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Forum on Franchising

The Franchise Lawyer

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Message from the Chair

Will K. Woods, Baker & McKenzie LLP

WILL K. WOODS
Baker & McKenzie LLP

Change is in the air! Yes, after a long, hot summer spent mostly at home as the Covid-19 pandemic wears on (and on), the cool mornings and evenings of autumn are finally here (even here in Texas). Hopefully, that is a sign of better and brighter times ahead.

Autumn is also a time of change in the life of the Forum on Franchising. Of course, our annual Forum meeting will be held from October 27, 2020 to October 30, 2020. Although this year's meeting will be in a virtual format, it will still be jam-packed with top-notch content and creative and fun networking events (there will even be a virtual lobby bar where we can all gather with our much more reasonably-priced home poured drinks!). This year is certainly a change from the 42 previous annual Forum meetings, but I believe it will be one of the best ever in terms of our programming.

The entire planning committee (but, our meeting co-chairs, Elizabeth Weldon and Gary Batenhorst, in particular) have put in countless hours on the development of this program over the last year (or more). They essentially planned three meetings as the situation throughout the spring and summer evolved (a live meeting; a hybrid meeting; and our fully virtual meeting). I (and the entire Forum) are so grateful for Gary's and Elizabeth's efforts. We will have a big party next year in Atlanta to celebrate them (in addition to next year's Forum co-chairs, Beata Krakus and Rob Lauer)!

This experience should also be a reminder to all of us of how fortunate we are to have such a wonderful group of colleagues, friends, and even competitors that we enjoy spending time with in person and will make our re-gathering as a group next October in Atlanta all that much sweeter. Absence (or should I say physical distancing), indeed, makes the heart grow fonder!

This season also brings new leadership to the Forum. In August, three new Forum members joined the Governing Committee following their election in Denver last October: Jason Adler from Cellairis Franchise, Inc. in Atlanta; Nicole Micklich from

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COVID-19 Consumer Liability Waivers – Practical Considerations for Franchise Systems

By Leslie Smith and Angelica Novick, Foley & Lardner LLP

In the wake of the COVID-19 pandemic that began sweeping the United States earlier this year, businesses of all stripes have been navigating an ever-shifting quagmire of laws and health protocols impacting their operations. As many states and municipalities continue reopening their economies in stages, franchisors and franchisees must work together to ensure that customers coming into more frequent contact with their businesses can do so safely. The extent to which that aim can be achieved, however, is uncertain. In light of that uncertainty, businesses are evaluating and implementing consumer liability waivers. This article provides an overview of the potential enforceability and desirability of these types of waivers, along with some general drafting advice franchise systems should consider when preparing their own waiver documents. This article is not intended to substitute for legal advice about any franchise system's specific circumstances, rather, we encourage interested franchisors to seek trusted legal counsel to assist them in evaluating their options.

Enforceability of COVID-19 Waivers is Unclear

Generally, enforceable liability waivers provide a way to avoid liability for consumer injuries, including personal injury, and as such, may also provide a way for franchise systems to avoid liability in the event a customer contracts COVID-19 while accessing a franchise location. However, liability waivers for infectious disease pandemics in general, and COVID-19 in particular, have not yet been tested or interpreted by courts (at the time of the drafting of this article in September 2020). At this juncture, franchise systems implementing COVID-19 liability waivers are only able to do so based on existing legal precedent applied under different factual circumstances (like personal injury lawsuits based in negligence). It is possible that some jurisdictions, when faced with the question of enforcing a COVID-19 liability waiver, will decide that such waivers are void as a matter of public policy. It is also possible that state legislatures will pass laws making COVID-19 liability waivers unlawful. Nevertheless, liability waivers are relatively easy to adopt and employ, and depending on the specific circumstances, may very well be enforced in court.

In Some Jurisdictions, Waivers May be Unnecessary

COVID-19 liability waivers may be unnecessary in some jurisdictions. For example, as of the drafting of this article, several states have begun enacting legislation to protect businesses from claims for COVID-19 exposure, with the details of such legislation varying state-by-state. The states that have enacted legislation limiting COVID-19- related civil liability for a broad range of businesses include Iowa (Iowa Code § 686D.1, *et seq*.); Louisiana (La. Rev. Stat.§ 9:2800.25; La. Rev. Stat. § 29:773); Mississippi, and Utah (Utah Code Ann. § 78B-4-517).

General vs. Jurisdiction Specific COVID-19 Waivers

Franchise systems need to remember that, absent an enforceable choice of law provision, each state's courts will likely apply the laws and policies of that respective state when evaluating whether a COVID-19 liability waiver will be enforced. As such, if a franchise system employs a blanket COVID-19 waiver in all of the states where it operates, that may increase the possibility of inconsistent enforcement across the system's operations.

If feasible, franchise systems should conduct an analysis of the laws in each of the states in which its franchisees operate, and consider

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preparing and employing COVID-19 liability waivers that comply with each jurisdiction's existing law. Otherwise, franchise systems should carefully consider including a choice of law provision in their liability waivers that selects the most favorable law available, but that has a sufficient connection to the business activity and the system to be enforceable. Franchise systems generally should not select the law of a state in which the franchise system has no locations or operations. Franchise systems often select the law of the state where the franchise system has its headquarters.

Waiver Language Must be Completely Clear and Unambiguous

Generally, courts reviewing liability waivers require that waivers be completely clear and unambiguous, and that they be the product of a fair bargain between the business and the consumer. The language of any liability waiver—perhaps especially a COVID-19 liability waiver—must be drafted in a way that will guarantee consumers understand the risk(s) associated with the business they want to patronize, as well as the rights they are waiving by patronizing the business. This means: (1) liability waivers must "clearly, unambiguously, and unmistakably inform the signer of what is being waived"; and (2) "the form, looked at in its entirety, must alert the signer to the nature and significance of what is being waived." *Rose v. Nat'l Tractor Pullers Ass'n, Inc.*, 33 F. Supp. 2d 757, 764 (W.D. Wis. 1998). It is safe to assume that any ambiguity in a liability waiver will be construed against the business that drafted it.

If negligence claims are intended to be covered by a liability waiver, the waiver should specifically reference negligence, or there is a risk that it will not be enforceable against claims arising from the negligence of the franchisor or franchisee. *See, e.g.*, *Bender v. CareGivers of Am., Inc.*, 42 So. 3d 893, 894 (Fla. Dist. Ct. App. 2010) (reversing summary judgment in favor of business where liability waiver did not include the term "negligence," stating "an exculpatory agreement must expressly include the term 'negligence' [in order] to be clear and unequivocal."); *Rose*, 33 F. Supp. 2d 765 (noting that the court had "no trouble concluding that the exculpatory agreement signed by plaintiff [was] valid," as the agreement was clear and unambiguous, because "the word 'negligence' appears in several places on the form in conjunction with the waiver language").

Depending on the jurisdiction, courts either start from the presumption of enforceability on the basis of the parties' freedom to contract, or conversely, will more closely scrutinize liability waivers because they are generally disfavored. *Compare BJ's Wholesale Club, Inc. v. Rosen*, 80 A.3d 345, 351 (Md. 2013) ("In the absence of legislation to the contrary, exculpatory clauses are generally valid, and the public policy of freedom of contract is best served by enforcing the provisions of the clause."), *and Standifer v. Best Buy Stores,* L.P., 364 F. Supp. 3d 1286 (N.D. Ala. 2019) ("Alabama law recognizes the freedom to contract and upholds 'clearly manifested limitations' in a contract"), *with Natchez Reg'l Med. Ctr. v. Quorum Health Res., LLC*, 879 F. Supp. 2d 556, 562 (S.D. Miss. 2012) ("Clauses limiting liability are given rigid scrutiny by the courts, and will not be enforced unless the limitation is fairly and honestly negotiated and understandingly entered into."), and *Murphy v. YMCA of Lake Wales, Inc.*, 974 So. 2d 565, 567-68 (Fla. Dist. Ct. App. 2008).

As of the time of the drafting of this article in September 2020, at least two states refuse entirely to enforce liability waivers that include personal injury claims: Montana (Mont. Stat. § 28-2-702), and Virginia (*Hiett v. Lake Barcroft Cmty. Ass'n, Inc.*, 244 Va. 191, 195 (1992)).

Businesses Cannot Waive Their Liability for Intentional, Reckless, or Grossly Negligent Conduct

Most jurisdictions will not allow a party to avoid liability for injuries that are the result of its intentional, reckless, or grossly negligent conduct or activity. *See generally Restatement (Second) of Contracts* § 195 (1981) ("A term exempting a party from tort liability for harm caused intentionally or recklessly is unenforceable on grounds of public policy."); *see also Mero v. City Segway Tours of Washington DC, LLC*, 962 F. Supp. 2d 92, 100 (D.D.C. 2013); Simmonds Equip., LLC v. GGR Int'l, Inc., 126 F. Supp. 3d 855, 867 (S.D. Tex. 2015); *BellSouth Telecomms., Inc. v. Kerrigan*, 55 F. Supp. 2d 1314, 1319 (N.D. Fla. 1999) ("An exculpatory clause…does not protect against claims of willful, malicious, or grossly negligent conduct."). Generally, conduct is reckless or grossly negligent where it constitutes an extreme departure from the standard of ordinary care applied by like parties

in like circumstances, or when it constitutes a conscious disregard for the rights and/or safety of others. *See, e.g.*, *Mero*, 962 F. Supp. 2d at 100; *see also Farrell v. Fisher*, 578 So. 2d 407, 409 (Fla. Dist. Ct. App. 1991) ("Gross negligence has been defined as the equivalent of slight care…that course of conduct which a reasonable and prudent person would know would probably and most likely result in injury to person or property.").

Liability Waivers that are Against Public Policy or Unconscionable are Not Enforceable

Even if a liability waiver meets the factors described above, it may still end up being voided as against public policy, or as otherwise being unconscionable. *Tunkl v. Regents of the University of California*, 383 P. 2d 441 (Cal. 1963), is widely cited for its discussion of public policy considerations in the context of liability waivers. In *Tunkl*, the Supreme Court of California stated that exculpatory agreements violate public policy if they affect the public interest adversely, and stated the following general factors that courts can apply when considering whether such agreements are void or voidable:

- Whether the agreement concerns a business of a type generally thought suitable for public regulation;
- Whether the party seeking exculpation is engaged in performing a service of great importance to the public;
- Whether the party holds itself out as generally willing to perform this service for any member of the public who seeks it;
- Whether as a result of the essential nature of the service, the party invoking exculpation possesses a decisive bargaining advantage;
- Whether, in exercising that bargaining advantage, the party invoking exculpation confronts the public with a standardized adhesion contract containing the exculpatory language, and does not include a provision to allow the purchaser to pay an additional reasonable fee to obtain protection against negligence; and
- Whether as a result of the transaction, the person or property of the purchaser is placed under the control of the party seeking exculpation, subject to the risk of carelessness by that party or its agents.

Tunkl, 383 P. 2d 445-46. Franchise systems that have implemented, or that are evaluating, COVID-19 liability waivers are encouraged to assess these six factors as they relate to the system's business when drafting these waivers.

COVID-19 Liability Waivers: Just Because You Can Does Not Mean You Should

In addition to the risk that COVID-19 liability waivers may ultimately prove unenforceable (or at least inconsistently enforceable) when tested in courts across the country, franchise systems considering such waivers also need to consider the public relations risks inherent in rolling such waivers out to consumers. While COVID-19 liability waivers may make franchise systems feel safer as they resume or increase operations, the same waivers may backfire by causing customers to question whether an establishment they want to patronize is safe. This is an especially important consideration for franchise systems in the hospitality, fitness, food service, and personal grooming service industries, where there is a pre-existing emphasis on and commitment to sanitation and customer safety. As the consuming public increasingly returns to hotels, gyms, restaurants, and salons across the country, marketing efforts that emphasize cleanliness and safety may be undermined by a customer needing to waive the business's liability for COVID-19 contraction (especially if customers were not expected to sign or acknowledge similar liability waivers pre-pandemic). Hotel franchise systems in particular face other potential pitfalls with respect to requiring COVID-19 liability waivers as a condition of doing business with the public—namely, what to do with a guest, holding a confirmed reservation, who has traveled a considerable distance and refuses to sign the waiver. There may also be feasibility considerations—for example, would the waiver be signed by every person who walks in the door of a restaurant prior to being permitted to place an order?

Franchise systems should weigh the legal uncertainty around COVID-19 liability waivers being enforceable in a lawsuit, against the business risk posed by customer perception of

such waivers before implementing them. As an alternative to COVID-19 liability waivers, franchise systems should consider publishing to customers, and otherwise conspicuously posting, disclaimers or safety advisories pertaining to COVID-19 on their premises.

Although it is beyond the scope of this article, franchisors' decisions whether to require or recommend that franchisees implement COVID-19 consumer liability waivers, whether those waivers cover both the franchisor and franchisees, and whether a given franchisor provides the form of the liability waiver, may result in unintended consequences. Most obviously, franchisors' decisions on these issues may lead to arguments that the franchisor is directly or vicariously liable for future COVID-19 claims brought against individual members of the franchise system.

Drafting Tips

Franchise systems that elect to implement COVID-19 liability waivers should generally consider the following drafting tips to increase the likelihood that their specific waiver will be enforceable:

- **Do not hide it.** If a customer is signing a longer contract, separate the COVID-19 liability waiver into a standalone document. If that is not feasible, draft the COVID-19 liability waiver as a standalone provision in the larger contract that is clearly and conspicuously labeled, including with typeface that is set off against the surrounding language.

- **Highlight the risk up-front.** Include language underscoring that COVID-19 is highly contagious, the uncertainty surrounding how it is transmitted from person-to-person, and the uncertainty surrounding whether transmission will result in symptoms, and if so, how severe those symptoms will be.

- **Specifically state that the customer is waiving the business's liability if the customer becomes ill.** Spell out who the customer is waiving liability on behalf of; whether the waiver extends beyond the specific franchisee's business to the franchisor and its affiliates; and what liability and/or rights the customer is waiving (including the right to sue, and what specific kinds of claims the customer is waiving).

- **Ask the customer to acknowledge the risk.** Clearly and conspicuously inform the customer that by signing the waiver, the customer acknowledges having read and understood the waiver, and understands the risk that the customer (including the customer's family or companions) may contract COVID-19 in the course of patronizing the business.

- **Include a separate and clear choice of law provision.** When choosing which state's law will apply to the COVID-19 liability waiver, make sure to invoke the law of a state with a connection to the business or activity covered by the waiver.

Conclusion

Because US courts have not yet ruled on whether COVID-19 liability waivers are enforceable, franchise systems that want to implement such waivers should do so in light of existing principles that govern liability waivers. A liability waiver is most likely to be enforced when: it is written clearly and unambiguously; it does not violate public policy and is not otherwise unconscionable; and it is conspicuous. Given the level of uncertainty surrounding such waivers and the fact-specific analysis that courts will employ when interpreting them, franchise systems should consult legal counsel and otherwise carefully consider their specific business, including its activities and where its franchisees operate, and draft COVID-19 liability waivers accordingly.■

Virtual Mediation Tactics and Tips

By Marlén Cortez Morris, Barnes & Thornburg LLP and Adele Vespa, Attorney & Mediator

In recent months, the COVID-19 pandemic has prevented timely access to the courts for resolution of disputes. Pending civil cases have suffered significant delays, with postponed trial dates, if trial dates are even available. With many franchisees and franchisors facing economic devastation as a result of the pandemic, the urgency to resolve claims swiftly has increased. Such businesses, and even those that were not wrecked by the pandemic, expect their counsel to adapt and offer creative solutions to changing business landscapes.

How can counsel help their clients resolve their disputes in these times? In-person mediations are not as feasible given travel restrictions, prolonged quarantine periods surrounding travel, potential exposure to COVID-19 in group gatherings, social distancing and face mask requirements. In the midst of the pandemic, it has become clear that virtual mediation is a necessary method of alternative dispute resolution, and that it is here to stay. In this article, we identify the key considerations involved in a virtual mediation and provide tactics and tips to facilitate successful virtual mediations of franchise disputes.

Key Considerations for Virtual Mediations

Some lawyers and clients have expressed a certain aversion to, or skepticism about, virtual mediation, particularly if they have not participated in one. However, virtual mediations can be a successful, efficient, and expedient dispute resolution vehicle for franchise and other disputes. Whether clients' disputes are in a pre-litigation stage, arbitration, or pending civil lawsuit, there are many advantages in choosing to resolve disputes in virtual mediation and avoiding protracted litigation. For example:

- Scheduling a virtual mediation is easier and quicker due to lack of travel.
- Travel costs are eliminated for parties and counsel located in different states or countries.
- Multiple owners, officers, and representatives for each party can attend for the entire virtual mediation or for specific times without added cost.
- Without time constraints looming because of impending travel the day of or after traditional in-person mediations, virtual mediations are less likely to result in hasty or poor resolution decisions by the parties and their counsel.
- Continuing the mediation to a second or third day is easier without adding incremental travel-related costs.
- In cases of high vitriol among the parties, avoiding face-to-face interaction can lead to a more productive mediation.

Conversely, there are also a few notable disadvantages:

- Personal dynamics such as the ability to gauge parties' body language and other nonverbal communication, and convey one's position effectively, may be impaired in a virtual mediation.
- By eliminating travel costs and reducing time commitments, some parties may be less invested in settlement.
- Without time constraints looming because of impending travel the day of or after traditional in-person mediations, the parties may feel less urgency to settle.

While there are certainly some downsides to virtual mediation, in most circumstances the advantages seemingly outweigh the disadvantages. This is particularly true when the alternative is no mediation at all, and will continue to be true (in the right circumstances) in a post-COVID world when in-person mediations resume.

Tactics for Handling a Virtual Mediation

Videoconferencing has made conducting a virtual mediation secure and simple. With a Zoom

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professional business license, for example, the mediator can invite attendees confidentially, and only invited participants can be securely admitted to the mediation. The mediator can also create confidential breakout rooms for the respective parties and their counsel (e.g., franchisor and franchisee breakout rooms). Once the rooms are opened by the mediator, the parties are virtually set up in their separate breakout rooms, akin to moving into separate conference rooms in an office environment.

At the outset of the mediation with this type of setup through Zoom, all parties and counsel may begin in a main session with the mediator, much like the start of an in-person mediation. During the main session, the mediator may make opening remarks, reinforce the protocols already addressed during a pre-mediation call between counsel and the mediator, and afford each party's counsel (or the parties) an opportunity to make opening remarks. The mediator then can open the breakout rooms for the parties to each move into their respective room to convene and caucus confidentially. The mediator remains in the main session but is able to move in and out of each breakout room (upon the parties' calling with the click of a button), much like walking in and out of office conference rooms, as many times as needed to facilitate bargaining and drive settlement discussions.

This technology allows for strategic sessions in the breakout rooms and main session. Counsel can leave the breakout room and return to the main session should counsel wish to confer with the mediator and/or the other party's counsel outside the presence of clients. This option can be used to move settlement discussions along, particularly in vitriolic or emotionally charged situations between the franchisor and franchisee. Conversely, breakout rooms can also be closed, returning all participants to the main session. This can allow the parties to talk openly with each other and get to the heart of the matter. It can also be useful when settlement is close and the negotiations would benefit from a face-to-face discussion with all stakeholders.

Parties also have flexibility during a virtual mediation. For example, parties may join the mediation after it starts, if needed for certain discussions, or leave the breakout room or the mediation altogether for a period of time. They can then easily rejoin the mediation and breakout room. This is a significant advantage given that stakeholders' availability often presents challenges when scheduling an in-person mediation, particularly where it involves travel and time away from the franchise business and personal obligations.

Parties can also easily share documents in a virtual setting. Any participant can screen share a document, whether it is the mediation submission, correspondence, pleadings, case law, financial information, or the like, with the mediator or the other side. This tool is extremely helpful in conveying settlement offers back and forth between the parties, and even more so where a settlement structure is multi-layered or complex. By memorializing the settlement proposals in a Word or Excel document, not only are the offers and counters communicated clearly, but that document can also be shared with the mediator and the other side to enable edits and counters.

When settlement ensues, a settlement memorandum can be prepared in real-time with both counsel and the mediator drafting and editing collaboratively on the shared screen, ensuring all material points of the settlement are covered. This is a significant advantage over many in-person mediations, where it can be difficult to memorialize the terms of a settlement agreement with specificity in real time.

Tips for a Successful Virtual Mediation

We offer the following tips to make your virtual mediation successful.

1. Choose a Mediator Who Has Successfully Resolved Disputes in Virtual Mediation.

When evaluating prospective mediators, ask them about their experience with virtual mediations, and choose one who understands the dynamics and technology.

2. Educate Your Client About Mediation and the Virtual Process.

Before engaging in a virtual mediation, counsel and their clients should discuss the virtual mediation process to ensure everyone understands the objectives, the advantages and disadvantages of virtual mediation, and how it will work.

Then, consider practicing using the virtual platform with clients. Not all clients are familiar with Zoom and other online platforms, or with the functionality of those platforms in mediation (e.g., the features discussed above). By practicing, counsel will uncover if a client does not have the bandwidth for online mediation or a camera-ready device for videoconferencing. A teleconference option is available in these instances, without losing the ability to caucus privately or participate in the main session.

The practice session can also be used to determine who will be the main speaker on certain matters if more than one representative is attending, and to review any unfavorable information (including the other side's mediation submission if shared) and gauge clients' reactions on camera. This can help attorneys to prevent a client from storming off, potentially causing the mediation to end, or taking other action that would set the mediation back significantly.

3. Schedule the Mediation to Minimize Disruption.

At the outset, schedule one to three days for the mediation, depending on the complexity of the dispute and anticipating a possible continuation. If not pre-scheduled, any continuation should occur within a few days after the first day of mediation, to avoid a loss of momentum. With respect to timing on the day of the virtual mediation, figure out if there are hard stops for participants and, if some will be leaving and rejoining, ascertain when that will be occurring. Before ending the first day of mediation, the mediator should draft a summary detailing the last offer(s) on the table and any tasks the parties or counsel have agreed to undertake before the continued session to avoid confusion or differing minds on resumption.

4. Schedule a Pre-Mediation Call and Virtual Practice Session with the Mediator.

Many mediators will schedule a pre-mediation call with counsel. When dealing with a virtual mediation, the pre-mediation call is even more important. Here is a checklist of items for discussion with a mediator prior to a virtual mediation:

- Determine the virtual mediation platform that will be used and schedule a virtual practice session for the mediator to illustrate to counsel the various features of the platform.

- Agree on any other communication methods to use to reach the mediator during the mediation (e.g., messaging via text or an app, phone calls, or email).

- Decide when the parties will submit mediation statements to the mediator, what items they should include, and whether the statements (or versions or portions of the statements) will be exchanged with the other party. Counsel should make very clear to the mediator what information, if any, should not be shared with the opposing side.

- Consider what, if any, information or documents should be exchanged to facilitate settlement, particularly when a matter is in a pre-discovery phase where no documents have been exchanged.

- Decide the protocol for the virtual mediation. Will opening statements be presented? Will it begin with a joint session or are the parties continuing directly to private caucuses in the virtual breakout rooms?

- Inform the mediator of the parties' settlement history, any pending demands or offers, and any key or challenging terms of settlement.

5. Craft a Strong Mediation Submission and Be Prepared to Use it at the Virtual Mediation.

Like with an in-person mediation, a well-crafted mediation statement with supporting exhibits can better prepare the mediator (and other party where mediation statements are exchanged) for a productive virtual mediation. The content of a mediation statement is similar for virtual and in-person mediations.

Once at mediation, counsel should be prepared to screen share their mediation submission exhibits (including key provisions of relevant agreements, correspondence, franchise disclosure documents, caselaw, or other documents) to facilitate bargaining. In a pre-discovery dispute, counsel should also consider

other information that would be beneficial to have ready to share.

6. Make Effective Use of Joint Online Sessions.

Resolve when and how to use joint online sessions. Similar to in-person mediations, there may be points during the virtual mediation where it may make sense to reconvene jointly, such as to apply pressure on the other side, to prevent the other side from walking away prematurely, or if the parties are close enough but could benefit from a joint session to humanize the experience and hammer out that lingering point.

7. Anticipate Third-Party Contingencies.

In franchise disputes, certain resolutions may involve third parties' buy-in in some manner. For example, if an exit is negotiated that allows the franchisee to either sell the franchise or de-identify and operate another business in the same location, lease and personal guaranty issues between the franchisee and its landlord may come into play. Loans and equipment leases that may be secured by the franchised business assets also need to be considered. Counsel should examine the different scenarios for resolution before the virtual mediation and anticipate steps necessary to accomplish the settlement. While the parties can opt to reach a settlement that is contingent on a third-party release, what happens if that contingency fails? Are there other terms that can be built into the settlement to accomplish a definitive settlement?

Addressing issues with third parties can be accomplished quickly and effectively in a virtual setting, with a short continuance, to afford resolution without losing momentum or incurring incremental costs for an in-person mediation.

8. Ensure the Right People (and Only the Right People) Attend the Virtual Mediation.

Like at an in-person mediation, each side at a virtual mediation should have a representative with final settlement authority present and actively participating. Likewise, because the mediation is literally occurring from the client's home or office, counsel and the mediator should take steps to ensure that non-essential people on either side do not attend the virtual mediation without consent. More is not always merrier and having too many participants on either side could prolong the mediation session or, worse, impede settlement because of lengthy caucuses without consensus on settlement offers and counter-proposals that aggravate the other side.

9. Plan for Technology Failures.

If your Internet fails or there is a complete power outage (it has happened), have contingency plans for reconnection. For example, everyone can download Zoom (or other app being used for the mediation) on a mobile phone to continue the mediation. Although there is no breakout room feature on the Zoom mobile version, parties and counsel can leave and rejoin the mediation meeting as many times as they need. A second alternative is to continue the mediation to a later time (but guard against momentum loss). And if all else fails, resort to the old-fashioned way of resolution, by engaging in a series of telephone calls with each side. Having a contingency plan in place to deal with technology failures will minimize the stress on all parties in an already stressful situation.

Along the same lines, counsel may want to prepare a back-channel to communicate with clients in strict confidence, separate and apart from a virtual caucus or breakout room. This is even more necessary in case there are no breakout rooms.

10. Document the Settlement Reached.

When settlement ensues, counsel and the mediator should stay in the virtual mediation meeting (with or without clients) and using the share screen feature jointly prepare a settlement memorandum documenting the essential terms of settlement for the parties' signature that day (or shortly after). After all that hard work, no one wants to see the deal vanish from buyer's or seller's remorse.

Conclusion

Virtual mediation has become an essential method of dispute resolution during the COVID-19 pandemic. With appropriate preparation and management of the virtual experience, attorneys and mediators can serve clients' interests, conceivably in better ways than before. Given its many advantages, virtual mediation is here to stay.■

Risks and Opportunities Facing Franchising in the Post-COVID-19 World

By Scott D'Angelo, Baker & McKenzie LLP

The COVID-19 pandemic has had a profound impact on businesses in all sectors of the global economy. In some sectors, it accelerated macro-trends already in motion at the time the pandemic began (e.g., the shift in the consumer goods and retail sector from brick and mortar to e-commerce). In others, it destroyed businesses that were unable to adapt to the restrictions and shifts in consumer demand that occurred in the wake of the pandemic (e.g., certain hotels, restaurants and fitness-focused businesses).

Franchising encompasses a broad range of businesses, from restaurants and hotels, to fitness centers, retail and consumer goods businesses, and more. However, this variety has not blunted the short-term impact of the pandemic on franchising, which has been overwhelmingly negative (with some exceptions for some franchise systems). While the longer-term impact of the pandemic is likely to present a number of challenges to the franchising industry, it may also present opportunities. This article aims to address briefly some of the key challenges and potential opportunities facing franchising in the wake of the COVID-19 pandemic.

Strengthening Supply Chains

The COVID-19 pandemic highlighted the dangers of emphasizing efficiency over diversity and redundancy in supply chain architecture. For example, in the initial stages of the outbreak, franchise systems that relied heavily on sourcing products from China and other countries seriously impacted by the pandemic found their sources of supply severely disrupted due to plant closures and work and travel restrictions. Prior to the COVID-19 pandemic, many businesses were already evaluating re-shoring and shortening their supply chains due to the disruptions caused by the ongoing trade war with China. That trend is likely to accelerate. Many franchisors may also consider taking steps to build a more resilient and diversified base of suppliers—one that is better equipped to adapt to the types of changes in supply and consumer demand that occurred during the pandemic. This is particularly true for franchisors who act as the main or only supplier to their franchise systems.

The post-pandemic recovery period will also present franchisors with an opportunity to address any deficiencies identified in their standard supply agreements, such as strengthening force majeure clauses, ensuring flexibility to use alternative sources of supply, modifying just-in-time inventory arrangements and creating more visibility to upstream suppliers. Identifying and onboarding new suppliers, or renegotiating existing supplier relationships without increasing costs or compromising quality, sustainability obligations, or system standards will be no small endeavor for any franchise system. As a result, franchisors are likely to spend considerable time and resources improving their supply chain infrastructures in the near term.

Adapting System Standards

Many franchise systems have successfully modified their procedures and standards to account for the operating restrictions and other preventative measures imposed to mitigate the spread of the COVID-19 virus. However, as health care professionals, scientists, and government officials continue to work to contain and neutralize the virus, the required and recommended measures to prevent its spread will continue to evolve and change. As a result, franchisors will need to continue to remain vigilant and be prepared to rapidly adjust their system standards and operating procedures to account for any such changes. Franchisees will need to remain equally prepared to implement those changes.

Unfortunately, due to the lack of clear precedent and standards, as well as the uncertainty created by the pandemic itself,

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adapting system standards and recommended operating procedures is likely to remain challenging. Franchisors that appreciate the symbiotic nature of the franchisor/franchisee relationship, and address issues presented by the pandemic through collaboration with their franchisees, are more likely to have success developing solutions that both mitigate risk and have a higher rate of adoption by franchisees. Franchisors should take care to ensure their mechanisms for monitoring and enforcing compliance with any new or modified system standards are consistent with their overall compliance regimes, but also flexible enough to account for the multitude of issues franchisees are facing due to the pandemic.

This is not to suggest franchisors should permit franchisees to compromise system standards, endanger the health or safety of employees or customers, or put their brands (or other franchisees) at risk. However, in the current environment, franchisors will be better served by addressing compliance issues through increased support and training, rather than becoming embroiled in litigation over the enforcement of system standards.

Accelerating the Use of Technology

The COVID-19 pandemic cemented the value of certain technology solutions already in use in many franchise systems. Mobile ordering systems, contactless payment solutions, delivery platforms and technologies designed to enable remote work arrangements have all helped businesses mitigate some of the disruptions caused by the pandemic. Franchise systems are likely to accelerate their use of emerging technologies—such as artificial intelligence and blockchain. Those technologies may play a pivotal role in making franchise systems more resilient and better able to absorb disruptions like the pandemic or major shifts in consumer demand. For example, sifting big data (derived from social media and other digital resources) using artificial intelligence technology can help franchise systems to better understand and predict consumer behavior in the face of the ongoing uncertainties presented by the pandemic and beyond. While each of these technology solutions has tremendous business potential, they can also present significant legal risks without a proper technology compliance regime. Counsel for franchisors and franchisees will play a pivotal role helping their clients navigate the legal issues and risks arising from the use of these technologies.

In light of the supply chain disruptions caused by the pandemic, franchisors may be more willing to consider investing in blockchain as a means of improving the transparency, traceability and security of their supply chain systems. Likewise, in light of the cost savings, convenience and widespread acceptance of remote working and learning during the pandemic, franchisors and franchisees will likely leverage those resources. While in-person meetings will remain important to building and maintaining strong franchisor/franchisee relationships, remote meetings may become more common for rolling out new initiatives, training on system standards, and delivering

important messages and direction to franchisees. In short, franchise systems that innovate and improve their operations through the use of these and other emerging technologies will be better positioned to weather future disruptions like the COVID-19 pandemic. Franchise counsel can serve as a valuable resource to assist in assessing any legal and business obstacles or obligations a franchisor may face in implementing virtual technologies to deliver trainings and other important system information, and identifying strategies to address and mitigate any such risks.

Doubling Down on E-Commerce

One of the most significant business trends emerging from the COVID-19 pandemic has been the dramatic shift in consumer spending from brick and mortar to e-commerce channels. While that macro-trend was already in place prior to the pandemic, by all accounts its "hockey stick" trajectory is likely to continue even after the pandemic subsides. Consumers have grown accustomed to the convenience, safety, variety and accessibility of buying products online. Consumers will now expect to locate their preferred brands and service providers online, and those franchise systems without a robust and sophisticated e-commerce presence will suffer as a result. Accordingly, franchise systems without a strong online presence will need to accelerate that process and build out their online platform or risk losing market share. Meanwhile, systems with a more developed presence are likely to double down to protect and grow their e-commerce market share. The accelerated shift of resources to supporting e-commerce may be accompanied by a proportionate reduction in the capital and resources devoted to supporting brick and mortar platforms. For example, franchisors or franchisees may seek to shrink the standard footprint or number of retail outlets, use ghost kitchens and other off-site locations to support online orders, or shift the balance of human capital from field operations to the management of digital assets. Counsel for franchisors and franchisees will need to be prepared to advise clients on how and whether such changes can be accomplished, given the content of legacy agreements.

Focusing on the Financial Health of Franchisees

Early in the COVID-19 pandemic, many franchisors adopted measures to blunt the financial impact of the quarantine and mandatory closures on their franchisees. Some opted to forgive royalty or advertising contributions for a period of time, while others deferred or extended the due dates for such payments. In addition, many franchisees were able to take advantage of the Paycheck Protection Program established through the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), to help cover certain payroll and overhead expenses. While the CARES Act provided some breathing room in the short term, many franchisees will continue to feel the ongoing financial impact of the pandemic for some time.

Consumer demand is likely to remain inconsistent in many segments of franchising, and forbearance periods and other franchisor-provided financial assistance either has ended or will end in the near future. Further, many franchisees have incurred significant costs implementing health and safety measures necessary to re-open their businesses. As a result, in order to mitigate the risk of franchisee bankruptcies, many franchisors' "new normal" must include more robust and proactive processes for monitoring and addressing franchisee financial health. For similar reasons, many franchisors may delay or cancel remodeling or reimaging programs until the overall financial health of their franchise systems improve. Under any circumstances, monitoring, assessing and addressing franchisee financial health involves the intersection of a number of complex business and legal issues, and counsel must be ready to anticipate and assist franchisors to address those issues and risks. Likewise, franchisee counsel must be prepared to help franchisees understand their rights and options when facing significant financial issues.

Conclusion

The COVID-19 pandemic has and will continue to present challenges for franchising. However, innovation and collaboration between franchisors and franchisees will help franchise systems weather the ongoing storm.■

Item 21, the Phase-in of Audited Financial Statements, and the Imposition of Financial Assurances

By Howard A. Caplan, Caplan Law P.A.

The Federal Trade Commission ("FTC") Franchise Rule (the "Rule") (16 C.F.R. § 436) prescribes 23 "Items" that must be included in a Franchise Disclosure Document ("FDD"). This article focuses on one Item that creates an ever-present challenge for new franchisors: the audited financial statement requirement. 16 C.F.R. § 436.5(u) ("Item 21") sets forth the rules and format for presenting the franchisor's financial statements. These financial statements include a balance sheet, an income statement (sometimes referred to as a profit and loss statement or P&L), and a statement of cash flow. Item 21 requires that the financial statements be audited by a certified public accountant, who will attest to the audit and include a letter addressing the audit along with notes to the financial statements. In general, Item 21 requires presenting the three most current years' financial statements.

Many, perhaps most, companies entering franchising form a new entity that will be the franchisor. There are multiple reasons for doing so, such as separating the ownership of so-called corporate-owned units from the franchisor entity, facilitating licensing issues, limiting loan covenants and other contractual matters, and avoiding the cost of auditing past years' financials. With some caveats, the Rule permits new franchisors to include only an unaudited opening balance sheet with the FDD for the first partial or full fiscal year of selling franchises. 16 C.F.R. § 436.5(u)(2). The FDD issued after the beginning of the second fiscal year selling franchises must contain an audited balance sheet as of the end of the first partial or full fiscal year. For subsequent years of selling franchises, all subsequent years' financial statements must be audited, with the three most recent years' audited financial statements comprising Item 21. The Rule also requires including the three most recent years' audited financial statements of any parent or affiliate that commits to performing or guarantees post-sale obligations of the franchisor. Importantly, the Rule permits states to impose stricter requirements on franchisors than those required by the Rule. 16 C.F.R. § 436.10.

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In the United States, 14 states have pre-franchise sale disclosure statutes (the "Registration States"). A Rule-compliant Item 21 can be used in all of the non-Registration States. The Registration States are more complicated. All Registration States require the inclusion of audited financials for fiscal years ending before the effective date of the FDD as well as all succeeding years' financial statements. The only differences are with respect to a franchisor's first incomplete year's financials. The individual state requirements vary from accepting the Rule's phase-in of audited financial statements without modification, to requiring audited financial statements from day one.

In addition, most Registration States authorize the state authorities to require financial assurances as a condition of registration ("Financial Assurances") for franchisors that do not show a strong financial position. The specific Financial Assurances can include a requirement to (a) escrow or impound initial fees and payments, (b) defer receipt of initial fees and payments, (c) provide a parent or affiliate guarantee of performance, or (d) maintain a surety bond. Such Financial Assurances last until the franchisor has performed its pre-opening obligations, the franchisee opens for business, or a time certain has elapsed. This article surveys the 14 Registration States and their specific requirements for Item 21 disclosure.

States Permitting Phase-In by Law

Five Registration States follow the Rule, accept an FDD following the format promulgated by the North American Securities Administrators Association ("NASAA"), or otherwise accept unaudited partial first year financials. These states

are: **Illinois** (815 ILCS 705/16), **Indiana** (Ind. Code § 23-2-2.5-13), **Michigan** (Mich. Comp. Laws Ann. § 445.1508(2)), **South Dakota** (S.D. St. § 37-5B-8; 37-5B-9), and **Wisconsin** (Wis. Stat. § 553.27 (4)). However, Illinois, Indiana, and South Dakota expressly provide that the franchise administrator can impose a Financial Assurance. *See* Ill. Admin. Code tit. 14 § 200.500; Ind. Code § 23-2-2.5-12; S.D. St. § 37-5B-5.

States Permitting Phase-In with Discretion

Four Registration States permit the phase-in, but expressly provide that the state's franchise administrator has the discretion to require audited financial statements. These states are: Hawaii (*See generally* Hawaii Rule 16-37-3(b)), **North Dakota** (N.D.C.C. §§ 51-19-06(7), 51-19-08(5)), **Rhode Island** (R.I. Gen. Laws §§ 19-28.1-3(6), 19-28.1-9(a)), and **Washington** (RCW 19.100.040(1)-(2)). The administrators in these states can also impose Financial Assurances. *See* Hawaii Rule 16-37-5; N.D.C.C. §§ 51-19-07(2); R.I. Gen. Laws §§ 19-28.1-9(b); RCW 19.100.050.

States Requiring Audited Financial Statements

Four Registration States require audited financial statements from inception, which may be only an audited opening balance sheet. These states are: **Maryland** (Md. Regs. Code Tit. 02, § 02.02.08.04(B)(4), Md. Regs. Code Tit. 02, § 02.02.08.13), **Minnesota** (Minn. Rule § 2860.1400(1)), **New York** (N.Y. Gen. Bus. § 683(g), 13 N.YC.R.R. Part 200.2 (Item 21)), and **Virginia** (Va. Code Ann. § 5-110-55(B), Va. Admin. Code § 5-110-95(B)(21)). Note that having audited financial statements does not preclude any regulatory authority in these four states from imposing Financial Assurances. *See* Minn. Stat. § 80C.04(3); Md. Code Ann. § 14-217; Md. Regs. Code Tit. 02 §02.02.08.08; 13 N.YC.R.R. Part 200.6; Va. Code Ann. § 5-110-65.

California

California has variable rules about an audit for the first year's application only. California generally requires audited financial statements for the first partial year. 10 Cal Admin. Code § 310.111.2(a). But the state commissioner, on a case-by-case basis, can permit certain franchisors to include unaudited financial statements. 10 Cal Admin. Code § 310.111.2(d) provides that:

> In extraordinary cases the Commissioner may waive the requirement for audited statements if the statements have been prepared by an independent certified public accountant or independent public accountant and the Commissioner is otherwise satisfied as to the reliability of such statements and as to the ability of the franchiser to perform future commitments. Such waiver will ordinarily be granted only upon a showing that the franchiser has not had prior audited statements; that the close of the most recent or current fiscal year is so near the time of filing of the application that it would be unreasonably costly or impractical to provide audited statements with the application; and that audited statements will be furnished within a reasonable time after the end of the most recent or current fiscal year.

In all cases the financial statements must be dated within 90 days of the application for registration. 10 Cal Admin. Code § 310.111.2(b). Like other regulatory authorities, the California commissioner can impose Financial Assurances. 10 Cal Admin. Code § 310.113 et. seq.

Summary

Based on this author's personal experience and communications with other practitioners, it appears that in general, unaudited financial statements will suffice except in Maryland, Minnesota, New York, and Virginia, and sometimes California. This is particularly so if the unaudited financial statements are dated within 90 days of the application for registration.

However, new franchisors without audited financials (as well as new or existing franchisors with less-than-stellar balance sheet equity, even if the financial statements are audited) should anticipate the imposition of Financial Assurances in California, Illinois, Maryland, New York, and Washington. Other than negative net worth, there does not appear to be a bright-line test for this requirement. However, the imposition of Financial Assurances is more likely when the audited financials show a limited operating history, declining financial performance, lack of working capital, high percentage of intangible assets, or similar indicators. ■

What is Prohibited by State Franchisee Right of Association Statutes?

By Thomas R. Ayres of Witmer, Karp, Warner & Ryan LLP

Media reports of large franchisors taking aggressive actions against their franchisees highlight the continuing struggle in a commercial relationship frequently marked by an imbalance of financial and contractual power. *See, e.g.*, Tiffany Hsu & Rachel Abrams, *Subway Got Too Big. Franchisees Paid a Price*, N.Y. Times, June 28, 2019; Lauren Etter & Michael Smith, *The War Inside 7-Eleven*, Bloomberg, Nov. 9, 2018. To try to address this imbalance, franchisees often form independent franchisee associations. An independent franchisee association need not antagonize the franchisor at each turn; indeed, if given the opportunity, it can collaborate closely with the franchisor to develop and advance the brand and the system. The health and stability of the relationship between a franchisee association and a franchisor often depends on the type of system culture the franchisor seeks to create. Regardless of the franchisor's attitude, all franchisors must act in accordance with state laws protecting franchisees' right to associate.

Twelve states have codified the right of franchisees to freely associate for lawful purposes. On their face, the statutes provide varying levels of protection, and there is scant caselaw interpreting, applying, or enforcing them. Below is a survey of the twelve state statutes (and any cases applying them) in order of least to most protective. Even in states without statutory protections for the franchisee right of association, franchisees have asserted claims based on franchisors' retaliating for franchisees' exercise of their rights, using common law theories.

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Michigan

Michigan makes any provision in a franchise agreement that would prohibit a franchisee from joining a franchisee association void and unenforceable. Mich. Comp. Laws § 445.1527(a). This statute was tested in the mid-1970s when a group of twelve Detroit-area franchisees who were members of the independent National AAMCO Dealers Association ("NADA") broke away from the AAMCO system to form a competing transmission repair business and operate independently. *McAlpine v. AAMCO Automatic Transmissions, Inc.*, 461 F.Supp. 1232, 1273 (S.D. Mich. 1978). The U.S. District Court stressed the importance of franchisees' freedom of association in their dealings with franchisors:

> One of the traditional control mechanisms of a franchisor has been to keep its franchisees disorganized. Franchisees, by necessity, must have access to the franchise group in order to act together to deal with common problems, whether those problems be the oppressiveness of the franchisor or some less momentous concern.

Id. at 1273-74. The court held that NADA's meetings—which began as a lawful vehicle to discuss legitimate business concerns—did not rise to the level of a tortious conspiracy, especially in light of the protections afforded by the Michigan Franchise Investment Law and the First Amendment to the U.S. Constitution. The court's endorsement of the legitimacy of collective franchisee activities is generally regarded as a victory for the franchisees.

Hawaii, Illinois, and Washington

Statutes in Hawaii and Washington provide that it shall be an unfair or deceptive act or practice or an unfair method of competition for a franchisor to restrict the right of franchisees to join a franchisee association. Haw. Rev. Stat. § 482E-6(2)(A); Wash. Rev. Code § 19.100.180(2)(a). Similarly, the Illinois Franchise Disclosure Act ("IFDA") deems any restriction of a franchisee from joining or participating in a trade association to be an unfair franchise practice. 815 ILCS 705/17.

A recent case calls into question a franchisee's private right to enforce this provision in Illinois, at least on certain facts. A long-time franchisee who served as the vice president of the National Coalition of Associations of 7-Eleven Franchisees

("NCASEF") recently alleged that—as retaliation for his activism—7-Eleven violated Section 17 of the IFDA by refusing to allow him to transfer to one of the company-owned stores he had requested. *Hashmi v. 7-Eleven, Inc.*, Case. No. 19-cv-04090 (N.D. Ill.) In a motion to dismiss under Fed. R. Civ. P. 12(b)(6), 7-Eleven argued that (1) Section 26 of the IFDA is the only source of private remedies for violations of the IFDA, and (2) Section 26 did not provide a private remedy for the alleged violation of Section 17 of the IFDA. (Doc. 17). 7-Eleven further argued that the complaint did not sufficiently allege that 7-Eleven actually restricted the franchisee from joining or participating in the NCASEF. The franchisee subsequently amended his complaint to remove the claim for violation of Section 17, and the U.S. District Court ultimately granted 7-Eleven's subsequent motion to dismiss the amended complaint on other grounds. While the IDFA provides statutory protection for franchisees, this case highlights a potential practical challenge for franchisees seeking to invoke such protection.

Arkansas, Connecticut, Minnesota, Nebraska, and New Jersey

Arkansas, Connecticut, Minnesota, Nebraska, and New Jersey each go a step further and prohibit the franchisor from "directly or indirectly" prohibiting the right of association among franchisees for any lawful purpose. *See, e.g.*, N.J. Stat. Ann. § 56:10-7(b) ("It shall be a violation of this act for any franchisor, directly or indirectly, through any officer, agent or employee to engage in any of the following practices:...b. To prohibit directly or indirectly the right of free association among franchisees for any lawful purpose."); *see also* Ark. Code Ann. § 4-72-206(2); Conn. Gen. Stat. § 42-133l(f)(2); Minn.R. 2860.4400(A).

The U.S. District Court for the District of New Jersey held that the New Jersey statute was enacted "to remedy the disparity in bargaining power between franchisors and franchisees by protecting franchisees against indiscriminate terminations and nonrenewals." *Red Roof Franchising, LLC v. Patel*, 877 F. Supp. 2d 124, 137 (D. N.J. 2012). A Connecticut state court cited Connecticut's identical statute as grounds for dismissing a gasoline supplier's tortious interference claim against the executive director of the Gasoline and Automotive Service Dealers of America because he was "entitled to inform his member dealers … of events that might be of interest to, or beneficial to the dealers." *Standard Petroleum*, Inc. v. Fox, 2009 WL 4282080, at *3 (Conn. Super. Ct. Nov. 2, 2009) (quoting Conn. Gen. Stat. § 42-133l(f)(2)).

California

The California statute provides that a franchisor may not restrict or inhibit the right of franchisees to join a trade association or prohibit the right of free association among franchisees for any lawful purpose. Cal. Corp. Code § 31220. In *It's Just Lunch Int'l, LLC v. Nichols*, No. 5:06-cv-01127-VAP-OP, 2009 WL 10672604 (C.D. Cal. Aug. 27, 2009), a franchisee's claim under this statute survived the summary judgment stage (it was not the direct target of the summary judgment briefing). To support its Section 31220 claim, the franchisee asserted: (1) Plaintiff franchisee sought to form a franchisee association; (2) in response, franchisor immediately interfered with the association and notified the other franchisees that plaintiff franchisee was a poor franchisee who may be terminated; and (3) other franchisees thereafter did not associate with plaintiff franchisee, and by this and other interference with the right to associate no franchisee association was formed and plaintiff franchisee was damaged. (C.D. Cal. 5:06-cv-01127-VAP-OP, Doc. 164 at PageID 3145).

Other courts interpreting Section 31220 have held that a franchisor may still demand that franchisees refrain from making disparaging online comments about the franchisor and may prohibit a franchisee from meeting with other franchisees at a franchisor-sponsored event at the franchisor's headquarters. *Overturf v. Rocky Mountain Chocolate Factory, Inc.*, 2009 WL 10675269, at *5 (C.D. Cal. Feb. 13, 2009); *United Studios of Self Defense, Inc. v. Rinehart*, 2019 WL 1109682, at *9-10 (C.D. Cal., Feb. 22, 2019).

Iowa and Rhode Island

Iowa and Rhode Island prohibit a franchisor not only from forbidding franchisees from associating with each other or participating in an association but also from retaliating against franchisees for engaging in such activities. Iowa Code § 537A.10(10); 19 R.I. Gen. Laws § 19-28.1-16.

Selected Cases Involving Retaliation Against Franchisees in States Without Statutory Protections

Even in states without statutory protections for the franchisee right of association, franchisees have asserted claims based on franchisors retaliating for franchisees' exercise of their rights. For example, in *Popeyes, Inc. v. Tokita*, Case no. 2:87-cv-03011, 1993

WL 386260 (E.D. La. Sept. 21, 1993), the franchisor sued a multi-unit franchisee for unpaid royalties and advertising fees. The franchisee filed various counterclaims, including intentional interference with business relationships, fraud, violation of the implied covenant of good faith and fair dealing, and breach of the franchise agreement for, *inter alia*, unreasonably withholding consent to transfer the franchises. Applying Louisiana law, the U.S. District Court granted Popeyes' motion for summary judgment as to most of its claims and found that the franchisee was in default of its franchise agreement; however, the Court held that the franchisee offered sufficient evidence that Popeyes' "apparent dislike for [franchisee] due to his ethnic background and his activities in the Western Franchise Association" raised a genuine issue of material fact as to the reasonableness of Popeyes' withholding consent to the transfer of the franchises. *Id.* at *11. Thus, the franchisor's hostility towards a leader of an independent franchise association turned the case from what appeared to have been a strong candidate for dismissal on summary judgment into one with issues for a jury to decide. The case settled before trial. (E.D. La. Case no. 2:87-cv-03011, Doc. 169).

In *Dunafon v. Taco Bell Corp.*, a multi-unit franchisee who was active in the International Association of Taco Bell Franchisees ("IATBF") sued Taco Bell for its refusal to allow expansion and renew an existing franchise agreement. Bus. Franchise Guide (CCH) ¶ 11,239 (Nos. 93-4490 & 96-4384, W.D. Mo. Sept. 2, 1997). The IATBF brought issues concerning the franchisee community to Taco Bell's attention and also discussed their concerns with the media. Taco Bell did not appreciate these activities and openly referred to IATBF leaders as "renegades and scum" and publicly stated that IATBF leaders would not be granted expansion rights within the system. The franchisee alleged that Taco Bell had previously established a three-step process for approving a franchisee's request to establish a new location, yet invented a fourth "ad hoc" step due to his "attitude problem." Applying Missouri law, the court denied Taco Bell's motions to dismiss and for partial summary judgment, stating that the franchisor's exercise of discretion may have been in bad faith and based on retaliatory motives. As a result, the court found that a general issue of material fact existed as to whether Taco Bell tortiously interfered with the franchisee's business.

In *Bray v. QFO Royalties LLC*, 486 F.Supp.2d 1237 (D. Colo. 2007), a U.S. District Court granted a motion for preliminary injunction brought by eight Quiznos franchisees, finding that they were substantially likely to succeed on their claims that the franchisor terminated their franchise agreements in retaliation for posting the suicide letter of a former franchisee on the website of the independent franchise association that they led. Each franchisee was an officer or member of the Toasted Subs Franchisee Association, Inc. ("TSFA") that had previously been a "thorn-in-the-side" of the franchisor. *Id.* at 1240. The TSFA published the letter of the former franchisee that attributed his suicide to Quiznos and the litigation he and his wife had been engaged in concerning their franchise, with the intent to establish a memorial fund. As soon as the franchisor learned that the suicide letter was posted online, it immediately sent notices of termination to all franchisees affiliated with the TSFA. The court determined that the TSFA was akin to a "Potemkin Village" non-profit organization whose only mission was to "provide a blog for Quiznos franchisees to vent their frustrations and exchange ideas to furthering their interests and bettering their bottom line." *Id.* at 1250–51. Since it was undisputed that the franchisor did not conduct any investigation and its immediate terminations were "purely punitive," the court granted the preliminary injunction under the federal standard in order to protect the franchisees' rights while the case was pending. *Id.* at 1251. The case was later settled before the Tenth Circuit could consider Quiznos' appeal of the District Court's decision. *Abid v. QFA Royalties LLC*, 296 Fed.Appx. 682 (10th Cir. 2008) (appeal dismissed due to mootness).

Conclusion

Although only twelve states formally protect the right of franchisees to freely associate for lawful purposes, courts nationwide have not been forgiving of retaliatory or discriminatory conduct by franchisors in response to franchisees' assertions of these rights. Despite the statutory protections afforded franchisees and their success in courts, there are credible accounts that retaliation and discrimination continue to be present in some franchise systems. Franchisors should steer clear of such unsavory—if not unlawful—actions aimed at franchisee associations and their leaders. ■

Urso, Liguori & Micklich in Westerly, Rhode Island; and Ben Reed from Plave Koch in Reston, Virginia. Additionally, Bethany Appleby from Appleby & Corcoran in New Haven, Connecticut is remaining on the Governing Committee for a second 3-year term.

Governing Committee members have specific responsibilities as officers or directors of one of our groups. We change those officer/director positions on a periodic basis. The following is a list of our current officers and directors. You should feel free to reach out to any of these Governing Committee members for questions falling within each's respective area of responsibility.

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This is Karen Marchiano's last edition of *The Franchise Lawyer* as its Editor-in-Chief. We are grateful for the significant contributions that Karen has made to this publication over many years on the editorial staff, and, personally, I will miss working with Karen. Erin Conway Johnsen will become the new Editor-in-Chief beginning with the Winter edition.

The Governing Committee and I are here to serve you, so I encourage you to contact me with any questions, comments, or suggestions about the Forum at will.woods@bakermckenzie.com or 214-978-3022.

See you all online for Franchising in Focus 2020 @Home. ■

Message from the Chair

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Message from the Editor-in-Chief

Karen C. Marchiano,
DLA Piper LLP US

What is the power that fuels the ABA Forum on Franchising? Volunteer power. To the left of my message is a chart listing folks who are currently volunteering massive numbers of hours to make the ABA Forum on Franchising the jewel it is. Past Governing Committee members have done the same, as have a multitude of volunteer writers, editors, and speakers who have generated first-rate content encapsulating – and sharing – the best expertise of this special corner of the law. Within this group, I particularly thank the talented editors from my many years at The Franchise Lawyer: Corby Anderson, Heather Carson Perkins, Himanshu Patel, Matt Gruenberg, Ray Konz, Len MacPhee, Keri McWilliams, Justin Sallis, and Paul Russell. I thank Will Woods for his leadership and his kindness. Finally, I thank the Governing Committee for providing me the opportunity to give back to the Forum by serving as Editor-in-Chief. You are in good hands with Erin Conway Johnsen, the next Editor-in-Chief. ■

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