>Yes/Yes</td>
<td>90/60</td>
<td>180</td>
<td>No</td>
</tr>
<tr>
<td>Mississippi</td>
<td>(Miss. Code Ann. § 75-24-51 to 75-24-53 &amp; 75-24-57 to 75-24-63)</td>
<td>No/No</td>
<td>90/0</td>
<td>90</td>
<td>No</td>
</tr>
<tr>
<td>Missouri</td>
<td>(Mo. Rev. Stat. §§ 407.400 to 407.420)</td>
<td>No/No</td>
<td>90/0</td>
<td>90</td>
<td>No</td>
</tr>
<tr>
<td>Nebraska</td>
<td>(Neb. Rev. Stat. §§ 87-401 to 87-410)</td>
<td>Yes/Yes</td>
<td>60/0</td>
<td>60</td>
<td>No</td>
</tr>
</tbody>
</table>

\(^{127}\) The statutory notice and cure periods may extend the notice and cure periods specified in the franchise agreement.

\(^{128}\) Not Specified, reasonable time required.

\(^{129}\) Does not apply to franchises subject to FTC Franchise Rule.

\(^{130}\) Idaho's statute makes out of state venue and jurisdiction clauses void for Idaho franchisees, including for arbitration. Choice of law clauses will be enforced as selected by the parties.

\(^{131}\) Only applies if term of the franchise is less than 5 years.
## States with General Franchise Relationship Laws

<table>
<thead>
<tr>
<th>State</th>
<th>Statute</th>
<th>Good Cause To Terminate/Not Renew</th>
<th>Days Notice To Terminate/Right To Cure&lt;sup&gt;132&lt;/sup&gt;</th>
<th>Days/Notice On Renewal Action</th>
<th>Inventory Repurchase Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Jersey</td>
<td>(N.J. Rev. Stat. §§ 56:10-1 to 56:10-12)</td>
<td>Yes/Yes</td>
<td>60/0&lt;sup&gt;132&lt;/sup&gt;</td>
<td>60</td>
<td>No</td>
</tr>
<tr>
<td>North Dakota</td>
<td>(N.D. Cent. Code §§ 51-20.2-01 to 51-20.2-03)</td>
<td>No/No</td>
<td>N/S</td>
<td>N/S</td>
<td>Yes</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>(P.R. Con. L. § 278a to 278d)</td>
<td>Yes/Yes</td>
<td>N/S</td>
<td>N/S</td>
<td>No</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>(R.I. Gen. L. § 6-50-1 to 6-50-9)</td>
<td>Yes/Yes</td>
<td>60/30</td>
<td>60</td>
<td>Yes</td>
</tr>
<tr>
<td>South Dakota</td>
<td>(S.D. Codified Laws § SB 51 2008, repeals prior laws)</td>
<td>No/No</td>
<td>N/S</td>
<td>N/S</td>
<td>No</td>
</tr>
<tr>
<td>Washington</td>
<td>(Wash. Rev. Code §§ 19.100.180 to 19.100.190)</td>
<td>Yes/No</td>
<td>30/30</td>
<td>365</td>
<td>Yes&lt;sup&gt;133&lt;/sup&gt;</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>(Wis. Stat. §§ 135.01 to 135.07)</td>
<td>Yes/Yes</td>
<td>90/60</td>
<td>90</td>
<td>Yes</td>
</tr>
</tbody>
</table>

<sup>132</sup> Although not specified in the statute, one decision in the U.S. District Court for the District of New Jersey interpreted the statute as having a 60 day right to cure. 7-Eleven, Inc. v. Sodhi, No. CV133715MASJS, 2016 WL 541135, at *4 (D.N.J. Feb. 9, 2016), order amended on denial of reconsideration, No. CV133715MASJS, 2016 WL 10572643 (D.N.J. Apr. 1, 2016). The authors believe there is no support for this interpretation among New Jersey practitioners.

<sup>133</sup> Unless one year's notice is given and any non-compete is released.
### APPENDIX B
Rescission Remedy for Violations of State Franchise Disclosure/Registrations Requirements

<table>
<thead>
<tr>
<th>State Statute</th>
<th>Rescission Remedy</th>
<th>Causation Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>California</strong></td>
<td>§ 31300 (&quot;if the violation is willful, the franchisee may also sue for rescission&quot;).(^{134})</td>
<td>Rescission not available if franchisee &quot;knew the facts concerning the untruth or omission, or that the defendant exercised reasonable care and did not know, or, if he or she had exercised reasonable care, would not have known, of the untruth or omission.&quot; § 31300.</td>
</tr>
<tr>
<td><strong>Hawaii</strong></td>
<td>§ 482E-9 (&quot;Any person who sells or offers to sell a franchise in violation of this chapter shall be liable to the franchisee or subfranchisor who may sue for damages caused thereby or for rescission or other relief as the court may deem appropriate.&quot;)</td>
<td>Rescission not available “if the defendant proves that the plaintiff knew the facts concerning the untruth or admission or that the defendant exercised reasonable care and did not know or if the defendant had exercised reasonable care would not have known of the untruth or admission.” § 482E-9</td>
</tr>
<tr>
<td><strong>Illinois</strong></td>
<td>§ 705/26 (&quot;In the case of a violation of [the registration and disclosure requirements] the franchisee may also sue for rescission.&quot;)</td>
<td>No statutory or case law basis for causation requirement.(^{135}) But franchisee may not bring claim for rescission 90 days &quot;after delivery to the franchisee of a written notice disclosing the violation.&quot; § 705/27.(^{136})</td>
</tr>
<tr>
<td>815 Ill. Comp. Stat. § 705, et. seq.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Maryland</strong></td>
<td>§ 14-227(c)(1) (&quot;A court may order the person who sells or grants a franchise to . . . rescind the franchise.&quot;)</td>
<td>Rescission available in every instance where franchise is not registered, but for untrue &quot;material&quot; statement/misleading omission, only if franchisee does not know of the untruth or omission. § 14-227(1)(ii).</td>
</tr>
</tbody>
</table>


\(^{136}\) Additionally, "[n]o franchisee may sue for rescission . . . who shall fail, within 30 days from the date of receipt thereof, to accept an offer to return the consideration paid or to repurchase the franchise purchased by such person." 815 ILL. COMP. STAT. § 705/26.
<table>
<thead>
<tr>
<th>Michigan</th>
<th>Mich. Comp. Laws § 445.1501, et seq.</th>
<th>§ 445.1531(1) (&quot;A person who offers or sells a franchise in violation of [the registration and disclosure requirements] is liable to the person purchasing the franchise for damages or rescission.&quot;)</th>
<th>Causation is not required, but equitable considerations can bar rescission remedy.(^{137})</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minnesota</td>
<td>Minn. Stat. § 80C.01, et. seq.</td>
<td>§ 80C.17(1) (&quot;A person who violates any provision of this chapter or any rule or order thereunder shall be liable to the franchisee or subfranchisor who may sue for damages caused thereby, for rescission, or other relief as the court may deem appropriate.&quot;)</td>
<td>No statutory or case law basis for causation requirement.(^{138}) The statute facially permits rescission for any violation of the statute or an accompanying rule.</td>
</tr>
<tr>
<td>New York</td>
<td>N.Y. Gen. Bus. Law. § 680, et seq.</td>
<td>§ 691(1) (&quot;A person who offers or sells a franchise in violation of [the statute] is liable to the person purchasing the franchise . . . if such violation as willful and material, for rescission . . . &quot;)</td>
<td>No statutory or case law basis for requirement that violation cause damage but only that it be willful.(^{139})</td>
</tr>
</tbody>
</table>

\(^{137}\) For instance, a franchisee must comply with its obligations in good faith under the franchise agreement to obtain rescission. *See Two Men & a Truck/Int'l Inc. v. Two Men & a Truck/Kalamazoo, Inc.*, 949 F. Supp. 500, 507 (W.D. Mich. 1996) ("Regardless, defendants were in default at the time they demanded rescission; thus, rescission is not an available remedy."); *Cf. Lofgren v. AirTrona Canada*, 677 F. App'x 1002, 1010 (6th Cir. 2017) (rejecting argument violation of statutory violation must be "the direct cause of the franchisee's losses" for recession to be available and distinguishing *Kalamazoo* because the franchisee in this case had "fulfilled his side of the bargain while maintaining his franchise").

\(^{138}\) *See Nauman v. J's Restaurants Intern., Inc.*, 316 N.W.2d 523, 524 (Minn. 1982) ("Following trial, plaintiffs were granted their request for rescission . . . based on the trial judge's conclusion that the defendants had offered and sold franchises in the state of Minnesota which had not been registered.").

\(^{139}\) *See Leung v. Lotus Ride, Inc.*, 198 A.D.2d 155, 156–57, 604 N.Y.S.2d 65, 66 (N.Y. App. Div. 1993) ("The rescission claim in the third cause of action should have been dismissed as against all defendants for failure to submit any evidence that the alleged violations were willful."); *Baker Boys of Glendale, Inc. v. 35–63 82nd St. Corp.*, 166 A.D.2d 397, 398, 560 N.Y.S.2d 465, 467 (N.Y. App. Div. 1990) (holding that franchisee could not use failure to provide accurate disclosure as defense against franchisor's breach of franchise agreement claim when no evidence of willful violation).
<table>
<thead>
<tr>
<th>State</th>
<th>Statute</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>North Dakota</td>
<td>N.D. Cent. Code § 51-19-01, et seq.</td>
<td>§ 51-19-12(1) (&quot;Any person who violates any provision of this chapter or any rule or order issued by the commissioner thereunder is liable to the franchisee or subfranchisor who may bring an action . . . for rescission . . . .&quot;) Caution is not required, but equitable considerations can bar rescission remedy.¹⁴⁰</td>
</tr>
<tr>
<td>Oregon</td>
<td>Or. Rev. Stat § 650.020, et seq.</td>
<td>§ 650.020(3) (&quot;The franchisee may recover any amounts to which the franchisee would be entitled upon an action for a rescission.&quot;) No. Failure to provide the disclosure document and required agreement is a de facto statutory violation, and rescission is a remedy for any violation.¹⁴¹</td>
</tr>
<tr>
<td>South Dakota</td>
<td>S.D Codified Laws § 37-5B, et seq.</td>
<td>§ 37-5B-49 (&quot;In the case of a violation of §§ 37-5B-4, 37-5B-7 to 37-5B-9, inclusive, or 37-5B-17, the franchisee may also sue for rescission.&quot;) No, but franchisor has affirmative defenses that franchisee affirmed the transaction with knowledge of the facts concerning the violation. § 37-5B-49. Additionally, equitable considerations can bar rescission.¹⁴²</td>
</tr>
<tr>
<td>Virginia</td>
<td>Va. Code § 13.1-557, et seq.</td>
<td>§ 13.1-565 (&quot;Any franchise may be declared void by the franchisee at his option by sending a written declaration of that fact and the reasons therefore to the franchisor by registered or certified mail. . . . &quot;). No. Any franchise can be rescinded if the franchisee is not provided the required disclosure documents, if the franchisee sends written notice to the franchisor not more than 72 hours after discovering the failure but, in any event, not more than 90 days after the franchise is executed. § 13.1-565(1)</td>
</tr>
</tbody>
</table>

¹⁴⁰ See Peck of Chehalis, Inc. v. C. K. of W. Am., Inc., 304 N.W.2d 91, 101 (N.D. 1981) ("We are not inclined to conclude, as the plaintiffs have here urged, that simply because rescission appears in a statute as a remedy available to the purchaser of a franchise sold in violation of the franchise laws it should be treated in a summary fashion and without consideration of equitable principles.")

¹⁴¹ OR. ADMIN. R. 441-325-002 ("Failure to timely provide the disclosure document and all proposed agreements required under this rule is a violation of ORS 650.020(1).")

¹⁴² See Nielsen v. McCabe, 442 N.W.2d 477, 481 (S.D. 1989) ("McCabe has waived his right to rescission through his conduct.")
<table>
<thead>
<tr>
<th>State</th>
<th>Code Section</th>
<th>Description</th>
<th>Resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Washington</td>
<td>Wash. Rev. Code § 19.100.010, <em>et seq.</em></td>
<td>§ 19.100.190(2) (&quot;Any person who sells or offers to sell a franchise in violation of this chapter shall be liable to the franchisee or subfranchisor who may sue at law or in equity for damages caused thereby for rescission or other relief as the court may deem appropriate.&quot;)</td>
<td>No, but franchisor has affirmative defense if it &quot;proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable care and did not know or if he or she had exercised reasonable care would not have known of the untruth or omission.&quot; § 19.100.190(2)</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>Wis. Stat. § 553.01, <em>et seq.</em></td>
<td>§ 553.051(1) (&quot;Any person who sells a franchise in violation of s. 553.27(4), if the violation was material in the franchisee's or subfranchisor's decision to purchase the franchise, shall be liable to the franchisee or subfranchisor, who may bring an action for rescission.&quot;)</td>
<td>Yes. To rescind franchise, franchisee must show that failure to provide or inaccuracy in required disclosure documents was material in its decision to purchase franchise. Wis. Stat. § 553.051(1).</td>
</tr>
</tbody>
</table>
JOEL R. BUCKBERG

Joel Buckberg is a shareholder in Baker Donelson's Nashville office and serves as leader of the Commercial Transactions & Business Counseling Practice Group. He is a co-chair of the Firm's Hospitality Industry Service Team, the practice group serving the franchise, distribution and hospitality markets. Mr. Buckberg counsels clients on business transactions and operations, particularly in hospitality, franchising and distribution, including strategic planning, development, disclosure, equity and debt financing, mergers and acquisitions, system policy development, regulatory compliance, commercial contracts and beverage licensing. Prior to joining Baker Donelson, Mr. Buckberg was executive vice president and deputy general counsel of Cendant Corporation. In his career, he has worked on the acquisition of worldwide hotel chains and their financing, de novo franchise and brand start-ups, multi-unit acquisitions, initial public offerings, hotel management agreements for existing and new build hotels, divestitures, master license grants, area development and multi-unit agreements, supply chain sourcing, distribution agreements, sales and marketing arrangements, and technology agreements.

Active in the International Franchise Association (IFA), he serves as administrator for the IFA's Franchise Compliance Training Program, a remedial educational program for violators of federal and state franchise regulations. He is a legal advisor and trainer for IFA's FranGuard compliance and business culture training program. In 2016, he was named to the Legal Eagle Hall of Fame by Franchise Times magazine, after having been selected by readers of the magazine as a franchising "Legal Eagle" for 10 consecutive years. He has been listed in Best Lawyers in America® in the area of Franchise Law since 2008, was named the Best Lawyers' 2014 and 2017 Nashville Franchise Law "Lawyer of the Year," and has been named to Who's Who Legal: The International Who's Who of Business Lawyers since 2009 in Franchising. He was recognized by BTI Consulting Group as a Client Service All-Star in 2017.

He served as co-editor of the 2009 edition of Annual Developments in Franchise and Distribution Law published by the American Bar Association, and is a frequent speaker at IFA and ABA meetings. He is editor emeritus of Baker Donelson's Hospitalitas electronic newsletter on franchising and hospitality. Additionally, Mr. Buckberg serves as the host for the IFA's quarterly Franchise Business Network meetings in Tennessee, Louisiana, Florida, Alabama and Mississippi. He is admitted to practice in Texas, Georgia, New Jersey and Tennessee. He holds J.D. and M.B.A. degrees from Vanderbilt University, and a B.A. from Union College. He serves as a member of the Board of Trustees of The Immune Deficiency Foundation and is a member of the United States Coast Guard Auxiliary.

For more detailed information: http://www.bakerdonelson.com/joel-buckberg/.

MICHAEL EINBINDER

Michael Einbinder is a founding member of Einbinder & Dunn and has been practicing law since 1981. His experience encompasses commercial litigation with a broad range of legal and business skills. Throughout his 30 years of practice, he has handled complex commercial cases in state and federal courts representing businesses and industries throughout the country in cases involving, among other things, claims relating to breach of contract, fraud, misappropriation of trade secrets, interference with contractual relations, enforcement of non-competition agreements, real estate transactions, partnership and shareholder disputes as well as intellectual property matters. He has also appeared in various arbitration and mediation forums.
A substantial portion of his practice includes representation of start-up and established franchisors as well as multi-unit and single unit franchisees. Franchisors and franchisees are represented in a wide variety of industries, including restaurant, retail, hospitality, real estate, manufacturing, optical, recreation, business services, household and home improvement services, health care, education, child care and pet care. For franchisor clients, he has litigated and arbitrated all categories of disputes including trademark infringement claims, termination issues, enforcement of non-competition agreements, breaches of contracts and fraud claims. For franchisee clients, he has litigated an array of claims including those relating to franchise disclosure violations, franchise relationship laws, fraud, misuse of advertising funds, breaches of franchise agreements, non-competition issues and franchise terminations. His firm also handles litigation, arbitration, and mediation nationwide for both franchisors and franchisees (including associations).

Mr. Einbinder is an author in numerous publications, including contributing a chapter to the “Franchise Litigation Handbook” published by the ABA Forum on Franchising, co-authoring “A Franchisee’s Guide to Franchisor Bankruptcy” published in the Fall 2011 edition of the Franchise Law Journal and contributing a chapter in the ABA Forum publication entitled “Covenants Against Competition in Franchise Agreements,” Third Edition, published in the Fall of 2012. Michael Einbinder has been listed among the top franchise lawyers by the Franchise Times since 2004 and is a frequent speaker on franchise issues at events hosted by the American Bar Association Forum on Franchising, the International Franchise Association Legal Symposium as well as the New York City Bar Association CLE program in which he has presented papers on franchise issues for other attorneys.