FROM THE EDITOR-IN-CHIEF

Daniel J. Oates

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Sally Lee Foley (foreword), Thomas L. Gravelle & Nicolas Guibert de Bruet

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FEATURE

Franchising & Distribution Currents
Earsa Jackson, William M. Bryner & Sawan Patel
Franchise Law Journal
Guidelines for Authors

The Franchise Law Journal, the quarterly scholarly publication of the ABA Forum on Franchising, seeks to inform and educate lawyers and other interested readers by publishing articles, columns, and reviews concerning legal developments relevant to franchising as a method of distributing products and services.

Article Length. Feature articles traditionally are 5,000–7,500 words or 25–30 double-spaced pages in length. Depending on the topic and depth of focus, the Journal also accepts some shorter articles.

Style. The writing should be appropriate for a law review article. To that end, authors should:

- Use gender-neutral language;
- Avoid long quotations;
- Avoid excess verbiage;
- Avoid using a long word when a short one will do;
- Avoid using a foreign phrase, scientific word, or jargon if you can think of a more common English equivalent;
- Avoid overworked figures of speech;
- Avoid excessive capitalization; and
- Avoid excessive use of commas.

Footnotes. All references must be completely and accurately cited, using the citation style of The Bluebook: A Uniform System of Citation (21st ed. 2020).

Author Biography. Please include a one-sentence description of your current professional affiliation, including your title and organization. Send us your mailing (both USPS and email) addresses and telephone number.

Manuscript Preparation. All references must be cited. Use footnotes rather than embedded references; number pages; italicize rather than underline; use Word; and submit the manuscripts as e-mail attachments. Do not use italics or boldface for editorial emphasis.

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From the Editor-in-Chief

Danel J. Oates

This issue marks the fortieth anniversary of the Franchise Law Journal. For forty years, the Journal has been the preeminent source of academic scholarship on franchising. To celebrate the occasion, we felt it appropriate to prepare a special symposium edition dedicated to the Journal’s long-standing mission of excellence.

Unfortunately, the lead up to this edition also happens to coincide with the most serious global pandemic that the world has seen in more than a century. As such, many of you have undoubtedly spent the last several months working from home, caring for loved ones, or learning to be a teacher to your young children. While this edition of the Journal was intended to be a triumphant celebration of this venerated periodical, I must admit that my own enthusiasm has been tempered by the plight of everyone dealing with the fallout of COVID-19. It is at times like these that I find comfort in the words of Tolkien:

‘I wish it need not have happened in my time.’ said Frodo.
‘So do I,’ said Gandalf, ‘and so do all who live to see such times. But that is not for them to decide. All we have to decide is what to do with the time that is given us.’

In the spirit of these words, we therefore bring to you this edition of the Journal. It is altogether fitting and proper that we should do this. For while our present is imbued with a great sense of fear and trepidation, it is only from reflecting on our past that we will remember the promise of our future.

1. J.R.R. Tolkien, The Fellowship of the Ring 82 (Ballentine Books, 1965); see also Marcus Aurelius, Meditations 27 (Dover Thrift ed. 1997) (161) (“I am unhappy, because this has happened to me.’ Not so: say, ‘I am happy, though this has happened to me, because I continue free from pain, neither crushed by the present nor fearing the future. . . . Remember, too, on every occasion that leads you to vexation to apply this principle: not that this is a misfortune, but that to bear it nobly is good fortune.”) (emphasis added).

2. Abraham Lincoln, Gettysburg Address (Nov. 19, 1863).

Daniel J. Oates (dan.oates@millernash.com) is a partner in the Seattle office of Miller Nash Graham & Dunn LLP. Dan focuses his practice on franchising and distribution litigation. Feel free to reach out to Dan directly for comments on this editorial or matters related to the Franchise Law Journal.
future. For this edition of the Journal, we have assembled an unrivaled collection of authors: every living former Editor-in-Chief of the Journal. They have each agreed to author an article, tailored to their own personal interest and experience. As you will see as you read this edition, it is an eclectic mix of interviews, reflections, historical developments, and substantive legal analysis.

In keeping with the more serious tone of this editorial, I would be remiss if I failed to discuss the enormous absence from our roster of authors. Unfortunately, by the will of fate, we are missing one person: Edward Wood “Jack” Dunham, who passed away on May 1, 2015. Sadly, I never had the opportunity to get to know Jack beyond mere acquaintance.

Jack was the Editor-in-Chief of the Franchise Law Journal from 1997 to 2000. Consistent with his nationwide stature as a titan of franchising, his work as EIC was exemplary, and his editorials were frankly humbling. He was a member of the Governing Committee from 2000 until 2007, and Chair of the Forum from 2007 until 2009.

Although I never had the pleasure of getting to know Jack, all of my Forum colleagues that knew him hold him in the highest regard. This includes his friends, his colleagues, and his adversaries. It is a rare person who can earn the respect and admiration of his opponents. Jack was just such a person. Ron Gardner, a similar titan of the plaintiff’s franchise bar, gave one of the eulogies at his funeral. The chair of the Franchise, Distribution and Dealer Law Section of the Connecticut Bar Association, Nicole Liguori Micklich (another frequent adversary of Jack), prepared and filed a formal memorial resolution with Connecticut Bar Association recognizing Jack as “an icon, one of the best litigators, and he was a gentleman.”

3. H. Stephen Brown (Editor-in-Chief from 1980 to 1982); Sally Lee Foley (Editor-in-Chief from 1982 to 1984); Bret Lowell (Editor-in-Chief from 1984 to 1988); W. Michael Garner (Editor-in-Chief from 1988 to 1993); Ann Hurwitz (Editor-in-Chief from 1993 to 1997); Jonathan Solish (Editor-in-Chief from 1997 to 2000); William Killion (Editor-in-Chief from 2003 to 2006); Deborah Coldwell (Editor-in-Chief from 2006 to 2009); Christopher Bussert (Editor-in-Chief from 2009 to 2012); Bethany Appleby (Editor-in-Chief from 2012 to 2015); and Gary Batenhorst (Editor-in-Chief from 2015 to 2018).

4. Each editorial was a clinic on how to substantively address a serious question of franchise law. See, e.g., Edward Wood Dunham, Federal Franchise Legislation and Congress’ Own Duty of Competence and Due Care, 21 Franchise L.J. 67 (2001); Edward Wood Dunham, Jury Trials for Franchisors: “. . . a delusion, a mockery and a snare”?, 21 Franchise L.J. 115 (2002); Edward Wood Dunham, A Rare but Scary Thing: More on Franchise Jury Trials, 21 Franchise L.J. 179 (2002); Edward Wood Dunham, Are There Due Process Limits on Arbitral Punitive Damage Awards?, 23 Franchise L.J. 3 (2003); Edward Wood Dunham, Some Thoughts on Settling Franchise Disputes, 22 Franchise L.J. 147 (2003). Effectively, these editorials were a law review article every quarter. I’m told that Jack was an avid Yankees fan. Jack is the Derek Jeter of EICs. The other venerable authors of this edition similarly represent a pantheon of hall of famers. With the zany Batman and The Oregon Trail references, this Editor-in-Chief can, at best, be considered the Bobby Valentine of EICs. See, e.g., Jack Curry, N.L. Gives Valentine Fine and Suspension, N.Y. Times, June 12, 1999 at D4 (discussing the infamous ejection/mustache disguise incident). I will nonetheless do my best to honor their contributions to the legacy of this publication.

5. Nicole Liguori Micklich, Memorial Resolution of the Franchise, Distribution and Dealer Law Section of the Connecticut Bar Association upon the Death of Edward Wood “Jack” Dunham (Nov. 2015).
grief and sadness from his colleagues and former adversaries in response to his untimely passing, I can safely say: “It’s true. All of it.”

We should all strive to be so well respected by our peers and adversaries, and hope for such kind words upon our passing. It is also comforting to know that the feeling was mutual. As expressed in his final editorial, Jack held the Forum and its members in equally high regard:

It is a pleasure to practice with other attorneys, including adversaries, who are thoughtful, fair, sincerely trying to do the right thing for their clients, and able zealously to advocate their client’s interests without demonizing their opponents. . . . I owe many of them a great debt of thanks for giving me the opportunity to serve in this position; for helping me identify authors, develop article topics, edit drafts, and otherwise try to ensure the quality of the publication; and, most important, for their friendship.

Although I have no authority to speak on behalf of my predecessors who have so graciously agreed to participate in this celebratory symposium anniversary edition, I think I can safely say that we all agree with this sentiment. It has been our privilege and honor to act as stewards of this publication, and we all look forward to the next forty years of kindness, respect, academic excellence, professional collegiality, and most important, friendship, that this Forum and Journal provide.

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The Early History of the ABA Forum Committee on Franchising and Its Publications

Steve Brown

In looking back forty years, many memories and lessons have been remembered and learned from my participation in the ABA Forum Committee on Franchising (Forum). These memories and lessons allow me to write this Article that will review the early history of
1. the publications of the Forum;
2. the Forum;
3. Franchise Law;
4. the purpose of both the Forum and its publications;
and conclude with lessons learned from all four.

I. The Early History of the Publications of the Forum

In the beginning, the publications of the Forum and the formation and organization of the Forum were intertwined. As the founding editor of the Forum publication that has come to be known as the Franchise Law Journal, many might consider me to be a dinosaur that was able to observe the beginning and in a very limited way to influence its growth and success. For the first year including the first issue, I was the only Editor and designed the layout of the publication, its graphics, its color, and its agreement with ABA Press for its printing and mailing. I also solicited and edited its articles, wrote both the Editor’s column, an article “Negotiating and Protecting the International Royalty,”1 an Editor’s Note to report on the on the second annual program in San Francisco, and worked with the Chairman and the Board on marketing efforts to increase both enthusiasm, participation, and acceptance of the Forum.


Steve Brown, of Dallas, Texas, was the Editor-in-Chief of the Franchise Law Journal (then known as the Newsletter of the Forum Committee on Franchising from 1980 to 1981, and the Journal of the Forum Committee on Franchising from 1981 to 1982).
The name, length and format of the Forum’s publications continually changed, with the first three issues being “Newsletter of the Forum Committee on Franchising;” and, the name changing in our fourth issue to “Journal of the Form Committee on Franchising.” Always, quality was our goal. After the first issue we were fortunate to be able to add two Associate Editors, Sally Lee Foley of Detroit and L. Seth Stadfeld of Boston. Both were terrific. Sally was totally dedicated to the Forum and to its publications. She was a pleasure to work with and started the Forum’s Women’s Caucus. Sally became our second Editor, and Seth started the very popular section of the Journal titled “franchising currents.” He continued as Associate Editor and writer of “franchising currents” for many years. Starting with the fourth issue of our publication, the Journal added Bret Lowell as our third Associate Editor. Bret was exceptional and always delivered. He later became the Editor-in-Chief of the Journal and then the Chairman of the Forum. It was always a pleasure to work with Bret. The workload for the four of us was still heavy and almost a full-time job for me. We needed to expand in order to continue to scale up. As a result, the Editorial Board was again expanded with the support of the Forum Board, the Spring 1982 Issue that we designated as Volume 2, Number 1 of the Journal with Sally Foley, Seth Stadfeld, and Bret Lowell continuing as the Associate Editors, and Richard M. Asbill of Atlanta, Rupert Barkoff of Atlanta, Laurence R. Heft of Washington, DC, Paul A. Lester of Bay Harbor Islands, Andrew C. Selden of Minneapolis, Harvey Shapiro of Toronto, Robert A. Shirnick of New York City, and Erik B. Wulff of Chicago joining us as Topic and Articles Editors. All of our Topic and Articles Editors were exceptional and a pleasure to work with. I would like to specially mention four: Rupert Barkoff, Andy Selden, Richard Asbill, and Eric Wulff. Rupert Barkoff, Andy Selden, and Richard Asbill all became Chairman of the Forum through hard work and exceptional participation. Erik Wulff is the fourth. I admired Rupert Barkoff for his practical views, work ethic and always going beyond what was required or expected. Andy Selden had great vision and leadership qualities. Every time we have a new United States President being inaugurated; I expect Andy to be appointed as the Chief Executive Officer of Amtrak. Andy has the unique knowledge and skill set to hold that position. Richard Asbill had great people and legal skills. Eric Wulff was smart and exceptional. His work product was always excellent. Volume 2, Number 1 of the Journal was my last issue as Editor and was thirty-four pages long, over three times longer than our first issue.

Many editorial procedures and editorial processes were improved over the first five issues that now are used to produce the excellent work product of our current journals. First, we had to go through a process to agree on topics and, at the same time, obtain articles. This was most difficult when there was only one editor. For the first issue, I was forced to lean on the Governing Board. After the first issue, this became much more manageable when we

2. See, e.g., Front Matter, 2 Franchise L.J. 2 (Spring 1982).
had two, then three, then four, and finally on our fifth issue, twelve editors to assist on selection of topics and obtaining or soliciting articles. Next, we had to set up the peer review process for each article. For the first issue the peer review of each article became problematic as I was also the author of one of the Articles. Lewis Rudnick and Harold Brown, then two Governing Board members, came to our rescue. For the second issue, we had two editors, Sally and me. With the third issue, we were fortunate to have Sally and Seth’s help, and, with the fourth issue, we added Bret Lowell, making four editors to do such peer reviews. Next, we set up a process to obtain feedback from the Governing Board, the Forum members, and the ABA so we could produce a better product that reflected the substantial input from others. We received feedback that the newsletter was good, but a journal would be better, and starting with Volume 1, Number 4, in the Fall of 1981, we published the first *Journal of the Forum Committee on Franchising*. Subsequently, a few years later when Bret Lowell became the Editor-in-Chief, the *Journal* was renamed and continues to be named the *Franchise Law Journal*. This Summer 2020 issue is Volume 40, Number 1, the fortieth anniversary of the original issue.

**II. The Early History of the Forum**

The Forum formation and organization were also intertwined with the announcement of, and then the promulgation of, the FTC Franchise Rule. Contemporaneously, the American Bar Association sections of Anti-Trust, Corporate, Litigation, and Intellectual Property recognized the rapidly expanding business format franchising concept, that touched on multiple legal areas and was rapidly becoming a regulated business, deserved to have a forum formed to focus on its development so that ABA members would have the opportunity to influence its growth and to educate and inform its members of developments.

**A. First, the American Bar Association**

Three American Bar Association Presidents, Justin A. Stanley of Illinois, William B. Spann of Georgia, and S. Shepherd Tate of Tennessee were all involved in the Forum’s formation. The above-mentioned ABA sections were also instrumental. As I remember it, from the ABA section involvement, Harold Brown of Boston [for Litigation], Lee N. Abrams of Chicago [for Antitrust], Albert Robin of New York [for Intellectual Property] Mark Rollinson of Washington, DC [for Corporate], and Harold L. Ward of Miami [also for Litigation] were designated from their respective sections to make it happen. Looking back over forty years ago, I was most fortunate to be invited and be able to participate in the organizational meeting of the

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Forum in Chicago with Harold Ward, Harold Brown, Lee Abrams, Albert Robin, Lewis G. Rudnick, Mark Rollinson, and Timothy H. Fine. It is most unfortunate that forty years later most of the group of founders has passed away, but what they started continues to be an outstanding Forum that we can all be proud of. Of the participants from the organizational meeting, only Lee Abrams and I are able to now memorialize this early history.

B. The Founding Members of the Forum’s Governing Board

Harold L. Ward of Miami was the founding chairman of the Forum Committee on Franchising, with Lee N. Abrams of Chicago, Judith M. Bailey of Phoenix, Harold Brown of Boston [deceased], Timothy H. Fine [deceased] of San Francisco, Albert Robin [deceased] of New York City, Mark Rollinson [deceased] of Washington, DC, and Lewis G. Rudnick [deceased] of Chicago, joining our first chairman as the other members of the first Board. Each one was very accomplished professionally and academically. For three years, I was able to interact with each one on a regular basis, getting together at least three times each year. I learned a great deal. Most were larger than life, and all were extraordinary practitioners. The Board agreed, and I welcomed at least one and generally multiple articles from each. Harold Ward, our first chairman, established the early direction for the Forum and tirelessly created the policies that would allow the Forum to grow and prosper. But most important, his policies allowed the Forum to meet its goals and objectives. Lewis Rudnick, our second chairman, had an encyclopedic knowledge of franchise law. He was outstanding in every way. To know him was to love him. He regularly kept up with new developments and brought a tremendous amount of passion and the pursuit of excellence to the Forum. Lee Abrams, our third chairman, was brilliant. His ABA experience generally, as well as previously being the finance officer of the Antitrust section, allowed him to guide us through the ABA requirements and regularly obtain the funding that was especially needed in the early days, as the Forum scaled to a self-funded organization. Lee’s management skills that he honed from serving in management positions in his firm were also very useful to the Forum, which continued to grow and prosper under Lee’s guidance and leadership. Harold Brown, I believe, was the most instrumental founding member in forming the Forum. He first suggested its formation. He considered himself a franchisee advocate and became an author of franchise books and franchise articles including regular newspaper columns. His style and personality always brought him centerstage. He dedicated himself to educating others. He was a showman. Albert Robin was a very knowledgeable and able intellectual property attorney. He held leadership positions in the ABA Intellectual Property section as well as serving as President of the American Intellectual Property Association. For those governing board members that I have not mentioned, I want to state you were terrific, and I plan to mention you in other parts of this article.
III. The Early History of Franchise Law

In 1978, we had the beginning of a federal-state web of laws that included the newly promulgated FTC Franchise Rule, the state “pre-sale” registration laws, the state relationship laws, and the state “little FTC acts.” At that time, the FTC Franchise Rule did not provide for a private right of action but did provide for certain disclosure requirements. Certain state franchise statutes began to be passed such as “Termination and Nonrenewal Statutes,” and “Repurchase on Termination Statutes.” Also the delicate and sensitive relationships between franchisors and franchisees were studied, and relationship planning became important. Forum members discussed fairness and balance in the franchise relationship from all perspectives. More state laws were passed, and associations were formed. Because of the Forum, the attorneys representing both franchisors and franchisees were able to work together on publications, educational annual forums, and other projects that were the beginning of a unique bond and appreciation that only the Forum could offer to its members.

The first five issues of the Newsletter of the Forum Committee on Franchising and the first issue of the Journal of the Forum Committee on Franchising reflect a balanced and fair presentation of this early history.4

IV. The Purpose of the Forum and Its Publications

The ABA recognized the rapidly expanding business format franchising concept that touched on multiple legal areas and was rapidly becoming a regulated business and believed the Forum would be able to provide ABA members the opportunity to participate in its development and growth. The Forum also provided a platform to help educate and inform its members.

4. See, e.g., Harold Brown, Survey of Private Remedies, 1 FRANCHISE L.J. 1 (Winter 1980); Albert Rubin, Trademark Licensing and the FTC Franchise Rule, 1 FRANCHISE L.J. 3 (Winter 1980); Brown, supra note 1; Harold L. Ward, Siegel—Is It Still a Delight?, 1 FRANCHISE L.J. 1 (Spring 1980); Timothy H. Fine, Developments in State Law Affecting Franchising, 1 FRANCHISE L.J. 3 (Spring 1980); L. Seth Stadfeld, Franchising Currents, 1 FRANCHISE L.J. 7 (Spring 1980); Lewis G. Rudnick, Structuring a Franchise Relationship, 1 FRANCHISE L.J. 9 (Spring 1980); Lewis G. Rudnick, Structuring a Franchise Relationship Part II, 1 FRANCHISE L.J. 1 (Summer 1981); Albert Rubin, Ipso Facto Clauses, 1 FRANCHISE L.J. 3 (Summer 1981); Jeffrey J. Keyes, Antitrust Problems in Franchise Advertising Programs, 1 FRANCHISE L.J. 5 (Summer 1981); Allen Carp, Franchising in Canada, 1 FRANCHISE L.J. 17 (Summer 1981); L. Seth Stadfeld, Franchising Currents, 1 FRANCHISE L.J. 27 (Summer 1981); Lee N. Abrams & T. Mark McLaughlin, Rights of a Franchisor Against a Franchisee Who “Holds Over” Without Permission, 1 FRANCHISE L.J. 1 (Fall 1981); Harold Brown, Unfairness Doctrine in Franchising, 1 FRANCHISE L.J. 3 (Fall 1981); Lewis G. Rudnick, Structuring a Franchise Relationship Part III, 1 FRANCHISE L.J. 5 (Fall 1981); L. Seth Stadfeld, Franchising Currents, 1 FRANCHISE L.J. 13 (Fall 1981); Bret Lowell, Bibliography of Sources and Trends for Franchise Law in the Eighties, 1 FRANCHISE L.J. 18 (Fall 1981); Mark Rollinson, Franchise Attorney Responsibility to Franchise Purchasers, 2 FRANCHISE L.J. 1 (Spring 1982); Laurence R. Heeter, Selection of Marks, 2 FRANCHISE L.J. 3 (Spring 1982); John P. James, Federal Income Tax Issues in Franchise Advertising Programs, 2 FRANCHISE L.J. 7 (Spring 1982); Harold Brown, Franchising: The Duty to Perform in Good Faith and Fair Dealing, 2 FRANCHISE L.J. 17 (Spring 1982); Michael J. Walter, Civil RICO: An End to Franchise Fraud?, 2 FRANCHISE L.J. 26 (Spring 1982); L. Seth Stadfeld & Erik B. Wulff, Franchising Currents, 2 FRANCHISE L.J. 28 (Spring 1982); Bret Lowell, Bibliography of Sources and Trends for Franchise Law in the Eighties Part 2, 2 FRANCHISE L.J. 33 (Spring 1982).
through the Forum’s publications and programs with fair and balanced presentations. It has been a success. If you have any comments or memories that you would like to share, please send me an email at hbrown@brownplc.com, and I will attempt to have them published on the Forum’s website or in a subsequent Journal.

V. Lessons Learned and Conclusion

The early history of participating in the Forum and its publications taught me many lessons that I have used throughout my career. I would like to share them with you. I hope that each of you that read this article, especially our newer members, will be able to benefit from my lessons learned.

Lesson 1. The first was the more work and effort contributed results in even more returns, rewards, or output being returned or received. Either go all in or do not go at all.

Lesson 2. Set individual goals or plans that make a difference for the group and for others.

Lesson 3. Be respectful and sensitive to the feeling of everyone you interact with.

Lesson 4. Set realistic expectations, and then exceed them.

Lesson 5. To be successful you should make more right decisions then wrong; but use your wrong decisions as a learning exercise.
Joint Employers and the National Labor Relations Board: McDonald’s Wins a Food Fight

Thomas L. Gravelle & Nicolas Guibert de Bruet

Foreword by Sally Lee Foley

Franchising has been a significant presence in my professional career as a legal counselor. As the first woman editor of the Franchise Law Journal, its second Editor-in-Chief, and an American Bar Association Forum on Franchising leader multiple times, I feel that I must give back to the Forum on Franchising. In the spirit of Thomas Jefferson, who chose to memorialize at

Thomas L. Gravelle is an attorney and an arbitrator in Bloomfield Hills, Michigan. Nicolas Guibert de Bruet is a business and technology sectors attorney in Birmingham, Michigan. The authors would like to thank Sally Lee Foley for the opportunity to write in the Fortieth Edition Symposium issue of the American Bar Association Franchise Law Journal. Her constant support and guidance in the production of this article were invaluable.

Sally Lee Foley is a retired attorney in Bloomfield Hills, Michigan. From 1973 to 1975, she championed consumer protection laws as Assistant Attorney General in the Consumer Protection Anti-Trust Division of the Department of the Attorney General of the State of Michigan. Subsequently, she advocated for clients in private practice. She has previously served as Editor-in-Chief of the Franchise Law Journal (then known as the American Bar Association (ABA) Journal of the Forum Committee on Franchising) from 1982 to 1984, member of the Governing Committee of the ABA Forum Committee on Franchising, co-chair of the fourth (1981, Chicago, Illinois) and tenth (1987, Tucson, Arizona) Annual Meetings of the ABA Forum Committee on Franchising and president of the National Association of Women Lawyers.
Monticello his achievements for his fellow Americans and Virginians over the illustrious honors and gifts conferred upon him by those very same groups, I am choosing to introduce to the *Franchise Law Journal* the work of Thomas L. Gravelle and Nicolas Guibert de Bruet, rather than write about the history of the Forum on Franchising. These are men of extraordinary intellect and skill. This and their future contributions to the *Franchise Law Journal* will be a legacy that I will be sure to relish as time marches on. Appropriately, they had chosen some time ago to share with me, and now with the rest of the *Franchise Law Journal* readers of this Fortieth Edition Symposium issue, an article on the monumental co-employment ruling of the National Labor Relations Board in the case of *McDonald’s USA, LLC, a joint employer, et al.*

**Introduction**

In 2015, McDonald’s USA, LLC (McDonald’s USA), arguably as a proxy for the entire franchising industry in the United States, found itself in the crosshairs of the United States National Labor Relations Board (NLRB or Board). One of the primary duties of a franchisor is to protect its trademarks and service marks, which entails oversight of its franchisees.

In 2012, a group called the “Fast Food Workers Committee” (the Committee) had begun a campaign against McDonald’s USA (and others) to unionize the employees of McDonald’s franchisees. The Committee’s efforts were supported by the Service Employees International Union (SEIU) and the NLRB General Counsel, an appointee of President Barack Obama. The NLRB General Counsel’s goal was to have the NLRB designate McDonald’s USA as a “joint employer” with its franchisees, under the National Labor Relations Act (hereafter, NLRA). If so, a franchisor would be vicariously liable to its franchisees’ employees. For example, if the franchisee committed an unfair labor practice (ULP), or, if in privity with the labor union of those same employees, employees of the franchisee campaigning to be represented by a labor organization in the United States, then the franchisor could face potential additional liability.

The following discussion addresses how, in 2015, McDonald’s USA found itself charged by the NLRB, in what may likely be the largest case in the

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1. The NLRB was created by the National Labor Relations Act (NLRA), 49 Stat. 449 (1935); 29 U.S.C. §§ 151–69.
2. The National Labor Relations Act, § 2(5), 29 U.S.C. § 152(5), broadly defines a “labor organization” as “any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers, concerning grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work.” 29 U.S.C. § 158(a) defines the ULP that an employer may solely commit. 29 U.S.C. § 159 outlines the NLRB’s power to investigate and prosecute an ULP. Repeat ULP violators may be subject to contempt charges per the NLRB *Cachandling Manual for Unfair Labor Practice Proceedings* (Part I, 100S2.10, published December 2009). Additionally, the NLRB may impose unusual or far more burdensome penalties to repeat or flagrant ULP violators. *HTH Corp.*, 361 NLRB No. 65 (2014).
history of the NLRB, and how franchisors and franchisees thus far have avoided a significant expansion of the legal meaning of “joint employer.” Partisanship among the Board members at the NLRB has long been noted.\(^3\) The prosecution of McDonald’s USA is a major example of partisanship at the NLRB.

I. The Campaign to Organize Franchisees from the Top Down

In the private sector of the United States economy, labor unions now represent about 6.2% of active employees across all industries.\(^4\) This amounts to a decline of 4.5 million labor union members from 16.8% in 1983, a period of time in which the number of private sector wage earners increased from 71 million to over 120 million.\(^5\) In the private sector, organized labor has been seeking ways to reverse these membership declines, and it has looked at the NLRB for support. Organized labor is active in politics and has predominantly contributed to the Democratic Party for many years.\(^6\)

In 2012, the Fast Food Workers Committee began its “Fight for $15,” a nationwide organizing campaign for higher wages. A major target of the campaign has been the McDonald’s franchise system in the United States, for which McDonald’s USA is the franchisor entity. A goal of the campaign was for the NLRB to rule that McDonald’s USA is a joint employer with its franchisees. The dissenting NLRB member in the *McDonald’s USA, LLC, a joint employer, et al.* case (*McDonald’s*) explained the importance of the issue:

> The heart of this proceeding is the allegation that McDonald’s [USA] is a joint employer with certain franchisees. A finding of joint-employer status, of course, would have important collateral consequences for McDonald’s [USA], in both unfair labor practice proceedings involving its franchisees and in possible representation cases, if workers employed at McDonald’s franchisees sought to organize. The prospect of such consequences makes this a case with very high stakes.\(^7\)

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B. The Disappointing Performance of the NLRB

The vision of labor law policy established through the vehicle of an expert Board knowledgeable about labor relations and supportive of collective bargaining has never been realized. There are a variety of reasons why the Board so little resembles the vision of its earliest advocates. One is the political nature of the appointments process, which sometimes has been used to reward labor for its support and sometimes has been used as a way of punishing labor for opposing the President’s policies. . . . Those with reputations as neutral experts have rarely been asked, and when asked, have generally declined.


7. McDonald’s USA, LLC, 368 N.L.R.B. No. 134 (Dec. 12, 2019) (Board order remanding to ALJ with instructions to approve settlement agreements) [hereinafter Order Remanding].
II. President Barack Obama’s NLRB General Counsel Appointee Joins the Campaign

The NLRB General Counsel is “appointed by the President, by and with the advice and consent of the Senate, for a term of four years.” The position includes the following powers:

The General Counsel of the Board shall exercise general supervision over all attorneys employed by the Board (other than administrative law judges and legal assistants to Board members) and over the officers and employees in the regional offices. He shall have final authority, on behalf of the Board, in respect of the investigation of charges and issuance of [unfair labor practice] complaints under section 160 of this title, and in respect of the prosecution of such complaints before the Board, and shall have such other duties as the Board may prescribe or as may be provided by law.

In turn, Regional Directors are appointed by the NLRB. On December 19, 2014, six Regional Directors under the direction of General Counsel Richard F. Griffin, Jr., issued six separate complaints against McDonald’s USA, McDonald’s Restaurants of Illinois, and twenty-nine franchisees in six major American cities. The complaints alleged that McDonald’s franchisees had committed 181 unfair labor practices, “including three discharges, suspensions, reduction of hours, surveillance, threats, promises of benefits, and interrogation, among others.” The complaints also alleged that McDonald’s USA was equally liable, even though McDonald’s USA had committed no violations. The December 2019 Order of the NLRB majority explains:

Although the complaints do not allege that McDonald’s [USA] independently violated the Act, they allege that McDonald’s [USA] “possessed and/or exercised” sufficient control over the labor relations policies of the [f]ranchisees that it is a joint employer with the [f]ranchisees and, as such, can be held jointly and severally liable for unfair labor practices committed by the [f]ranchisees.

In October 2017, General Counsel Richard F. Griffin, Jr.’s term ended; he was succeeded by a new General Counsel, Peter B. Robb, appointed by President Donald Trump. Further, the Obama majority Board was succeeded by the Trump majority Board.

III. The Hearing Before the NLRB Administrative Law Judge

At the onset of the case, the McDonald’s Respondents submitted proposed full settlements of the ULP charges, with the proviso that McDonald’s USA was not liable as a joint employer. The General Counsel Richard F. Griffin, Jr. and the Charging Parties rejected the proposed settlements because they

9. Id.
10. Id. § 4(a).
11. Order Remanding, supra note 7
12. Id.
wanted to resolve the joint employer issue. The complaints then proceeded to hearing before the NLRB Administrative Law Judge (ALJ).

The hearing before the ALJ opened on March 30, 2015. In the following years, numerous hearing days were held, focusing primarily on McDonald’s USA’s alleged status as a joint employer. The ALJ explained:

The parties gave their opening statements on March 10, 2016, and General Counsel began presenting witnesses on March 14, 2016. General Counsel called 52 current and former McDonald’s [USA] employees to testify regarding various aspects of the relationship between McDonald’s [USA] and its franchisees, including the Franchisee Respondents, over 78 days, concluding on January 26, 2017. General Counsel then called 34 witnesses in connection with the New York and Philadelphia unfair labor practice allegations, who testified over 24 days, concluding on May 23, 2017.


McDonald’s [USA] began presenting its direct witnesses on October 30, 2017, and 15 of its witnesses had testified when the hearing adjourned on December 13, 2017.

General Counsel presented 52 witnesses primarily addressing the joint employer issue over a ten month [sic] period. These witnesses testified for 78 days, and were [re]presented by seven attorneys for General Counsel. McDonald’s [USA] presented 15 witnesses who testified for 14 days. These case presentations comprise the bulk of the largest case ever adjudicated by this agency, and the longest hearing the agency has ever conducted.13

After conducting the longest hearing on record, and spending years litigating the joint-employer question, on March 19, 2018, the new NLRB General Counsel and the Respondents submitted settlement proposals resolving all the cases, including the proviso that McDonald’s USA was not a joint employer.

The settlement proposals were about the same as what the Respondents had offered at the commencement of this extraordinary labor case.14 The difference? A new NLRB General Counsel appointed by President Donald Trump.

IV. The Decision of the ALJ Relies on an Expanded Definition of Joint Employer

On July 17, 2018, the ALJ issued an Order Denying Motions to Approve Settlement Agreements. The ALJ found the proposed agreements

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13. App., Order Remanding, ALJ Order Denying Motions to Approve Settlement Agreements (July 17, 2018), supra note 7.
14. App., Order Remanding, supra note 7 (noting that “the Settlement Agreements . . . provide relief that largely could have been obtained in 2015”).
unreasonable in large part because they did not include joint employer status for McDonald’s USA.

A basis for this ruling was the novel formula of the previously composed NLRB, later overruled by the NLRB members appointed by President Donald Trump.15 The short litigation history is described in a recent publication of the ABA’s Forum on Franchising:16

In denying the proposed settlement agreements, the ALJ wrote:

On August 27, 2015, the Board issued its Browning-Ferris decision. Thus, General Counsel was no longer required to prove McDonald’s [USA’s] actual exercise, as opposed to possession, of authority over terms and conditions of employment at the Franchisee Respondent locations, and was no longer required to demonstrate McDonald’s [USA’s] “direct and immediate control” over the work of employees at Franchisee Respondent locations in order to establish joint employer status.

. . . .

On December 14, 2017, the Board issued its decision in Hy-Brand Industrial Contractors, Ltd., overruling Browning-Ferris and returning “to the principles governing joint employer status that existed prior to that decision”—the legal standard applicable when General Counsel issued the Consolidated Complaint herein. . . . [On February 26, 2018,] the Board vacated its decision in Hy-Brand Industrial Contractors, Ltd., reinstating the Browning-Ferris standard which would presumably be more advantageous to General Counsel.17

Hy-Brand was not reversed on the merits, but rather was vacated because one member of the 3-2 majority was recused, resulting in a 2-2 tie (which served to revive the 3-2 NLRB decision in Browning-Ferris). Accordingly, the ALJ rejected the settlement based on the Browning-Ferris standard.

V. The New NLRB Engages in Rulemaking to Restore and Clarify the Meaning of Joint Employer

The NLRA authorizes the NLRB to engage in rulemaking.18 On September 14, 2018, following the circuitous procedural history in the McDonald’s case, the NLRB issued its Notice of Proposed Rulemaking regarding the
Standard for Determining Joint-Employer Status. The proposal amended 29 C.F.R. pt. 103 as follows:

§ 103.40: Joint employers.
An employer, as defined by Section 2(2) of the National Labor Relations Act (the Act), may be considered a joint employer of a separate employer’s employees only if the two employers share or codetermine the employees’ essential terms and conditions of employment, such as hiring, firing, discipline, supervision, and direction. A putative joint employer must possess and actually exercise substantial direct and immediate control over the employees’ essential terms and conditions of employment in a manner that is not limited or routine.

Example 5 to § 103.40. Under the terms of a franchise agreement, Franchisor requires Franchisee to operate Franchisee’s store between the hours of 6:00 a.m. and 11:00 p.m. Franchisor does not participate in individual scheduling assignments or preclude Franchisee from selecting shift durations. Franchisor has not exercised direct and immediate control over essential terms and conditions of employment of Franchisee’s employees.

Example 6 to § 103.40. Under the terms of a franchise agreement, Franchisor and Franchisee agree to the particular health insurance plan and 401(k) plan that the Franchisee must make available to its workers. Franchisor has exercised direct and immediate control over essential employment terms and conditions of Franchisee’s employees.

After satisfying the notice and comment period for rulemaking, the NLRB joint employer rule officially became effective on April 27, 2020, thereby overruling the Browning-Ferris standard.

VI. The New NLRB Reverses the ALJ

By reason of the United States presidential appointment process, by late 2017 the Obama Board majority had been succeeded by the Trump Board majority. On December 12, 2019, while the rulemaking was pending before the NLRB, a panel majority reversed the ALJ and accepted the settlements agreed to by the new General Counsel and Respondents.

In accepting the settlement agreements, the NLRB majority explained that the cases encompassed “over 150 hearing days over almost three years,” and that further litigation would needlessly prolong the cases despite the fairness of the remedies in the settlement agreements:

From the employees’ point of view, the remedy they will receive under the settlement agreements is essentially identical to that which they would have received if the General Counsel’s joint-employer theory had prevailed, except for a broader notice-posting requirement. This is especially true given that the complaint does not allege that McDonald’s [USA] independently committed any unfair labor practices itself.

The NLRB majority also explained that “the Board has generally not held franchisors to be joint employers with their franchisees.” 22 As to Browning-Ferris, the NLRB majority explained that it was distinguishable on several grounds. First, on appeal to the Court of Appeals, Browning-Ferris was affirmed only in part.23 Second, not only was Browning-Ferris not a franchise case, but also the Browning-Ferris NLRB majority “explicitly disclaimed an intent to address the joint-employer standard in the context of the relationship between a franchisor and a franchisee.”24 And finally, Browning-Ferris did not decide that a franchisor would be a joint employer by acting to protect its product or brand: “Browning-Ferris thus left open the question of whether the Board should continue to exempt franchisors from joint-employer status to the extent their control over employee working conditions is related to their legitimate interest in protecting the quality of their product or brand.25

Taking into consideration the viewpoint of the Franchisee Respondents, the NLRB majority wrote:

The Franchisees agree with and adopt McDonald’s [USA] arguments. They emphasize that they are small businesses with limited resources that have become unjustifiably embroiled in costly and time-consuming litigation over matters that have nothing to do with the mostly minor unfair labor practice charges against them, but instead relate to the previous General Counsel’s desire to establish McDonald’s [USA] as a joint employer.26

In accepting the settlements, the NLRB majority also relied on its proposed rule, which would clarify future NLRB law regarding joint-employer status, bringing to an end “this unique case”:

[T]he potential adverse impact on all parties of delay and expense from further litigation in a unique case such as this, which already ranks among the longest and most complex proceedings in Board history—for the judge to update and clarify the case law on a matter that is now the subject of a proposed rulemaking—further demonstrates why it is appropriate for the Board to rule on the propriety of the settlement agreements now rather than in a subsequent review on exceptions to the judge’s eventual decision.27

Later, in its Order, the panel majority added:

22. Id.; see also, e.g., S.G. Tilden, Inc., 172 NLRB 752, 753 (1968) (finding that franchisor was not a joint employer, even though the franchise agreement dictated “many elements of the business relationship,” because the franchisor did not “exercise direct control over the labor relations of [the franchisee] and “the requirement that the franchisees observe . . . standards set by [the franchisor] was merely to keep the quality and goodwill of the [franchisor’s] name from being eroded”).
23. Order Remanding, supra note 7, n.24 (citing Browning-Ferris Indus. of Cal., Inc. v. N.L.R.B., 911 F.3d 1195 (D.C. Cir. 2018)). Indeed, “[t]he court . . . found, that in applying the indirect-control factor, the Board failed to confine its analysis to indirect control over the essential terms and conditions of employment. The court accordingly remanded that aspect of the decision to the Board for it to explain and apply its test consistent with common-law limitations.” Id.
24. Id. (citing Browning-Ferris, 362 N.L.R.B. at 1618 n.120).
25. Id. (citations and quotations omitted).
26. Id. n.24.
27. Id. n.15.
Moreover, the Board’s recent notice of proposed rule-making regarding the standard for determining joint-employer status, which issued after the judge’s order, may render moot the utility of using this case as a vehicle to develop joint-employer law. The proposed rule specifically addresses elements of the franchisor/franchisee relationship [examples 5 and 6]. As the General Counsel points out, if the Board implements a new joint-employer standard through rule-making, it will likely supplant any standard arising from the litigation of these cases. As a result, a decision regarding joint-employer status may have limited precedential value.28

VII. President Donald Trump’s Administration Is Developing Similar Joint Employer Rules for Other Federal Agencies

In January 2020, the United States Department of Labor (DOL) announced its Final Rule for determining “joint employer” status under the Fair Labor Standards Act (FLSA).29 The FLSA requires minimum wage and overtime pay for hourly employees. The effective date of the new DOL FLSA rule was March 16, 2020.30

Like the NLRB rule, the DOL rule contains a four-factor balancing test. For franchisors, the factors are whether the franchisor hires or fires its franchisor’s employee; supervises and controls the employee’s work schedule or conditions of employment to a significant degree; determines the employee’s rate of pay and method of payment; and maintains the employee’s employment records.31 Under the new test, a franchisor would avoid joint employer liability, if it did not engage in the day-to-day employment decisions of its franchisees.32

The United States Equal Employment Opportunity Commission is also proposing a joint employer rule.

VIII. Concluding Observations on Franchisor Liability Under Federal Labor and Employment Laws

It happens on occasion that conflicting political goals can lead to turmoil in a sector of the economy. In the authors’ view, partisanship at the NLRB put the franchise business model at risk in the United States. If a franchisor with many franchisees were a joint employer, the franchisor easily could vicariously become a “repeat violator” although it had committed no unfair labor practice. Repeat violators are subject to more severe remedies and to adverse publicity. Despite the claims of the administration of President Donald Trump that it has aided the economy by eliminating administrative rules,

29. See 29 C.F.R. § 791 et seq.
30. Id.
31. Id.
32. Id.
the issue at the heart of the *McDonald’s* case demonstrates that not all administrative rules are bad.

**IX. Epilogue: Federal Rules Alone May Not Save the Franchise Business Model**

The franchise business model in the United States may suffer a series of collateral attacks from state governments. While the new NLRB was working to resolve the *McDonald’s* case, the state of California passed Assembly Bill 5 (AB5), which became effective January 1, 2020. Since the NLRB wields federal preemption on all labor union issues, California’s AB5 instead considers franchisors joint employers for state wage and employment law provisions. For many such provisions, such as the minimum hour wage regulation, state governments in the United States federal system may require employers to comply with rules beyond those promulgated by the DOL and other federal agencies. This means that, while the NLRB rule prevents franchisee employees from organizing as a labor union and negotiating as a bloc against the franchisors, state law may negate the utility of any such federal protections: franchisors still can be held liable for a litany of other state employment regulations vis-à-vis franchisee employees.
Franchisor Consolidations in a Post-Pandemic World

Bret Lowell

“If nothing else, this pandemic has made us understand that there are real risks we sometimes can’t see or don’t credit until it is too late.”

The wave of franchisor consolidations resulting in families of franchisors in the same or related industries will be different post-pandemic than it was before COVID-19. The consolidation craze that existed pre-COVID-19 will continue in an opportunistic way, but will be moderated by a recognition that consolidation sometimes yields rewards that can be overtaken by risks.

I. The History of Consolidation

Virtually every franchisor began with a glimmer in the eye of a single entrepreneur. Some of those made it big time, and others did not. For those concepts that caught on, the company may have become the unicorn in their industry. Think of Ray Kroc and McDonald’s; Colonel Sanders and KFC; William Rosenberg and Dunkin Donuts; the Bloch brothers and H&R Block; and Ben and Jerry, Bill Marriott, and Conrad Hilton and their namesake companies. More recent examples include Fred Deluca of Subway, Annie Beiler of Auntie Anne’s, Jerry Murrell and sons of Five Guys, and Jimmy John and his namesake sandwich shops.

At some point, the founding entrepreneurs typically sell to investors—either in whole or in part. From there, winning buyers often take the franchise system to “the next level.”

Franchise systems can be attractive targets. The most desirable have strong financials such as healthy and predictable revenue streams and margins, cost controls, corresponding profitability, superior debt to equity


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leverage potential, and great return on investment (ROI) (which could arise in either a “gold plated” deal or a deal involving underperformance with superior turnaround). Franchise systems also typically come with positive drivers for expansion, including a proven business concept and model, a growing market, few or manageable regulatory hurdles, a strong trademark and a positive brand reputation, healthy relations with franchisees, untapped potential (such as new markets and technological efficiencies), and a good and stable management team. Attractive targets also sometimes provide “synergies” with other already owned businesses (more on this ahead).

The acquirers of attractive franchise systems are commonly private equity (PE) firms. These financial management companies have been acquiring operating franchisors through both leveraged buyouts and the provision of growth capital. Their relatively long-term investments of roughly seven years are often industry focused with, for example, some focused on the restaurant space, while others focus on the need for household services, automotive, health and wellness, and other industries and industry segments. After an initial acquisition in an industry space, these PE firms sometimes acquire, in what is called an “add-on” or “bolt-on,” one or more additional franchisors in the same or a complimentary space to create synergies among the franchise systems.

Other common acquirers are “strategic” buyers, who are looking to buy others in their industry. These may be direct competitors, who operate virtually in the same type of business as the acquirer (such as a pizza franchisor acquiring another pizza franchisor) or indirect competitors who operate in a related type of business (such as a chicken franchisor acquiring a hamburger franchisor). Strategic buyers too may later acquire additional add-on companies.

II. Types of Consolidations

Both of these types of acquirers—PE firms and strategic buyers—can eventually amass a “franchisor family,” and many have done so. As discussed in Part III ahead, the synergies that derive from such consolidations are a natural force that drives this result. The consolidations, however, are not all the same, and it is useful to distinguish among them. In the four descriptions ahead, designations of Synergy Level One through Synergy Level Four indicate the different types of consolidations and the perceived potential to achieve greater profitability through synergies.

A. Acquisition of Direct Competitors (Synergy Level One)

Some acquisitions are of franchisors that compete practically head-to-head—or at least in the same industry space. While management may draw appropriate distinctions among geographic footprints, customer bases, marketing strategies, and more, the essence is that these businesses are the same type and, therefore, perceived as being capable of deriving the most synergy from a consolidation. The synergy often derives from the efficiencies of
eliminating or combining overlapping functions, such as the merger of two similar departments into one, or the enhanced purchasing power of buying for two systems instead of for just one.

Examples of ownership of direct competitors on the PE side include the following: CenterOak Partners (the owner of FullSpeed Automotive (which in turn owns Grease Monkey and SpeeDee Oil, and their common focus on oil changes)), Palladium Equity Partners (the owner of CircusTrix (which in turn owns Sky Zone and Rockin’ Jump, and their common focus on indoor trampoline and entertainment parks), and Quad Partners (the owner of Streamline Brands (which in turn owns SafeSplash, Swimtastic, and SwimLabs, and their common focus on swim schools).

And, on the strategic side directly competitive ownership examples include the following: Avis Budget Group (Avis and Budget), Annex Brands (Pak Mail and Parcel Plus), Fat Brands (Fatburger and Elevation Burger, and Ponderosa and Bonanza), Franchise Services (PIP Printing and Sir Speedy Printing), Hertz Global (Hertz, Dollar, Thrifty), Ichan Automotive Group (AAMCO Transmissions and Cottman Transmissions), Regis Corporation (Supercuts and Cost Cutters), and Realogy Holdings Corp. (Century 21 and Coldwell Banker).

B. Acquisition of Indirect Competitors (Synergy Level Two)

Some franchisor families compete only indirectly. They are arguably in the same industry segment (e.g., restaurants), but because of the different product offering (chicken vs. pizza), delivery method (e.g., dine-in vs. take-away), or other characteristics are most appropriately perceived as only indirectly competitive. In the sense that we typically eat lunch only once a day, these disparate restaurants are in competition, but then some days we are not really looking for chicken or pizza so they are not competitive in that direct sense. In a market generally best defined broadly (e.g., as the restaurant industry, the automotive repair industry, or the hotel industry), these segmented businesses are only indirectly competitive as they provide different product or service offerings. Such businesses when consolidated offer synergies that can be significant, but (as discussed later) not as potentially significant as those at Synergy Level One.

Examples of common ownership of indirect competitors abound. On the PE side, they include Roark Capital (the owner of Focus Brands and Inspire Brands, which in turn own franchisors that use different brands for different types of restaurants), Brentwood Associates (the owner of restaurant franchisors Blaze Pizza, Chicken Salad Chick, and Veggie Grill), Levine Leichtman (the owner of Caring Brands, which, in turn, owns Interim Healthcare and two other healthcare franchisors), and TZP Group (the owner of Lift Brands, which in turn owns franchisors that use different brands for different types of fitness businesses).

And, on the strategic side, examples include YUM Brands (NYSE: YUM) (owner of KFC (chicken), Pizza Hut (pizza), and Taco Bell (Mexican)),
ServiceMaster (NYSE: SERV) (owner of ServiceMaster Clean and Merry Maids), and Restaurant Brands International (NYSE: QSR) (owner of Burger King (hamburgers), Tim Hortons (donuts), and Popeye’s (chicken)), and Dessange International (owner of Fantastic Sam’s, Camille Albane Salons, and Dessange Salons).

Hospitality is another industry in which examples of indirect competition abound. With a broadly defined market consisting of lodging, the major hotel companies have segmented the various brands that they each own into categories such as budget, economy, mid-priced, upscale, luxury, business, limited-service, full-service, extended-stay, suite, resort, leisure, lifestyle, apartment, and more. Despite this segmentation, many of the acquired brands indirectly compete for “heads in beds” with other brands within the same hotel family. The number of such brands currently owned by the major hotel families are approximately as follows: Accor (37), Marriott (30), Wyndham (20), Hilton (18), Hyatt (15), Intercontinental (IHG) (18), and Choice Hotels (12).

C. Acquisition of Complimentary Franchisors (Synergy Level Three)

In consolidating franchisors, some acquirers have sought not to bring on direct or even indirect competitors but, rather, other types of franchisors that are only (or mostly) complimentary to the franchisors already in their portfolio. For example, the owner of a franchise system that services residences, would acquire franchise systems that can also service homeowners but in other segments of the residential service category. When consolidated, these businesses offer synergies that can be almost as synergistic as those at Synergy Level Two, especially when the systems are encouraged to collaborate.

A classic example of such an amalgamation is Neighborly (owned by Harvest Partners, and formerly known as The Dwyer Group). This collection of almost twenty franchisors performs residential services in categories such as painting, plumbing, electrical repair, appliance repair, residential cleaning, carpet cleaning, glass repair, landscaping, and more. And systems are in place to encourage referrals from one franchise system to the other. Similarly, Apax Capital owns Authority Brands, which in turn owns seven franchisors that offer different types of household services.

Another example is the real estate franchisor, Re/Max, which acquired a mortgage franchisor, Motto Mortgage, to compliment the services that it provides to home buyers.

D. Acquisition of Unrelated Franchisors (Synergy Level Four)

Many buyers of franchisors do not seek the synergies associated with “addons” and “franchisor families.” These buyers are often opportunistic and see value even without the maximization of synergies. While there may be some synergies as a result of owning multiple yet diverse types of unrelated franchisors, those synergies are likely to be less than those associated with the Synergy Levels described previously.
As an example, Sentinel Capital Partners owns and has owned not just restaurant franchisors, but also franchisors of automotive transmission repair, massage, and pet-supply systems. Similarly, Roark Capital owns and has owned not just restaurant franchisors, but also franchisors related to fitness, beauty and health; home improvement, signage and advertising, education; batteries, pet supplies, and more. Another example is KSL Capital Partners (which owns WellBiz Brands (with separate franchisors for fitness, massage, and eyelashes), as well as unrelated dine-in and snack food franchisors). The commonality of owning several franchise systems, even in diverse industries, provides for some synergies. Overwhelmingly though, that diversity helps to minimize risk for the consolidator in the case of a downturn in a particular industry.

III. Reasons for Consolidation

Franchising itself is successful, in large part, because it takes advantage of certain efficiencies. Rather than have 100 independent businesses, with 100 brands, 100 marketing departments, and 100 sales and operating procedures, these functions are streamlined at the single level of the franchisor. In contrast to the 100 business operations, the combined and cooperative activities and functions undertaken at the franchisor level with the assistance and on behalf of the 100 operating franchisees leads to efficiencies and cost savings called “economies of scale,” and an overall combined effect that is greater than the sum of the 100 individual parts. This latter gain is known as “synergy.”

Increased or enhanced economies of scale, and greater synergy, can be achieved by putting several franchisors under one roof. Doing so provides opportunities to pool resources. For example, three franchisors from the same industry with common leadership enables reliance on and support from one executive team, one marketing department, one sales department, one operations department, one supply chain, one IT department, one training department, one HR department, one accounting department, one legal department, one office building, and so on. From this merging of departments arises the cost savings associated with economies of scale.

The degree to which economies of scale are available, however, will vary based on many factors. One of these factors is the degree to which the combined franchisors are similar. The more similar the franchisors, the greater the economies of scale and the greater the synergies. Thus, in the types of acquisitions described earlier, acquisitions of franchisors:

• that are in direct competition with other owned franchisors (Synergy Level One) enjoy the greatest potential for economies of scale and synergy (see the list in the prior paragraph of potential single-department implementation);

• that are in indirect competition with owned franchisors (Synergy Level Two) enjoy the second highest level of potential for economies of scale
and synergy (where certain departments may be able to be merged, but not others);
• that are *complimentary* to already owned franchisors (Synergy Level Three) enjoy the third highest level of potential for economies of scale and synergy (and where even fewer departments than in Synergy Level Two will be able to be merged); and
• that are *unrelated* to already owned franchisors (Synergy Level Four) enjoy the lowest level of potential for economies of scale and synergy (and where very few departments are likely to be able to be merged).

**IV. Consolidation Increases Risk**

Consolidation and its “economies of scale” and “synergies” can be and often is a winning strategy. We have gone through unprecedented waves of consolidation in franchising, with enormously positive results, both on the franchisor level and the franchisee level. Sales of franchisors have led to extremely active auctions with the activity having even been called a “feeding frenzy” and with multiples of “earnings before interest, taxes, depreciation and amortization” (EBITDA) reaching into the high teens and even the low twenties. Sales of multi-unit franchised businesses also have been active and high priced. But along with these rewards comes risk.

These risks have come to the surface with COVID-19. Entire industries have been decimated, including many in which franchising is commonly used. These industries include restaurants and bars, hotels, amusement and entertainment venues, travel planners, car rental companies, personal service businesses, fitness clubs, and more. The Hertz/Dollar/Thrifty bankruptcy serves as one high profile example of what can happen when a franchise family is heavily concentrated in a single space (i.e., car rental). And it is curious to consider whether the outcome might be different if Hertz still owned the industrial and construction equipment rental operations that it sold off several years ago.

Even franchise families that do not compete directly, like restaurants and hotels, for example have suffered significant pandemic losses. Those portfolios typically have less diversification than franchisor families made up of complementary franchised businesses or unrelated businesses. During the initial wave of pandemic-related shutdowns, a portfolio of dine-in businesses or hotels dropped more or less in tandem. A portfolio that had within it complementary franchisors or franchisors in diverse industries might have had some of the losses mitigated. Of course, the mix matters, and exceptions exist, such as for a mix of franchisors of dine-in and take-out restaurants that might have had losses mitigated by the take-out restaurants that were already in place to respond to the abrupt change in demand.
V. Lessons for the Post-Pandemic World

The post-pandemic world will no doubt lead to many opportunities for greater consolidation of franchisors. There will be sales of failed franchisors, fallen franchisors, bankrupt franchisors, and insolvent franchisors. And many of these transactions will be far different from those that took place pre-COVID. Processes that worked pre-pandemic will be adjusted. No longer will it mean simply hiring an investment banker, reviewing the Teaser and Confidential Information Memorandum, conducting due diligence, preparing a Buy-Sell Agreement, holding Management Meetings, conducting an auction, and picking a winner. These deals will likely have more “hair” on them and require more careful analysis to understand the full picture.

While each will be different, we can anticipate some upcoming transactions needing bankruptcy court approvals (which will allow, for example, the shedding of certain contracts, and transfers free of prior claims), sales of some assets (or territories) and not others, heavy lender and landlord negotiations, real estate sale-and-leasebacks, recapitalizations (debt or equity), infusions of working and growth capital, holdbacks and earn outs, complicated structures such as convertible arrangements, purchases of distressed debt, and more. How these transactions are structured can be as important as the stock or assets being acquired.

Those PE firms with “dry powder,” and strategic buyers with cash hoards, no doubt will be wanting to gain market share and greater synergies by buying up prior competition. The temptation to acquire industry competitors will be significant, especially so at the right price.

But, COVID-19 has illuminated a risk that previously lurked in the dark. On top of all of the financial, industry, and system analyses, diversification and correlation concerns will move to the forefront. Sponsors will be looking across the portfolio to understand how a new acquisition might make investors especially vulnerable during a crisis, for example, investors with Synergy Level One portfolios might consider Synergy Level Four opportunities to diversify and thereby mitigate risk at the cost of lower synergies. Some eventual market conditions can be readily imagined, such as a second COVID-19 wave, another pandemic, or even industry-focused headwinds such as the effect on auto repair franchises of increased consumer demand for electric vehicles, and the work-at-home phenomenon affecting franchises for commercial printing.

In other words, is the extra reward that comes from the economies of scale and synergy of consolidating same or similar types of franchisors going to be worthwhile when considering the increased risk? This analysis may also lead some owners of consolidated franchisors to conclude not only that further consolidation in a non-diversified manner is too risky, but also that the current portfolio is too risky and that some divestiture of same or similar businesses needs to take place.
VI. Conclusion

The “feeding frenzy” era of traditional franchisor acquisitions is likely over at least for a while. But the appetite for franchisors, and the synergies that they bring to the table, will clearly continue. In the short run, this will entail picking up the pieces from the current economic crisis often in bankruptcy and through financial reorganizations. In the long term, it will likely mean a return to traditional M&A activity, but this time with a greater understanding of the need for diversification or at least the risks of running an industry-concentrated portfolio.
Dispute Resolution in the Twenty-First Century: The Challenge to Get ADR Right

W. Michael Garner

Well before the Internet and, indeed, personal computers, I was a first-year associate in a large firm, working on a large case. One sunny spring day, I was called into a conference room for a “team meeting” and found the lead partner, surrounded by a dozen associates, raising a glass for a toast: “Five years,” the partner boomed. “Five years since they filed the complaint, and we still haven’t had to answer!” I didn’t fully appreciate the celebration at that time.

It was true. Through extensive motion practice—changes of venue, standing challenges, third-party practice, motions to dismiss—the case, on the merits, stood pretty much where it had been when it had been filed, manually, with the court, in the prior decade. And while five years was extreme even in those days, the delay was emblematic of commercial litigation of that era: endless motion practice; depositions without time limits, riddled with speaking objections and theatrics; document productions that consisted of sending the other side to a dank, cavernous warehouse, accompanied by two security guards. In that early case, plaintiffs had to take emergency depositions to preserve the testimony of some witnesses who might die before trial.

All of that has changed. Amendments to federal and state procedural rules, strengthened judicial supervision of case scheduling, and an expanded role for federal magistrate judges have made most court cases fulfill the promise of Federal Rule of Civil Procedure 1 to effectuate the “just, speedy, and inexpensive determination of every action.” At the same time, franchisors have embraced arbitration and other alternative dispute resolution (ADR) methods—particularly mediation—as the preferred pathways to resolving disputes. The rapid and ubiquitous rise of ADR in the last two decades, like any new development, raises novel questions as to

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its application and effectiveness. At the same time, as franchisor lawyers have been drafting ADR clauses for long-term agreements, the ground has changed under them as the Supreme Court has decided a number of cases affecting the construction and enforceability of those clauses and lower courts and arbitrators have reached differing results on enforceability of mandatory mediation provisions. This article will focus upon some of the key issues that ADR has raised, along with some of the lessons to be learned from recent decisions. At the conclusion, a model ADR provision is proposed that reflects the current state of the law and, it is hoped, avoids pitfalls that many provisions have raised.

I. An Overview of ADR Mechanisms

ADR is significantly different from litigation in several respects. First, ADR is a product of agreement between the parties; the type of ADR, the time frame, and the possible solutions to a dispute are all controlled by contract. Those contractual provisions, usually made well prior to a dispute, may conflict with either the parties’ needs or rapidly changing applicable law at the time a dispute arises. Second, ADR may be, and usually is, private and confidential. Confidentiality may be an advantage or disadvantage for either party; if the dispute is in arbitration, an arbitration award may be disclosable in a franchisor’s Item 3. As a practical matter, however, confidentiality has a price: confidential ADR, including arbitration, does not yield public precedents that attorneys can look to for guidance. In franchising, moreover, there may be disparity in access to those decisions—a franchisor may have numerous decisions at hand, while a franchisee does not. Further, even if arbitration awards are available, their precedential value is questionable and may vary, depending upon governing law. A third difference is cost: mediators and arbitrators must be paid, and contracts may dictate that one or the other of the parties pay those costs. The burden of these expenses raises practical hurdles that may bar some persons from pursuing dispute resolution, while non-payment of fees in arbitration may lead to sanctions or a finding that

1. First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995) (determining whether an arbitrator has the authority to decide arbitrability if a party is not a signatory to arbitration agreement); Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662 (2010) (holding that where parties had reached “no agreement” on class arbitration, arbitrators could not impose class arbitration); AT&T v. Concepcion, 563 U.S. 333 (2011) (upholding contractual waiver of class arbitration); Lamps Plus, Inc. v. Varela, 139 S. Ct. 1407, 1412–13 (2019) (dicta that class arbitration is inconsistent with the FAA).
2. See infra text accompanying notes 15–17, 26–29.
3. 16 C.F.R. § 436.5(c).
5. See, e.g., American Arbitration Association (AAA) Commercial Arbitration Rules R-57 (non-payment of fees may result in suspension of proceeding, preclusion of presentation of affirmative case, or termination of the proceeding).
the non-paying party breached the arbitration agreement, thereby permitting the other party to go to court. Finally, if the parties must arbitrate, there is essentially no appeal from an arbitration decision.6 Arbitrators have much broader authority to decide cases than courts, and the absence of plenary appeal means that the parties face a far more uncertain, and ultimately binding, result when they arbitrate, as opposed to when they litigate. This, along with costs, raises the stakes of a dispute, and may encourage the parties to settle—but perhaps on terms that are less favorable than if they had litigated.

Although ADR opens the door for parties to resolve disputes on their own, the relative newness of ADR and the absence of substantial precedent make the path to resolution more uncertain than litigation. On the one hand, ADR provisions may indeed be a productive way to resolve disputes; on the other hand, they may be tools to delay, frustrate, and ultimately defeat legitimate claims of one of the parties.

II. Common ADR Provisions in Franchise Agreements

The most common ADR provisions in franchise agreements today include mediation and arbitration; some also include pre-mediation negotiation.7 Typically, franchise agreements require a party to engage in negotiation or mediation—and sometimes both—before bringing a claim for arbitration. For that reason, negotiation and mediation are often referred to as “prerequisites” to commencing an arbitration or filing a lawsuit.

6. The Federal Arbitration Act (FAA) permits courts to vacate an award only in the following circumstances:

   (1) where the award was procured by corruption, fraud, or undue means;
   (2) where there was evident partiality or corruption in the arbitrators, or either of them;
   (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
   (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.


7. See, e.g., Anytime Fitness Franchise Agreement, art. 18 (2019) (optional dispute resolution through Peer Compliance Committee if both sides agree; otherwise, mandatory mediation for at least four hours, followed by arbitration; emergency relief in court), https://www.cards-commerce.state.mn.us/CARDS/security/search.do?documentId=90EE266A-0000-4F96-9CA1-51AE4FA65B9B; Aamco Franchise Agreement, art. 26 (2019) (mandatory mediation through JAMS followed by JAMS arbitration; emergency relief in court), https://www.cards-commerce.state.mn.us/CARDS/security/search.do?documentId=90D1496C-0000-C73A-815F-71E476503044; Brightstar Senior Living Franchise Agreement, art. 16 (2019) (mandatory negotiation between senior executives of franchisee and franchisor within sixty days of notice of dispute, followed by mandatory mediation before AAA; followed by arbitration; emergency relief in court), https://www.cards-commerce.state.mn.us/CARDS/security/search.do?documentId=8021416E-0000-C63F-9E63-88063F6A684A.
A sample mandated negotiation provision might state:

We and you have entered into a long-term franchise relationship which gives rise to an obligation, subject to and consistent with the terms of this Agreement, to endeavor to make the relationship succeed, in light of the overall best interests of the System. To that end, you and we acknowledge that you and we need to attempt to resolve disagreements or disputes before such disagreements or disputes negatively impact the relationship. Good faith communications between us are an important aspect of that obligation. The parties hereby pledge and agree that they will first attempt to resolve any dispute, claim or controversy arising out of or relating to this Agreement by first having our executive officers and your Principal Equity Owners meet in person at our principal executive office (with or without legal counsel) to conduct a good faith discussion and negotiation of the issues with a view to arriving at a settlement. Until such discussions are completed, you agree that you will not commence any mediation, arbitration or litigation in any court.

While at first blush, this provision appears to be a salutary effort to resolve disputes, it leaves questions unanswered: Why does the franchisee have to bear the cost of going to the franchisor’s office? Who are the franchisor’s “executive officers?” Must they all be present? What if the franchisor sends an underling with no authority to the meeting? And perhaps the most important questions: Is there a time limit in which the meeting must take place, and who determines when “discussions are completed”?

More common than requirements for negotiation are provisions requiring mediation. A typical provision states:

The parties agree to submit any claim, dispute or disagreement, including any matter pertaining to the validity, enforcement or interpretation of this Agreement or issues relating to the offer and sale of the franchise or the relationship of the parties to mediation before a mutually-agreed mediator prior to arbitration. If the Dispute is not resolved by mediation within 30 days after either party makes a demand for mediation, the parties will submit the dispute to binding arbitration.

Again, the simplicity of this provision is deceptive: Who pays for the mediation? What if the parties cannot agree on a mediator? And is 30 days from the demand for mediation sufficient time to conduct it?

Arbitration provisions in franchise agreements vary considerably. A simple provision follows:

Unless either party seeks injunctive relief to prevent irreparable harm to its business or goodwill, all disputes and claims arising out of or relating to this agreement, the validity thereof, its performance, or to the relationship of the parties shall be submitted for decision to arbitration before a single arbitrator of the American Arbitration Association under its then-existing Commercial Rules. Such arbitration shall take place where the Franchisor has its principal place of business. The arbitrator must have at least five years’ experience in franchise law and must follow applicable law and this Agreement, and will file a reasoned award. All arbitration proceedings shall be individual proceedings between you and us, and no class or consolidated proceedings involving other franchisees shall be permitted. The arbitrator may permit limited discovery prior to the hearing, consisting of no more than 10 document requests and two depositions per side.
Issues that arise with respect to arbitration provisions include the enforceability of arbitration generally, the scope of the parties subject to arbitration—for example, whether the franchisor’s or franchisee’s officers or employees, if named as parties, are subject to a clause that they did not sign; the scope of discovery; allocation of arbitration costs between the parties; and the enforceability of prohibitions on class or consolidated actions.

Issues abound with respect to ADR mechanisms. Considered below are, first, issues concerning prerequisites to arbitration or litigation, followed by selected issues that arise in arbitration.

III. Common Issues in Negotiation and Mediation

Because of the relative novelty of ADR, there are issues for the practitioner that may cut across a wide variety of situations, considered in the following.

A. Statute of Limitations

Negotiation or mediation takes time. If a limitations period is about to run, either under a statute or pursuant to a contractual provision, the need to file or serve a lawsuit promptly may conflict with required prerequisites. Should suit be filed prior to the expiration of the limitations period despite the prerequisites, or should compliance with required negotiation or mediation take place before bringing an action and risk that the limitations period will pass?

In the absence of an agreement to the contrary or an applicable tolling statute, a request to negotiate or a demand for mediation will not toll the limitations period. A few states provide by statute that mediation conducted pursuant to specified mediation programs tolls the limitations period, but the practitioner should be careful to check whether such a statute will apply under the agreement’s choice of law clauses and whether mediation under the agreement is consistent with the statute. In the absence of such a statute, a simple solution is to request that the other side toll limitations periods pending prerequisites. Such a tolling agreement should be as broad as possible and cover known and unknown claims. It may toll the limitations periods for an indefinite period, until the dispute is settled or the prerequisites are completed, or it may have a finite tolling period of a stated number of days. If the other side will not agree to toll the claims, the only safe recourse is to file a demand for arbitration or a lawsuit. While such an action may be


subject to a motion to dismiss for failure to comply with the prerequisites.\textsuperscript{10} It may be possible to avoid such a motion by filing a motion or request to stay the proceedings pending completion of the prerequisites.

If the limitations period runs during the time the prerequisites are pending, a plaintiff may be able to avoid the limitations bar through equitable tolling or equitable estoppel. Equitable tolling “is generally applied where a plaintiff has been misled or lulled into inaction and has, in some extraordinary way, been prevented from asserting his rights, or has timely asserted his rights in the wrong forum.”\textsuperscript{11} It usually requires a showing of three factors: the defendant had notice of a claim; the defendant is not prejudiced by being required to defend; and plaintiff’s conduct must have been reasonable and in good faith.\textsuperscript{12} In \textit{Beck v. Battelle Energy Alliance, LLC}, the court held that a required mediation in an employee handbook tolled the limitations period for an employment claim and observed that “the mandatory mediation requirement effectively cut [Plaintiff’s] time for pursuing his claim in half.”\textsuperscript{13} In contrast, where a mediation clause was not clearly mandatory, equitable tolling did not apply.\textsuperscript{14} Certainly, a party’s participation in contractually required negotiation or mediation raises compelling equities raising the defense of equitable tolling.

Ideally, franchise agreements requiring prerequisites would include a provision automatically tolling limitations periods upon the filing of a request to negotiate or to mediate; but unless such provisions bind all potential parties to a dispute, they may not be fully effective. In that case, it would still be necessary to start an action before completion of the prerequisites.

\section*{B. Time Limits for Prerequisites}

If the contractual prerequisites to commencing an action do not limit the time in which they must take place, there is a high risk they will be used to frustrate and delay. The absence of a time limit puts the aggrieved party in a dilemma: once it has requested negotiation or mediation, if the other party delays, how long should it wait before taking further action, and if so, what action?

\textsuperscript{12} Fink v. Shedler, 192 F.3d 911, 916 (9th Cir. 1999) (limitations period not tolled for lack of good faith where amended complaint proposed to add new parties and claims); Preston v. Transp. Ins. Co., 102 P.3d 527, 530 (Mont. 2004) (worker’s compensation limitations period equitably tolled during statutory mediation period).
In a series of parallel arbitration cases against franchisor ILKB, LLC, the franchisor of iLoveKickboxing studios, the franchise agreement required, first, a face-to-face meeting between the parties to attempt to resolve the dispute, followed by mediation; if mediation was unsuccessful, either party could commence arbitration. Each of the franchisees, in accordance with the agreement, sent demand letters to the franchisor calling for a face-to-face meeting to resolve their claims of fraud in connection with the purchases of their franchises. The franchisor responded to each with a string of delaying tactics: demanding extensive franchisee financial documents, proposing to buy the franchisees’ businesses pending lengthy “due diligence,” and claiming that any resistance to these demands constituted bad faith. After roughly ninety days, each of the franchisees filed demands for mediation and arbitration. ILKB moved to dismiss each arbitration on the ground that the franchisee had not completed the prerequisites. The franchisees opposed the motions, contending that the law implied a reasonable time limit for the prerequisites, that that time had passed, and that ILKB’s delay was a breach of the prerequisite requirements that excused the franchisee from performing. They also argued that, in any event, ILKB had waived the prerequisites. Each of the cases had a different arbitrator, but the results were similar.

Most of the arbitrators held that the parties had to comply with both prerequisites, but all imposed strict deadlines. One arbitrator gave the parties ten days to hold the face-to-face meeting, followed by ten days to complete mediation. Another found that ILKB’s insistence upon the franchisee producing documents prior to the meeting when the agreement did not require such production amounted to a waiver of the meeting requirement; the decision went on to require mediation within forty-five days, provided that ILKB confirm its intent to mediate in writing and that it pay mediation fees within three days of billing by JAMS. A third arbitrator ordered a conference of the attorneys, at which dates for a meeting and mediation were set; the meeting went forward without resolution, but as the mediation date approached, ILKB’s counsel ceased responding to communications. The arbitrator held another call five days before the mediation date to confirm it was going forward, and ILKB’s counsel withdrew from representing his client. At that point, the arbitrator ruled that the mediation prerequisite had been waived, set down a date by which ILKB was to retain new counsel and establish a hearing date.

15. The Orange Rabbit, Inc. v. ILKB LLC, JAMS Arbitration No. 1425029384 (filed Mar. 27, 2019); Hasko v. ILKB LLC, JAMS Arbitration No. 1425029352 (filed Mar. 27, 2019); Johnson-Delgado v. ILKB, LLC, JAMS Arbitration No. 1425029364 (filed Mar. 27, 2019); Van Saders v. ILKB, LLC, JAMS Arbitration No. 1425029450 (filed Apr. 4, 2019); Merz v. ILKB, LLC, JAMS Arbitration No. 1425028854 (filed Feb. 1, 2019).
17. The Orange Rabbit, JAMS Arbitration No. 1425029384, Scheduling Order No. 2, July 6, 2019.
18. Two other ILKB cases, ILKB, LLC v. Gould, JAMS Arbitration No. 1425029100, and Van Saders, JAMS Arbitration No. 1425029450, throw additional light on the mischief a party may create in an ADR setting where there is little or no recourse to a neutral decision maker.
While the ILKB franchisees prevailed in moving their cases forward, it came at an unfair and unnecessary cost. The JAMS arbitrators had hourly rates as high as $800; and the motion practice easily ran into thousands of dollars in JAMS fees alone, simply to end up in roughly the same position that they started from. Thus, what appeared to be a simple procedure to advance resolution of the dispute—a face-to-face meeting, followed by mediation—turned into a tool of substantial delay and financial carnage for the franchisees.

Two lessons can be drawn from these cases. First, because negotiation and mediation take place without a neutral decision-maker with some kind of enforcement power, there is plenty of room for abuse of the process and little meaningful opportunity for redress. Second, to stanch the temptation to abuse this phase of alternative dispute resolution and to encourage focused efforts to find a resolution, contractual provisions should set a finite—and short—time limit for completion of any prerequisites.

C. Emergency Relief

Either party to a franchise agreement may need prompt emergency relief, usually a preliminary injunction, as arises, for example, with a franchisee’s scramble to stop a termination of the franchise agreement, a franchisor’s blocking a franchisee’s trademark infringement, or violation of a non-compete. Contractual requirements to negotiate, mediate, or arbitrate can make the path to emergency relief twisted and tortuous. While a good agreement should lead an aggrieved party directly to a reliable venue for emergency relief, a mediocre agreement can lead to surprisingly bad results. Further, the relatively recent addition of emergency relief rules in arbitration opens another avenue, albeit one that will not be available in all cases for some years. The key issues for emergency relief are the availability, under the agreement, of courts or arbitrators to hear applications for emergency relief, and the effect of required mediation or negotiation on the ability to obtain injunctive relief.

1. Availability of Courts or Arbitrators for Emergency Relief

Historically, arbitrators rarely heard requests for emergency relief; unless the agreement gave arbitrators specific authority to hear such applications, arbitrators did not have authority to hear them under most rules. Consistent with this practice, many franchise agreements that require arbitration of claims provide exceptions to arbitration for emergency relief, usually in the

Gould, the parties voluntarily mediated for an entire day, with ILKB proposing a buyback of the franchisee’s business; at the end of that day, ILKB called for further mediation on the buyback. The mediator and parties continued telephone negotiations two to three times a week for the ensuing six weeks until ILKB abruptly called them off. In Van Saders, after the arbitrator had ordered mediation and it had been scheduled, ILKB emailed the mediator fifteen minutes before the mediation was to begin, announcing that it would not be attending. The arbitrator, upon learning of ILKB’s refusal to appear, ordered it to pay the claimant’s $5,000 mediation fee. Van Saders, JAMS Arbitration No. 1425029450, Order No. 3, July 17, 2019.
venue where the franchisor has its principal place of business. Such provisions, if clearly written, provide an effective forum for hearing and deciding emergency requests.

Even if there is no exception for emergency relief in the agreement, courts have historically heard motions for emergency relief to preserve the status quo pending arbitration. For example, in Roso-Lino Beverage Distributors, Inc. v. Coca-Cola Bottling Co. of New York, Inc., the Second Circuit reversed the district court’s refusal to grant a distributor a preliminary injunction against termination pending arbitration of the dispute: “The fact that a dispute is to be arbitrated, however, does not absolve the court of its obligation to consider the merits of a requested preliminary injunction. . . .”20 Other courts have reasoned that the Federal Arbitration Act (FAA) does not prohibit emergency relief and that granting emergency relief furthers the FAA’s purpose in preserving the status quo so that the subject matter of the arbitration and the relief that the party may obtain is not destroyed.20 From a practice standpoint, the aggrieved party typically files a demand for arbitration seeking final relief, such as a permanent injunction, at the same time that it files in the appropriate court to obtain the emergency relief. If the court grants the preliminary injunction, the court action is stayed pending completion of arbitration.

Resort to courts for emergency relief, however, may be on the wane. Effective October 13, 2013, and July 1, 2014, the American Arbitration Association (AAA) and Judicial Arbitration and Mediation Services (JAMS), respectively, enacted rules governing emergency procedures.21 The rules are effective only with respect to agreements providing for arbitration under each organization’s rules after the date of enactment, unless they are otherwise incorporated by the agreement.22 Thus, franchise agreements entered into before those dates calling for arbitration before JAMS or the AAA do not automatically have the option of emergency arbitration. Emergency arbitration in fact may be faster, less costly, and more manageable than court proceedings. For example, AAA Commercial Rule 38 requires the AAA to appoint an emergency arbitrator within one business day of a written application for emergency relief.23 The emergency arbitrator will “immediately” disclose any conflicts, and parties have one business day to challenge the

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22. AAA R-38(a); JAMS R. 2(c).
23. AAA R-38(c).
appointment.24 Within two days of appointment, the arbitrator must set a schedule for consideration of the request for relief.25 In the normal course, the entire procedure is by telephone or teleconference. Contrast that with filing in court and waiting to get a hearing date, then traveling to the court to make an appearance in person.

2. Effect of Mandatory Mediation upon Emergency Relief

A requirement to mediate prior to arbitration or litigation may undercut and defeat a motion for a preliminary injunction. For example, in World of Beer Franchising, Inc. v. MWB Development, LLC, the franchise agreement required the parties to mediate before arbitrating, but provided an exception to arbitration for preliminary injunctive relief in court.26 The agreement also required that a party seeking such relief would “immediately and contemporaneously submit the dispute for non-binding mediation.”27 The district court had denied the franchisor’s motion for a preliminary injunction against the terminated franchisee’s continuing use of its marks because the franchisor had failed to mediate. On appeal, the Eleventh Circuit affirmed.28 Significantly, neither the district court nor the appeals court had any difficulty enforcing the contractual requirement for mediation prior to consideration of a motion for emergency relief, even though, in practice, requiring mediation might considerably delay or even destroy the opportunity for emergency relief. The result likely would have been avoided if the agreement had provided an exception to the mandatory mediation provision for emergency relief.

The court reached a different result Auntie Anne’s, Inc. v. Wang.29 In that case, the franchise agreement’s dispute resolution provisions collided: one section stated that all disputes first had to be mediated and then arbitrated; another provision, which did not reference the mediation and arbitration sections, stated that nothing in the agreement prevented the franchisor from obtaining “injunctive relief” in any court having jurisdiction.30 The franchisor had terminated the franchisee and then filed suit, without seeking mediation or arbitration, against the franchisee to obtain possession of the premises and enjoin the franchisee’s continued use of the marks. Although the franchisor apparently requested this injunctive relief in the complaint, it did not move for a preliminary injunction. The franchisee, however, counterclaimed for wrongful termination and breach of contract and moved to enjoin the termination and the franchisor’s cutting off of the franchisee’s sources of authorized supplies.31

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24. Id.
25. AAA R-38(d).
27. Id. at 563.
28. Id.
30. Id. at *3.
31. Id. at *1.
The court denied the franchisee’s motion for a preliminary injunction on termination and sources, but granted it with respect to mediation and arbitration.\textsuperscript{32} Noting that there was little evidence of the intent of the parties on how the conflicting provisions should be construed, the court rejected the franchisor’s interpretation that the exception for all actions seeking injunctive relief excused it from the prerequisites.\textsuperscript{33} Without pausing for citation of authority, the court observed that “the majority of disputes arising under franchise agreements . . . involve decisions by the franchisor to terminate the franchisee,”\textsuperscript{34} which in turn led to both sides seeking injunctive relief. In this context, the agreement’s exception from arbitration for injunctive relief, if read literally to encompass any complaint calling for any type of injunctive relief, could “vitiates the arbitration provision entirely.”\textsuperscript{35} The court concluded that the exception permitted a party to obtain “limited relief” in court, but only pending arbitration.\textsuperscript{36} Accordingly, the court denied the motion, directed the parties to mediation, and, if it was unsuccessful, to arbitration.

The cases on requests for emergency relief point up some practical lessons. First, courts uniformly uphold clearly written contractual provisions.\textsuperscript{37} But, in the relatively new world of ADR, it is not surprising that many agreements do not clearly spell out the role of each dispute-resolution mechanism. The courts in both \textit{Auntie Anne’s} and \textit{World of Beer} struggled with clauses that were less than clear. If the agreement has conflicting or ambiguous provisions, the most prudent course is to seek mediation and arbitration at the same time that a suit is filed for emergency relief, and to advise the court that its work will be done when the request for relief is decided.

\textbf{D. When Does Mediation End?}

Because many agreements require mediation before either side can commence arbitration or litigation, it is critical to understand when mediation ends. Some franchise agreements provide for a time limit on mediation, usually four to eight hours, which creates a natural conclusion. In the absence of a time limitation or a declaration by the mediator that there has been an impasse, one of the parties may attempt to delay further proceedings by claiming that mediation is ongoing. The AAA Mediation Procedures, for example, state that a mediation is terminated when (1) the parties settle; (2) the mediator declares that “further efforts at mediation would not contribute to a resolution of the parties’ dispute”; (3) all of the parties agree the mediation is at an end; or (4) no communication has taken place between the

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\textsuperscript{32} Id. at *16.
\textsuperscript{33} Id. at *10.
\textsuperscript{34} Id.
\textsuperscript{35} Id. at *11.
\textsuperscript{36} Id.
\textsuperscript{37} See, e.g., Flip Flop Shops Franchise Co. v. Neb, 2016 WL 9275403, at *5 (C.D. Cal. Dec. 5, 2016) (where agreement provided clearly that mediation was not required if one of the parties sought injunctive relief, that provision was enforced in accordance with its terms).
mediator and any party for twenty-one days following the mediation conference.38 This array of alternatives is anything but certain if the parties are not in agreement. A much better solution is to seek agreement prior to mediation on an outside time limit for completion.

IV. Selected Issues in Arbitration

As a creature of contract, arbitration takes the form to which the parties agree when the agreement is executed; when a dispute arises, however, the needs of the parties for resolution of their dispute may not square with the dictates of the agreement. Apart from issues concerning emergency relief, some of the principal questions pertinent to franchise practitioners include who must participate in the arbitration and whether more than one franchisee can bring claims in arbitration in the face of contractual provisions barring class or consolidated actions. Disputes in which the franchisee seeks redress for registration or disclosure violations may name franchisor executives or sales people as respondents; disputes focused on relationship issues, and especially operational issues, may involve many franchisees or a franchisee association. In either of these broad scenarios, the franchisor is likely to resist either the inclusion of individuals as respondents or prosecution of a case by a group or an association. Both the courts and arbitrators have struggled with the tension between an agreement that restricts the parties and the reality that failure to include all stakeholders or liable parties makes an arbitral result incomplete and leaves open the possibility for further disputes.

A. Who Is Subject to Arbitration?

Many, if not most, franchise agreements do not name individual officers or employees as persons subject to an arbitration clause; even when they are named, as in an agreement that stated that all “officers, directors, agents, brokers or employees” of both franchisor and franchisee will be included in . . . the arbitration proceeding,” those persons generally do not sign the agreement in their individual capacities. As a result, courts will hold that a non-signatory, even an officer who had signed the agreement in an official capacity, is not subject to arbitration.39

An initial question that arises in such cases is whether a court or arbitrator will decide whether non-signatories are subject to arbitration. It has long been settled that the parties may agree to refer questions of arbitrability to the arbitrator if there is “clear and unmistakable evidence” that they intended to do so.40 In fact, when the agreement to arbitrate states that it

will be governed by rules of an arbitrating body that provide for the arbitrator to decide questions of arbitrability, the courts have held such a reference to satisfy the “clear and unmistakable evidence” threshold. When, however, a party to an arbitration agreement seeks to compel non-parties to arbitrate, or non-parties seek to compel parties to arbitrate, the resisting party may legitimately claim that the issue must be decided by the courts, since they are not party to the arbitration agreement in the first instance. This may lead to the anomalous result that courts may decide that such persons are subject to the arbitration clause.

Courts have struggled with the tension between an agreement whose signatories do not include potentially liable persons who are intertwined with the dispute, and the need or desire to provide complete relief. Most courts hold that there are five state law grounds on which a non-signatory may be required to arbitrate with a signatory to the agreement: estoppel; agency; veil piercing; assumption; and incorporation by reference. Estoppel and agency arise in franchise cases most frequently; each is considered briefly below.

Estoppel requires that the party seeking to enforce the arbitration clause show that the other party knowingly sought or received benefits from the agreement containing the arbitration clause. This theory, sometimes known as “direct benefits estoppel,” requires that the non-signatory party receive benefits that flow directly from the agreement to the non-signatory. For example, where individual principals of a franchisor were not parties to the franchise agreement, but that agreement provided that they were entitled to certain benefits of the agreement, including disclaimers of having made financial performance representations, the principals were estopped from denying application of the arbitration provision to them. Similarly, the non-signatory wife of an individual who had signed a franchise agreement was subject to arbitration when she brought suit seeking the benefits of the agreement. In another case, a subdistributor of an energy drink was compelled to arbitrate its claims of wrongful termination under the Illinois Franchise Act because it received direct benefits from the agreement between the supplier and the master distributor, which contained an arbitration clause. On the contrary, a franchisor was unsuccessful in compelling arbitration against a transferee of a franchise who had neither assumed the transferor’s agreement nor signed a new agreement. The transferee claimed there was
an oral franchise agreement with the franchisor, and the court found that there was no evidence that the transferee had knowingly exploited the benefits of the franchise agreement containing the arbitration clause.\footnote{Id.}

The agency theory rests on common-law principles of contract and agency: an agent of a disclosed principal who is a non-signatory may avail itself of an arbitration provision and compel arbitration by a signatory because of its relationship to the principal.\footnote{Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH, 206 F.3d, 411, 416–17 (4th Cir. 2000).} In some cases, a signatory may enforce arbitration against a non-signatory on an agency theory. For example, in \textit{Salad Bowl Franchise Corp. v. Crane}, the court compelled arbitration against three principals of the corporate franchisee who had not signed the agreement on the ground that they were “being sued for actions they allegedly took in their capacities as co-owners and representatives.”\footnote{Salad Bowl Franchise Corp. v. Crane, 2011 WL 942239, at *5 (N.D. Tex., Mar. 17, 2011); see also World Rentals & Sales, LLC v. Volvo Constr. Equip. Rentals, Inc., 517 F.3d 1240, 1247–48 (11th Cir. 2008) (non-signatory may be compelled to arbitrate under an agency theory if a signatory signed the arbitration agreement as the non-signatory’s agent); Embroidme. com, Inc. v. Am. Design Studios, Inc., 2011 WL 13227754 (S.D. Fla., July 5, 2011) (same). But see Inception Mining, Inc. v. Danzig, Ltd., 311 F. Supp. 3d 1265, 1275 (D. Utah, 2018) (noting that under Utah law, nonsignatory agents could not be compelled to arbitrate); Kwatinetz v. Mason, 356 F. Supp. 3d 343, 348 (S.D.N.Y. 2018) (non-signatory could not enforce arbitration against signatory).}

The remaining theories have limited application in franchising, and they will be treated summarily. The doctrine of incorporation by reference may be used by a signatory to an arbitration agreement to compel arbitration by a non-signatory if the non-signatory is party to another agreement that incorporates the agreement containing the arbitration clause. Thus, where franchisees had signed agreements transferring a franchise agreement to them from a prior franchisee, and the underlying franchise agreement contained an arbitration clause, the court found that the obligation to arbitrate was incorporated in the transfer agreement, even though no express “incorporation by reference” language was used.\footnote{Awuah v. Coverall North Am., Inc., 703 F.3d 36, 43–44 (1st Cir. 2012).} The doctrine of assumption may be invoked to compel arbitration by a signatory when a non-signatory, by words or conduct, has assumed the obligations of an agreement containing an arbitration clause, as when a franchisee’s corporate principal was found to have assumed the agreement by causing performance by the franchisee over many years.\footnote{Cajun Global, LLC v. Swati Enter., Inc., 283 F. Supp. 3d 1325, 1330 (N.D. Ga. 2017).} Veil piercing, or alter-ego theories, may be invoked when the proponent of arbitration shows, under traditional state-law principles, that a non-signatory is the alter ego of a signatory.

\begin{footnotes}
\footnote{Id.}
\footnote{Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH, 206 F.3d, 411, 416–17 (4th Cir. 2000).}
\footnote{Awuah v. Coverall North Am., Inc., 703 F.3d 36, 43–44 (1st Cir. 2012).}
\footnote{Cajun Global, LLC v. Swati Enter., Inc., 283 F. Supp. 3d 1325, 1330 (N.D. Ga. 2017).}
\end{footnotes}
B. Enforceability of Restrictions on Class Actions and Multiple Parties

Many recent franchise agreements contain provisions that prohibit multiple franchisees from joining in one action or prosecuting a class action.\footnote{See, e.g., Anytime Fitness 2019 Franchise Agreement, supra, note 7 at § 18.D.7 (“All arbitration proceedings will be individual proceedings between you and us, and will not be conducted on a “class” basis, or include any other of our franchisees as named parties unless you and we agree.”).} Because arbitration is the product of agreement between the parties, such provisions will be enforced.\footnote{AT&T v. Concepcion, 563 U.S. 333, 344 (2011).} For groups of franchisees who have system-wide grievances, these restrictions effectively prohibit using arbitration to achieve system-wide solutions. One potential path to resolution is a single test case that would be supported by other franchisees; if the franchisee prevails, the decision may have binding, or at least persuasive authority,\footnote{The preclusive effect of arbitration decisions depends partly on whether the parties have addressed it in the agreement and partly upon the jurisdiction in which preclusive effect is sought. See cases cited supra note 4.} and the franchisor may be well served by honoring the decision and amending its agreement or policies accordingly. Otherwise, if the franchisees are well-financed, the franchisor may be facing a series of similar proceedings.

An alternative to a test case is an action by a franchisee association, provided that it meets the standing requirements for such a claim. While association actions present their own issues, discussed below, precedent indicates that they are not within the scope of prohibitions on class actions.\footnote{Fantastic Sams Franchise Corp. v. FSRO Ass’n Ltd., 683 F.3d 18 (1st Cir. 2012) (holding that association action was not encompassed by class action bar).}

C. Association Actions

Associations of franchisees have successfully prosecuted claims against franchisors on behalf of their members in court when they have satisfied the requirements of associational standing.\footnote{See, e.g., EA Indep. Franchisee Ass’n, LLC v. Edible Arrangements Int’l., Inc., 2011 WL 2938077 (D. Conn. 2011); Nat’l Franchisee Ass’n v. Burger King Corp., 715 F. Supp. 2d 1232, 1239 (S.D. Fla. 2010). For an association to sue on behalf of its members, it must allege that (a) its members would otherwise have standing to sue in their own rights; (b) the interests it seeks to protect are germane to the organization’s purposes; and (c) neither the claim asserted nor the relief requested requires participation of the members in the lawsuit. Hunt v. Wash. State Apple Adver. Comm’n, 432 U.S. 333 (1977); Warth v. Seldin, 422 U.S. 490 (1975); Nat’l Franchisee Ass’n, 715 F. Supp. 2d at 1237. As a practical matter, only an action for declaratory or injunctive relief will ordinarily satisfy the standing requirements. See, e.g., Nat’l Franchisee Ass’n, 715 F. Supp. 2d at 1237 (seeking declaration that franchisor did not have authority to impose maximum prices).} When the franchise agreement provides that disputes between the franchisor and franchisee must be resolved in arbitration, the question arises whether the association is bound by the arbitration provisions signed by the franchisee. On the one hand, a number of courts have held that franchise associations must follow whatever dispute-resolution procedures are in the agreements of its members, which...
would require the association to mediate or arbitrate. On the other hand, because the association is not party to the franchise agreement, it may argue that it is not required to arbitrate. Viewed from the franchisees’ perspective, the better avenue toward resolution is a single case, or series of single cases, to avoid lengthy disputes over standing.

V. Toward a Model Dispute-Resolution Provision

The recent history of ADR cases in the courts shows that the evolution of such provisions, like natural selection, has had many failed attempts and a few survivors. In an effort to apply the lessons of the past to the practice of the future, we propose a model ADR provision, incorporating both negotiation and mediation prior to arbitration:

If any party to this agreement has a dispute with the other party, the following dispute-resolution procedures shall apply:

1. The party raising the dispute shall promptly notify the other in writing of the nature of the dispute, each claim that the party is raising (“Claims”), and all of the persons against whom the dispute is raised (the “Notice of Dispute”). Within 7 days of such notification, each of the parties shall designate a person with full decision-making authority (“Decision Makers”) to participate in a face-to-face meeting (the “Meeting”). Within 21 days of the Notice of Dispute, the Decision Makers shall meet in person or via teleconference to discuss, in good faith, resolution of the dispute. The Meeting need not take more than three hours, and this requirement of a Meeting shall be deemed fulfilled within three hours of its commencement. As of the earlier of completion of the Meeting or conclusion of 21 day from the Notice of Dispute, the Meeting requirement shall be deemed fulfilled. The parties may, by written agreement, extend the time for completion of the Meeting.

2. If the parties are unable to resolve the dispute through the Meeting, the party giving the Notice of Dispute shall, within 28 days of the Notice of Dispute, file with the American Arbitration Association a Request for Mediation. Failure to file such a request within such time shall be deemed abandonment of the Claims and shall preclude such party from pursuing them further. The parties shall, in good faith, attempt to resolve the dispute through mediation (“Mediation”). The costs of the Mediation shall be shared equally. The Mediation shall conclude or be deemed concluded within 45 days of the request for Mediation. The Meeting and the Mediation shall hereafter be referred to as the Prerequisites.

3. No party may commence arbitration or litigation against the other unless the Prerequisites have been completed or deemed completed. After completion of the Prerequisites, either party may commence arbitration before the American Arbitration Association by filing a demand for arbitration within 30 days after completion of Mediation. Failure to file such a demand within such time shall be deemed an abandonment of the Claims and shall bar the party from pursuing such claim further. Arbitration shall be pursuant to the AAA’s Commercial

59. Doctor’s Assocs., Inc. v. Downey, 2007 WL 9378840 (D. Conn. Feb. 12, 2007) (compelling directors of franchisee association to arbitrate on individual basis); NIACCF, Inc. v. Cold Stone Creamery, Inc., No. 12-CIV-20756, 2012 WL 1852941, at *2 (S.D. Fla. May 21, 2012) (staying litigation brought by association against franchisor and holding that franchisee association “should not be able to end-run the arbitration agreements to which all franchisees are individually bound”).
Arbitration Rules and shall be before a single arbitrator in the location where the franchisor has its principal place of business at the time arbitration is commenced. Discovery shall be limited to 15 document requests per side, 15 interrogatories, and three depositions. Depositions may be conducted electronically through teleconference or by conference call. The arbitrator shall render a reasoned award.

4. The making of a demand for a face-to-face meeting shall toll all limitations periods pending completion of the dispute-resolution process.

5. Any party needing immediate injunctive or other emergency relief shall seek it only through the AAA, pursuant to its rules for emergency relief. The requirements of a Meeting and Mediation shall not bar any application for or the granting of emergency relief, provided that the party initiating the request for emergency relief has given the other a Notice of Dispute. The parties shall otherwise comply with the Prerequisites concurrently with the application for emergency relief.

This model addresses some of the key issues that have arisen over the past two decades in ADR cases: the need for emergency relief that is congruent with other provisions; an orderly and swift pre-arbitration procedure that has self-executing deadlines; and arbitration that should be relatively quick and comparatively inexpensive. Issues of non-parties are not addressed, given the difficulty of identifying the persons and situations in which these issues will arise.

Of course, no model is perfect, and the road ahead will be surely be filled with additional bumps and turns. But getting ADR right is about the same as the punch line from the famous old joke, often attributed to the world-famous violinist Jascha Heifetz. Asked by a young violinist whether the best way to get to Carnegie Hall was to play a Stradivarius, the virtuoso replied, “Stradivarius? It doesn’t matter! The best way to get to Carnegie Hall is to practice, practice, practice!”

Managing the Proliferation of Global Franchise Regulation

Ann Hurwitz

I. Evolution of the Franchise Regulatory Landscape

I began practicing franchise law more than thirty-five years ago. Franchise regulation was then in its infancy. California had enacted its Franchise Investment Law in 1970, adopting a regulatory regime similar to securities law; that is, registration of the franchise offering with the state and required disclosure to the prospective purchaser. The U.S. Federal Trade Commission (FTC) soon followed with federal regulation, promulgating the original FTC Franchise Rule (Original FTC Franchise Rule) in December 1978, with an effective date of October 21, 1979. Applicable in all U.S. states and territories, the Original FTC Franchise Rule mandated pre-sale disclosure, but did not require registration of the franchise offering. In addition to California, a few other states (Registration States) adopted franchise sales laws resembling the California Franchise Investment Law model and requiring registration of the franchise offering with the state, as well as disclosure to the prospective franchisee. A number of U.S. states (Relationship States) also enacted laws, commonly referred to as “relationship laws,” regulating certain aspects of the post-sale relationship between the franchisor and the franchisee.

2. 16 C.F.R. § 436. The Original FTC Franchise Rule was amended in January 2007.
3. The Registration States include California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. Oregon also has a franchise law that mandates disclosure. The relevant statutes and regulations are collected in the Business Franchise Guide (CCH).
But throughout the 1970s and 1980s, the franchise regulatory landscape outside the United States was decidedly less robust than the regulatory picture inside the United States. The Canadian province of Alberta adopted a franchise disclosure law in 1971, and the Japan Fair Trade Commission issued certain franchise guidelines in 1983, but it was not until 1989 that another non-U.S. jurisdiction—France—sought to regulate franchising under the *Loi Doubin*, using a disclosure model for the regulation.

This pattern of domestic franchise regulation, and the relative absence of international franchise regulation, helped shape franchise sales and expansion practices in interesting ways. At the time, the U.S. franchise regulatory regime was perceived as making the franchise sales process costly and unwieldy, and not without reason. In adopting the Original FTC Franchise Rule, the FTC had determined that federal law would not fully preempt state franchise laws:

The FTC does not intend to preempt the franchise practice laws of any state or local government, except to the extent of any inconsistency with this Rule. A law is not inconsistent with this Rule if it affords prospective franchisees equal or greater protection, such as registration of disclosure documents or more extensive disclosures.

This approach to regulation meant franchisors had to comply with both federal and state franchise sales laws, and those laws were by no means uniform. Among other consequences, the absence of full federal preemption under the Original FTC Franchise Rule and the divergence in regulations among the Registration States required the creation of multiple different forms of disclosure documents—one for use in the states regulated only under the Original FTC Franchise Rule (Non-Registration States) and separate disclosure documents for use in each of the Registration States.

Aside from the costs of complying with different federal and state regulations and the burdensome process for providing disclosure, the lack of alignment in the regulation of franchise sales created inherent risk. If the laws of multiple states were potentially applicable to a single franchise sale—as, for example, when the franchise prospect resided in one state but planned to open the franchised unit in a second state with communications about the sale taking place in a third state—U.S. franchise law practitioners were challenged to answer such questions as “which disclosure document should

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5. Franchises Act, R.S.A. 1971, c. F-38 (Can.).
7. Loi 89-1008 du 31 décembre 1989 relative au développement des entreprises commerciales et artisanales et à l’amélioration de leur environnement économique, juridique et social [Law 89-1008 of December 31, 1989, on the development of commercial and artisanal enterprises and the improvement of their economic, legal and social environment], Journal Officiel de la République Française [J.O.] [Official Gazette Of France], Jan. 1, 1990 (Fr.).
I use?” Franchisors were legitimately concerned that if they provided the wrong disclosure document, the sale might be tainted and the franchisee would have a rescission remedy that could be exercised years later, creating significant risk for the franchisor.

In contrast, the lack of widespread franchise regulation outside the United States was viewed by many as an opportunity. Domestic brands were an attractive business proposition in many foreign jurisdictions, and local operators were eager to partner with U.S. franchisors to take their brands “international.” The fundamental value proposition of the franchise distribution model applied equally outside the United States as it did domestically. In both cases, franchising allowed a franchisee to benefit from the experience of the franchisor and enabled the franchisor to expand the brand rapidly using the resources of the third-party franchisee, without investing the capital and committing the human resources necessary to establish company-owned units. International franchise expansion also offered a franchisor the additional benefits, among others, of being able to:

• utilize local management personnel and thus overcome problems of language and culture;
• overcome problems of detailed supervision often otherwise insuperable because of distance; [and]
• leave compliance with local laws to those familiar with such laws . . . .

During this period, the dearth of franchise sales regulation in jurisdictions outside the United States served to minimize the legal risks of international franchise expansion and allowed U.S. franchisors to shift some of their expansion costs to the local operator by charging significant up-front territory fees. Indeed, at the time there was a perception that international expansion might be necessary to proactively protect the brand by preventing non-U.S. operators from “pirating” popular U.S. brands for development in their home countries.

In the decades following the 1980s, regulatory patterns have shifted. In the United States, franchise disclosure regulation has become more streamlined and better understood. In April 1993, the North American Securities Administrators Association (NASAA) adopted Guidelines for Preparation of the Uniform Franchise Offering Circular and Related Documents (UFOC Guidelines). Disclosure documents prepared in compliance with the UFOC Guidelines were accepted by all of the Registration States, and, in December 1993, the FTC approved the UFOC Guidelines as an alternative to the disclosure format required by the Original FTC Franchise Rule. The FTC’s amendment of the Original FTC Franchise Rule in 2007 (FTC Franchise Rule or Rule) further aligned federal and state disclosure requirements by

incorporating into the Rule, and adapting, many of the disclosure requirements included in the UFOC Guidelines. Following a one-year grace period subsequent to the July 1, 2007, effective date of the amended Rule, all franchisors selling franchises in the United States were required to conform to the Rule’s disclosure requirements and could no longer prepare disclosure documents under the Original FTC Franchise Rule or the UFOC Guidelines.11 State practice was conformed when, in June 2008, NASAA published the 2008 Franchise Registration and Disclosure Guidelines,12 adopting the disclosure format of the amended Rule and, among other things, adding a state cover page and updating state registration application forms.

Over the years, efficiencies have also developed in the state registration process. Certain Registration States now permit or require that filings be made electronically, thereby expediting the process.13 Four of the Registration States require notice filings only.14 And franchisors that satisfy certain experience and net worth requirements may claim a registration exemption in a number of the Registration States.15

In addition to aligning federal and state disclosure requirements and streamlining registration processes, federal and state regulators have provided important guidance regarding franchise disclosure and registration requirements. In January 2007, the FTC released the Statement of Basis and Purpose in connection with the amendment to the Original FTC Franchise Rule16 and, in May 2008, issued a Compliance Guide to replace the Interpretive Guides to the Original FTC Franchise Rule.17 The staff of the FTC has also addressed Frequently Asked Questions (FAQs) raised in connection with the FTC Franchise Rule.18

NASAA’s Franchise and Business Opportunity Project Group has provided additional significant disclosure guidance as well, including an April 2009 Commentary on the 2008 Franchise Registration and Disclosure

15. See, e.g., CAL. CORP. CODE § 31101(a)–(b); ILL. ADMIN. CODE tit. 14, § 200.202(e); MD. CODE REGS. 02.02.08.10D (l)(a)–(b); N.Y. GEN. BUS. LAW § 684(2)–(3); N.D. CENT. CODE § 51-19-04(l)(a)–(b); 19 R.I. GEN. LAWS § 19-28.1-6(l); WASH. REV. CODE § 19.100.030(4)(b)(i)(A)–(B).
Guidelines, a Multi-Unit Commentary adopted in September 2014 to provide guidance for disclosing multi-unit franchising arrangements (including area development, subfranchise, and area representation arrangements), and a Commentary on Financial Performance Representations adopted in May 2017 to answer questions raised by both regulators and practitioners regarding the disclosure of financial performance representations.

Some differences remain. Importantly, the amended FTC Franchise Rule adopted in 2007 includes three new exemptions from the general requirement under federal law to provide pre-sale disclosure (Sophisticated Investor Exemptions). These exemptions were added to the Rule based on the recognition that

franchising today often involves heavily-negotiated, multi-million dollar deals between franchisors and highly sophisticated individuals and corporate franchisees with highly competent counsel. In the course of such deals, prospective franchisees often demand and receive material information from the franchisor that equals or exceeds the disclosures required by the Rule.

Unfortunately, the Registration States have not adopted the Rule’s Sophisticated Investor Exemptions, although some Registration State franchise laws do include exemptions from registration and disclosure premised on the sophistication and bargaining power of the franchisee prospect. In addition, some state franchise laws require a different disclosure period than the fourteen-calendar-day disclosure period required by the FTC Franchise Rule and most state franchise laws.

But significant progress has occurred towards minimizing the differences between federal and state disclosure requirements, and the general alignment of those requirements allows franchisors offering and selling franchises in the United States to make the disclosures required by federal and state franchise laws in one disclosure document with remaining state differences addressed in state-specific addenda. The use of a single disclosure document helps to reduce costs, simplify the disclosure process, and lower the risk of providing the wrong disclosure document. Where Registration State filings are required, clearly defined processes contribute to efficiencies. The additional guidance provided by the FTC and NASAA serves to further establish a common baseline for the franchise regulatory practice in the United

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23. See, e.g., CAL. CORP. CODE §§ 31106, 31109; S.D. CODIFIED LAWS § 37-5B-13; WASH. REV. CODE § 19.100.030(5).
States. In short, franchise sales regulation in the United States has matured, and with that maturity has come a measure of stability and predictability that provides the basis for a rational and efficient domestic franchise sales and disclosure process.

During this same period, franchise regulation outside of the United States has proliferated. Since the early 1990s, numerous foreign jurisdictions have enacted laws regulating franchising. Although many of these laws include disclosure, registration, and/or relationship provisions, they are by no means uniform or susceptible to easy categorization. And this regulatory activity shows no signs of abating. Among other recent developments, in 2019, the Kingdom of Saudi Arabia passed a franchise statute, and Egypt and the Netherlands are each considering comments to proposed new franchise laws. Even jurisdictions that have regulated franchising for years continue to reexamine and revise their approaches to that regulation. For example, in September 2019, Indonesia revised its existing franchise law; in December 2019, Brazil adopted a new franchise law to replace franchise legislation that had been in effect in that country since the early 1990s; and, as of this writing, an extensive reexamination of Australia’s franchise law is currently ongoing with changes likely to follow.

For businesses that want to capitalize on the commercial benefits of expanding their brands into other countries using a franchise model, the enactment of numerous and diverse franchise regulations across multiple non-U.S. jurisdictions raises some of the same issues that were presented by early domestic franchise regulation: high costs of compliance and potential increased risk. Franchisors must carefully consider how best to manage those costs and risks when implementing an international franchise expansion program.

26. Government Regulation No. 71/2019 (Indon.) (issued by the Minister of Trade (MOT Regulation 71/2019), revoking a number of regulations that had been enacted between 2012 and 2014).
28. Following reports of abuses in the Australian franchise sector, a Parliamentary Committee conducted an inquiry resulting in a report released in March 2019 setting out seventy-one recommendations for change (Parliamentary Joint Committee on Corporations and Financial Services’ Fairness in Franchising Report or Report). Following the release of the Report, the Government appointed an inter-agency task force to examine the recommendations.
II. International Franchise Regulation: An Exercise in Complexity

A. Variations in the Law

The majority of non-U.S. jurisdictions that regulate franchising require the disclosure of specific information to a prospective franchisee within a specified period of time prior to the occurrence of one or more designated triggering events. In all jurisdictions that require disclosure, execution of a franchise agreement will trigger the requirement to provide disclosure within a designated period of time before the agreement is signed. In some jurisdictions, however, the disclosure requirement may be accelerated, triggered by events that take place earlier in the franchise sales process than execution of the franchise agreement. For example, execution of “an agreement to enter into a franchise agreement” triggers a requirement to provide disclosure in Australia, as does the execution of any “pre-contract” or preliminary franchise agreement, in Brazil. Payment of a fee by the prospective franchisee to the franchisor or its affiliate may also trigger the obligation to provide earlier disclosure.

The time periods specified for making disclosure vary widely among the international disclosure jurisdictions. While many jurisdictions require disclosure at least ten or fourteen days before the event that triggers the requirement to disclose, these time periods are by no means uniform. Mexico’s franchise law imposes perhaps the longest disclosure period of any jurisdiction, requiring that franchisors make disclosure thirty business days before the franchise agreement is executed. The laws of other disclosure jurisdictions lack specificity. For example, Argentina requires disclosure “prior to” the execution of the franchise agreement.

Adding to the complexity, there is no uniform format for disclosure across the international disclosure jurisdictions. In the United States, the required franchise disclosure document (Franchise Disclosure Document or FDD) is in a standard format that can be used, and includes information that is

32. Id.; see also, e.g., the franchise legislation in the Canadian provinces of Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island; Trade Practices (Industry Code—Franchising) Regulations 2014 (Cth) sch 1 pt 2 div 2 para 9(I)(e) (Austral.) (earlier disclosure is required if the prospective franchisee makes a non-refundable payment to the franchisor or its associate in connection with the proposed franchise agreement).
33. Abell, supra note 29.
34. Ley de la Propiedad Industrial [LPI] art. 142, as amended, Diario Oficial de la Federación [DOF], 27-6-1991 (Mex.); Reglamento de la Ley de la Propiedad Industrial [RLPI] art. 65, as amended, Diario Oficial de la Federación [DOF], 23-11-1994 (Mex.).
required to be disclosed, in all fifty states and U.S. territories, with state law differences addressed in state-specific addenda to the FDD.\textsuperscript{36} No comparable practice exists internationally. Some Canadian franchise law practitioners have developed a consolidated form of disclosure document (Canadian FDD) to satisfy the requirements of, and that can be used to provide mandatory pre-sale disclosure in, each of the Canadian provinces that regulate franchise sales (Canadian Disclosure Provinces),\textsuperscript{37} but just as the FDD is specific to disclosure in the United States and its territories, the Canadian FDD is specific to the Canadian Disclosure Provinces.

Some U.S. franchisors have developed a form of international disclosure document (IDD) to provide information deemed to be material to franchise prospects in non-U.S. jurisdictions. These IDDs are often based on the franchisor’s form of U.S. Franchise Disclosure Document. However, IDDs have limited utility. They should not be used in international disclosure jurisdictions that require the use of a jurisdiction-specific disclosure format.\textsuperscript{38} Even if a specific disclosure format is not legally mandated, the use of a single document to address the disclosure requirements of multiple jurisdictions poses other risks. First is the risk of over-disclosure; that is, disclosing more information—or different information—than what is required by the law of a particular jurisdiction. Over-disclosure can increase the risk of misrepresentation claims. In addition, it is virtually impossible to “check the box” for several countries’ disclosure laws in a single document, and any attempt to use a single disclosure document covering multiple disclosure jurisdictions would require extensive customization, potentially resulting in a higher cost of maintaining such a document than the cost to create a tailored document as and when transactions arise. The potential value of an IDD, therefore, appears limited to jurisdictions that do not otherwise have a legally mandated requirement to provide disclosure. Where the local law includes a disclosure mandate, the format for that disclosure and the information that is disclosed must conform to the local law.

In addition to the variations in disclosure formats, the type of information required to be disclosed by law varies from jurisdiction to jurisdiction. U.S. franchisors offering franchises in a non-U.S. jurisdiction may very well be required to disclose information in addition to, and different from, the information included in their U.S. Franchise Disclosure Documents.

For example, under the French franchise disclosure law—the \textit{Loi Doubin}\textsuperscript{39}—franchisors are required to make certain pre-sale disclosures to

\textsuperscript{36} As of July 1, 2008, franchisors were required to “prepare and distribute disclosure documents that, at a minimum, comply with the disclosure format” of the amended FTC Franchise Rule. However, “states may impose additional requirements under state law consistent with the . . . FTC Franchise Rule,” N. Am. Sec. Adm’rs Assoc., 2008 FRANCHISE REGISTRATION AND DISCLOSURE GUIDELINES, https://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOPC.pdf.

\textsuperscript{37} These are the provinces of Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island.

\textsuperscript{38} For example, Korea, Indonesia, Malaysia, Vietnam, and Australia.

\textsuperscript{39} Code de commerce [C. com] [Commercial Code] art. L. 330-3 (Fr.)
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potential franchisees at least twenty days before the franchise agreement is executed. In addition to information about the franchisor, the trademarks to be licensed, the business to be franchised, a list of franchisees, open and terminated outlets, and the general terms of the franchise relationship, the disclosure document must include “a presentation of the general and local market status for the relevant products or services and the development prospects of such market” (Market Study). A Market Study may include information pertaining to the accessibility of the proposed site, demographics, market potential, information about the competition, and other relevant information. A franchise agreement may be declared null if the franchisor's Market Study is found to be incomplete or fails to contain information on the local market conditions. Franchisors may therefore find it prudent to engage a company that specializes in preparing Loi Doubin studies to prepare the Market Study.

Even when the information that must be disclosed in another jurisdiction appears to be similar to the information that is disclosed in the United States—or across other international disclosure jurisdictions—the requirements may not be identical, and the standard of review may vary. As a result, U.S. franchisors may be required to modify or supplement the information they disclose in the United States for use internationally. The variation in financial statement disclosure requirements offers one example.

In the United States, the FTC Franchise Rule requires franchisors to disclose audited financial statements of the franchisor that satisfy the requirements of § 436.5(u)(1)(i) and (ii) of the Rule. However, the Rule also permits franchisors to satisfy the financial statement disclosure requirements by using the financial statements of an affiliate, provided that the affiliate’s financial statements satisfy the requirements of § 436.5(u)(1)(i)–(ii) and the affiliate absolutely and unconditionally guarantees the franchisor’s obligations under the franchise agreement. As a result, a U.S. franchisor may not separately audit its financial statements, relying instead on the audited financial statements (and guarantee) of its parent company or other affiliate.

U.S. franchisors expanding abroad may be unpleasantly surprised to find that other jurisdictions with financial statement disclosure requirements may not allow the use of parent or affiliate financial statements to satisfy the requirement, even with a guarantee. Absent an exemption, each of the Canadian Disclosure Provinces require the disclosure document to include financial statements for the most recently completed year of the franchisor’s operations, prepared in accordance with the specific provincial requirements. Canadian franchise counsel have advised that none of the Canadian

40. Id. art. R. 330-1 4, al. 2.
41. 16 C.F.R. § 436.5(u)(1)(iii).
42. See, e.g., Arthur Wishart Act, S.O, 2000, c 3, s 5(4)(b) (Can.); General, O. Reg. 581/00 (Can.).
43. At various points throughout this article, I have referred to advice received from local counsel in certain jurisdictions. That advice was specific to the matter for which counsel was engaged and is included here for illustrative purposes only.
Disclosure Provinces allows the substitution of parent or affiliate financial statements for the financial statements of the franchisor, even if the parent’s or affiliate’s financial statements are consolidated and include the franchisor’s financial information and the parent or other affiliate provides a guarantee. Under Indonesia’s franchise law, the prospectus submitted for registration must include two years of the franchisor’s audited financial statements.\textsuperscript{44} Local counsel have advised that the Indonesian Ministry of Trade will not accept the audited financial statements of an affiliate as a substitute for those of the franchisor entity. Audited financial statements of the franchisor also must be submitted as part of the registration process under South Korea’s Fair Transaction in Franchise Business Act (Korea Franchise Act or KFA).\textsuperscript{45} In contrast to Indonesia, local counsel in South Korea have advised that the Korean Fair Trade Commission (KFTC) has accepted audited statements of a franchisor’s parent company, but only rarely and for a compelling reason. However, they also have advised that the KFTC may accept unaudited financial statements of the franchisor if audited statements are not available.

Apart from the additional and differing international disclosure requirements U.S. franchisors confront in expanding internationally, some non-U.S. jurisdictions require pre-sale registration of the franchisor, the disclosure document, and/or the franchise agreement. In Vietnam, foreign franchisors have historically been required to register with the Ministry of Industry and Trade prior to selling franchises.\textsuperscript{46} Before selling a franchise in Malaysia, a foreign franchisor must obtain approval from the Franchise Development Division of the Ministry of Domestic Trade and Consumer Affairs, headed by the Registrar of Franchises.\textsuperscript{47} Indonesia requires pre-sale registration of the franchisor and of the disclosure document. Other jurisdiction-specific requirements may have to be satisfied prior to closing a franchise sale. In the Philippines, to be valid, the franchise agreement must be pre-cleared under the Technology Transfer Law.\textsuperscript{48} And, in Russia, the relevant trademarks must be registered with the trademark authorities before a franchise may be granted.\textsuperscript{49}

\textsuperscript{44} Government Regulation No. 53/M-DAG/PER/8/2012 (Indon.) (issued by the Minister of Trade on Aug. 24, 2012).

\textsuperscript{45} Fair Franchise Transactions Act, Act No. 6704, May 13, 2002, amended by Act. No. 14135, Mar. 29, 2016, arts. 7 & 11(2) (S. Kor.); FDD template issued by the Kor. Fair Trade Comm’n.

\textsuperscript{46} Government’s Decree No. 35/2006/ND-CP detailing the regulations of the Commercial Law on Franchising (amended and supplemented by Government’s Decree No. 120/2011/ND-CP) ("Decree 35"), Articles 17 and 17a (Viet.). (In 2018, the Vietnamese government issued Decree No. 08/2018/ND-CP ("Decree 08") to remove the registration requirement under Article 5 of the Commercial Law on Franchising. However, the registration requirements are still applicable under Articles 17 and 17a.)

\textsuperscript{47} Section 54 of the Franchise Act 1998 (Act 590), amended by the Franchise (Amendment) Act 2012 (Act A1442) (Malay.).

\textsuperscript{48} Additional requirements may apply. See Ferdinand M Negre & Wesley K Rosales, Philippines, in Franchising Global Guide, Thomson Reuters Practical Law, supra note 24.

Post-sale registration also may be required, or recommended, under the franchise laws of a particular jurisdiction or under other jurisdiction-specific laws that affect franchises. In China, a franchisor must register within fifteen days following the first franchise sale. A franchise agreement with a Russian franchisee is not enforceable in Russia unless it is registered with the Russian trademark office. The Brazilian Central Bank will not permit royalty fees or other payments to be remitted abroad by a Brazilian franchisee under a franchise agreement unless that agreement is first registered with Brazil’s intellectual property office. And, in Mexico, it has become accepted practice to register the franchise agreement (or a summary of the franchise agreement) post-sale with the Mexican Institute of Industrial Property (IMPI) to establish that the trademark is being used in compliance with the usage requirements under Mexico’s Industrial Property Act.

Although not a disclosure or registration issue per se, the relationship provisions included in the franchise laws of certain jurisdictions may require modifications to the terms of the franchise agreement. For example, Mexico’s Industrial Property Law sets forth twelve mandatory terms to be agreed upon by the parties and included in the written franchise agreement:

1. the relevant geographic area;
2. possible locations, minimum area, and characteristics of the infrastructure investment;
3. inventory, marketing, and advertising policies;
4. reimbursement, funding and consideration policies, proceedings, and terms;
5. criteria and methods to determine profit margin and franchisee’s commission;
6. description of technical and operational training, and the form or methods of technical assistance and services to be provided by the franchisor;
7. performance and quality of service supervision, information, evaluation, and qualification criteria, methods, and proceedings;
8. subfranchise terms and conditions;
9. grounds for termination (if unilateral termination is only allowed with proper cause, or if the contract has an indefinite term);
10. grounds for reviewing or modifying terms and conditions;

51. Grazhdanskii Kodeks Rossiskoi Federatsii [GK RF] [Civil Code] art. 1028 (Russ.).
53. For an excellent discussion of these and other post-sale activities that may be required under the laws of various jurisdictions, see Jeffrey A. Brimer, Thibault de Chatellus, Mark Forseth & Kevin E. Maher, After the Agreements Are Signed: Post-Closing Legal and Business Matters in International Franchise Transactions, 46th Int’l Franchise Ass’n Annual Legal Symposium (May 2013).
(11) unless agreed by the parties, there is no obligation for the franchisee to accept franchisor as a partner or to give shares in the franchisee; and
(12) unless agreed by the parties, there is no obligation for franchisee to sell its goods only to franchisor after the contract termination.

The relationship provisions of local franchise laws also may require changes in a franchisor’s procedures for transfer or termination as reflected in the franchise agreement. By way of illustration, the Korean Franchise Act includes a very detailed procedure for terminating franchise agreements. Generally, the KFA requires the franchisor to provide two written notices of breach and a two-month cure period (2-Notices-in-2-Months Rule). The cure period begins to run upon the provision of the first notice of breach. During the cure period, the franchisor must provide a second notice of breach. If the franchisee has not cured the default by the end of the two-month cure period (provided that two written notices of breach were given), the franchisor may then terminate the franchise agreement. There are certain statutory exceptions to this general 2-Notices-in-2-Months Rule for which the franchisor may terminate the franchise agreement immediately. Franchise agreement modifications are likely to be needed to reflect the statutory defaults allowing for immediate termination and to provide that all other listed defaults fall under the 2-Notices-in-2-Months Rule.

B. Variations in the Practice

As illustrated by the preceding discussion, franchise regulations in jurisdictions outside the United States vary widely. Yet, even in jurisdictions where the local franchise law requirements appear similar to those in the United States, important differences in practice may exist. Those differences can create significant risks for an ill-prepared U.S. franchisor.

Ontario’s Arthur Wishart Act (including its Implementing Regulations) requires franchisors provide

a prospective franchisee with a disclosure document and the franchisee shall receive the disclosure document not less than fourteen days before the earlier of
(1) the signing by the prospective franchisee of the franchise agreement or any other agreement relating to the franchise; and (2) the payment of any consideration by or on behalf of the prospective franchisee to the franchisor or franchisor’s associate relating to the franchise.

56. Id.
57. Id.
58. Id.
59. Id.
60. Arthur Wishart Act, S.O, 2000, c.3, s. 5(1) (Can.).
This requirement is strikingly similar to the FTC Franchise Rule’s requirement for franchisors “to furnish a prospective franchisee with a copy of the franchisor’s current disclosure document . . . at least fourteen calendar days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale.”

Both the Arthur Wishart Act and the FTC Franchise Rule also specify the information that must be included in the disclosure document provided to prospective franchisees, but with a critical difference. The FTC Franchise Rule contains a clear direction to franchisors limiting the information included in the FDD: “Do not include [in the FDD] materials or information other than those required or permitted by . . . [the Rule] or by state law not preempted by . . . [the Rule].”

In contrast, the Arthur Wishart Act includes an open-ended mandate: “The disclosure document shall contain . . . all material facts, including material facts as prescribed. . . .” This means that “[i]nformation disclosed must be complete and accurate as of the date of the disclosure document (except for certain information, such as financial statements, which must be current as of the end of the previous fiscal year).” And the risks of providing a deficient disclosure document are quite high, including the risk that a franchisee might exercise its right to rescind the franchise agreement, recover its investment, and claim damages.

As a result, U.S. and Canadian practitioners have developed distinctly different approaches to the franchise disclosure process. The general practice in the United States is for franchisors to prepare a Franchise Disclosure Document that satisfies the requirements of the FTC Franchise Rule (including applicable state-specific addenda addressing any additional Registration State requirements), taking into account the disclosure guidance provided by the FTC and state regulatory authorities. This FDD is the disclosure document that is provided to all prospective franchisees (following registration in the Registration States, if applicable), including to prospective purchasers in transfers of existing franchised locations and to existing franchisees who have the right, and elect, to renew their franchises.

Similar to the U.S. practice, the practice in Ontario is for franchisors to prepare a form of Canadian FDD that satisfies the requirements of the Arthur Wishart Act (Template FDD). But, unlike in the United States, local Canadian counsel have advised that the Template FDD is provided to a new prospective franchisee and starts the fourteen-day disclosure period running, only if a particular site for the franchise has not been identified. Even in that...
circumstance, the Template FDD is subsequently supplemented, when a site is identified, by the issuance of a Statement of Material Change that includes material information about the site but that does not restart the fourteen-day waiting period. If, however, the franchise is being offered for an identified site, the Template FDD is customized prior to delivery to include material information about the site. Since transfers and renewals necessarily involve an identified site, in those transactions the franchisor delivers a customized FDD at the outset. If material information becomes known after the customized Canadian FDD is issued, the franchisor then also issues a Statement of Material Change.

In short, although the Ontario disclosure statute was based, in part, on the FTC Franchise Rule,66 and, while the requirements of the two are quite similar, key differences exist, and those differences shape the disclosure practice in each jurisdiction. A franchisor not aware of the differences could easily find itself the subject of a disclosure-based claim and at risk of a franchisee’s demand for rescission and recovery of not only the amount of the franchisee’s investment but damages as well.

III. Consequences of Expanded International Franchise Regulation

A. Increased Costs

The proliferation of franchise regulation in jurisdictions outside the United States has significantly increased the up-front investment required to sell franchises internationally in compliance with those laws. Compliance can be a costly proposition both in terms of the time and money required to complete the transaction.

When selling a franchise outside the United States, U.S.-based franchisors have traditionally adapted their domestic agreements for use in other jurisdictions by “internationalizing” those agreements. Among other changes, this modification means adding provisions applicable to currency repatriation and compliance with laws regulating foreign corrupt practices and anti-terrorist activities; adding or adapting provisions allocating the responsibility for withholding taxes; and adapting the dispute resolution provisions of the agreements to provide for international arbitration. Franchisors also have had to consider additional jurisdiction-specific changes to their agreements to address non-franchise laws that have an impact on the franchise relationship or to reflect commercial practices in the jurisdiction. For example, local competition laws may require changes to the in-term or post-term non-competition provisions and may impact the enforceability of indemnification provisions and guarantee requirements. In addition, insurance coverage and terms common in the United States may not be available in the target jurisdiction.

66. Id.
But the overlay of franchise-specific regulation in a jurisdiction raises additional issues. As noted earlier in this article, the local franchise law may require the addition of specific franchise agreement terms or the modification of other terms to comply with the relationship provisions of the law. Other agreement changes may not be required, but may nonetheless be advisable in circumstances where the local franchise law imposes an obligation on, or allocates a risk to, one party or the other by default unless the parties’ agreement specifically addresses the issue in a different manner.

In the international disclosure jurisdictions, the preparation of a disclosure document that satisfies the requirements of the local franchise laws adds additional time and expense. And, as illustrated earlier, to prepare those disclosure documents, U.S. franchisors can anticipate they will have to do more than simply re-package the information they disclose in their U.S. FDDs. To satisfy the disclosure requirements of a particular non-U.S. jurisdiction, the franchisor may have to gather information not typically required to be disclosed in the United States and/or adapt, often at significant cost, information it has developed for the United States to conform to the regulatory requirements outside the United States.

The additional requirement in certain jurisdictions to register the franchisor, the disclosure document, and/or the franchise agreement before the sale serves to further increase both the financial cost of the transaction and the time needed to complete it. Among other things, preparing a registration application often requires the franchisor to file the core franchise documents, as well as a number of supporting documents designed to provide substantiating information about, for example, (1) the organization and good standing of the franchisor entity; (2) the franchisor’s right to license the intellectual property that is the subject of the franchise; and (3) the franchisor’s executives or other employees responsible for managing the franchise system or supporting the local franchisee. To be accepted for filing, documents submitted with the registration application may have to be notarized and legalized (including by apostille for any country that is a party to the Hague Convention) or consularized. Although these requirements are designed to ensure that the authenticated or certified documents are accorded full legal effect in the target jurisdiction, they can add significant time to the process of preparing the application. Once the application is filed, prosecuting it can also be time-consuming and expensive as the local regulatory authority often has, and exercises, the right to require additional or supplemental information in connection with its review of the documentation.

Requirements to translate one or more of the relevant franchise documents into the local language prior to filing or disclosure adds still more time and expense. Vietnam’s franchise laws require registration with the Ministry of Industry and Trade before beginning franchise activities and disclosure to the prospective franchisee at least fifteen working days before the franchise agreement is signed. All documents submitted with the registration application (including the application form, disclosure document, and supporting
documents) that are in a language other than Vietnamese must be translated into Vietnamese for filing.\textsuperscript{67} Recent changes to Brazil’s franchise law now mandate that the pre-sale disclosure document be in Portuguese.\textsuperscript{68} Translations also may be required in connection with filing requirements under local trademark laws or in order for the franchisee to remit payments abroad to the franchisor. As noted earlier in this article, it has become accepted practice in Mexico to file the signed franchise agreement (or a summary) with the IMPI to establish trademark usage in compliance with Mexico’s Industrial Property Law. Often, a dual column summary will be prepared for filing in both English and Spanish. In Russia, it is necessary to register a franchise agreement with a Russian franchisee with the Russian patent and trademark office (Rospatent) to enforce that agreement. No summary filing is permitted, and the full franchise agreement must be translated into Russian (and notarized and apostilled) for filing.\textsuperscript{69}

Changes to local regulations also can add considerably to the costs of compliance. They may be changes to the franchise regulations themselves (as occurred recently in Brazil), or they may be changes in other laws that have an impact on franchise regulatory compliance. Such changes can be made without prior notice and with little, if any, guidance from the local regulatory authority. For example, in 2018, Indonesia introduced a new online business licensing system (the Online Single Submission System or OSS).\textsuperscript{70} While applicable to more than franchising, the new system required foreign franchisors, for the first time, to obtain a business identification number and conditional business license through the OSS before proceeding with the franchise registration process. For some months, however, there was no reliable guidance on the OSS process and no available precedent for issuing a business identification number or business license to a foreign franchisor. The lack of readily accessible published guidance for compliance with the local laws makes it essential to engage experienced local franchise counsel.

While the up-front cost of international franchise sales has risen due to the proliferation of international franchise regulations, those regulations have also negatively impacted strategies previously used by franchisors to shift some of those costs to the local operator. In many jurisdictions, one of the consequences of the regulation is that the franchisor cannot collect an up-front fee or deposit from its prospective franchisee in order to help defray those initial costs. In a number of disclosure jurisdictions, no payment

\textsuperscript{67} Vietnam’s franchise requirements are in (a) the Commercial Law, adopted on June 14, 2005; (b) Decree No. 35/2006/ND-CP dated March 31, 2006 (Decree 35), which was amended by Decree 20/2011/ND-CP dated December 16, 2011 (“Decree 120”); and (c) Circular No. 09/2006/TT-BTM of the Ministry of Industry and Trade dated May 25, 2006 (Circular 09). Decree 35 also requires that the franchise contracts must be made in Vietnamese, although execution of both Vietnamese and English language versions is recommended.

\textsuperscript{68} Lei No. 13,966, de 26 de Dezembro de 2019, art. 2, Diário Oficial da União [D.O.U.] de 27.12.2019 (Braz.).

\textsuperscript{69} Brimer, de Chatellus, Forseth & Maher, supra note 53.

\textsuperscript{70} Government Regulation No. 24 of 2018 (Indon.) (Electronic Integrated Business Licensing Services, issued and effective on June 21, 2018).
can be made to the franchisor until after disclosure has been made and the legally required waiting period has expired. The South Korean law is particularly strict, permitting receipt of initial franchise fees only after the disclosure document is registered, the prospect is disclosed with the registered disclosure document, and two months have passed after the earlier of execution of the franchise agreement or opening of the franchised unit.\footnote{Jae Hoon Kim & Sun Chang Lee, \textit{Korea, in Getting the Deal Through (Franchise)} (Aug. 2019), \url{https://gettingthedeleathrough.com/area/14/jurisdiction/35/franchise-south-korea}.}

B. \textit{Increased Risk}

Expanding a franchised brand across international borders has always presented certain risks. They include the risk that the brand will not be commercially successful in a particular jurisdiction due to differences in operating costs, local tastes, or other market-based factors. The inherent risk also exists that the operator selected to develop the brand in a particular jurisdiction will prove to be unable to do so successfully. And the general geopolitical risks that have the potential to threaten any international business expansion apply equally to the cross-border expansion of a franchised brand.

However, the adoption of franchise-specific regulations by multiple jurisdictions has resulted in the creation of additional risks distinct to franchised brands. First is the legal risk of non-compliance. Even inadvertent non-compliance with the local franchise law can lead to serious consequences. Statutory remedies in various jurisdictions include rights to invalidate the franchise agreement, rescind the transaction, and seek damages. For example, in Mexico, if a franchisor fails to make the disclosures required under the Industrial Property Law, or if any of the disclosures made are determined not to be truthful, the franchisee is entitled to bring a civil action to annul the franchise agreement, and recover all amounts paid by the franchisee to the franchisor and monies expended by the franchisee in its endeavors.\footnote{Jorge Mondragon, \textit{Mexico, in Franchising Global Guide}, Thomson Reuters Practical Law, \textit{supra} note 24.} In addition, in the first year after execution of the franchise agreement, the franchisee may claim any damages and lost profits caused by the violation.\footnote{Id.}

Less obvious, perhaps, are the commercial risks that may arise from the very act of complying with a local franchise-specific regulation. As in the United States, much of international franchise regulation is designed to regulate the franchise sales process, requiring disclosure and, in some jurisdictions, registration, before the parties can legally sign binding agreements and before the franchisor can receive any money. Unlike in the United States, however, satisfying these requirements often requires transaction-specific disclosures and a significant up-front investment of time and money. Moreover, few, if any, exemptions allow a franchisor to bypass the full range of regulatory requirements or expedite the process. In the United States, the FTC Franchise Rule’s Sophisticated Investor Exemptions do not require an
FDD in transactions with prospects that have a presumed level of sophistication and bargaining power. But similar exemptions are not common internationally. Even when dealing with a very experienced prospect, a franchisor may be required to spend the time and money to develop a disclosure document that complies with local law, and to file and prosecute a registration application, before closing the transaction.

Nevertheless, these arrangements frequently involve multi-year commitments and significant investments in the brand by very sophisticated counterparties, resulting in highly negotiated transactions. The negotiations often proceed simultaneously with the regulatory process so that the transaction can be closed as soon as legally possible following satisfaction of all regulatory compliance obligations. A franchisor may find itself investing substantial time and money to advance its regulatory compliance obligations, only to lose the prospect during the course of the negotiations. The time and money required for compliance on the front end of an international transaction may also exert pressure on a franchisor to make concessions in the negotiations that it may not otherwise make to avoid walking away from a significant investment.

IV. International Expansion in a Complex and Changing Legal Landscape

International franchising is at an interesting crossroads. The commercial benefits of cross-border expansion continue to be compelling, but the proliferation of diverse and idiosyncratic franchise regulations across multiple jurisdictions has significantly increased the time, cost, and risk associated with that expansion.

And it is simply unrealistic to expect that all—or any—of the jurisdictions regulating franchising will cooperate in any meaningful way to coordinate their respective regulatory regimes as was done in the United States by federal and state regulatory authorities. A relatively recent examination of the issue by one of the leading franchise law practitioners concluded that franchisors can expect to see neither the elimination of different regulatory approaches in the foreseeable future, nor any attempt by individual jurisdictions to modify their regulatory regimes in ways that would allow franchisors to test the waters or to proceed under exemptions from some of the more burdensome aspects of the regulations, even when dealing with a sophisticated counter-party.74 We can expect that differences will remain and must work for clarity and additional guidance from the regulatory authorities in each jurisdiction.

But given the current regulatory environment, what strategies can a franchisor use to manage the costs and risks of international expansion? Here are some strategies that a prudent franchisor should follow.

74. Zeidman, supra note 24.
A. Know the Regulatory Landscape

Knowledge is vital. Franchisors that decide to undertake an international expansion program must not only educate themselves about the potential impact of a target country’s cultural differences, market-based challenges and geopolitical risks, they also must have some basic knowledge of whether the target jurisdiction regulates franchising and, if so, how. Entering into discussions with a prospect without at least a rudimentary understanding of the jurisdiction’s approach to franchise regulation opens the door to possible actions—such as the execution of binding preliminary agreements or the receipt of deposits—that could have significant negative consequences for the franchisor.

Until relatively recently, access to that type of knowledge could prove challenging as widely available resources were scarce; relationships with local counsel were often the best—and in some cases the only—way to source the required information. Today, however, numerous publications address international franchise regulations, some of which are cited in the notes to this article. These sources include online publications that can be used not only as a quick reference, but also to make a comparative analysis of different regulatory systems. These materials provide a useful starting point and can serve as an invaluable resource when used as an early warning system for spotting regulatory red flags in potential target jurisdictions.

Counsel for franchisors can also look to professional organizations like the ABA Forum on Franchising, the franchise committee of the International Bar Association, and the international committee of the International Franchise Association for more in-depth analyses of the regulatory requirements of various jurisdictions. Program materials addressing the legal issues that arise in international franchise expansion have become increasingly prevalent over the years as more companies have made international expansion an important part of their growth strategies and their in-house and outside counsel have developed expertise in the area. Membership in these organizations and attendance at their programs have the added benefit of providing opportunities to connect with others who practice in the area and who can serve as valuable resources.

Developing a network of experienced local counsel who practice in the area is also critical. As noted earlier in this article, new franchise laws, changes in existing franchise laws, and other developments in international franchise regulation are occurring frequently and at times with little or no advance publicity or warning. Alerts published by local counsel are often one of the first ways other practitioners learn of a new development. Being on the distribution list of local franchise counsel practicing in various jurisdictions is itself a good early warning system to have in place.

When a client does decide to enter a particular market, engaging with knowledgeable local counsel in the target jurisdiction is essential. They will have the most up-to-date guidance on how the jurisdiction’s regulations are then being interpreted and implemented, as well as access to the local
regulatory authority in the event additional guidance on particular questions is needed. It is especially helpful to work with local counsel who have experience assisting other U.S. franchisors who have expanded into the local market. Their understanding of the U.S. approach to various legal issues and their ability to “translate” the U.S. approach for use in the local jurisdiction can be invaluable.

B. Select Local Operators Thoughtfully

A company engaged in franchise sales in the United States will typically prepare a disclosure document that complies with federal and applicable state franchise disclosure laws, register the disclosure document as required in one or more of the Registration States, and then market the franchise to prospective franchisees. As posited in the introductory sections of this article, that process works in large part due to the coordination of federal and state disclosure requirements and the maturity of the U.S. franchise regulatory practice. Compliance with federal and applicable state franchise regulations can take place before identifying a prospective franchise purchaser because the disclosure requirements are generally uniform and the costs and time to prepare and register a compliant FDD are relatively predictable.

As also described in the earlier sections of this article, in many jurisdictions outside the United States the timeline for complying with the local franchise regulations is often extensive and not easily predictable, and the costs of compliance can be high. Moreover, in some jurisdictions those requirements include a mandate not only to disclose information about the franchise system generally, but also to disclose information relevant to the particular opportunity that is being offered.

Given these differences, it is more typical internationally than in the United States to first identify a potential local franchise operator and only then move forward with the documentation necessary to comply with the applicable local franchise regulations. But what does it mean to “identify” a potential local operator? Clearly, the vetting process should include preliminarily testing the prospect’s interest and obtaining some information about its experience in the relevant business, including whether the prospect is a franchisee of other U.S. franchise systems. However, additional due diligence may be warranted before deciding to move forward with a particular candidate. There is often some reluctance on the part of a prospect to provide detailed financial and corporate due diligence information early in the process. That is understandable, and more detailed due diligence may be properly conducted only as the deal moves forward. However, before committing significant resources to complying with the local franchise regulations in anticipation of concluding an arrangement with a particular prospect, an early screening of the prospect is advisable to identify any potential disqualifying red flags, such as those relating to litigation, bankruptcy, adverse regulatory actions, criminal matters, or local political issues. Those screenings can be conducted by outside vendors that routinely provide such services.
Although it is an additional cost, the screening can be a cost-effective way of assessing potential risks early in the process.

C. Consider the Appropriate Structure

The structure that a franchisor elects to use when expanding into another jurisdiction can affect compliance with local franchise regulations. Although this is not an article about how to structure an international franchise program, it is important from a compliance perspective to at least note that differences in compliance requirements may exist based on the type of structure that is adopted.

At a high level, a franchisor should consider whether it will engage in direct franchising into the target jurisdiction or whether it will adopt a master franchise model. In a direct franchise model, the U.S. franchisor will enter directly into agreements with all local operators, including unit franchise agreements and, when appropriate, development agreements. In a master franchise model, the U.S. franchisor will enter into a master franchise agreement with the local operator (the master franchisee), and the master franchisee will then enter into unit franchise agreements (and possibly development agreements) with other subfranchisees in the market to build out the franchise system in the local jurisdiction.

A number of factors will influence the franchisor’s decision to adopt a particular franchise model, including whether the unit economics can support a multi-tiered structure and whether the franchisor has the expertise and resources to provide significant ongoing in-market support. While compliance is not the only—or indeed the most important—consideration that factors into the adoption of a particular structure, the structure that is ultimately selected may reduce or eliminate the need to comply with some or all of a jurisdiction’s regulatory requirements for the offer and sale of franchises. These questions are not susceptible to generalizations because the outcome depends on the precise language and interpretation of the applicable local legal requirement and because the final structure must align with the parties’ commercial goals. But a couple of examples serve to illustrate the point.

The Korean Franchise Act requires a franchisor to register a disclosure document with the KFTC and provide the registered disclosure document to a prospective franchisee at least fourteen days before the prospective franchisee signs a franchise agreement. However, local counsel in South Korea have advised that the KFTC takes the position that the registration and disclosure requirements of the KFA do not apply to the grant of a master franchise by a foreign master franchisor to a Korean master franchisee if the master franchise agreement grants the master franchisee only the right to solicit subfranchisees, but not operate outlets, in South Korea. That position is perhaps best understood by examining the basic principles underlying the

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KFA. In essence, the KFA is concerned with matters relevant to the operation of a franchised unit. Indeed, the definition of a franchise license under the KFA focuses on the franchisee's contractual right to run the franchised outlet, and a franchisee is someone that holds a license granted by the franchisor to run the franchised unit. Importantly for purposes of this discussion, applying the KFTC's interpretation of the KFA, a U.S. franchisor that enters into a master franchise with a Korean master franchisee would have no obligation either to register or to deliver a disclosure document to the Korean master franchisee if the master franchise agreement does not grant the master franchisee operating rights. Although it may not be commercially desirable—or feasible—to grant a master franchise that does not require the master franchisee to operate any of the outlets that are the subject of the grant, in the right situation the time and cost of concluding the master franchise arrangement could be significantly reduced by adopting the type of master franchise structure described. And, of course, the Korean master franchisee would be required to register and deliver the registered disclosure document to prospective subfranchisees in Korea when granting operating rights.

Under China’s franchise regulation, a franchise must have three elements: (i) a franchisor, through an agreement, grants other operators (franchisees) the right to use the franchisor’s business-operating resources, including registered trademarks, logos, patents, and proprietary technologies; (ii) the franchisee conducts business under a uniform mode of operation; and (iii) the franchisee pays franchise fees according to the agreement.

The Chinese franchise regulations apply to franchising operations within China, including those involving a non-Chinese franchisor and a direct Chinese franchisee. However, a franchise arrangement between two offshore (non-PRC) entities would not be subject to the China franchise regulations. Under the first prong of the franchise definition, the franchise regulations also should not apply if one of the offshore entities (the franchisee) then establishes one or more wholly- or majority-owned subsidiaries (self-owned subsidiaries) in China and sublicenses the self-owned subsidiaries to operate the franchised units. The Chinese franchise regulations should be triggered only when the offshore franchisee or one of its Chinese self-owned subsidiaries subfranchises to other third-party operators in China.

As illustrated by the preceding examples, a franchisor’s compliance obligations may depend on how a transaction is structured. Each outcome is jurisdiction-specific and highly dependent on the wording and interpretation.

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of the relevant regulations. Although it is certainly not advisable to adopt a particular structure solely to lessen the burden of regulatory compliance, if a franchisor is able to accomplish its business objectives using a structure that reduces the time and cost associated with regulatory compliance, it may be beneficial to adjust the structure of the transaction.

D. Allocate Resources Wisely

Once a decision has been made to move forward in a jurisdiction with a specific local prospect under a particular structure, a franchisor may begin to consider how best to sequence the stages of the transaction. As the negotiations develop, the possibility always exists that the parties will fail to reach a meeting of the minds on the terms of the arrangement. One of the challenges in an international franchise transaction is to find ways to verify the parties’ agreement at various stages of the transaction while remaining in compliance with local regulations, but without incurring costs that may be disproportionate to the level of the parties’ commitment.

Traditionally, one way of seeking to verify that a prospective franchisee had a genuine level of commitment to the transaction was to require the prospect to pay a significant up-front fee or deposit against the initial fees that it would be required to pay on completion of the transaction. The payment helped to ensure that the prospect had an incentive to negotiate seriously and in good faith. However, as the earlier discussion of international franchise regulations explains, in many jurisdictions a franchisor is now prohibited from taking a fee or deposit before it is required to invest the time and money needed to satisfy the local franchise law, typically by preparing (and possibly registering) a disclosure document that complies with the local law and delivering that disclosure document to the prospect. In those cases, a franchisor must consider whether there are other ways to measure a prospect’s level of commitment at various stages of the transaction so that it can allocate—but not over-allocate—the appropriate level of resources to move the transaction forward in compliance with local laws commensurate with the prospect’s demonstrated level of commitment.

One way to test whether the parties have agreement on fundamental deal terms is to first negotiate a letter of intent (LOI). An LOI can perform an important function by allowing the parties at an early stage of the transaction to confirm they have a mutual understanding of the material terms of the proposed arrangement, including the territory and fees. An LOI also can serve to establish a definitive time period within which the parties agree to negotiate exclusively with one another in order to reach a full and final agreement on all terms of the transaction. Setting a clearly defined period of time for the negotiations can give the franchisor some assurance that the market under negotiation will not be tied up indefinitely if the franchisor and the prospect cannot agree on final terms. The regulatory question, of course, is whether an LOI can be signed before the franchisor complies with any applicable disclosure and registration requirements under the local franchise law. Not surprisingly, the answer varies depending on the jurisdiction.
As discussed in an earlier section of this article, under the Arthur Wishart Act, franchisors in Ontario must provide the disclosure document at least fourteen days before the earlier of payment of a fee or the prospective franchisee’s execution of “the franchise agreement or any other agreement relating to the franchise.”\(^\text{79}\) Under this standard, it is not clear that any LOI—even if expressly made non-binding—can be signed without triggering an obligation to disclose under the Ontario statute.

In contrast, under the KFA, the obligation to disclose is triggered by payment of any fee or execution of a franchise agreement. A franchise agreement is specifically defined as:

> [A] continuous business relationship in which a franchiser allows its franchisees to use its own trade marks, service marks, trade names, signs, or any other business marks (hereinafter referred to as “business marks”) in selling goods (including raw materials and auxiliary materials) or services in conformity with certain quality standards or business methods, and supports, trains, and controls its franchisees in regards to their management, business activities, etc., and in which franchisees pay franchise fees to their franchiser in return for the use of business marks and the support and training provided for their management, business activities, etc.\(^\text{80}\)

Since an LOI would typically not fall within this definition of a “franchise agreement,” in South Korea it should be permissible to execute a binding LOI before providing disclosure, although the terms of the LOI should be reviewed to ensure they are consistent with local laws, including local franchise laws.

Once past the LOI stage, a franchisor also may wish to consider whether it is permitted under local franchise regulations to sign an even more significant agreement—such as a development agreement—before disclosure and registration (if required) are complete. Many U.S. franchisors structure their direct franchise programs to use both a development agreement and separate unit franchise agreements. The development agreement defines the territory within which the developer/franchisee will develop franchised units and includes a schedule that establishes the number of franchised units to be opened, and the dates for opening those units, in the territory. A separate unit franchise agreement is then signed for each unit opened under the development agreement.

It can be helpful from a commercial perspective to be able to sign the development agreement—if not the unit franchise agreement—before spending the time and money necessary to prepare (and possibly register) a franchise disclosure document, particularly if the local regulatory requirements are perceived to be time consuming and/or expensive. Because the

\(^{79}\) Arthur Wishart Act, S.O, 2000, c.3, s. 5(1)(a) (Can.). Proposed amendments to the Act include an exception for confidentiality agreements signed prior to disclosure, but, although the proposed amendments received Royal Assent in 2017, they have not been declared in force, and Ontario remains the only Disclosure Province without such an exception.

\(^{80}\) Fair Franchise Transactions Act, Act No. 6704, May 13, 2002, amended by Act. No. 14135, Mar. 29, 2016, art. 2 (S. Kor.); see also Kim, supra note 71 (similar translation).
Managing the Proliferation of Global Franchise Regulation

A development agreement establishes the number of franchised units to be opened and the schedule for opening; it can serve as a good barometer for determining the parties’ mutual understanding of certain key terms, prior to investing the significant time and money required to prepare a disclosure document, register, and disclose. Early execution of a development agreement also allows the parties to begin the site selection and development process as quickly as possible.

Execution of a binding development agreement prior to delivery of a disclosure document that satisfies local franchise requirements may not be feasible in jurisdictions where the disclosure (and any applicable registration) obligation is triggered by a prospective franchisee’s execution of any binding agreement with the franchisor or its affiliate in connection with the proposed franchise sale. However, in jurisdictions that impose such requirements before a “franchise agreement” is executed, a franchisor may well ask whether its development agreement is a “franchise agreement” under the local franchise law. If not, it may be possible for the parties to sign the development agreement and begin the site selection process while the franchisor contemporaneously prepares (and, where required, registers) a disclosure document that covers only the unit franchise agreement.

As with all questions involving the legal effect of local franchise regulations, the answer will depend on the wording of the applicable requirement and its interpretation. The development agreement analysis is arguably more nuanced than the LOI analysis in that the development agreement grants certain rights to the developer/franchisee, but typically does not grant rights to use the franchisor’s trademarks or to operate franchised units. Those rights are usually granted only in the unit franchise agreement, which may be referenced in the development agreement. Often, the answer is not “black and white,” and a franchisor will have to determine whether the benefits of signing a development agreement before disclosing and/or registering outweigh the potential risks.

For example, under the KFA, the recommended approach is to register and disclose before entering into a development agreement with a prospect. The reason is that signing a development agreement contractually obligates the prospect to sign a franchise agreement at a later date, which would result in the formation of a franchisor-franchisee relationship. Nevertheless, there is a position that registration and disclosure may not be required before signing the development agreement. As discussed in an earlier section of this article, the KFA’s definition of a franchise license or right focuses on the franchisee’s right to operate a franchised unit. Thus, it is arguable that the right to develop, but not operate, franchised units falls outside the scope of the KFA. If a franchisor wishes to take that position, it is well advised to restrict the terms of its development agreement to those related to the grant of development rights and to state clearly in the development agreement that the franchise agreement (and only the franchise agreement) governs all operating rights. In addition, because the KFA’s definition of a franchise fee
is very broad,\textsuperscript{81} and because the KFA places significant restrictions on when a franchise fee may be paid,\textsuperscript{82} payment of any development or territory fee should be deferred until payment can be made in compliance with the KFA’s provisions governing payment of the franchise fee. Although the risks attendant to execution of the development agreement in advance of registration and disclosure cannot be completely eliminated, we have received advice that the most probable consequence for the franchisor would be a corrective order from the KFTC mandating registration of the FDD and undertaking future compliance. Neither the development agreement nor the franchise agreement should become invalid because the development agreement was signed before registration or disclosure.

\textbf{V. Conclusion}

Since I first began practicing franchise law, international franchise expansion has become increasingly complex, time consuming, and expensive. A significant contributor to those trends has been the ever-increasing number of regulations adopted by many non-U.S. jurisdictions to regulate franchising activities. The proliferation of those regulations is not likely to end soon, and this article was intended to suggest some strategies that may help franchisors expanding into multiple regulated jurisdictions to manage the attendant costs and risks.

The article was planned, and much of it was written, before the widespread outbreak of the COVID-19 virus disrupted franchise system operations worldwide. The virus, and the lockdowns of many franchised businesses mandated in response to the virus, will likely have a long-term impact on many franchisors’ plans for future international expansion. However, as global growth rebounds, as surely it must, the principles discussed in this article should continue to have validity for franchisors that decide to access the international markets.

\textsuperscript{81} Fair Franchise Transactions Act, Act No. 6704, May 13, 2002, amended by Act No. 14135, Mar. 29, 2016, art. 2 (S. Kor.) ("Franchise Fee" includes consideration that a franchisee pays to a franchiser (a) in order to obtain a franchise license, including a license for the use of business marks, or to receive support for and training on his/her business activities, such as membership fees, admission fees, franchise fees, training fees, or down-payments; (b) as a security for the payment of obligations or damages incurred in connection with the purchase price for commodities, etc. supplied by the franchiser; (c) as the price for fixture, facilities, or commodities supplied or a rent for real estate provided by the franchiser at the time a franchise license is granted in order to start a franchise business; (d) on a regular or irregular basis, for the use of business marks licensed under an agreement with the franchiser, support for and training on business activities, etc., and that is specified by Presidential Decree; and (e) any other consideration that a prospective franchisee or a franchisee pays to a franchiser to acquire or maintain a franchise license.).

\textsuperscript{82} Id. chap. III (restricting receipt of “initial franchise fees” prior to (1) disclosure of registered FDD, and (2) two months after signing the FA or opening of the franchised unit, whichever comes earlier).
Stradivarius Revisited: Re-Tuning Your Franchise Arbitration Instrument

Jonathan Solish & David Harford

I. Introduction

Franchising has had a long and fitful struggle with arbitration. When the California legislature passed the first franchise law in the country in 1971, it prohibited the use of arbitration clauses in franchise agreements. Soon after, the U.S. Supreme Court struck down this protective statute as preempted by the Federal Arbitration Act (FAA). This tension between protecting franchisees from unfair arbitration proceedings and the FAA can be traced like a fault line through decades of franchise litigation.

In 1992, I published an article in the Franchise Law Journal, “How to Make Your Arbitration Instrument into a Stradivarius” (1992 Article), making several proposals with respect to arbitration agreements. The 1992 Article proposed that franchise arbitration agreements should include class action waivers, a decade before the 2003 U.S. Supreme Court decision in Green Tree Financial Corp. v. Bazzle, which embraced the concept of class


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arbitration, stimulating popular discourse on what had previously been a relatively obscure issue. The 1992 Article also proposed allowing for appellate review on the merits, a right that was subsequently rejected by the U.S. Supreme Court in 2008, but was fully embraced by the California Supreme Court the same year.

In 1992, franchise agreements in general, and arbitration clauses in particular, were drafted by one party—the franchisor. The “perfect” arbitration clause provided the greatest possible benefit to the franchisor and often impinged on the rights of franchisees by limiting their substantive and procedural rights. The 1992 Article suggested various arbitration provisions that favored the interests of franchisors, including carving out certain types of disputes, waiving punitive damages, including shortened statutes of limitations, and limiting the collateral estoppel effect of adverse arbitration awards. These suggestions make less sense in 2020.

In the course of the last three decades, franchisees have attained more leverage at the bargaining table. Franchisees are now more likely to operate multiple units with further development rights. Franchisees in many systems have developed associations, represented by capable counsel. As a result, franchisees are now far more likely to push back when confronted with unacceptable contract terms.

As the use of arbitration clauses has expanded, courts have been less willing to endorse arbitration clauses that stack the deck unfairly against franchisees. There is greater risk today that an arbitration clause that is too one-sided will not be enforced, leading to the possible loss of the right to arbitrate altogether. A “perfect” arbitration clause today would, therefore, avoid extremes that might undermine its enforceability.

Last year, in an article on “Best Practices in Franchise Arbitration,” Peter Silverman, an experienced arbitrator of franchise disputes, pointed out that “arbitration clauses in franchise agreements may be up to twenty years old and outdated.” This article reconsiders the 1992 Article with the benefit, quite literally, of 2020 hindsight. To place franchise arbitration caselaw into context, the analysis must start with the passage of the FAA. After the FAA has been placed into its historical context, the article discusses the tension between Article III of the Constitution and the FAA. The article describes the development of arbitration tribunals and an alternative dispute resolution system. A discussion of whether arbitration is fair is followed by a review of newly developed empirical evidence of arbitrator bias and the recent decision of the Ninth Circuit Court on a case handled by the authors, where an arbitration award was vacated because an arbitrator failed to disclose that

5. See, e.g., discussion infra Section II.A.
6. See generally Solish, supra note 2.
he was an equity owner of a for-profit arbitration tribunal with an ongoing commercial relationship with one of the parties. Finally, the recommendations of the 1992 Article are reconsidered with an updated analysis of the developing law as to unconscionable carve-outs, appellate review, class action waivers, collateral estoppel, mediation and emerging misclassification issues.

II. The Changing Landscape of Arbitration Law

A. Short History of the Federal Arbitration Act

Before the passage of the FAA, arbitration provisions had been struck down under the doctrines of non-arbitrability and ouster because arbitration offended the public policy in favor of court trials. In 1925, Congress passed the FAA, expressly negating the doctrines of non-arbitrability and ouster and making pre-dispute arbitration provisions “valid, irrevocable, and enforceable,” in the same manner as other contracts.

Herbert Hoover, then Secretary of Commerce, was a primary supporter of the FAA. Hoover was a part of the “Associationalism” movement, which envisioned a “new capitalism” in which cooperative associations would regulate themselves without the need for the government intervention then favored by the Progressive movement. The FAA was viewed as a means for merchants to resolve routine trade disputes about quantity, quality, time of delivery, and compliance with contract payment terms, without burdening the judicial system.

Under the FAA, courts were required to stay proceedings where the parties had agreed to arbitrate. Arbitrators, however, had no power to enter judgments, a function that still remained vested in the courts alone. The FAA allowed judges to overturn an arbitration award, but only on very tightly-restricted grounds. Arbitration clauses could not be invalidated except on generally applicable contract defenses. Statutes that singled out arbitration clauses were preempted by the FAA, making it very difficult to invalidate an arbitration agreement.

When the California legislature adopted the Franchise Investment Law (FIL) in 1971, the first generally applicable franchise statute in the nation, it chose to include a provision that outlawed arbitration clauses in franchise

12. Id. at 987–1005.
13. The Automobile Dealers’ Day in Court Act, 15 U.S.C. §§ 1221–1225, which applied to automobile dealers only, was passed in 1956.
agreements. Presumably, the legislature believed that franchisees would not get a fair shake in arbitration and that it was important to preserve franchisees’ rights to present their claims in courts of law. Some have advocated that franchisees “are entitled to protection under the U.S. Constitution and federal and state laws” that should not be forfeited through the use of arbitration clauses. The prohibition on franchise arbitration in the FIL fell victim to the U.S. Supreme Court’s expanding interpretation of the range of the FAA and was struck down as violative of that act in Southland Corp. v. Keating.

In Keating, 7-Eleven franchisees had sued their franchisor for breach of contract and violation of the FIL. The California Supreme Court had initially ordered the common law claims into arbitration, but had held that the FIL claims could not be compelled to arbitration because of the statutory prohibition. The U.S. Supreme Court reversed because “the defense to arbitration found in the California Franchise Investment Law is not a ground that exists at law or in equity ‘for the revocation of any contract.’” Keating was seen as a “major expansion of the scope of the [FAA]” because it expanded the FAA to apply to statutory claims and to state court cases, as long as the dispute involved interstate commerce.

In the 1985 case, Mitsubishi Motors Corp. v. Soler-Chrysler-Plymouth, Inc., another franchise dispute, the U.S. Supreme Court reassured those concerned about the loss of the right to a court trial on their statutory rights: “By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum.” This statement suggests that arbitration is merely a change of tribunal, where the parties’ substantive rights can be resolved in the same way that they might otherwise have been resolved in a court of law. A statutory right could be forced into arbitration, as long as the “litigant effectively may vindicate its statutory cause of action in the arbitral forum. . . .” This right of a litigant to effectively vindicate statutory rights in arbitration was later brushed off by the Court as mere dicta.

In a concurring 1995 opinion, Justice Sandra Day O’Connor charged that the U.S. Supreme Court had “abandoned all pretense of ascertaining congressional intent with respect to the [FAA], building instead, case by case, an

20. Id.
22. Id. at 637.
edifice of its own creation.” Her observation is well taken. The FAA was not meant to apply to state courts,25 was expressly intended for contractual and not for statutory claims,26 and was not meant to apply to employment claims.27 Despite those intentions, the FAA now applies to state courts,28 statutory claims,29 and employment claims.30 This complete turnabout as to the scope of the FAA transpired through a series of cases that channeled franchise, consumer, and employment cases into an alternate judicial system that has been derided as a “junior varsity justice system.”31 Under the FAA as it is currently interpreted, a franchisee in California, or any other state, with an arbitration clause in its franchise agreement is required to arbitrate all of its legal claims, including noncontractual, statutory, and even employment claims.

B. Article III of the Constitution

Article III of the U.S. Constitution vests in the court system the “judicial power of the United States,” granting judges the power to hold their offices with undiminished power as long as they exercise “good Behaviour.”32 This constitutional power ensures litigants that their disputes will be heard by impartial judges. Part of the objection to arbitration had been that it deprived parties of their right to a trial before an unbiased Article III court. As Justice Joseph Story explained in an 1845 decision, courts

necessarily pause to consider, whether [arbitration] tribunals possess adequate means of giving redress, and whether [courts] have to compel a reluctant party to submit to such a tribunal, and to close against him the doors of the common courts of justice, provided by the government to protect rights and to redress wrongs.33

In a dissenting opinion in the early stages of the Court’s expansion of the FAA, Justice Hugo Black raised the same question 122 years later: “I am by no means sure that . . . forcing a person to forgo his opportunity to try his
legal issues in the courts where, unlike the situation in arbitration, he may have a jury trial and right to appeal, is not a denial of due process.\textsuperscript{34}

After the expansion of arbitration under the FAA, legal scholars, judges, and journalists have expressed concerns about whether arbitration is consistent with Article III of the U.S. Constitution. The FAA is an act of the legislature that impedes upon the right to trial before an Article III court. After the passage of the FAA, the right to a court trial was limited to a cursory review on the way into arbitration (whether the parties had agreed to arbitrate) and on the way out of arbitration (whether arbitrators had abused their powers). Lower courts generally refused to review the findings of fact and conclusions of law determined by the arbitrator. The U.S. Supreme Court has suggested, however, that courts reviewing an arbitration award “should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate review.”\textsuperscript{35}

Some argue that the Court’s expansive reading of the FAA has “plainly ignored the people’s . . . basic constitutional guaranty to have all their cases tried in courts of record before Article III judges.”\textsuperscript{36} Others contend that “questions about unresolved Article III issues have grown in importance.”\textsuperscript{37}

Scholars have questioned the right of Congress to pass a bill like the FAA which has eliminated the protections of Article III from arbitration proceedings.\textsuperscript{38} These scholars assert, for example, that “\textit{any} person who would have been entitled to bring a claim in federal court, absent arbitration, can argue that the court’s imposition of arbitration denied them their right to have their claim heard by an Article III Judge.”\textsuperscript{39}

The U.S. Supreme Court has recognized that the “nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action.”\textsuperscript{40} Denying access to an Article III court may be “significant because a judge, who is appointed for life, may well be subject to less bias than an arbitrator. . . .”\textsuperscript{41} Kathryn Werdegar, a former justice of the California Supreme Court, has advocated that courts must be responsible for the integrity of the arbitration system and to impose, “as necessary, the fundamental requirements of due process.”\textsuperscript{42}

\textsuperscript{37} Rutledge, supra note 8, at 1193.
\textsuperscript{38} Jean R. Sternlight, Rethinking the Constitutionality of the Supreme Court’s Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns, 72 Tex. L. Rev. 1, 78–80 (1997); Zick, supra note 36, at 249.
\textsuperscript{39} Sternlight, supra note 38, at 78.
\textsuperscript{40} Bernhardt v. Polygraphic Co. of Am., 350 U.S. 198, 203 (1956).
\textsuperscript{41} Sternlight, supra note 38, at 335.
Concerns about Article III appear most often in scholarly literature on the FAA, but some courts have addressed these concerns by requiring arbitrators to act more like judges. In a 1997 employment case, the D.C. Circuit imposed due process requirements on private arbitration tribunals in *Cole v. Burns International Security Services*. The court held that arbitrators were obligated to educate themselves about the law; demonstrate a working knowledge of the statutes; follow precedent; provide procedural fairness; ensure a fully developed record; and adopt an attitude of judicial restraint.

C. Arbitration Tribunals

Soon after passage of the FAA, some of the lobbyists who had pressed Congress to pass the act formed tribunals that were consolidated into the American Arbitration Association (AAA). Herbert Hoover was the Honorary President of the AAA from its inception in 1926. The founding of the AAA right after passage of the FAA “appears to reinforce the notion that the FAA did, in fact, lead to the creation of non-Article III tribunals to handle Article III business.”

For many years, virtually all commercial arbitration agreements designated the AAA as the arbitration tribunal and adopted its rules. In 1979, a retired judge founded Judicial Arbitration and Mediation Services (commonly known as JAMS), the first of many rival tribunals that eventually eroded AAAs nearly complete dominance over arbitration proceedings. Numerous tribunals currently offer arbitration services, but, with the exception of JAMS and AAA, these forums are regional or, like the Financial Industry Regulatory Authority (FINRA), restricted to adjudicating only certain kinds of disputes. JAMS now claims to be the largest private provider of alternative dispute resolution in the world.

D. Developing Concerns About Whether Arbitration Is Fair

In 2015, a series of *New York Times* front-page stories asserted that American businesses have used arbitration to establish the “Privatization of the Justice System,” where “an alternate system of justice” has replaced the fundamental right to a day in court. The anecdotal experiences reported by the *New York Times* suggested that arbitration tribunals have a strong bias in favor of repeat customers. Arbitrators reported their concerns that adverse

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44. *Id.* at 1488.
46. *Stone, supra* note 11, at 991.
47. See *Zick, supra* note 36, at 264.
rulings would scare away repeat customers. The California Supreme Court has also recognized a bias that favors repeat players in arbitration.\footnote{Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 690 (Cal. 2000).}

Since the U.S. Supreme Court rejected the California statute meant to protect franchisees from arbitration in \textit{Keating},\footnote{See supra notes 18–20 and accompanying text.} federal courts have dismissed claims that there is anything inherently unfair about forcing franchisees to arbitrate their disputes with franchisors. For example, in a 1996 decision, the Second Circuit rejected the claims of Subway franchisees that the AAA was biased against them because Subway was a repeat AAA customer.\footnote{Doctor's Assocs., Inc. v. Stuart., 85 F.3d 975 (2d Cir. 1996).} The court held that the franchisees had failed to present any credible evidence of bias on the part of AAA.\footnote{Id. at 981.} The same court rejected a similar claim by another Subway franchisee a few years later, again finding the failure to present any evidence of bias.\footnote{Doctor's Assocs., Inc. v. Hamilton, 150 F.3d 157, 163 (2d Cir. 1998).}

In a 2006 franchise arbitration decision, \textit{Nagrampa v. Mailcoups, Inc.}, an \textit{en banc} panel of the Ninth Circuit held that raising the “repeat player effect,” without also presenting more particularized evidence of partiality, is insufficient to establish that an arbitration provision is unconscionable.\footnote{Nagrampa v. Mailcoups, Inc., 469 F.3d 1257 (9th Cir. 2006) (en banc).} The repeat player effect has been acknowledged by some courts, but this factor alone does not render an “arbitration clause unconscionable per se.”\footnote{Mercuro v. Superior Court, 96 Cal.App.4th 167, 178 (Cal. Ct. App. 2002).}

E. Recent Empirical Evidence

Researchers have developed substantive evidence bearing on the neutrality of arbitration tribunals when dealing with repeat players. A series of empirical studies (conducted between 1993 and 2013) followed rigorous standards in analyzing data from 270 AAA employment cases; 203 employment cases; 301 AAA consumer arbitrations; 1,213 AAA employment cases; 2,802 employment cases; 341 AAA financial service arbitrations; 4,839 AAA consumer arbitrations; and 4,883 AAA employment arbitrations.\footnote{Andrea Cann Chandrasesekher & David Horton, \textit{Arbitration Nation: Data from Four Providers}, 107 CAL. L. REV. 1, 24 (2019).}

Analysis of this extensive empirical data has demonstrated a very strong bias in favor of the customers of arbitration tribunals who are repeat players. One study found that employees won seventy-one percent of their cases where the employer had not appeared before the tribunal before, but won only sixteen percent of the cases against employers who were repeat customers of the tribunal.\footnote{Id.} The most extensive studies demonstrated that the odds of a consumer victory fell by seventy-nine percent against a “high-level” repeater and by ninety-four percent against a “super-repeater.”\footnote{Id. The report does not describe the difference between “high-level” repeaters and “super-repeaters.”} It does not
appear that any study has attempted to quantify repeat-player bias in franchise arbitrations, although it might be inferred from existing data that a study of franchise arbitration could reach similar conclusions.

Home court advantage is commonly recognized in sports. According to betting services, home court is worth 2.33 points in the National Basketball Association and 2.5 points in the National Football League.61 These are tangible advantages but pale in comparison to data showing that one party’s chances of winning are diminished by ninety-four percent against a "super-repeat" adversary in arbitration.62 It is difficult to reconcile the findings of these empirical studies with the expectation of the U.S. Supreme Court in Mitsubishi that parties do not forgo any rights when compelled to arbitrate.63

The vast expansion of the scope of the FAA since the Court’s 1985 Mitsubishi decision has taken place without the benefit of data which calls the Court’s fundamental assumptions into question. Commentators have suggested that the issue of repeat arbitrators calls for more attention.64 The data supports this suggestion. If disputants are receiving treatment at an alternate tribunal, such as arbitration, that mirrors Article III fairness guarantees, it could be said there is “no harm, no foul.” But if a series of rigorous empirical studies demonstrate that the home field advantage of repeat players tilts the scales to where a consumer claimant’s chance of losing is increased by ninety-four percent, the Mitsubishi Court’s grounds for giving arbitration a free pass as to Article III fairness guarantees may be due for reconsideration.

F. Inherent Bias—The Elephant in the Room?

Arbitration awards may be vacated under the FAA where there is “evident partiality or corruption in the arbitrators, or either of them. . . .”65 As noted in Justice Byron White's concurring opinion in Commonwealth Coatings, “[I]t is enough . . . to hold, as the Court does, that where the arbitrator has a substantial interest in a firm which has done more than trivial business with a party, that fact must be disclosed.”66 Similarly, in a prescient dissent joined by Justices William O. Douglas and Potter Stewart, Justice Hugo Black raised due process concerns about allowing an arbitrator to decide “an issue which will determine his compensation.”67

In a 2019 franchise case, Monster Energy Co. v. City Beverages, LLC, the concerns expressed by the Court in Commonwealth Coatings were combined

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62. See Chandrasekher & Horton, supra note 58.
65. 9 U.S.C. § 10(a)(1)–(2).
with the inherent advantages to repeat players in arbitration. 68 The Ninth Circuit vacated an arbitration award because the arbitrator had failed to adequately disclose his ownership interest in an arbitration tribunal that profited from a continuing relationship with a repeat player. 69

Monster Energy and a Washington distributor, Olympic Eagle, entered into a twenty-year distribution agreement. 70 After Monster Energy signed a distribution agreement with Coca Cola, it terminated Olympic Eagle pursuant to the contract. Olympic Eagle disputed the termination and asserted that the distribution relationship met the definition of a franchise under the Washington Franchise Investment Protection Act, which prohibits the termination of a franchise without good cause. 71 Monster Energy sued to compel arbitration and obtained an order directing the parties to arbitrate their dispute before JAMS, pursuant to their contract. 72

An arbitrator was then appointed. After a two-week arbitration hearing, the arbitrator determined that the relationship of the parties was not protected by the Washington franchise law, ruling in favor of Monster Energy and awarding substantial attorneys fees. 73 The district court confirmed the arbitrator’s award and awarded additional attorneys fees to Monster Energy. 74

As the opposing motions to vacate or confirm the arbitration award were pending, JAMS executives were being deposed in an unrelated action against JAMS. In depositions, these executives disclosed that the interests of the JAMS neutrals differed significantly. Only about a third of the JAMS neutrals held an equity interest in JAMS, which is a for-profit corporation. Upon learning that the arbitrator in its dispute with Monster Energy was an equity owner in JAMS, Olympic Eagle appealed the confirmation of the arbitrator’s award. 75

Before he had been selected, the JAMS arbitrator in Monster Energy made the following disclosure: “I practice in association with JAMS. Each JAMS neutral, including me, has an economic interest in the overall financial success of JAMS.” 76 This statement “expressly likened [the arbitrator’s] interest in JAMS to that of ‘each JAMS neutral,’ who has an interest in the ‘overall financial success of JAMS.’” 77 The JAMS arbitrator did not disclose that, unlike the majority of JAMS neutrals, he was also an equity “co-owner of JAMS,” entitled to a share of its overall profits. 78 The arbitrator had also failed to disclose that JAMS and Monster Energy had “done more than trivial business” together. 79

68. Monster Energy Co. v. City Beverages, LLC, 940 F.3d 1130 (9th Cir. 2019).
69. Id. at 1138–39.
70. Id. at 1132–33.
71. Id. at 1133.
72. Id.
73. Id.
74. Id.
75. Id.
76. Id. (emphasis added).
77. Id. at 1134.
78. Id. at 1133.
79. Id. at 1136 (quoting Commonwealth Coatings Corp. v. Cont’l Cas. Co., 393 U.S. 145, 151–52 (1968)).
The Ninth Circuit noted that “over the past five years, JAMS has administered 97 arbitrations for Monster: an average rate of more than one arbitration per month. Such a rate of business dealing is hardly trivial, regardless of the exact profit-share that the Arbitrator received from these matters.”

The court vacated the arbitration award because the failure to disclose the ownership interest created an appearance of partiality in favor of Monster Energy. The court held that “arbitration organizations like JAMS . . . will have no difficulty fulfilling, and even exceeding, the [disclosure] requirements described here.”

The dissent frankly acknowledged that the private arbitration system may favor a “repeat player” over “a non-repeat player that had no choice but to agree to arbitration in order to acquire employment, purchase a product, or obtain a necessary service.” The dissent saw no need for disclosures, however, about “the elephant that everyone knows is in the room,” namely that because “arbitrators are hired and paid by the parties for whom they conduct private arbitrations, arbitrators have an economic stake in cultivating repeat customers for their services.” The dissent concluded that “[t]his feature of private arbitration, even if distressing, is an inevitable result of the structure of the industry.” After explaining how Article III guarantees litigants the right to an impartial judiciary, the dissent concluded: “When parties like those here, who could have their disputes resolved in federal court, instead have entered into a contract that requires resolving any disputes in private arbitration (whether the arbitration term was desired by both parties or not), they have given up those Article III protections.”

The dissent in Monster Energy calls into question the assumption of the U.S. Supreme Court in Mitsubishi—that it was fair to order parties into arbitration and to forgo their Article III rights because they would be receiving the same kind of impartial hearing they would have received had they remained in court. On May 28, 2020, Monster filed a petition for Writ of Certiorari, which was denied on June 29, 2020. A Pennsylvania district court judge, citing Monster Energy, characterized the failure of a JAMS arbitrator to mention her ownership interest in JAMS as “a blatant and indefensible failure” to disclose.

Fairness is of critical importance in arbitration, just as it is in a courtroom. Although it is important to safeguard the neutrality of arbitration tribunals, it is also important to recognize that the arbitration process generally
functions smoothly, fairly, and effectively. And that impropriety, or even the appearance of impropriety, has not invalidated the benefits of arbitration as an alternative dispute resolution system. Arbitration is a vital part of the dispute resolution process in the United States and worldwide. Measures must be taken to ensure that stronger parties do not enter into arbitration proceedings with unfair advantages so that the arbitration process does not devolve into a dispute resolution system where one party will always be a second-class citizen.

III. Re-Tuning Your Arbitration Instrument

A. Stradivarius Reconsidered

The continuing tension between franchising and arbitration, from the initial outlawing of franchise arbitrations in 1971, to the vacating of a franchise arbitration award for inadequate disclosures in 2019, sets the stage for considering the perfect franchise arbitration clause in 2020. It is time to open the time capsule to revisit the 1992 Article, assess whether the advice given has been borne out over time, and identify areas where the advice must be reconsidered in light of subsequent caselaw. The next sections focus on specific areas covered in the 1992 Article before turning to some new issues that may be emerging in franchise arbitration law.

B. Unconscionability and Carve-out Clauses

As “arbitration clauses have become a routine part of consumer, franchise and employment contracts,” it has been noted that “[s]ome companies have sought not just to funnel cases from courts, but to tilt the scales of justice in their favor: stripping remedies, slashing discovery, selecting biased arbitrators, eliminating the right to bring a class action, and saddling adherents with prohibitive costs and fees.”91 The doctrine of unconscionability has “emerged as the primary check on drafter overreaching.”92 The more aggressively that the deck is stacked against franchisees, the more likely it is that a court or even an arbitrator or arbitration tribunal will refuse to enforce an arbitration clause.

When arbitration clauses are challenged, courts must employ generally applicable contract doctrines like unconscionability because the FAA only allows an arbitration clause to be invalidated on a ground that would warrant the “revocation of any contract.”93 The U.S. Supreme Court has acknowledged, in another franchise case, that the doctrine of unconscionability meets that statutory standard.94

92. Id.
In 1992, it was common for franchisors to “carve out” certain issues from their arbitration clauses. Over the past three decades, franchise arbitration clauses drafted in this manner have often been set aside on unconscionability grounds, particularly in California and the Ninth Circuit. Unconscionability has a substantive and a procedural component. Generally, the party challenging the validity of an arbitration clause has the burden of proving unconscionability.

1. Procedural Unconscionability

“Procedural unconscionability involves ‘oppression’ or ‘surprise’ due to unequal bargaining power.” For example, in Bridge Fund Capital Corp. v. Fastbucks Franchise Corp., the franchise arbitration clause was held to be procedurally unconscionable on the ground that “franchise agreements have some characteristics of contracts of adhesion because of the ‘vastly superior bargaining strength’ of the franchisor.” In Ticknor v. Choice Hotels International, a franchise agreement was held to be procedurally unconscionable because “the Franchise Agreement was a standardized, form agreement that [the franchisee] was forced to accept or reject without negotiation.”

It should be noted, however, that in some franchise systems the franchisees may have negotiated changes to proposed franchise agreements or franchise associations may have played a significant part in the drafting of the franchise agreements.

Courts are less likely to enforce an arbitration clause where the franchisee can show “surprise” created by “a prolix agreement drafted by [the franchisor].” Franchisees, however, receive extensive pre-contract disclosures, which may undermine any finding that an arbitration clause can “be viewed as creating unfair surprise.”

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95. See, e.g., Bridge Fund Capital Corp. v. Fastbucks Franchise Corp., 622 F.3d 996, 1005 (9th Cir. 2010) (despite a Texas choice of law provision, franchise arbitration clause was unconscionable under California law); Ticknor v. Choice Hotels Int’l, Inc., 265 F.3d 931, 942 (9th Cir. 2001) (arbitration clause in Econo-Lodge franchise agreement was unconscionable under Montana law because the franchisor had reserved for itself judicial remedies for various claims and Maryland law was to apply); Indep. Ass’n of Mailbox Ctr. Owners, Inc. v. Superior Court, 34 Cal. Rptr. 3d 659 (Ct. App. 2005) (arbitration clause in franchise agreement is unconscionable).


99. Id.

100. Ticknor, 265 F.3d at 939.


103. See, e.g., We Care Hair Dev., Inc. v. Engen, 180 F.3d 838, 843 (7th Cir. 1999).
2. Substantive Unconscionability

Substantive unconscionability is established by “unfair and unreasonable contract terms.”\(^\text{104}\) For example, in *Bridge Fund*, the Ninth Circuit found several substantively unconscionable terms in the arbitration clause, including the agreement’s “mandatory waivers of non-waivable statutory rights granted under” protective franchise statutes, the franchisor’s reservation of the unilateral right to seek injunctive relief, and a Texas choice-of-forum provision.\(^\text{105}\) In *Independent Ass’n of Mailbox Center Owners, Inc. v. Superior Court*, the court held that the damages limitations in the franchise agreements were substantively unconscionable.\(^\text{106}\) A substantively unconscionable provision goes to the essence of the provision, and whether it is inherently unfair and unreasonable, not how it is applied.

3. Severability of Unconscionable Clauses

Even if some provisions in an arbitration agreement are unconscionable, a court may still “uphold the arbitration provision while severing the unconscionable clauses.”\(^\text{107}\) In *Bridge Fund Capital*, four of the five provisions in the arbitration clause were unconscionable but could not be severed because they permeated the arbitration clause and severing them would have negated the entire arbitration clause.\(^\text{108}\)

Similarly, the Ninth Circuit at first turned away a franchisee’s challenge to an arbitration clause in *Nagrampa v. MailCoups, Inc.*\(^\text{109}\) The franchisee claimed that the arbitration clause was procedurally unconscionable because it was buried on the twenty-fifth page of the franchise agreement and had not been brought to her attention.\(^\text{110}\) The Ninth Circuit rejected the argument because the franchisee had failed to read the agreement or to consult with a lawyer.\(^\text{111}\)

In an *en banc* review, however, the Ninth Circuit found a lack of mutuality in a unilateral carve-out provision that allowed only the franchisor to go to court for provisional remedies and in the choice of a Massachusetts venue, which was advantageous to the franchisor.\(^\text{112}\) These non-mutual provisions made the arbitration clause substantively unconscionable.\(^\text{113}\) Further, the


\(^\text{105}\) Bridge Fund Capital Corp. v. Fastbucks Franchise Corp., 622 F.3d 996, 1004–05 (9th Cir. 2010).

\(^\text{106}\) Indep. Ass’n of Mailbox Ctr. Owners, Inc. v. Superior Court, 34 Cal. Rptr. 3d 659, 672–73 (Ct. App. 2005).


\(^\text{108}\) Bridge Fund Capital Corp., 622 F.3d at 1005.

\(^\text{109}\) Id. at 1029.

\(^\text{110}\) Id. at 1030.

\(^\text{111}\) Id. at 1293.
The arbitration clause was so permeated by substantive unconscionability that it could not be severed from the franchise agreement without rewriting the contract. The en banc panel, accordingly, found that the arbitration clause was invalid and unenforceable.

Previously, in a 1994 case, *Graham Oil Co. v. ARCO Products Co.*, the Ninth Circuit struck down an arbitration clause because it required the franchisees to forfeit their right to recover punitive damages and attorneys fees, which were both allowed under the Petroleum Marketing Practices Act, and shortened the statute of limitations from one year to only ninety days. The court held that “the fact that franchisees may agree to an arbitral forum for the resolution of statutory disputes in no way suggests that they may be forced by those with dominant economic power to surrender the statutorily mandated rights and benefits that Congress intended them to possess.”

Not all courts have agreed that carve-outs are unconscionable. In a franchise dispute, a California appellate court held that a bar on punitive damages in an arbitration clause was not unconscionable because it was mutual. Several U.S. Circuit Courts have likewise held that “[p]rovisions in arbitration agreements that prohibit punitive damages are generally enforceable.”

The arbitration clause in the Dickey’s Barbecue franchise agreement unilaterally carved out several kinds of issues that the franchisor could pursue in court: real estate claims, injunctions, and suits for monies owed. “Although Dickey’s reservation of the right to litigate certain claims lacks mutuality, under Texas law, this ‘allocation of risk because of superior bargaining power’ was still enforceable.” The carved-out claims were “not so one-sided to render the arbitration provision unconscionable.”

At this point, any attempt to carve out claims from a franchise arbitration agreement invites invalidation of the entire clause on unconscionability grounds. A simple fix might be to make any carve-out reciprocal, so that both parties have the same rights.

### C. Appellate Review of Arbitration Awards

When the 1992 Article was written, it was not clear whether an arbitration clause could provide for expanded judicial review of arbitration awards.
The 1992 Article noted conflicting law on expanded judicial review, with the warning “that the judicial system may turn a deaf ear to even the most finely tuned entreaty for appellate review.”\textsuperscript{124} Parties were still advised to consider “true appellate review” by contracting for such review through tribunals like JAMS.\textsuperscript{125} Both JAMS and AAA now offer special appellate procedures, if agreed upon by the parties. Both providers’ websites describe these procedures and suggest sample appellate review clauses.\textsuperscript{126} According to its website, JAMS adopted its appellate review procedures ten years after the 1992 Article was published.\textsuperscript{127}

The state and the federal judicial systems have taken divergent paths on whether parties can contract for expanded judicial review of an arbitration award. Under the FAA, appellate review in a court, pursuant to the agreement of the parties, is now prohibited under the 2008 U.S. Supreme Court decision in \textit{Hall Street Associates, L.L.C. v. Mattel, Inc.}\textsuperscript{128} Justice Souter cited the “national policy favoring arbitration with just the limited review needed to maintain arbitration’s essential virtue of resolving disputes straightaway,” concluding that any “other reading opens the door to the full-bore legal and evidentiary appeals that can ‘rende[r] informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process . . . and bring arbitration theory to grief in post arbitration process.’”\textsuperscript{129}

In the same year, the California Supreme Court, noting that “the \textit{Hall Street} majority had left the door ajar for alternate routes to an expanded scope of review,” took the opposite approach on appellate review.\textsuperscript{130} In \textit{Cable Connection, Inc. v. DIRECTV, Inc.}, the arbitration clause provided that “[t]he arbitrators shall not have the power to commit errors of law or legal reasoning. . . .”\textsuperscript{131} The California Supreme Court first noted “the general rule that an arbitrator’s decision is not ordinarily reviewable for error by either the trial or appellate courts” but the extent of review can be modified by the parties.\textsuperscript{132} “If the parties constrain the arbitrators’ authority by requiring a dispute to be decided according to the rule of law, and make plain their intention that the award is reviewable for legal error, the general rule of limited review has been displaced by the parties’ agreement.”\textsuperscript{133} This is permissible because it “has a foundation in the [California] statutes governing

\begin{footnotes}
\item[124] Solish, \textit{supra} note 2.
\item[125] Id.
\item[127] \textit{Arbitration Appeal Procedure}, JAMS, \textit{supra} note 126.
\item[129] Id. at 588 (alteration in original).
\item[130] \textit{Cable Connection, Inc. v. DIRECTV, Inc.}, 190 P.3d 586, 595 (Cal. 2008).
\item[131] Id. at 590 n.3.
\item[132] Id. at 600.
\item[133] Id.
\end{footnotes}
judicial review, which include the ground that ‘[t]he arbitrators exceeded their powers.’”

The states are split on the question of expanded review. The Texas Supreme Court affirmed the rights of parties to agree upon expanded review, citing Cable Connection. Massachusetts, however, has expressly rejected California’s approach and followed Hall Street in determining that its arbitration act prohibits expanded review.

In Biller v. Toyota Motor Corp., the parties had agreed that the “Arbitrator [was] required to follow the applicable law and case precedent.” When the losing party petitioned to vacate the award under an expanded standard of appellate review, the Ninth Circuit rejected the argument and refused to apply Cable Connection to an arbitration agreement governed by the FAA. The Ninth Circuit advised that “the parties here might have chosen to expand the scope of judicial review by providing for a merits review of the arbitration award and designating the California Arbitration Act as the controlling law under which review of an arbitral award was to occur. They did not do so.”

Ultimately, if parties to an arbitration agreement want expanded review of arbitration decisions, they may agree to use JAMS’ or AAA’s appellate review programs; or they can contract for such expanded review and designate that the arbitration law of a state like California will govern enforcement and review of the arbitration award.

D. Class Action Arbitration and Waivers

Class arbitrations were in the embryonic stage when the 1992 Article was written. In the landmark U.S. Supreme Court decision Southland v. Keating, the California Supreme Court had sanctioned a franchisee class arbitration. Although the U.S. Supreme Court ultimately overturned the California Supreme Court’s decision in Southland, California courts continued to protect the right to seek class-wide arbitration. For example, in 2007, in Gentry v. Superior Court, the California Supreme Court reversed a decision granting a motion to compel arbitration and ordered the trial court to reconsider whether the matter could proceed as a class arbitration.

A common defense to class actions was to require arbitration, with the agreement specifically providing that the parties would arbitrate only in their individual capacities. After such clauses had become commonplace, the California Supreme Court attempted to limit their use in several high-profile cases, often by holding that the agreements were unconscionable. In 2011,

134. Id.
135. See Nafta Traders, Inc. v. Quinn, 339 S.W.3d 84, 102 (Tex. 2011).
138. Id.
139. Id. at 665.
the expanding California doctrine of unconscionability struck an immovable force in the U.S. Supreme Court.

In *AT&T Mobility LLC v. Concepcion*, the Court held that the FAA preempted a California law that made class action waivers unenforceable in consumer arbitration contracts.\(^{142}\) An AT&T customer had filed a class action challenging the company’s right to charge sales tax on “free” cell phones.\(^{143}\) The Ninth Circuit determined that the class action waiver in the AT&T arbitration clause was unconscionable under California law.\(^{144}\) The U.S. Supreme Court reversed because the California consumer class action waiver law was preempted by the FAA.\(^{145}\)

Some courts subsequently concluded that *Concepcion* bars all challenges to class action waivers on unconscionability grounds.\(^{146}\) The California Supreme Court continued to blunt the scope of the *Concepcion* decision by holding that a class action waiver could still be “invalidated by ‘generally applicable contract defenses, such as fraud, duress, or unconscionability.’”\(^{147}\)

In 2019, however, the U.S. Supreme Court struck an arguably fatal blow to class arbitration. Lamps Plus had fallen victim to a phishing scam, allowing a hacker to access personal tax information of 1,300 employees.\(^{148}\) After one of the impacted employees filed a putative class action lawsuit, Lamps Plus moved to compel individual arbitration of his claims under the arbitration clause in his employment agreement.\(^{149}\) The district court granted the order compelling arbitration but ordered the arbitration to proceed as a class arbitration.\(^{150}\) The Ninth Circuit affirmed the district court’s order, holding that “the agreement was ambiguous on the issue of class arbitration” and deciding that the ambiguity should be construed against the drafter, Lamps Plus.\(^{151}\)

The U.S. Supreme Court acknowledged that the provision was ambiguous, but still reversed the order for class arbitration. The Court, noting that “[c]onsent is essential under the FAA,” held that “[c]ourts may not infer from an ambiguous agreement that parties have consented to arbitrate on a class-wide basis.”\(^{152}\) Interpreting the ambiguity as to class arbitration against Lamps Plus was “inconsistent with the FAA.”\(^{153}\) The Court based its decision on the “fundamental” difference between class arbitration and the

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143. *Id.* at 338.
144. *Id.*
145. *Id.* at 340.
149. *Id.* at 1413.
150. *Id.*
151. *Id.*
152. *Id.* at 1419.
153. *Id.* at 1417–18.
individualized form of arbitration envisioned by the FAA.”154 In individual arbitrations, parties expect “lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes.”155 By contrast, class arbitration “sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment.”156 The Court also noted that class arbitration “raises serious due process concerns by adjudicating the rights of absent members of the plaintiff class—again, with only limited judicial review.”157 After Lamps Plus, class waiver clauses may have become superfluous. Unless a pre-dispute arbitration clause expressly authorizes class arbitration, there can be no class arbitration.

E. Collateral Estoppel

The 1992 Article suggested that an arbitration clause should include a statement disavowing any collateral estoppel effect.158 Under the doctrine of offensive collateral estoppel, a franchisor suffering a final adverse arbitration award on an issue in litigation with one franchisee may be bound by the ruling on that same issue in a later dispute with a franchisee who had not been a party in the arbitration. For example, if an arbitrator ruled that a franchisor did not have the right to set the retail price of a hamburger in an arbitration with one franchisee, offensive collateral estoppel would bar the franchisor from contesting the same issue in a subsequent proceeding with another franchisee.

As Harold Brown noted in his treatise, “Franchising is a particularly ripe field for the use of the doctrine of collateral estoppel because franchisors generally treat their franchisees in a uniform manner.”159 He encouraged franchisees to take advantage of a ruling against the franchisor in one case to avoid litigating the same issue in a subsequent dispute.160

The same year that the 1992 Article was published, the California Supreme Court ruled that arbitration awards “have no collateral estoppel effect in favor of third persons.”161 “The very fact that arbitration is by nature an informal process, not strictly bound by evidence, law, or judicial over-

154. Id. at 1416.
155. Id.
156. Id.
157. Id.
158. Id.
160. Brown, supra note 159.
161. See Vandenberg v. Superior Court, 982 P.2d 229, 236 (Cal. 1992) (because “private arbitration lacks significant safeguards of court litigation, particularly the right to full judicial review,” there can be no preclusive effect arising from an “arbitration award, even if judicially confirmed”). See also Benasra v. Mitchell Silberberg Knupp, LLP, 116 Cal. Rptr. 2d 644 (Ct. App. 2002) (no collateral estoppel from arbitration award in a franchise dispute).
sight, suggests reasonable parties would hesitate to agree that the arbitrator’s findings in their own dispute should thereafter bind them in cases involving different adversaries and claims.”162 Other courts, however, have held that the losing party in an arbitration is collaterally estopped from litigating the same issue against other parties.163

Because some courts do give collateral estoppel effect to arbitration rulings, an arbitration clause should address the potential preclusive effect of adverse rulings in subsequent proceedings. If a franchisor does not wish to be barred from relitigating a matter decided in an arbitration proceeding, the arbitration clause should expressly state that adverse rulings will not have preclusive effect in subsequent actions with other franchisees.

F. Mediation Provisions

Many franchise agreements require mediation before a lawsuit may be filed. On the one hand, such provisions may be beneficial in avoiding the breakdown of relations between the parties that can be caused by ongoing litigation and give franchisors a final chance to avert the filing of a lawsuit, which can trigger long-term disclosure obligations.164 On the other hand, the obligation to mediate before litigation may make it more difficult to obtain immediate relief from a court through an injunction or other interlocutory relief, although it may be possible to carve out such relief from a mediation clause.165

Some courts have required the parties to honor their pre-dispute obligations before allowing them to litigate their cases. In a car dealership dispute, the Seventh Circuit held that a pre-litigation mediation obligation was “a condition precedent to any litigation” and insisted on strict compliance before allowing the parties to litigate.166 Other courts have also held that mediation was a “condition precedent to suit.”167

Although it might appear at first blush that the FAA has no bearing on the enforcement of nonbinding mediation provisions, the concept of

162. Vandenberg, 982 P.2d at 240.
163. See, e.g., Commonwealth Ins. Co. v. Thomas A. Greene & Co., Inc., 709 F. Supp. 86, 88 (S.D.N.Y. 1989) (“Collateral estoppel applies as well to arbitration awards as to judicial adjudications, and thus may bar the relitigation of an issue decided at arbitration.”).
164. See, e.g., 16 C.F.R. § 436.5(c) (requiring disclosure of litigation matters in franchise disclosure document).
165. See e.g., Passport Health, Inc. v. Travel Med, Inc., 2011 WL 6211874, at *1 (E.D. Cal. Dec. 14, 2011). In Passport Health, the franchise agreement contained a clause requiring mediation as a condition precedent for any prevailing party to obtain an award of attorneys’ fees, but carved out of this requirement any claims “for monies owed, [and] for injunctive or other extraordinary relief.” Id. After the franchisor won a lawsuit against the franchisee, the district court held that the franchisor’s claim was exempted from the mediation requirement and that the franchisor was, thus, entitled to recover attorneys’ fees even though it had not mediated the dispute before filing its lawsuit. Id.
“arbitration” is broad enough that courts have sometimes recognized that mediation provisions fall within the purview of the FAA. In Wolsey, Ltd., v. Foodmaker, Inc., a franchise dispute, the Ninth Circuit ordered the plaintiff to first complete a contractually required nonbinding arbitration procedure before proceeding with suit, holding “that arbitration need not be binding in order to fall within the scope of the Federal Arbitration Act.” Another court similarly held that “arbitration has become ‘synonymous with “mediation” and “conciliation.””

G. Misclassification Claims—An Emerging Issue?

The limits of arbitration in franchise relationships may also be tested in the employment misclassification context. Franchise relationships arise from the licensing of a trademark, which brings with it the obligation to “control” the licensee to ensure that the public receives the product or service associated with the licensed mark. In recent years, some courts have concluded that trademark controls must be considered in determining whether franchisees are misclassified employees. The so-called ABC Test, adopted in some very recent cases and statutes, determines employee misclassification based on whether the putative employee is engaged in the same business as the employer. Setting aside whether it makes sense to apply the ABC test to franchise relationships, misclassification claims may bring another level of complexity to franchise arbitrations.

An entirely different body of protective laws has developed to protect employees in arbitrations. If a franchisee claims to be a misclassified employee, must the arbitration clause comply with procedural safeguards that are meant to protect employees? And if the arbitration clause does not provide the required safeguards in a misclassification case, is the entire arbitration clause subject to being struck on unconscionability grounds?

For example, California passed a law, scheduled to take effect on January 1, 2020, which prohibited California employers from requiring their employees to “waive any right, forum or procedure” for violation of the California labor laws. The law was quite obviously aimed at barring the mandatory

168. Wolsey, Ltd., v. Foodmaker, Inc., 144 F.3d 1205, 1209 (9th Cir. 1998).
170. See, e.g., Vazquez v. Jan-Pro Franchising Int’l, 923 F.3d 575 (9th Cir. 2019) (holding that the franchise business model was entitled to no special consideration in misclassification analysis); Williams v. Jani-King of Phila., Inc., 837 F.3d 314 (3d Cir. 2016) (same).
171. See, e.g., Dynamex Operations W., Inc. v. Superior Court, 416 P.3d 1 (Cal. 2018) (adopting the ABC test by judicial fiat); CAL. LAB. CODE § 2750.3 (effective January 1, 2020; codifying the ABC test and modifying its scope).
173. CAL. LAB. CODE § 432.6(a).
arbitration of employment claims, and a court had little difficulty in enjoining enforcement of the statute because it was preempted by the FAA.174

Even though there is no threat of immediate enforceability of this state law banning mandatory employment arbitration, there should still be some concern about the effect of misclassification claims in drafting franchise arbitration clauses. If the franchisee includes a misclassification claim in a complaint, the arbitration clause might have to meet state laws meant to protect employee arbitrations.

Misclassification claims bring other complications. For example, California’s Private Attorney General Act (PAGA) allows one putative employee to act as a private attorney general on behalf of the defendant’s other employees.175 Should a franchise arbitration clause bar PAGA actions? Some courts have struck arbitration clauses that attempt to limit PAGA claims on the grounds of unconscionability.176 Addressing PAGA actions in an arbitration clause is, therefore, risky and could jeopardize the entire arbitration provision.

IV. Conclusion: What to Leave in, What to Leave out177

There have been considerable changes in the law on franchise arbitration clauses over the past thirty years. Throughout most of that period, a clause excluding class claims from arbitration, suggested in the 1992 Article, served as an effective bar against franchise class actions. Such clauses are probably superfluous after the 2019 U.S. Supreme Court Varela decision, though there is probably no harm in continuing to include them.178

The 1992 Article suggested consideration of appellate arbitration procedures. Since then, federal courts have refused to enforce such provisions, but some states, like California, have embraced them. Both JAMS and the AAA have adopted rules for arbitration appeals, if provided for in an arbitration agreement. Franchisors will want to include provisions against collateral estoppel, but according collateral estoppel effect to arbitration awards would benefit franchisees.

The 1992 Article also recommended various carve-outs from arbitration, which have been incorporated into many franchise arbitration agreements.179

176. E.g., Smigelski v. Pennymac Fin. Servs., Inc., 2018 WL 6629406, at *12 (Cal. Ct. App. Dec. 19, 2018). The Ninth Circuit held that it was bound by the California Court of Appeal’s ruling and reversed an order that had compelled arbitration in Heidrich v. Pennymac Financial Services, Inc., 792 F. App’x 540 (9th Cir. Feb. 7, 2020), finding that Pennymac was bound by offensive collateral estoppel and that the arbitration clause was unenforceable in its entirety, despite a severability clause. 2018 WL 6629406, at *12.
177. Bob Seger, Against the Wind (Capitol Records 1980).
179. Christopher R. Drahozal & Erin O’Hara O’Connor, Unbundling Procedure: Carve-Outs from Arbitration Clauses, 66 Fla. L. Rev. 1945, 1979 (2014). In that article, the authors conducted
Since 1992, however, some courts have held that such provisions may render the entire arbitration clause unenforceable, as occurred in franchise disputes like Bridge Fund Capital Corp. v. Fastbucks Franchise Corp. and Nagrampa v. MailCoups, Inc.\textsuperscript{180}

Some attention should be given to the relationship of a proposed arbitrator to the arbitration tribunal, especially where the franchisor is a steady customer of the tribunal. Where there is a substantial ongoing relationship with a tribunal, full disclosure should be provided before an arbitrator has been selected.

Thirty years ago, there was no concern that a franchisee might be able to raise a credible misclassification claim and that safeguards meant to protect employees in arbitration might apply to franchise disputes. Now, it is worth giving some consideration to this issue.

Franchise agreements are long-term agreements that often span serial twenty-year terms, over the course of which the law is certain to change. There is no way to know whether cases that have come down in the past five years are augurs of things to come or aberrations that are soon to be forgotten. Over decades, the orientation of the U.S. Supreme Court may change. The development of U.S. Supreme Court doctrine on class arbitrations over the past twenty years illustrates how political views have tempered the development of arbitration law.

Just as Peter Silverman warns that the arbitration clauses we are using now “may be up to twenty years old and outdated,”\textsuperscript{181} the arbitration clauses we are now writing will become outdated, in turn. If we imagine another look back at franchise arbitration clauses thirty years from now, the legal landscape will surely have changed. The long and fitful struggle between franchising and arbitration would no doubt have gone a few more rounds. The U.S. Supreme Court may reconsider the balance between Article III and the FAA, or change its view on class arbitrations, or instill procedural safeguards to ensure fairness in arbitration proceedings. Concerns about protecting those most often subjected to arbitration clauses—consumers, employees and franchisees—may lead to protective legislation that will invalidate unfair arbitration clauses.

Even as the Supreme Court has expanded the scope of the FAA, the general vector of change over the last three decades has been to limit the power of the stronger party to dictate terms in an arbitration clause that are not fair to the weaker party. The arbitration clauses that most aggressively impinged on the rights of a weaker party have been rejected by courts, despite the fact a survey of eighty-six franchise contracts in use in Minnesota in 2011. They found that all but one of the agreements in their survey that had an arbitration clause “carved out one or more claims or proceedings from arbitration and provided a right to the parties to instead proceed in court.”

\textsuperscript{180} Bridge Fund Capital Corp. v. Fastbucks Franchise Corp., 622 F.3d 996 (9th Cir. 2010); Nagrampa v. Mailcoups, Inc., 469 F.3d 1257 (9th Cir. 2006) (en banc).

\textsuperscript{181} See Silverman, supra note 7, at 12.
that they would have been fully enforceable when written. Over the coming decades, it would be sensible to consider that this trend will continue to the point where clauses fully enforceable today may become unenforceable because they go too far in rigging the arbitration process.

When setting out to draft a “perfect” arbitration instrument in 2020, we therefore should consider that the fundamental purpose of arbitration is to provide the just alternative dispute resolution system that the Court anticipated in *Mitsubishi*, not to create a kangaroo court where the scales of justice are unbalanced from the start. Those who strain the boundaries of what is permissible by today’s standards may not meet future standards of fairness, jeopardizing the enforceability of their arbitration clauses.
The Forum and the Franchise Law Journal: Forty Years of Building Social Capital

William Killion

When Dan invited me to write an article for the Journal’s fortieth anniversary issue, I immediately said yes. After all, I had collected every book I could find on franchising (in and out of print) as a resource for articles about the history of franchising and the contribution of laws and lawyers to it. Retirement, I figured, would give me time to continue writing on the subject.

In the following weeks, as I put pen to paper, I struggled to come up with something to write. In the two plus years since my retirement, I had not opened any of the books that I had collected. They sat out of reach on the top of the storage cabinets in my garage, lined up one after the other, collecting dust.

With the deadline to complete an article finally upon me, I turned to Mark Twain for advice: “Write what you know.” I know the most about me and my experiences. I finally had a topic.

Now, I realize that readers of the Journal aren’t biting-at-the-bit to learn more about me. Be patient. I will try to tie my personal story into franchising, franchise law, the Forum, and the Franchise Law Journal. I start from the beginning.

My Hometown

Like John Mellencamp, I was born in a small town. I was born and raised in Yankton, South Dakota. The town had about 8,000 souls as I was growing up there.

Most of the members of the Forum have probably never heard of Yankton. It’s a river town. It sits along the shores of the Missouri River in the southeast corner of the state, just across the river from Nebraska. (Someone once described South Dakota as Nebraska without all the glitter.)

Legend has it that Lewis and Clark arrived at or near the ultimate site of Yankton in the fall of 1804 and wrapped a small child from the Yankton

William Killion was the Editor-in-Chief of the Franchise Law Journal from 2003 to 2006.
Sioux Tribe in an American flag as a gesture of love and affection for the Dakota people. The legend continues that the youngster grew up to become the chief of the tribe, leading his people in some significant battles against other tribes.

Although most of our brothers and sisters in the Forum probably don’t know Yankton by name, they likely know of some of the famous (and not so famous) people who touched the town in their lives. For example, Jack McCall was hanged in Yankton.

McCall had shot and killed Wild Bill Hickok in the Black Hills town of Deadwood. He shot Hickok in the back of the head while the latter held the “Dead Man’s Hand” of aces and eights at a poker table in the Number Ten Saloon. McCall was captured immediately and given a quick trial before a supposedly rigged jury of gold miners who found him not guilty.

Apparently double jeopardy was applied sparingly in the Dakota Territory. McCall was re-arrested and hauled 400 miles from the west end of what is now the state of South Dakota to Yankton at the east end to be tried again. Yankton was then the capital of the Dakota Territory. The town still likes to refer to itself as the “Mother City of the Dakotas.”

The folks in Yankton weren’t as impressed with McCall as the miners in Deadwood. The local paper described McCall as “an evil looking man young in years but apparently old in sin.” A jury convicted McCall, and he was hanged on a cold, drizzly March 1, 1877. He was buried at the present-day Yankton Cemetery, reportedly with the noose still around his neck.

Readers who followed Deadwood on HBO may remember that Yankton was mentioned frequently in the series. The show painted the town as a far-off place where decisions were made and laws imposed on an otherwise lawless Wild West town in the Black Hills.

Another figure of the Old West who touched Yankton was George Armstrong Custer. Custer was an enigmatic individual, known by his fellow cadets at West Point as the “dare-devil of the class,” who devoted more energy to pranks than to his academic studies. He did, however, manage to graduate from the Academy in 1861, albeit as the lowest-ranking cadet, now known as “the goat.”

Custer was flamboyant, as reflected in his appearance. He wore a black velvet uniform with coils of gold lace, spurs on his boots, a red scarf around his neck, and a large, broad-brimmed sombrero. He was especially proud of his cascading golden locks, which he perfumed with cinnamon oil.

Custer made a name for himself in the Civil War. He fought in the First Battle of Bull Run and served with distinction in the Virginia and Gettysburg...
campaigns. His cavalry unit played a critical role in forcing the retreat of Confederate General Robert E. Lee's forces.

Custer assumed command of the United States Seventh Infantry Calvary Regiment following the Civil War. The Seventh Regiment was created as a part of an Army reorganization after the War. It was charged with protecting settlers, travelers, and railroads as they filtered into the Great Plains.

On June 25, 1877, Custer's scouts for the Seventh Regiment spotted Native Americans camped along the Little Bighorn River in present-day Montana. The camp consisted of a large group (estimated at 2,000) of Lakota Sioux, Cheyenne, and Arapaho tribes who were brought together by Sitting Bull and attended by Crazy Horse. The purpose of the meeting was to discuss resisting the infiltration of setters and gold rushers into the Black Hills area.

Custer ordered an attack on the encampment. He divided his troops into three battalions, which were to attack the camp from different directions. Custer and 210 men headed north into the Battle of the Little Bighorn never to be seen alive again.

Three years earlier, Custer and the Seventh Regiment were in Yankton on a layover before proceeding north to Fort Rice and ultimately Fort Abraham Lincoln, both in present-day North Dakota. Yankton was the end of the Dakota Southern railway line and a logical place for troops traveling by train to begin their long march across the Dakota territory along the Missouri River Valley. The troops arrived in Yankton in April 1874. Most camped in tents just outside of Yankton, while Custer and his wife Libbie were in a half-finished cabin in the town.

A chilly rain on April 13, 1874, turned into a furious blizzard by the next day. Yanktonians came to the rescue of members of the regiment who were stranded in tents at the end of town. Their efforts were captured by Custer in a flowery resolution:

Whereas, in this terrible emergency and when in a condition of comparative helplessness, and when, without assistance, a large portion of the lives of this command must have been lost by exposure, the citizens of Yankton, acting in concert and harmony with the territorial officers, hastened to the relief of this command, and by extending the hospitality of their homes, the freedom and use of their legislative and public halls, to the officers and men of the Seventh Cavalry, and by granting the use of their stables, workshops and other buildings as shelters for their horses, they undoubtedly preserved the lives of a great number belonging to this command, besides saving to the Government the value of the public animals amounting to many thousands of dollars; therefore, be it, Resolved, That in acknowledgment of the noble generosity, the unbounded and universal hospitality, the unwavering and constantly repeated kindness with which every member of this command was treated . . . we desire in this feeble manner to convey . . . our heartfelt and lifelong gratitude for extending the helping hand to us in our hour of need.

Yankton treated Custer like the Civil War hero that he was. The town's citizens held a reception for him featuring local musicians led by Felix Vinatieri. Vinatieri was born in Italy, immigrated to the United States, and served
as a musician in the Civil War. An article in the February 2012 issue of *Wild West* said that two of Vinatieri's pieces, “Sitting Bull's March” and “The Mosquitoes of Dakota,” are “genuine art.”

Custer was so impressed with the Yankton band that he asked Vinatieri to join the Seventh Regiment as its chief musician. Vinatieri accepted. Fortunately, Vinatieri and Custer's band did not march into battle with Custer three years later at the Battle of the Little Bighorn.

Vinatieri ultimately returned to Yankton and was buried in the same cemetery where McCall is interred. Felix was the great-great grandfather of Adam Vinatieri, the famous place kicker for the New England Patriots. Adam was born in Yankton but left at age five. (Another professional football player with ties to Yankton was Lyle Alzado. Alzado was an All-Pro football defensive end for the Denver Broncos. He graduated from Yankton College.)

Back to Custer. I remember a billboard along one of the two major roads through Yankton in the 1950s and 60s that featured a cartoon caricature of Custer with the caption, “Custer slept here.” A speech balloon coming out of Custer's mouth said, “Sure wish I'd stayed.”

Another famous musician with ties to Yankton was Lawrence Welk. Famous on national television for his “Champagne Music,” Welk was history by the time punk rock, hip-hop, and Lady Gaga hit the scene. Our younger members will remember him only if they have a fondness for reruns on classic television channels or grandparents with a love for accordions, Myron Floren, and the Lennon Sisters.

Welk was neither born nor raised in Yankton. He was born on a farm in 1903 in Strasburg, North Dakota. He spoke with an accent because Strasburg was a German-speaking town. Welk learned English when he was twenty-one. Although born in Strasburg, Welk made his name in Yankton.

The first big break in Welk's long and storied career came in 1927, when he and his Hotsy Totsy Boys began a six-year stint at radio station WNAX in Yankton. Parenthetically, WNAX, for some time, could (and did) boast that it had the tallest radio tower in the United States; the tower is still standing. If my mother showed me once, she showed me a hundred times, where Welk lived in Yankton whenever we drove down 8th Street. His home was not particularly remarkable.

A more familiar favorite son of Yankton is Tom Brokaw. A former NBC anchor, Brokaw moved to Yankton from an even smaller town at age fifteen. Brokaw meet his wife, Meredith Auld, a former Miss South Dakota, in Yankton. Brokaw has shared many fond memories of Yankton, but he never planned to spend the rest of his life there. He once described his worst nightmare as a young man that he got a young woman pregnant and ended up spending his life in South Dakota, buried on a farm with a pile of children and no idea what to do.
Social Capital

Yankton was not the domain of only famous people. In fact, the Yankton of my youth was the home of “ordinary people”—ordinary in the best sense of the phrase, like the salt-of-the-earth. It consisted of ordinary people steeped in “social capital,” at least as I remember it.

The classic work on “social capital” is Robert Putnam’s bestseller, Bowling Alone: The Collapse and Revival of American Community, published in 2000. The concept of social capital has been around for decades, but Putnam brought it into prominence. Putnam defines social capital as “networks and norms of civic engagement.” According to his book:

Whereas physical capital refers to physical objects and human capital refers to the properties of individuals, social capital refers to connections among individuals—social networks and the norms of reciprocity and trustworthiness that arise from them. In that sense, social capital is closely related to what some have called “civic virtue.” The difference is that “social capital” calls attention to the fact that civic virtue is most powerful when embedded in a sense network of reciprocal social relations. A society of many virtuous but isolated individuals is not necessarily rich in social capital. . . .

How does social capital work? Social capital is not about just warm and cuddly feelings. It encompasses a wide variety of quite specific benefits that flow from the trust, reciprocity, information, and cooperation attendant to social networks.

The touchstone of social capital for Putnam is reciprocity—the idea that one person does something for another, without knowing if or when the favor will be returned. “I will do this for you, not expecting anything specific back from you, confident that you or someone else will do something for me down the road.” It is similar to a society governed by the Golden Rule: “Do to others as you would have them do to you.”

A critical component of social capital is trust. According to Putnam, “Networks and norms of civic engagement” allow members of a community to trust one another. It is trust in the form of a standing decision to give most people the benefit of the doubt, even those with whom you have had no direct experience. Putnam focuses in particular on the role of religious organizations in creating social capital. He observes that churches have been incubators for civic participation and community interests.

Putnam bemoans the decline of social capital in many of our communities. “Bowling Alone” is a metaphor that Putnam uses to illustrate the decline. He observes that, while the total number of participants (and games bowled) has been increasing, there has been a continuing decline in league bowling. Putnam cites declining memberships in civic and charitable organizations and clubs and groups as evidence of the decline in social capital. Putnam notes that we sign fewer petitions, belong to fewer organizations that actually meet, know our neighbors less, meet with friends less frequently,
and even socialize with our families less often. Putnam shows how changes in work, family structure, age, suburban life, television, computers, and other factors have contributed to this decline.

Putnam’s book was published in 2000, but the decline in social capital has not abated in the following twenty years. For example, the decline in religious association has continued at an accelerated rate. The Pew Research Center found in a telephone survey in 2018 and 2019 that two-thirds of U.S. adults (sixty-five percent) describe themselves as Christian. That’s down twelve percentage points since 2009. The share of U.S. adults who identify with non-Christian faiths has ticked up slightly, from five percent in 2009 to seven percent today. At the same time, the share of “nones”—religiously unaffiliated adults who describe their religion as atheist, agnostic or “nothing in particular”—has reached twenty-six percent, up from seventeen percent a decade ago. And these numbers do not reflect how many Americans who identify themselves as having a religious affiliation are actually active in their religion by, among other things, attending worship services.

The United States Congress Joint Economic Committee authorized the Social Capital Project in 2017. Led by Senator Mike Lee of Utah, the Committee released a report in April 2018. The report looks at the decline of “associational life” in America since the 1970s and finds that we do less together and trust each other less. Faith and family are not as central in our lives as in the past. We are marrying less or doing so later in life. We are not as willing as we once were to give of our time or money. Neighborhoods are less neighborly and more divided by income.

The report establishes a social capital index to measure the geographic distribution of social capital in the United States. The report also presents the geographic distribution of several subcomponents of social capital, including the family unit, family interaction, social support, community health, institutional health, collective efficacy, and philanthropic health.

Utah has the highest social capital score, followed by Minnesota, my winter and summer homes, respectively. I’d like to think (but can’t) that this is no coincidence. South Dakota also ranks high in social capital in the study.

**Social Capital in Yankton in the 1950s and 1960s**

Yankton was, in my view, the poster child of small-town America steeped in geographic social capital in the 1950s and 60s. I use participation in clubs and churches to illustrate the point.

America has had a long history of its citizens belonging to social clubs. Alexis de Tocqueville, the French philosopher who visited the United States back in the 1830s, wrote in *Democracy in America* that Americans of “all ages, all stations in life, and all types of disposition are forever forming associations.” He said that “there are not only commercial and industrial associations in which all take part, but others of a thousand different types—religious, moral, serious, futile, very general and very limited, immensely large and very minute.”
It seemed like almost everyone belonged to one or more social clubs in Yankton during my youth. Freemasons, the Knights of Columbus, the Odd Fellows, the Shriners, the American Legion, the VFW and so on were big in Yankton. The Masons in the Dakota territory started in Yankton. Social clubs named after animals were particularly popular—the Elks, the Lions, and the Moose.

None of these social institutions was as important or as significant as the church in Yankton when I was a kid. My family life, for example, revolved around the church. My parents, grandparents, uncles, aunts, and cousins rarely missed a Sunday church service. Members of my family served as officers of the church. We had a parochial school, which I attended from kindergarten through eighth grade. Frequent potluck dinners were a favorite of everyone. Christmas programs, men's and women's leagues, youth groups, and on and on were a big part of our lives. Groups like “Ladies Aid” were the hallmark of commitment to church and family. Churches sponsored Boy Scout troops. Friends that joined you for pinochle on weekends were fellow parishioners.

And my church was not the only one. The question in Yankton was not whether you were or were not a member of a church; it was whether you belonged to the Lutheran or the Catholic church. It was not unlike Lake Wobegon, Garrison Keillor's fictional town featured in his NPR program, A Prairie Home Companion. Keillor wrote a piece in November 2000 for National Geographic that described the churches in Wobegon. Keillor said that

to the German Catholics I added, for dramatic interest, an equal number of Norwegian Lutherans. The Norwegians, ever status conscious, vote Republican, and the Germans vote Democratic because the Norwegians don't. The Catholics worship at Our Lady of Perpetual Responsibility and the Lutherans at Lake Wobegon Lutheran Church (David Ingqvist, pastor), home of the National Lutheran Ushering Champions, the Herdsmen.

Now, to be sure, we had Methodists in Yankton, but not too many. As I recall, we had one Jewish family that attended the Synagogue in Sioux City, Iowa, sixty miles away.

Social Capital in Franchising

Social capital that is defined by a location—Yankton, for example—is called geographic social capital. Another form of social capital arises in the context of a non-geographic network. These are networks of individuals who unite around shared values arising from something other than geographic proximity.

Brian Schnell, my long-time partner in the practice of law until my retirement, and I developed what we called the “Five Habits of the Highly Successful Franchisor.” Although we did not use the catch phrase “social capital,” the Habits embody the elements of social capital. Under the Five Habits, the highly successful franchisor (1) maintains an undying devotion to the brand;
(2) balances the interests of the franchisee, franchisor, and system as a whole; (3) stacks the deck with ace franchisees; (4) obsesses over the franchisee's bottom line; and (5) empowers the franchisee.

Franchisees typically enter a franchise relationship with two objectives in mind—to make money and to enjoy the social capital that characterizes a successful franchise system. The most important of these is making money. After all, franchising is basically a business model for making money. It is for this reason that Habit Four says that the successful franchisor obsesses over the franchisee's bottom line.

Uninformed lawyers sometimes argue that franchisors are not interested in their franchisee's bottom line because royalties are based on revenues and not profits. They argue that the franchisor is focused on making sales at the expense of the franchisee's profits. No serious franchisor has this mindset. If the typical franchisee is not making a decent return on its investment, there will ultimately be no sales upon which the franchisor can collect royalties.

Social capital in a franchise system cannot be monetized. It is, in my view, about making franchisees a part of something more than earning a living. We often use words like “marriage,” “family,” and “partnership” to describe the franchisor-franchisee relationship. What we mean is that the relationship is one characterized by social capital arising from fellowship among the franchisor and its franchisee and between franchisees, resulting from reciprocity, trust, and the like. Borrowing Putnam's words, social capital in franchising “refers to connections among individuals' social networks and the norms of reciprocity and trustworthiness that arise from them.” It manifests itself in conventions and regional meetings where franchisees, franchisors, and suppliers socialize and support each other by sharing lessons from their businesses. It arises when franchisors seek buy-in from franchisees to marketing activities and other significant system developments. And on and on.

Ultimately, the measure of social capital in a franchise system turns on two things—reciprocity and trust. Stakeholders in a franchise system high in social capital do things for each other without expecting something in return in the belief that they will be treated the same someday.

Trust does not mean believing that a franchisor will sacrifice its interests to protect yours. That is the essence of a fiduciary relationships, and, if there is anything certain in franchise law, it is that franchisors and franchisees are not in a fiduciary relationship. It is trust in the sense of giving each other the benefit of the doubt. It is the presumption that a franchisee or franchisor is acting in good faith until proven otherwise. It is, as Martin Luther (the lightning rod of the Reformation) said in his statement of the meaning on the Eighth Commandment, “[P]ut the best construction on everything,” that is, choose to evaluate your neighbor's words and deeds in as positive a light as possible.

Each of the Five Habits involves some level of building and maintaining social capital, but the most important is empowering franchisees. Empowering franchisees is all about building and maintaining social capital. This does
not mean giving franchisees ultimate control of any of the essential elements of the franchise system. To the contrary, a franchisor must never give up control of the system. Franchising is not some form of democracy, partnership, or legal joint venture. Although I have taken some heat for it, I have at times described a successful franchisor as a “benevolent dictator.”

I made a living off of litigation for more than forty years, most of it off of franchise litigation. Nevertheless, I developed over time the view that litigation in franchising is a poor way to resolve disputes. It is, at best, a necessary evil where other means of dispute resolution fail. Litigation does not generally build social capital within a franchise community. It typically does the opposite: it breaks down (and can even destroy) social capital.

The best evidence of the negative effects of litigation on a franchise system is the franchisee class action. I have defended several class actions filed against franchisors and tracked several others in which I was not involved. The old saw is that the only winner in a class action is the lawyer, and there is a lot of truth to the claim. Defending class actions is a huge drain on the resources of the franchisor, not only its financial resources, but also the time available to the executives and others to address the needs of the system. And the *in terrorem* effect of class actions risks settlements that do major harm to the franchise system, like giving control of advertising funds to franchisees. In class-action damages cases, the interests of former and existing franchisees are almost always at odds. Awarding huge sums of money to former franchisees does little to advance the interests of existing franchisees.

It is for these reasons that I have favored arbitration clauses in franchise agreements with a specific disclaimer of any right of franchisees to file class actions or other multiparty claims. Arbitration is not without its downsides, but most of these can be avoided by careful drafting of the franchise agreement.

I also believe that litigation confuses what’s good for an individual franchise with what is good for the system as a whole. The perfect example is the post-term noncompete. Enforcement of the noncompete is critical to protecting the goodwill of the franchisor—goodwill that benefits and is crucial to the success of the franchisee. Yet, enforcement of a post-term noncompete pits the interests of a past franchisee against the interests of existing franchisees.

I am a strong advocate for franchise agreements that minimize the chances of litigation. The franchise agreement should never use the “D-word” (discretion) to describe the franchisor’s rights. Doing so only invites lawsuits claiming that the franchisor has violated the implied covenant of good faith and fair dealing. Call a “right” a “right.” The covenant cannot override specific rights in the franchise agreement. Similarly, the franchise agreement should define the parameters of the covenant to reduce its unbridled use in litigation.

Another critical component in a franchise agreement is a firm statement that the franchisor—and the franchisor alone—owns and controls goodwill
arising from the use of the its marks or system. Some franchisee advocates claim that the franchisee owns “local goodwill” arising from its operation of the franchise at a specific location. I don’t believe that the claim is consistent with the prevailing law, but, if there is any doubt, spell out in the franchise agreement that “local goodwill” belongs to the franchisor as well.

The right language in a franchise agreement will go a long way toward avoiding litigation, but an even better way is having profitable franchisees in a system with copious amounts of social capital. I have yet to defend a lawsuit by a happy franchisee making a decent profit. A franchise system that consistently produces profitable franchised locations can probably survive with limited social capital, but only so long as the profits keep rolling in. When hard times come and profits diminish, the franchise system steeped in social capital has a far better chance of weathering the storm. Even profitable systems devoid of social capital risk failure when unhappy franchisees refuse to validate the system to prospective franchisees or, worse yet, give the franchisor a bad score when speaking to prospective franchisees (“I would not do it all over again.”).

Social Capital in the Forum

Growing up in Yankton, I vacillated between becoming a preacher and becoming a lawyer when I “grew up.” When I finally realized that I didn’t have the “divine” call (God wasn’t calling me to be a pastor), I turned to the law. As the reader well knows, practicing law may be a “calling,” but there is little that is “divine” about it. I figured I’d be a small-town lawyer.

My “coming of age” didn’t happen until my twenty-fifth year when I was hired as an associate by a Minneapolis firm of about thirty-five lawyers, a big firm for Minneapolis in 1973. Now, I had been on vacations around the country with my family as far back as I can remember, but I was still a “country boy” from Yankton as I walked through the doors of the firm.

Proving that circumstances (more than planning) often guide our fate, the firm had acquired a new client shortly before I arrived—International Dairy Queen. As a new “trial lawyer,” I handled all kinds of cases. But the client for which I did the most work was “Dairy Queen.” The firm was essentially general counsel to the franchisor, including handling all of its litigation around the country. I had worked on a number of cases for “the Queen” under the supervision of other lawyers for a number of years. I became the lawyer responsible for that litigation in 1985, a role I continued to enjoy during the following thirty plus years of practicing law.

Over time, more and more lawyers in my first firm (I lateralled to a different firm where I spent the last twelve years of my practice) devoted their practices to “franchise law.” They became active members of the Forum, as well as the International Franchise Association. I was a holdout. I figured that a “trial lawyer” was just as able and well-equipped to represent franchisors or franchisees as a supposed “franchise lawyer” without joining an organization. I was wrong.
Becoming an active member of the Forum, in particular, was a critical event in the development of my career. I became a part of an organization that, over the course of its history, has become the model for building social capital among a group of lawyers.

The Forum website describes one of its missions in the language of social capital. It says that “the Forum actively solicits your involvement in and contribution to its activities. These activities are not only a pathway to leadership in the Forum, but collegial endeavors that permit Forum members from all over the country—and the world—to get to know one another and work together in ways that build professional relationships and friendships.”

This is not just a lot of talk. I will let others fill in the details of all of the things the Forum does and has done to develop and enhance social capital, but my greatest insight into the building of social capital in the Forum comes from my participation in meetings of the Governing Committee as the Editor-in-Chief of the FLJ. I observed, firsthand, the commitment of leadership to the Forum’s mission.

**Social Capital in the Franchise Law Journal**

Staying with the theme of social capital in franchising, the *Franchise Law Journal* is a critical component of the social capital in the Forum. It is one of the Forum’s “paths to leadership.” Social capital requires leaders who build and support the principles of the organization. Many of the present and former leaders in the Forum have served on the *Franchise Law Journal*.

The *Journal* is a contributor to the reason for the existence of the Forum as an organization dedicated to franchising in general and franchise law in particular. Articles in the Journal have helped shape the law of franchising. A search of Westlaw or Google Scholar for the *Franchise Law Journal* reveals the many cases that have relied on the publication.

The *Journal* builds pride within the Forum. As a retired franchise lawyer looking back at the history of the *Journal*, I am amazed at what the *Journal* has become today. The *Journal* has always been a source of pride for the Forum, but the *Journal* of today is far superior to the *Journal* of the past. And this is largely the result of the work of my successors in the Forum and on the *Journal*.

As much as I proclaim that I was a “franchisor lawyer,” and as much as I criticize litigation as a means of resolving franchise disputes, I have great respect for our brothers and sisters within the Forum who represent the interests of franchisees. It was almost always easier to resolve disputes where a Forum member represented the franchisee. The Forum member just “got it” in ways that others did not. The *Journal*, by presenting articles reflecting different views of franchising and franchise law, has helped Forum members “get it.”

And on and on and on.

**Conclusion**

Happy anniversary to the *Franchise Law Journal*. 
Forty Years of the *Franchise Law Journal*

Deborah S. Coldwell

**Introduction**

In 2007, to celebrate the thirtieth anniversary of the Forum on Franchising, we invited all former chairs of the Forum to express their views on the past, present, and future of franchising. To help elicit their views, we posed questions regarding various aspects of franchising.1 And now, for the fortieth anniversary of the *Franchise Law Journal*, we have again invited the past chairs to weigh in—but with a slightly different set of questions:

1. What trends have you seen develop in franchise law during the last ten years that you least expected?
2. How has franchise law advanced in ways that you feel has helped franchising?
3. In your opinion, which are the most significant court decisions that have impacted franchise law in the last ten years?
4. What were the most important decisions you made during your tenure as Chair of the Forum? Why? What impact do you believe they had?
5. What unknown story or anecdote do you have from your time as Chair that you’ve always wanted to share?
6. How has the Forum changed since your time as Chair, and how can it improve in the future?


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2. Ms. Coldwell is the editor of this article and was the Editor-in-Chief of the Franchise Law Journal in 2007.
1. What trends have you seen develop in franchise law during the last ten years that you least expected?

Summary
The past chairs were surprised at how franchising and franchise law have developed in the last several years. Unanticipated trends included the issues raised, and responses necessary, to the COVID-19 pandemic, the development of misclassification and joint employer claims, the increased sophistication of franchisees and the growth of multi-unit franchisees, the nature of foreign franchise and privacy laws, increased domestic privacy and protection laws, the swelling ownership of franchise companies by private equity, and the decrease in big-ticket litigation.

COVID-19 and Franchise Community Issues

Lowell: The current pandemic and resulting economic crisis that is gripping the world has presented a highly unexpected development and has already begun the process of a variety of unexpected trends. These pandemic-related developments and trends extend not just to the franchise business world, but also to the practice of franchise law.

One historical franchise law trend that has been timeless is the ability of franchising and of franchise law to apply to a variety of new businesses. It is classic that when a trend in society arises, it is almost instantaneous that a franchise concept is ready to deliver the product or service associated with that societal trend. When in the early twentieth-century America turned from an agricultural society to an industrial society, that shift led many manufacturers to turn to franchising to sell their wares—through franchised auto dealerships, gasoline stations, or syrup bottling companies. And, when WWII veterans returned home and became a newly mobile and motoring society, fueled by national FM radio, it was not too long thereafter that the roadsides became crowded with franchised hotels (such as Holiday Inns—with its “great sign” and predictably clean rooms), franchised restaurants (such as McDonald’s, KFC, Dairy Queen, and more), and even franchised auto parts stores and auto service facilities. As women entered the workforce in great numbers, franchises sprang up to cater to their interests—such as those related to child care, education, home care, and personal care. And, as lesser and more-focused developments have arisen through the years, franchising has similarly sprung up to meet the societal needs. For example, the advent of

- computers have led to franchised kids’ computer camps, software stores, and computer sales and repair shops;
- cell phones have led to franchised cell phone stores; and
new medical developments have led to franchised dental centers, laser treatment centers, and even non-hospital based primary and urgent care centers.

And even more niche developments have led to new and emerging franchised systems, such as advancements in (1) chemicals related to yard care leading to franchised mosquito and tick proofing franchises, (2) gaming hardware and software leading to new shopping-center based “Virtual Reality Centers,” and (3) legalization of “CBD” oil leading to new franchised CBD product stores.

This popularization of franchise concepts has made the practice of franchise law interesting and dynamic. While we franchise lawyers always counsel new clients on the core concepts (e.g., the license of a trademark in the Franchise Agreement, the descriptions of the concept in an FDD, state registrations, and questions then and thereafter about concepts like “uniformity” and “system changes”), we also all pride ourselves on figuring out and dealing with the nuances of how newer concepts bring to the table novel needs and differences from the other franchise programs that we have put together. For me, what makes practicing franchise law “fun” are the opportunities to (1) learn about new businesses, (2) apply principles from diverse areas of the law to a single method of distribution (e.g., antitrust, contracts, corporate, intellectual property, litigation, M&A, and securities), and (3) be (as described above) on the “cutting edge” of what is happening in our society.

Currently, however, and for the first time, dealing with the legal issues that arise from the latest development in franchising (COVID-19)—while still “diverse” and “cutting edge”—is anything but “fun.” Franchise clients are asking questions like:

• Should employees be “fired” or “furloughed”? And, as we wish to hire the employees back, will periodic conference calls with them—perhaps to plan for our re-openings—entitle the currently former employees to their prior hourly or weekly wages, as well as jeopardize their unemployment compensation benefits?

• How do franchisors—and their franchisees too—apply for the new COVID-19 SBA Loan Guarantees, and will all or a portion of those loans be forgiven?

• While some of our franchisees have been required by state law to close, can the others stay open as “essential businesses” under other states’ laws? Or, if we want our system to help “flatten the curve,” can we mandate (or at least recommend) that our franchisees close their stores?

• If franchisees do close their stores, will the coronavirus constitute a force majeure event enabling our franchisees to stop paying royalties (e.g., on permitted take-out and delivery) and other non-revenue-based fees?

• If franchisees close or curtail operations, will that closure qualify as a “business interruption” under applicable insurance policies and,
considering the insurance policy exclusion for “viruses,” was the closure
due to the “virus” or to the governmental order to close?

- Oh, and by the way, is the franchisor’s FDD still usable, or must it be
  supplemented to reflect new post-pandemic Item 19 FPR numbers,
  and to add in updated financial statements that reflect the “subsequent
  event” of sales (or lack thereof) during the pandemic?

The societal trends that will flow from the current pandemic are currently
unpredictable. And the “cutting edge” businesses that will emerge from these
trends are also unknown and only matters of speculation. As “past is pro-
logue,” however, what is now clear is that some of these new businesses will
be franchised and that we, as franchise law practitioners, will be servicing
these new kinds of businesses in the world of tomorrow.

**Spandorf:** I agree with Bret: COVID-19 is the least expected development
ever to hit franchising or, let me add, mankind. It is not difficult to pre-
dict that legal concepts like *force majeure, impossibility and impracticability of
performance*, which have not before played major roles in settling franchi-
see performance disputes, will become de rigueur claims and reshape “good
cause” for termination in the coming years. I look forward to celebrating the
Forum’s next milestone birthday (#45 in 2022) and commending franchisors
and franchisees for their resilience, ingenuity, and community in leading the
country out of an unprecedented human crisis that grips us in this moment.

### Joint Employer and Privacy Laws

**Spandorf:** Ten years ago, when the Massachusetts Supreme Judicial Court ruled in *Awuah v. Coverall North
America, Inc.*\(^3\) that Coverall franchisees were really mis-
classified employees under Massachusetts’s independent contractor (ABC) test, it shattered what had until then
been considered a truism about franchising: owning a franchise guaranteed a franchisee’s legal status as an
independent contractor. The assumption’s upending fab-
ulously begun by *Awuah* continues in a clear trend. Last
year, in *Vazquez v. Jan-Pro Franchising International, Inc.,*
the Ninth Circuit embraced the “ABC” factors as the litmus test for whether
franchisees are independent contractors under California’s wage and hour
laws.\(^4\) The California legislature has since codified the “ABC” test for inde-
pendent contractor status across all industries by enacting AB-5 (effective
January 1, 2020).\(^5\) Because the “B” and “C” prongs are nearly impossible for
franchisors to meet, these developments threaten to transform franchisors
into employers of their franchisees and their franchisees’ employees and

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4. *Vazquez v. Jan-Pro Franchising Int'l, Inc.*, 923 F.3d 575 (9th Cir. 2019), *reb’g granted, opinion withdrawn*, 930 F.3d 1107 (9th Cir.), and *on reb’g*, 939 F.3d 1045 (9th Cir.), and *opinion reinstated in part on reb’g*, 939 F.3d 1050 (9th Cir. 2019).
5. *Cal. Labor Code § 2750.3(a)(I).*
destroy the franchise business model as we know it. The trend continues as other states consider AB-5 like legislation. Questions about a franchisee’s legal independence have spread beyond a franchisee’s potential misclassification to the symbiotic issue of whether the trademark license’s role as the cornerstone of a franchise relationship automatically makes a franchisor the joint employer of its franchisee’s direct employees. I never saw these assaults on the franchise business model coming ten years ago, but coming they are. Asbill: There are at least three that do not specifically relate to franchising, but nevertheless significantly impact franchisors and franchisees:

I agree with Shelley that one is the joint employer issue. Over the years, cases like Browning Ferris, Domino’s, SuperShuttle, and McDonald’s and firms that outsourced services such as cleaning and maintenance have seen efforts by plaintiffs’ attorneys and the National Labor Relations Board (NLRB) to hold franchisors liable as joint employers of its franchisees’ employees for alleged violations of unfair labor practices under the National Labor Relations Act. The claims were that if the franchisor possessed and/or exercised sufficient control over the policies of its franchisees relating to their employees that it should be held to be a joint employer. After many years of extended litigation, the Labor Department just issued a final rule that clarifies when a worker is employed by more than one company. This rule, first proposed last spring, replaces an Obama administration policy that potentially made more businesses liable for failure by franchisees or contractors to pay overtime and minimum wages. Effective March 16, 2020, a four-part test will be used to determine whether a company is a “joint employer.” The tests are (1) whether a company can hire and fire the employee; (2) whether it supervises the employee’s work schedule; (3) whether it sets pay; and (4) whether it maintains their employment records. This four-part test may result in more outsourcing by franchise companies.

Somewhat related is the issue of whether workers are employees or independent contractors. California Assembly Bill 5 (AB 5) has generated much attention and comes after the Dynamex case that created a presumption that a worker who performs services for a hirer is an employee and not an independent contractor for purposes of claims for wages and benefits. AB 5 impacts a multitude of industries, and much more than franchising is at issue. It codifies a three-part test, commonly known as the “ABC” test, to establish that a worker is an independent contractor for these purposes. Specifically, the worker providing labor or services for compensation would be considered an employee rather than an independent contractor unless the hiring entity demonstrates that the person is free from the control and direction of

9. In re McDonald’s USA, LLC, 368 N.L.R.B. No. 134 (Dec. 12, 2019); see also Salazar v. McDonald’s Corp., 944 F.3d 1024 (9th Cir. 2019).
the hiring entity in connection with the performance of the work, the person performs work that is outside the usual course of the hiring entity’s business, and the person is customarily engaged in an independently established trade, occupation, or business. The past Forum in Denver had a well-attended program about this topic, and efforts are currently underway to exempt various businesses from coverage or to delay implementation of AB 5.

Next is the issue of data privacy and protection. With the tremendous growth of the Internet and smart phones, companies like Google and Facebook have made available instant access to information, which can cause major issues for firms dealing with data privacy. The General Data Protection Regulation (GDPR) implemented in 2018 is a regulation in EU law on data protection and privacy in the European Union and the European Economic Area. It also addresses the transfer of personal data outside the EU and EEA areas. Personal information that can identify you is strictly regulated. Often you must opt in to policies. Potential penalties are massive. Since many U.S. companies operate in European countries, the coverage and possible exposure is potentially massive. Those with primarily an online presence, instead of significant overseas operations, may find it hard to understand the breadth and scope of the GDPR.

In addition, the California Consumer Privacy Act, effective January 1, 2020, is designed to provide California residents with increased control over their data. It allows consumers to find out what personal information of theirs has been gathered, to request that businesses delete their data, and to opt out of having their information sold. A big concern here is that many online sites generally do not enable a company to know whether someone looking at the information is a California resident. Thus, I personally have noted that nearly every day, when looking at a website, I am regularly informed that privacy and data policies have been updated, and, if I continue further into the site, I am deemed to have accepted those updates. Even though I can click through and read the policy, I typically do not take the time to do so and believe many others make a similar approach. Since the CCPA provides for private attorneys general, I expect more litigation and a boon for the plaintiffs’ bar.

Another trend is the ever-increasing use of the Internet and social media to obtain information and to communicate, both good and bad comments, reviews, etc. Franchisors generally try to manage the use of websites and intellectual property, but disgruntled franchisees very often express their frustrations in ways that may not have been done a decade ago.

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Dienelt: I also did not anticipate the development of misclassification and joint employer claims, but I should have. In retrospect, it seems obvious that franchisees, at least most of them, are not traditional independent contractors. They also are not traditional employees, at least not most of them. Likewise, the concept of joint employment does not fit. As franchise law has developed, with the development of franchising, franchise law has continued to try to define a “franchisee” by analogy to existing categories of business relationships, rather than defining “franchisee” as a separate category, with separate rules governing the relationship. Unless and until then, I think courts will still be trying to fit “a square peg in a round hole.”

Fittante: I agree. The debate over whether franchisors are the joint employers of their franchisees’ employees is one I did not expect. I also did not expect that the practice of structuring franchise relationships would become such a commoditized business or that various third parties without law degrees would be writing disclosure documents.

Large Multi-Unit Operators and Less Big-Ticket Litigation

Gardner: While I will freely admit that I “least expected it” because I had not really thought about it, the trend that has been the most striking for me is the explosion of extremely large multi-unit operators. Virtually none of the large legacy franchise brands is without at least some of these types of operators. The shift away from “Mom and Pops” to large multimillion-dollar businesses has changed the way we all do business, no matter what part of the franchise industry we service. I, for one, did not see that coming. As a result, I think the “trend” in the law that has resulted from that is less large-scale litigation, with big fights between large operators and franchisors being less prominent in the last decade than prior. There are a few exceptions to that blanket statement, but I think that the trend is away from lots of litigation for established systems.

More Franchisor-Friendly Franchise Agreements, the Business Judgment Rule, and Private Equity Ownership of Franchise Companies

Karp: About ten years ago, I concluded that the continuing efforts of my friends who represent franchisors to make franchise agreements as one-sided as possible in favor of their clients had reached an endpoint of my and their imagination. But I was clearly wrong. In the past decade, franchise agreements have generally reserved more and more discretion to the franchisor, closed every loophole created by franchisee victories in court or in arbitration, drafted around the implied covenant of good faith and fair dealing,
and moved more and more obligations of the franchisee from the agreement into the operations manual, which can be changed unilaterally. In my view, this overreach is one of the reasons we are seeing litigation and claims in the area of joint employment, misclassification, and even vicarious liability.

Emblematic of this trend has been the increasing use of the business judgment rule, a concept drawn from corporate governance law. The appropriateness of the business judgment rule was the subject of a spirited and fascinating debate between Ron Gardner and Brian Schnell in their excellent article in these pages, “The Battle over the Franchise Business Judgment Rule and the Path to Peace.” While franchisors believe that the use of this rule gives them the flexibility that they need to adjust to market and regulatory changes and trends, franchisees see the rule as granting franchisors a license to act solely in their own interest without considering the impact on franchisees. It seems that one’s perspective on this question depends on which side of the aisle he or she stands.

And the $8.8M jury verdict in Bryman v. El Pollo Loco, Inc., win, lose or draw on the appeal, will continue to generate intense debate as to whether it is a case that plows new ground on the application of the implied covenant of good faith and fair dealing, or just another case where bad facts dictate the outcome. Will more courts strike down unconscionable provisions—that allow franchisors to willy nilly—undermine the profitability of their own franchisees? Or will the deck be stacked against the use of the implied covenant if the franchise agreement creates barriers to its application?

Another trend that has had and will continue to have a significant impact on franchising is the ubiquitous presence of private equity ownership of franchisors. One particular private equity group has become the largest restaurant company in the world. While private equity provides a vital source of capital to franchise systems, its influence is not always positive, particularly in systems that are facing other external challenges. Private equity firms ensure that they get paid even if no one else in the system makes money, which is not a recipe for long-term growth.

With private equity firms and others acquiring portfolios of franchise brands, in the 2020s I hope to see more alliances between franchisee associations in brands operating under the same corporate umbrella. The common ownership and culture of theses affiliated systems can create real synergies and political muscle for franchisees.

We are seeing fewer and fewer franchisors willing to engage in meaningful, transparent dialogue with franchisees in general and independent franchisee associations in particular. Too few franchisors understand the lesson of the 1998 Bankruptcy Court decision in In Re Sizzler:

and inoculates a franchisor from claims by franchisees. I am a great fan of Cheryl Bachelder, the CEO of Popeyes from 2007 to 2017, who turned that company around based on what she calls servant leadership. As she has said, nobody has more skin in the game than the franchisees. In her 2015 book, *Dare to Serve*, Ms. Bachelder points out that if the Popeyes franchisees did not prosper, there was no chance that royalty revenue to the franchisor or new openings would increase. As she wrote, “Either franchise owners would succeed or Popeyes would fail.” Her collaborative relationship with that system’s independent association was like a partnership and led to substantial increases in the number of franchised units, market share, net income, and shareholder value for the franchisor.

Corporate psychologist and founder of the Franchise Relationship Institute, Greg Nathan, touts the advantages of mutual respect in the franchise relationship, stating: “Cooperation, commitment and communication are the real building blocks of success in a franchise chain.” The best candidate for the next franchise location in any system is an existing, satisfied franchisee willing to vote with her checkbook by investing further in the brand. For franchisors having a positive and constructive relationship with their franchisees is not just the right and ethical thing to do, it also makes money for both parties and avoids costly disputes. It is my hope that in the coming decade more franchisors will take the insights, valuable experiences, and leadership skills of Cheryl Bachelder and Greg Nathan more seriously.

Third-party delivery services provided by companies such as Grubhub, Door Dash, Uber Eats, and the like have already created significant disruption in restaurant franchise systems and are likely to have lasting and significant impact in the years to come. Sales by these companies grew by more than forty percent last year alone, and twenty-six percent of Americans last year ordered from one of these services. These companies take as much as twenty-five percent or more of the retail price off the top and charge the customer a delivery fee on top of that. But franchisees are often required to shoulder the financial risk of a cancelled order or a refused delivery. Most franchisors are requiring franchisees to pay royalty and advertising contributions on the phantom income that they never receive. With minimum-wage rates rising across the nation, and pre-pandemic unemployment rates at historic lows, unit-level profitability will encounter serious challenges going forward.

**Grueneberg:** Contrary to what some of my colleagues have seen, I have seen an increase in cooperation among various stakeholders in franchise regulation—franchisor counsel, franchisee counsel, and franchise regulators. The Annual Forum is an event that encourages

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the sharing of these perspectives. I believe that understanding one another’s experiences allows us to develop better compliance practices, more knowledgeable franchisees, and practical regulatory guidance.

2. How has franchise law advanced in ways that you feel has helped franchising?

Summary
The former chairs noted several changes, most being positive but a few on the negative side. There was a strong view expressed regarding the impact of technological advances, including the Internet. Others pointed to increased international franchise laws and regulations, greater sophistication of franchisors and franchisees domestically and internationally, the predictability of certain areas of franchise law, and the higher-profile franchising shares in the investment community and globally.

Spandorf: Because “advance” means different things, let me offer two different answers.

If “advance” means improving the predictability of franchise law for the benefit of franchise parties, I cite the progress with regulating financial performance representations (FPRs). FPRs, which remain optional for franchisors, are the single most important information that a prospective franchisee requires to size up a franchise opportunity completely. Anecdotally, twenty years ago maybe, twenty percent of all franchisors made an FPR; today that figure is closer to seventy percent. Many factors contribute to the spike in this percentage, which benefits franchising by filling an important informational gap for franchisees. The most qualified franchisees today expect this information. Consequently, franchisors that compete for the best candidates are under pressure to make FPRs. Equally important, the North American Securities Administrators Association improved its disclosure guidance by publishing a 2017 FPR commentary that offers specific guardrails for the open-ended “reasonable basis” legal standard, replacing a nebulous set of FPR disclosure rules that franchisors may have felt exposed them to legal risk if they volunteered an FPR. Whatever the reason for the spike, the added transparency in selling franchises benefits franchising.

On the other hand, if “advance” means more generally the process of moving forward over time, let me put a pin in 2012. This year marks the start of the union-led “Fight for $15” movement, which had franchising in its crosshairs from its inception because franchisee-owned businesses have historically employed a disproportionate percentage of low-wage workers. The “Fight for $15” movement has sullied the public’s perception of franchising and perpetuated misunderstandings about the legal relationship between franchise parties. Developments like California’s AB-5 and reverberating efforts in other state capitols, which threaten to throw the franchise
business model under the bus are, in my view, a byproduct of franchising’s tarnished reputation.

At the same time, the gig economy, with which the public has always had a love affair, finds its business model under assault from similar pressures. Although the gig-economy business model may not be a franchise under statutory definitions and gig companies reject any comparison between their business model and franchising, franchisors and gig businesses have important things in common, which may ultimately help franchising. They both offer third parties the opportunity to be their own boss under a brand owner’s tent. A franchisee like an Uber driver is drawn to the branded business opportunity precisely because they do not want to be someone else’s employee. As franchisors and gig-economy companies each face bet-the-company litigation with billions of dollars and their very business models at stake, they are asking courts and lawmakers to throw out old independent-contractor tests that do not work in today’s modern economy. Both are advancing the same public policy argument: the law must be adjusted to accommodate their business model, which is vital to prosperity and economic growth.

In fighting for its existence, franchising may get a boost by riding on the coattails of the politically well-connected gig-economy sector, the darling of Silicon Valley and Wall Street. Any gains that gig economy companies notch either by repealing or amending AB-5 or through public referendums may open up pathways that benefit franchising. Finding an ally in the sexier gig sector should improve franchising’s public image. At the same time, gig economies may find franchise law helpful to their efforts to convince courts and lawmakers that a worker’s substantial association with a brand owner’s trademark is not incompatible with the worker’s legal independence.

Asbill: A decade ago, international franchising laws and regulations were not extremely widespread. During the past ten years, much has happened by way of laws, regulations, and court decisions outside the United States. The Forum’s Annual Developments have covered, in no particular order, the United Kingdom, Spain, Germany, Italy, Belgium, several Canadian provinces, Egypt, South Korea, China, Australia, Argentina, and Indonesia. As more and more companies expand internationally, the continued legal developments in these countries, together with the extensive growth of the Forum’s International Division, enable U.S.-based practitioners to get a good handle on legal issues and local resources that can help their companies grow internationally.

Also, the past decade has seen the acquisition of franchisors and larger franchisees by private equity firms. In many cases, such firms have avoided the typical plan of a five to seven year investment before reselling and have held onto franchise companies for the long term. For example, Roark Capital Group, founded in 2001, and based in Atlanta, has a portfolio of forty-five...
Franchise companies. Since the M&A side of an acquisition has to be made in conjunction with the legal aspects of franchise and distribution laws, business folks without franchise background and expertise necessarily have to bring those skills into the equation. However, the relative stability of U.S. franchise laws and regulations enable private equity firms to bring financial and business skills to the table, so they can offer to help a franchise company transition from the start up, entrepreneurial phase to the longer term operational phase, including the necessity to manage system changes as the system ages and matures.

**Dienelt:** I believe that franchise law and franchise practitioners have, for the most part, become more sophisticated. There will always be disputes, and there will always be risk in litigation, but I believe there is generally more certainty in the rules that govern the franchise relationship than at earlier times. Business people want certainty; as long as they know the rules, they will usually try to follow them. I think that the greater sophistication and certainty about franchise law has made growth of franchise businesses easier. However, I must note an important exception to this trend: the misclassification/joint employer cases are creating great uncertainty and will haunt franchising until the issues those cases raise are settled, perhaps only by legislation.

**Gardner:** From a franchisee perspective, I am not sure franchise law has advanced in ways that I feel has helped franchising. The number of decisions that have bolstered the franchisor’s ability to basically do whatever it says it wants to do under the terms of an agreement, and gives it virtually unfettered authority, has steadily grown. Whether that “helps franchising” or not really depends on where you sit, and, even if you think that franchisors should have virtually unlimited power, whether or not the decisions they make turn out to be good for their company or not, is going to have to be judged on a case-by-case basis.

3. In your opinion, which are the most significant court decisions that have impacted franchise law in the last ten years?

**Spandorf:** In my humble opinion, the California Supreme Court’s 2014 decision in *Patterson v. Domino’s Pizza, LLC* is the most significant court decision in franchise law in the last ten years. *Patterson* rejected the plaintiff’s joint employment claim and recognized the “special features” attendant to franchising relationships, which have at their core a trademark license. This feature makes franchise relationships different because the federal Lanham Act requires the brand owner to retain certain control over a licensee’s operations in order both to guarantee the quality of the products that the licensee sells to the public under the licensed brand and to protect the brand’s reputation.

Patterson was a vicarious liability, not an employment law, case, but its explanation of the trademark license's role in the franchise relationship applies equally to both types of claims. Both vicarious liability and joint employment cases focus on the interactions between franchisors and franchisees who are tethered to one another by a trademark license. Too many joint employment cases wrongly confuse employment controls with brand controls. They improperly cite as examples of a franchisor's undue control over a franchisee's employment decisions conduct that lies at the heart of every trademark owner's legitimate right to set brand standards, even if these standards trickle into the ways in which licensees interact with their employees. The Patterson decision is a lucid moment during a turbulent period of inconsistent misclassification and joint employment rulings in which the highest court of the most populated state in the country, and the state most influential in setting nationwide franchise public policies, correctly elucidated the distinction between employment and brand controls and the trademark license's special role in the franchise business model.

Karp: I agree with Shelley on the significance of the 2014 decision in Patterson v. Domino's, which limited the circumstances under which a franchisor is liable for the acts or omissions of a franchisee or his or her employees. Its prominence is drawn not so much from the specific holding, but from the fact that the California Supreme Court, of all courts, essentially created a special rule to accommodate what it described as the contemporary realities of the franchise model. The decision is a monument to effective advocacy by our colleagues and the significance of franchising in the U.S. economy.

Dienelt: Rather than list a particular case, I suggest two clusters of them: (1) the arbitration decisions that seem (except possibly some state law decisions) to uphold well-drafted, pre-dispute arbitration requirements that arguably provide franchisors a significant advantage in disputes with franchisees, at least as the franchisees perceive them; and (2) the misclassification/joint employer decisions that have roiled what seemed to be settled law that franchisees were, as their franchise agreements invariably specified, independent contractors, and that franchisors and franchisees were not joint employers.

Gardner: I offer four cases for your consideration:

- Mac's Shell Service Inc. v. Shell Oil Products, which has had a significant impact on the ability of franchisees to claim constructive termination when a franchisor has taken an action that has significantly reduced the profitability of the franchisee, but has yet to drive it out of business;

18. Id.
• National Franchisee Association v. Burger King,\textsuperscript{20} which indicated, in essence, that it was not a violation of good faith and fair dealing for a franchisor to take an action that is economically adverse to the interests of its franchisees, so long as it does not drive the franchisee out of business.

• Riverisland Cold Storage v. Fresno-Madera Credit Association,\textsuperscript{21} which found that disclaimers will not prevent a party from using parol evidence to prove fraud (greatly enhancing a franchisee's ability to proceed on a fraud claim in the face of disclaimers contained in the FDD or franchise agreements); and

• As Eric mentioned previously, Bryman v. El Pollo Loco,\textsuperscript{22} finding that a franchisor who complied with its franchise agreement in placing a new store still violated the covenant of good faith and fair dealing in driving another franchisee out of business, and essentially re-igniting the debate that has existed since the early 1990s after Scheck v. Burger King\textsuperscript{23} and In re Vylene.\textsuperscript{24}

Grueneberg: On the one hand, the California Supreme Court in Patterson v. Domino's\textsuperscript{25} gave us a great discussion of franchising as a business model. Even beyond the disposition of the case itself, it is helpful to have a court understand why traditional tests for such concepts as vicarious liability have to be viewed through the way franchising works. On the other hand, the U.S. Supreme Court's decision not to grant certiorari in the Direct v. Hall\textsuperscript{26} case was disappointing. Instead of establishing a national test for vicarious liability, we are left with a hodgepodge of different state approaches.

Fittante: Over the last five years, there has been a greater emphasis on educating the public on the franchisor-franchisee relationship and the independent nature of the parties.

Coldwell: For my practice, Mercedes-Benz USA, LLC v. Carduco\textsuperscript{27} is one of the most significant court decisions that have impacted franchise law in the last ten years. The Texas Supreme Court clarified that, under Texas law, a franchisee may not justifiably rely on misrepresentations by the franchisor's representatives when such misrepresentations are contradicted by the express terms of the franchise agreement. The court also cautioned that, in an arm's-length

\textsuperscript{20} Nat'l Franchisee Ass'n v. Burger King, 715 F. Supp. 2d 1232 (S.D. Fla. 2010).
\textsuperscript{21} Riverisland Cold Storage v. Fresno-Madera Credit Ass'n, 291 P.3d 316 (Cal. 2013).
\textsuperscript{24} In re Vylene, 90 F.3d 1472 (9th Cir. 1996), as amended on denial of reb'g and reb'g en banc (Sept. 12, 1996).
\textsuperscript{25} Patterson v. Domino's Pizza, LLC, 333 P.3d 723 (Cal. 2014).
\textsuperscript{26} Hall v. DIRECTV, LLC, 846 F.3d 757 (4th Cir. 2017), cert. denied, 138 S. Ct. 635, (Jan. 8, 2018).
\textsuperscript{27} Mercedes-Benz USA, LLC v. Carduco, 583 S.W.3d 553 (Tex. 2019).
transaction, the party alleging fraud must exercise ordinary care to protect its own interests and that justifiable reliance is based, in part, on the parties’ experience and bargaining power.\textsuperscript{28} That case appears to close the door on certain fraud and fraudulent inducement claims based on alleged false representations that are contradicted by the parties’ agreement. In the end, the court reversed the judgment of the court of appeals and adjudged that plaintiff take nothing.\textsuperscript{29}

I also agree with my esteemed colleagues who cited \emph{Patterson v. Domino’s}\textsuperscript{30} as one of the most significant court decisions that have impacted franchise law in the last ten years.

\textbf{Karp:} I would reiterate the cases cited in my response to question number one above.

\textbf{4. What were the most important decisions that you made during your tenure as Chair of the Forum? Why? What impact do you believe they had?}\textsuperscript{31}

\textbf{Abrams:} During the early years of the Forum, the ABA president appointed all members of the Governing Committee—frequently for political reasons and even though the persons appointed did not have any background in, or knowledge about, franchising. As a result, there was no way for the Forum to reward people who contributed to the Forum’s activities and who were sufficiently knowledgeable about franchising to speak at programs, write articles, etc.

During my term as Chair, I advocated aggressively within the ABA for adoption of a system that enabled the Forum leaders to select Governing Committee members who were knowledgeable about franchising and had contributed to the work of the Forum. Ultimately, we were successful in achieving implementation of the present system, which provides a logical path to leadership and rewards those who contribute to the Forum’s success.

\textbf{Selden:} I led the Governing Committee to agree to three innovations that I think shaped much of what has happened since: (1) We made a collective decision to establish rigorous financial controls over the annual Forum, and the operations of the Governing Committee. We formalized these processes

\textsuperscript{28} Id. at 563.

\textsuperscript{29} Id.

\textsuperscript{30} \textit{Patterson}, 333 P.3d 723.

\textsuperscript{31} The Forum is indebted to all eighteen of its past chairs for their contributions, including those of the five past chairs who are no longer with us: Harold Ward, Lew Rudnick, Rupert Barkoff, Dennis Wieczorek, and Edward Wood (Jack) Dunham. Each of these chairs made significant changes and improvements that have helped make the Forum what it is today. We remain in their debt, and their legacies are an integral part of the institutional memory of the Forum.
and began serious budgeting as a management tool; (2) We agreed to pursue an explicit expectation of academic excellence and impartiality in Forum papers, articles, and speeches. That has not been perfectly realized, but we did succeed in setting an expectation of excellence that has motivated contributors to Forum publications and programs ever since; and (3) We began the practice of strategic planning by the Governing Committee at five-year intervals, to try to force the Forum’s leadership to step back from the day-to-day challenges periodically to think proactively about big-picture issues and long-term trends.

Let me also speak for Rupert Barkoff and suggest that his term as Chair saw the Forum really crack down on partisanship in writing and programming for the Forum, and the hugely important move to transition the Forum to a regime of self-governance and elected leadership. As Lee mentioned, members today could not imagine the challenges that we faced when our leadership was appointed—sometimes blindly as political patronage—by the president-elect of the ABA.

Lowell: During my term as Chair, I decided to upgrade a few aspects of the Forum. And each of these improvements, I like to think, set the Forum on a path of continual improvement in each of these areas. The first improvement was to morph the Forum’s newsletter (originally, The Newsletter of the Forum Committee on Franchising) into a more scholarly “journal.” Hence, we then changed the name to the “Franchise Law Journal.” Not only have the quality of articles published constantly improved, but also a second publication, The Franchise Lawyer, eventually emerged. The second improvement was the development of a “logo” for the Forum on Franchising. The original logo was used for many years and was an early step designed to brand the quality of Forum programs and publications. Finally, I began the notion of having formal “divisions” (or caucuses) within the Forum. Considered and evaluated at the time were a corporate counsel division (which was then emerging), a diversity division, and an international division. Each one of these (along with a litigation division and a women’s division) came into existence then or in subsequent years.

Spandorf: The decision of which I am most proud is conceiving of The Franchise Lawyer. The objective then, and still, is to offer Forum members an easier pathway for publishing articles on franchise law topics to increase their visibility within the franchise legal community and, if they wish, advance on a leadership path within the Forum.

Asbill: Establishment of the Past Chair’s Council, which was done to keep past leadership interested in the Forum and to provide continuity, insight, and guidance to current leadership as to the history of the Forum. In coordination with my predecessor, Shelley Spandorf, and successor, John Dienelt, the relentless focus on being an open, collegial, and welcoming body, is largely exemplified by the enforcement of the Policy Against Self-Promotion. This effort continues today and is a major distinguishing characteristic of the Forum.
Dienelt: For me, doing what my predecessors did, and my successors have done, making every significant decision in consultation with past chairs and the Governing Committee, in an effort to improve the academic quality of our programming and the collegiality of our meetings, was far more important than any particular decision I made. I think that I succeeded in helping achieve those basic goals. I know others have.

Grueneberg: If I had to pick one decision that I am glad I made, it would be starting down the path of creating an international division. Creating a division is a long process that starts with setting up a task force and only culminates years later with a final determination (one that was made by my wise successor). When I was chair, this idea was not universally applauded. But international expansion of U.S. concepts has increased, and more non-U.S. concepts have enriched the U.S. market. As a result, the Forum has tremendous participation by lawyers from other parts of the world. The Forum is also a place where U.S. lawyers can share best practices about representing their clients as they expand abroad.

The most difficult time was after 9/11. I became chair in August 2001, and the Annual Forum was scheduled to begin on October 11, 2001. Many people voiced a desire to cancel the Forum, and many others decided not to attend that year. After listening to the membership, the Governing Committee decided to move forward and hold the Forum but to allow any speakers who decided not to attend to do so without any negative consequences. That was the short-term issue. The longer-term issue was how to function as an organization when we lost any positive revenues from the Forum (although we broke even) and when all the Forum’s investments were in the red.

As an organization, we all owe our deep gratitude to the wise decisions made by the Forum’s Finance Officer at the time, Chuck Modell, that helped right the ship.

Gardner: This one for me is the discount for young lawyers to come to the Forum. For years, the Forum has suffered from a “graying problem.” To combat the coming demographic crisis, and the need to make sure that we could attract younger lawyers to participate while keeping our core membership coming to our meeting (e.g., so firms did not have to choose between the two), we devised a way to allow younger lawyers and new members to attend for a couple years at a substantially reduced rate. Our data suggested that once people attended a few times, they were much more likely to continue to return.

From where I sit, this program has been wildly successful. The Governing Committee’s foresight in instituting this policy has resulted in a slowing of our graying, a series of years with record attendance (even though our absolute number of members has not grown), and more new faces walking around than I care to admit. It is the achievement I am most proud of.

Fittante: The implementation of annual reviews on the various divisions and caucuses of the Forum. I feel like these have been used to sharpen and ultimately better the mission/purpose of each of these divisions and caucuses.
Coldwell: There were two initiatives during my tenure as Chair of which I am most proud. First, we substantially expanded the various committees supporting the Governing Committee’s marketing, publications, program, and membership officers. This not only provided additional opportunities for sustained member involvement but gave the officers added assistance and thought diversity in carrying out their work. The second initiative was to work with the Governing Committee and a marketing professional to figure out how to engage more consistently and directly with our members (e.g., more “touches” with the Forum’s constituents) and to update and clarify our Forum brand. The quarterly Chair’s letter, the Pathways to Leadership brochure, and various other forms of direct communication with the Forum’s membership are some examples.

Satterlee: The most important decision I made as Chair was to reevaluate the Forum’s finances to ensure we were on a path for future financial sustainability. This required rethinking the structure for the annual meeting, including ending full subsidies for many long-term events at the annual meeting. We also reviewed the costs related to annual events, including the Thursday and Friday night events, resulting in more modest events than the membership had become accustomed to. Fortunately, our membership appreciated the financial challenges faced by the Forum and were, in large part, receptive to these necessary changes.

Karp: In my tenure as Chair I pursued three major goals. The first was to make the Forum as self-sustaining as possible, financially as well as in our relationship with those that provide goods and services to our organization. Second, we formed a Task Force on Balance to create concrete standards by which we make sure that all our publications, articles, and workshop presentations created tangible value to all our members, whether a member represents franchisors or franchisees, are in-house with a franchisor, or works for a government agency. Third, the Transparency Initiative addressed our members’ stated desire to know more about how the Forum operates, how we allocate our financial resources, how speakers are chosen for the Annual Forum, and the qualities of leadership sought by the Nominating Committee.

5. What unknown story or anecdote do you have from your time as Chair that you’ve always wanted to share?

Selden: We learned two critical lessons about the Annual Forum at the San Antonio meeting in the mid-1980s—basically, don’t rely on assumptions. We got to the hotel the day before the program was to begin and saw that the hotel had us in a room that resembled a very long hallway, not a ballroom. Some VERY intense negotiations ensued, another group got moved to a different set-up, and we got an acceptable space for our plenary sessions, just in time to allow the room to be set to our specifications. Then, on the first
morning, we learned that our opening plenary speaker was trapped in an airliner that was circling due to fog at the airport. We went to our second-morning plenary speaker and told him, “You’re going on in twenty minutes!” Now, we do not allow first-day speakers to fly to the site the same day.

Asbill: Years ago, during the 1999 Forum in Rancho Mirage, California, there was an earthquake in the middle of the night. It woke most of the attendees, and we all rushed outside so as not to be trapped in a collapsing building if things got serious. One of our attendees, who had grown up in a country that frequently experienced earthquakes, came running out of his room and immediately jumped into the hotel swimming pool which he had been told by his parents was a safe place to go. However, once the quake subsided, he realized he did not have his room key, so he had to go to the hotel front desk, dripping wet, wearing only his undershorts, and try to prove he was a registered guest and needed a new room key.

Dienelt: None. So, Rick (my predecessor) and Susan (my successor) are safe.

Grueneberg: I think it would be a good idea for me not to share those stories.

Gardner: While this happened almost twenty years ago, I am still going to withhold the names to protect the innocent. When at the Forum in Vancouver in 2004, a franchisor colleague of mine had a medical episode, which ended with him in the hospital. When I visited him (as we were friends), he asked me if I could go to the room of one of his partners and notify him so that he could let their firm know. I went to his partner’s door, and knocked, and once the partner asked who it was, and I told him it was me, he then refused to open the door claiming that I was trying to trick him in order to serve him with process on a case that we had been discussing! It was only after I made several promises that I would not serve him and noting that, because we were at an international location, it might not be valid service anyway, did he sheepishly open the door and let me explain why I was really there!

Fittante: Dennis W. told me on my first day—Don’t screw it up, and begin thinking about your successor. At the time I thought it was crazy advice, but in retrospect it was advice that was as true as the day is long and that I tried to pass down to those who followed me.

Coldwell: Silence is the better part of valor here.

6. How has the Forum changed since your time as Chair, and how can it improve in the future?

Summary: While the Past Chairs universally agreed that the increase in attendance at the Forum each year was a good development, they also concurred that the Forum needed to be ever-vigilant to protect the sense of camaraderie and inclusiveness with that growth.
Selden: The Forum has become a lot bigger and more complicated than it was twenty-five years ago. That means many more opportunities for members to become involved in Forum activities and to learn how it operates if they want to pursue leadership roles, but it also introduces some bureaucracy and rigidity, and the challenge I see is to sustain the Forum’s greatest single attribute—its collegiality and camaraderie.

Spandorf: Andy certainly got that right—an obvious change is the number of attendees at the Annual Forum, which has more than doubled in size since I was Chair. Another is the greater legal community’s recognition of franchise and distribution law as a significant and distinct legal specialty. The Forum’s biggest challenge is to maintain its collegiality and inclusiveness, which are qualities that attract talent from all corners of the greater franchise community to produce exceptional programs and publications that, in turn, cement the Forum’s reputation as the preeminent organization advancing franchise law. The Forum will remain the leading voice of franchise law by exalting opportunities for debate among diverse viewpoints and never selling out to sponsorships or tolerating cliquish behavior.

Asbill: I agree with Andy and Shelley here. One of the biggest changes is the ever-increasing attendance at our Annual Forum. Although total lawyer members of the Forum have not changed significantly, the percentage of our members attending the Annual Forum is likely larger than any other ABA section or Forum. This means we provide important value to our members. One downside of this is that fewer hotels and cities can host us due to size. Perhaps we can plan meetings for three to four years out, ideally with one hotel chain in different cities, and get better bulk rates for rooms and facilities.

Another change is the increase in size of our leadership group, including many younger and diverse members, needed to manage the programs and publications and keep them at the highest level. We need to continue to be diligent in connection with the ongoing ABA issues, so we can still be a major factor in our mission of being the preeminent forum for the study and discussion of the legal aspects of franchising.

Not sure of things to improve the Forum on the theory that if it ain’t broke, don’t fix it. However, we need to continue to be open and available to our members and solicit ideas from them on what we can do better. Eric’s transparency initiative and pathways to leadership programs have been very helpful in this regard.

Dienelt: The Forum’s active membership, certainly as measured by attendance at the annual forum meeting, has become larger; its programming and publications have become better and more diversified; and, in general, the Forum has gotten better. However, I believe the Forum has become “grayer” and not as diverse as it should be. I believe it can improve by continuing to
get even better in programming and in collegiality, but also must improve by attracting a younger more diverse membership.

**Grueneberg:** One thing that has not changed is the desire to make the Forum a meritocracy. An important aspect of a meritocracy is creating opportunities for all members to thrive and contribute. That can be a difficult process in real life. We are all volunteers, and creating too high a bar for participation can discourage newcomers from getting involved. Fresh perspectives are the lifeblood of an organization like the Forum. While the Forum must strive to maintain the excellence of its publications and programs, it also must find ways to involve members who may not have as much time to give at this point in their working lives. I think it is also important to have franchise regulator participation, not just on a regulator panel at the Annual Forum, but on committees and publications and leadership.

**Gardner:** The Forum has improved in almost more ways than I can count. That is one of the great things about the organization—it builds on what has come before, rather than resting on its laurels. The evolution in technology, in the way that we reach a broader audience, yet still manage to keep most of our “culture” are the things that make me continue to come back year after year.

As for specific future improvements, I will leave that to those who follow in the footsteps of those who are leading now. Choices need to be made based on the demands of the time, and those of us whose time has come and gone do well to stay out of the way of that progress.

**Fittante:** I think the challenge of any organization is to stay true to its roots as time passes, something I took very seriously when I was the Chair. The Forum must continue to cast a wide net to include those with different views or from different backgrounds, but cling to its reputation as a meritocracy.

**Satterlee:** Although it has not been that long since I was chair, I will say that what has changed the most in the twenty-plus years I have been a member is the focus on diversity and inclusion of all types in the Forum. The growth of the Diversity and Women’s caucuses and the YLD are the result of the decades-long focus of the Governing Committee on building strong leadership that reflects the make-up of our membership.

**Karp:** Since I am the Immediate Past Chair, I will offer my reflections instead on what has happened in the ten years since I first joined the Governing Committee. During that time, we have seen two major developments. First, the substantial cadre of young franchise lawyers, who have stepped up, volunteered to serve in a variety of capacities, and provided valuable learning to their colleagues in articles and publications, gives me great confidence in the future of the Forum.

Second, as mentioned by others, our attendance at the Annual Forum, which is the envy of every other Section, Division and Forum in the ABA, continues to rise. Attendance grew from 838 in 2017, to 893 in 2018, and
927 in 2019. And the ratings of the Annual Forum by attendees continue to rise. The entire Forum should be proud of this trend, which indicates that we are doing several things right, including increased programming, roadshows, robust publications, the promotion of young and diverse speakers, and our continued unwavering commitment to provide the highest quality research and writing in all our articles, publications, and presentations.

Summary

The editorial in the 2007 Fall edition of the Franchise Law Journal focused on the need to know where you have gone to know where you are headed. As stated in that editorial and reiterated here:

Institutional memory loss is one of those large, unmeasured resource drains that a company or an organization experiences. It happens slowly and imperceptibly but may have a devastating cumulative effect over time. It has become quite the topic de jure because of the number of baby boomers reaching retirement age, leaving their companies and taking their knowledge and experience with them. Experts suggest that one way to stem the loss of institutional memory and to preserve some of it for the future is to interview the “keepers of the lore” and to memorialize what those keepers have to say. We have made a modest attempt to do that in this issue. . . .

Again, it is important to understand where we have been to figure out where we are headed. It is important for us to hear the thoughts and opinions of those who have governed the Forum. Without becoming too maudlin about this, we are thankful to the former chairs for their past hard work and for reminding us why they led our group during their tenures.32

Trademark Law and Franchising: Five of the Most Significant Developments

Christopher P. Bussert

Trademarks are at the very heart of franchising. Indeed, at the core of every franchising relationship is the license of a trademark. In addition to trademarks constituting a foundational element of the franchise relationship, trademark law has significantly shaped franchising, and continues to this day to shape franchising, including elements of the system that can be protected, how rights in those elements are enforced, and the remedies available if rights in those elements are found to be infringed. This article will explore five of the most significant trademark case law and legislative developments that have impacted, and will continue to impact, the protection and enforcement of trademark rights in the field of franchising since the enactment of the Lanham Act (Trademark Act of 1946).1

I. Protection of Interior and Exterior Trade Dress

Franchisors have long recognized the value in protecting their principal or house word and design marks, but more and more have also sought to extend trademark protection to other elements of their systems, including exterior and interior layout, one or both of which often incorporate a distinctive color scheme. Historically, courts resisted recognizing anything other than traditional word and design marks as being protectable and serving a trademark function. Before Congress passed the Lanham Act, color alone was not recognized as functioning as a trademark and was not eligible for federal registration. For example, in one pre-Lanham Act case, the United States Supreme Court openly questioned whether color alone could constitute a valid trademark:2


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Whether mere color can constitute a valid trademark may admit of doubt. Doubtless it may, if it impressed in a particular design, as a circle, square, triangle, a cross, or a star. But the authorities do not go farther than this.3

Other pre-Lanham Act Patent and Trademark Office and court decisions also shared skepticism in extending trademark protection to anything other than traditional word and design marks.4

However, the negative perception of color serving as a trademark began to change with the Lanham Act’s enactment. One of the Act’s express purposes was to modernize current trademark law and, accordingly, Section 45 of the Act has been widely construed by courts to include any word, name, symbol, or device or any combination thereof adopted and used by a manufacturer or merchant to identify its goods and distinguish them from those manufactured or sold by others. Despite expanding the definition of trademark, courts were slow to allow protection of color marks. Among the rationales courts advanced for denying protection were: (1) allowing protection of color marks would result in color depletion or monopolization;5 (2) infringement determinations would devolve into a debate over “shade confusion” between closely similar shades of that color;6 or (3) application of color to goods serves primarily a utilitarian purpose7 or is “aesthetically functional.”8

Despite these hurdles, recognition that color could serve as a designation of source began to take firm root once the Federal Circuit ruled in In re Owens-Corning Fiberglass Corporation.9 There, in a 2-to-1 decision, the Federal Circuit held that the Owens-Corning could register the color pink for its fiberglass residential insulation. In so holding, the court found that the color pink had no utilitarian purpose and did not deprive competitors of any reasonable right or competitive need and that Owens-Corning had

3. Id. at 171.
4. See, e.g., In re Gen. Petroleum Corp. of Cal., 49 F.2d 966 (C.C.P.A. 1931) (rejecting application to register the color violet for gasoline); In re Sec. Eng’g Co., 113 F.2d 494 (C.C.P.A. 1940) (rejecting application to register blue and aluminum color for oil well reamers).
5. Courts adopting this rationale reasoned that because there were only a limited number of colors in the palette; it would not be wise policy to foster further limitation by permitting trademark registrants to deplete the reservoir by claiming rights to color marks. See, e.g., Campbell Soup Co. v. Armour & Co., 175 F.2d 795, 798 (3d Cir. 1949) (court refusing to protect the red and white colors of Campbell’s labels on the grounds that doing so would result in a monopolization of the color red and competition would be negatively affected), cert. denied, 338 U.S. 847 (1949).
7. See, e.g., Sylvania Elec. Prods., Inc. v. Dura Elec. Lamp Co., 247 F.2d 730 (3d Cir. 1957) (blue dot on flashbulb not a valid trademark because it was functional); In re Pollak Steel Co., 314 F.2d 566 (C.C.P.A. 1963) (registration of reflective fence post coating refused registration).
8. See Deere & Co. v. Farmhand, Inc., 560 F. Supp. 85, 96 (S.D. Iowa 1982) (refusing to enforce the color “John Deere Green” as a common law trademark on agricultural equipment on the grounds that the color green was “aesthetically functional in that purchasers wanted the farm equipment to match”), aff’d, 721 F.2d 253 (8th Cir. 1983).
submitted ample evidence establishing that the color pink had achieved source significance with the relevant consuming public.

Unfortunately, even after the Federal Circuit’s *Owens-Corning* decision, courts continued to be split on whether color marks were protectable.10 The United States Supreme Court ultimately resolved that split in *Qualitex Co. v. Jacobson Products Co.*11 There, Qualitex had for many years colored the dry cleaning pads it manufactured with a special shade of green gold and ultimately obtained a federal registration for that color. After Jacobson adopted a similar color for its competitive product, Qualitex sued Jacobson for trademark infringement. Qualitex prevailed in the district court, but the Ninth Circuit reversed, holding that the Lanham Act did not permit registration of color alone.

The Supreme Court disagreed with the Ninth Circuit and reversed. At the outset, the Court noted that the basic underlying principles of trademark law and the language of the Lanham Act indicated that color was within the universe of designations that qualify for trademark protection.12 The Court added that like many other designations, color alone could distinguish a business’s goods or services and identify their source without serving any other significant function.13 Jacobson resorted to many of the same theories on which courts before *Owens-Corning* relied in refusing to protect color marks, namely, that allowing protection to Qualitex’s color mark would result in shade confusion and color depletion.14 The Court, however, found these concerns to be overblown and noted to the extent there were limited circumstances where color scarcity ever came into play, the utilitarian use or functionality doctrine would be available as a defense.15

Although protection of color alone has historically proven to be a challenge, business entities have had an easier time in establishing protectable rights when color is not claimed alone but, instead, is one of several elements of a claimed trade dress configuration. Even before the Lanham Act’s passage, trade dress protection was recognized under a common-law unfair competition theory if a claimant established the trade dress was non-functional and had achieved secondary meaning as well as a likelihood of confusion.16 By the 1980s, more and more courts began instead relying on

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10. See, e.g., First Brands Corp. v. Fred Meyer, Inc., 809 F.2d 1378 (9th Cir. 1987) (court affirmed the denial of injunctive relief against a competitor of the owner of the PRESTONE mark who sold antifreeze products utilizing an imitation of PRESTONE yellow color products); see also *NutraSweet Co.*, 917 F.2d at 1027; *AmBrit, Inc. v. Kraft, Inc.*, 805 F.2d 974 (11th Cir.) (noting “the general rule is that no seller can foreclose others absolutely from using any particular color”), order superseded by 812 F.2d 1531 (11th Cir. 1986), cert. denied, 481 U.S. 1041 (1987).
12. *Id.* at 162.
13. *Id.*
14. *Id.* at 168−69.
15. *Id.* (citing *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844, 863 (1982) (capsule colors of a pharmaceutical product were found to be functional)).
16. See, e.g., *Maytag Co. v. Meadows Mfg. Co.*, 35 F.2d 403 (7th Cir. 1929) (a washing machine), cert. denied, 281 U.S. 737 (1930); *Crescent Tool Co. v. Kilborn & Bishop Co.*, 247 F. 299 (2d Cir. 1917) (a crescent wrench); *Yale & Towne Mfg. Co. v. Alder*, 154 F. 37 (2d Cir. 1907)
the broad language of Lanham Act Section 43(a) in offering protection to trade dress, although they disagreed about whether secondary meaning was a prerequisite to establishing protectable trade dress. Many courts, like the Fifth Circuit in *Chevron Chemical Co. v. Voluntary Purchasing Groups, Inc.*, held that trade dress should be treated the same as other designations of origin as either inherently distinctive or non-inherently distinctive depending on the trade dress at issue. Only when trade dress was found to be non-inherently distinctive would proof of secondary meaning be required. Other courts, including the Second Circuit in *Murphy v. Provident Mutual Life Insurance Co.*, held that “nonverbal marks that are unregistered always require secondary meaning.”

The U.S. Supreme Court in *Two Pesos, Inc. v. Taco Cabana, Inc.* resolved the disagreement over whether secondary meaning was required in establishing protectable trade dress. *Two Pesos* involved a dispute between competing Mexican restaurant chains. Taco Cabana had been operating its chain of restaurants in the state of Texas since 1978 and claimed protectable trade dress in the interior and exterior design of its restaurants, which was described as follows:

A festive eating atmosphere having interior dining and patio areas decorated with artifacts, bright colors, paintings and murals. The patio includes interior and exterior areas with the interior patio capable of being sealed off from the outside patio by overhead garage doors. The stepped exterior of the building is a festive and vivid color scheme using top border paint and neon stripes. Bright awnings and umbrellas continue the theme.

In 1985, *Two Pesos* opened its first restaurant in Houston and adopted a motif very similar to Taco Cabana’s claimed trade dress. *Two Pesos* then rapidly expanded its chain to other markets in Texas. Once Taco Cabana entered the Texas markets in which Two Pesos operated, Taco Cabana brought an action against Two Pesos in the United States District Court for the Southern District of Texas for trade dress infringement. The parties

(a padlock); Enter. Mfg. Co. v. Landers, Frary & Clark, 131 F. 240 (2d Cir. 1904) (a coffee mill).
Secondary meaning is deemed to be established where the claimant can successfully demonstrate that a designation is recognized in the minds of consumers as the single source of goods or services.

17. *Chevron Chemical Co. v. Voluntary Purchasing Grps., Inc.*, 659 F.2d 695, 702 (5th Cir. 1981). See also *Fuddruckers, Inc. v. Doc’s B.R. Others, Inc.*, 826 F.2d 837, 843 (9th Cir. 1987); *AmBrit, 805 F.2d at 979; Blau Plumbing, Inc. v. S.O.S. FixIt, Inc.*, 781 F.2d 604, 608 (7th Cir. 1986) (“[T]he “proposition that secondary meaning must be shown even if the trade dress is a distinctive, identifying mark, [is] wrong, for the reasons explained by Judge Ruben for the Fifth Circuit in Chevron.”).


20. *Id. at 765.*
21. *Id. at 766.*
22. *Id.*
23. *Id.*
tried the case to a jury, which was instructed to answer a series of questions the trial judge had prepared relating to Taco Cabana’s trade dress claim. The jury responded:

Taco Cabana has a trade dress; taken as a whole, the trade dress is nonfunctional; the trade dress is inherently distinctive; the trade dress has not acquired a secondary meaning in the Texas market; and the alleged infringement creates a likelihood of confusion on the part of ordinary consumers as to the source or association of the restaurant’s services.

As a result of these findings, the court found Two Pesos to have infringed Taco Cabana’s trade dress and awarded Taco Cabana $2,000,000 in damages.

Two Pesos appealed to the Fifth Circuit, which affirmed the jury verdict below. In doing so, the Fifth Circuit followed its earlier decision in *Chevron Chemical* and determined that the jury instructions adequately stated the applicable law and that the evidence supported the jury’s findings. Among other things, the Fifth Circuit rejected Two Pesos’ contention that the jury’s finding of no secondary meaning contradicted a finding of inherent distinctiveness.

An appeal to the U.S. Supreme Court ensued. At the outset, the Court observed that its review was limited to resolving the issue of whether Taco Cabana’s inherently distinctive trade dress was entitled to protection despite the lack of proof of secondary meaning. The Court began its analysis by noting that protection of trade dress should be treated no differently from other designations. Two Pesos contended inherently distinctive trade dress should receive only limited protection if secondary meaning could not be established. Specifically, it argued that any such protection should be temporary and subject to defeasance if the trade dress had failed to acquire secondary meaning over time. The Court rejected Two Pesos’ analysis and held that there was no basis for treating inherently distinctive trade dress any differently from inherently distinctive verbal or symbolic trademarks, and that, because proof of secondary meaning was not required as a condition for protecting these trademarks, it should also not be required as a condition to protecting inherently distinctive trade dress.

The business community, and particularly those involved in franchising, widely publicized and warmly received the *Two Pesos* decision. Many of these businesses have since expended significant resources developing and protecting the interior and/or exterior design configurations of their premises.
with varying levels of success. On the one hand, in some cases, franchisors have failed to demonstrate protectable rights in their claimed trade dress, either because it was deemed to be generic, or not inherently distinctive and secondary meaning had not been shown or a likelihood of confusion could not be shown.34 On the other hand, other franchisors have success-fully demonstrated protectable trade dress in their exterior or interior configurations and that those rights have been infringed by a competitor.35 Still other franchisors have been successful obtaining Principal Register trademark registrations for their exterior trade dress configurations.36 For those franchisors who seek to create an indelible overall image of their franchised businesses in the minds of the consuming public, adopting protectable trade dress consisting of unique, yet memorable interior and exterior design elements including color schemes has gone a long way to reaching that goal.

II. Proving Trademark Infringement Against Remote Infringers

Franchisors have long recognized the value of obtaining Principal Register registrations in their house marks as well as other marks that are significant to the goods or services that the franchised business provides. In fact, marks registered on the Principal Register are often viewed as a key element of the value franchisors provide to franchisees, and the extent of franchisors'34 See, e.g., Ale House Mgmt., Inc. v. Raleigh Ale House, Inc., 205 F.3d 137, 142 (4th Cir. 2000) (“As with generic trade names, the trademark laws do not protect a generic trade dress.”); D.P. Dough Franchising, LLC v. Southworth, BUS. FRANCHISE GUIDE (CCH) ¶ 16,049, 2017 WL 4315013 (S.D. Ohio Sept. 26, 2017) (plaintiff denied relief on its trade dress claim in part because its red and black color scheme was common in Italian restaurants); Cava Grp., Inc. v. Mezeh-Annapolis, LLC, 119 U.S.P.Q.2d 1593 (D. Md. 2016) (summary judgment granted to alleged infringer on trade dress claim involving restaurant decor); Rib City Franchising, LLC v. Bowen, 2015 WL 6695723 (D. Utah Nov. 3, 2015); Happy’s Pizza Franchise LLC v. Papa’s Pizza, Inc., 108 U.S.P.Q.2d 1239 (E.D. Mich. 2013) (pizzeria interior design consisting solely of generic elements); W. Sizzl. Corp. v. Pinnacle Bus. Partners, LLC, 103 U.S.P.Q.2d 1148 (M.D. Fla. 2012) (finding no likelihood of confusion in view of changes made to interior and exterior design elements by alleged infringer).35 See, e.g., Elements Therapeutic Massage, LLC v. White, 2018 WL 2972929 (D. Nev. Apr. 18, 2018) (massage studio successful in demonstrating that its interior design and brown color scheme were protectable as trade dress and infringed); Cajun Glob., LLC v. Swati Enters., Inc., 283 F. Supp. 3d 1325 (N.D. Ga. 2017) (fast-food franchisor’s restaurant trade dress found to be protectable and infringed); Cici Enters., LP v. Four Word Motion, LLC, 2016 WL 9244626 (M.D. Fla. Oct. 17, 2016) (pizza franchisor successful in protecting specific color palette and restaurant decor); Maaco Franchising, LLC v. Boensch, BUS. FRANCHISE GUIDE (CCH) ¶ 15,829, 2016 WL 4746215 (W.D.N.C. Sept. 12, 2016) (vehicle painting and body shop franchisor successful in protecting particular configuration of color design features); TWTB, Inc. v. Rampnick, 152 F. Supp. 3d 549, 556 (E.D. La. 2016) (restaurant owner successful in protecting “surfer bar trade dress”); Dunkin’ Donuts Franchising, LLC v. Claudia I, LLC, 2014 WL 5343724 (E.D. Pa. Oct. 20, 2014); Happy Sumo Sushi, Inc. v. Vapona, Inc., 89 U.S.P.Q.2d 1380 (D. Utah 2008) (sushi restaurant successful in demonstrating that its interior design qualified as trade dress and was infringed).36 See, e.g., Kentucky Fried Chicken exterior (Registration No. 5,590,676); Waffle House exterior (U.S. Registration No. 2,638,549); Merlin’s Muffler Shop exterior (Registration No. 2,578,539). Those franchisors that have developed uniform interior layouts for their locations or franchisees may want to consider taking a page out of Apple’s playbook and pursue registration of that interior layout on the Principal Register. See Apple Inc. Registration No. 4,271,914, which covers the glass-fronted rectangular patterned design of the interior of an Apple store.
efforts to obtain Principal Register federal registrations is often detailed in item 13 disclosures in the Franchise Disclosure Documents provided to prospective franchisees.

One of the key benefits that arises from a Principal Register federal registration is nationwide priority vis-à-vis third parties who adopt subsequently confusingly similar marks for related goods and/or services. However, many owners of Principal Register registrations are under the mistaken impression that they can prevail in an infringement action simply by demonstrating a third party’s use of a confusingly similar mark for related goods or services. This, however, is not the case, because the owner of a Principal Register registration is also required to show that there is a likelihood of confusion; that is, consumers in the geographic area in which the alleged infringer is operating believe, mistakenly, that its operations are affiliated or associated with or licensed or endorsed by the owner of the Principal Register registration. If the respective parties are operating in the same or overlapping geographic areas, this showing is ordinarily not particularly difficult. The problem in demonstrating a likelihood of confusion typically arises when the Principal Register trademark owner and the alleged infringer operate in separate and distinct geographic territories.

The landmark case addressing this issue is *Dawn Donut Co. v. Hart’s Food Stores, Inc.* which involved a dispute between donut businesses. Dawn Donut owned federal registrations for the trademarks DAWN and DAWN DONUT and sought to enjoin Hart’s Food from using the DAWN mark on the packaging of its donuts. The court denied Dawn Donut’s request for injunctive relief, finding that at the time the action was brought Dawn Donut and Hart’s Food operated in distinct geographic markets, and, as a result, Dawn Donut could not establish a likelihood of confusion in the geographic area in which Hart’s Food operated. However, the court added that, although Dawn Donut was not presently entitled to injunctive relief, Hart’s Food should not be viewed as having acquired a permanent right to use the DAWN mark in its geographic area, and that should Dawn Donut expand its activities in the future into that geographic area, it would be entitled to injunctive relief.

The rule articulated in *Dawn Donut* has been adopted by all Circuits, except for the Sixth Circuit. Despite suggestions that some commentators have made that *Dawn Donut* may no longer be relevant as a result of the rise of the Internet, courts today still routinely take into account the *Dawn Donut* rule both in terms of assessing infringement as well as the scope of

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38. Id. at 360.
39. Id.
40. See Circuit City Stores, Inc. v. CarMax, Inc., 165 F.3d 1047, 1056 (6th Cir. 1999) (noting “no particular finding of likelihood of entry or irreparable harm is necessary for injunctive relief in trademark infringement or unfair competition cases”).
injunctive relief granted to the owner of the Principal Register registration. Yet recently some courts have adopted a more relaxed approach when considering Dawn Donut issues, particularly when considering equitable and monetary relief.

Application of the Dawn Donut rule has found its way into the franchise field as well, and the experience of a small Mexican restaurant franchisor in Comidas Exquisitos, Inc. v. Carlos McGee’s Mexican Cafe, Inc. serves a cautionary note to trademark owners of what can happen when trademark infringement litigation is instituted without taking into account the geographic scope of an alleged infringer’s operations. Comidas Exquisitos involved a trademark infringement action that the owner of the Atlanta-based Carlos McGee’s restaurant chain (Carlos McGee’s Atlanta) brought against a third party entity who had subsequently adopted the Carlos McGee’s name in connection with a restaurant located in Ames, Iowa (Carlos McGee’s Iowa). At the outset, the court noted that the parties were essentially in agreement as to the following facts:

- Carlos McGee’s Iowa had adopted its Carlos McGee’s restaurant name after the nationwide priority date of Carlos McGee’s Atlanta’s Principal Register registration for the Carlos McGee’s mark;


43. Guthrie Healthcare and Boldface are relatively recent examples of courts not applying a strict Dawn Donut analysis on the issue of the geographic scope of injunctive relief sought by a prevailing trademark plaintiff. In both cases, nationwide injunctions issued despite the fact that the plaintiff operated in only a limited geographic area. BBQ 4 Life, LLC v. Dickey’s Barbecue Rest., Inc., BUS. FRANCHISE GUIDE (CCH) ¶ 16,414 (D. Idaho Apr. 23, 2019) applied a similar approach on the issue of the award of an accounting of profits. There, a successful plaintiff in a trademark infringement action, which operated a small restaurant chain primarily in Boise, Idaho, sought a profits awards from a defendant restaurant chain that operated hundreds of restaurants nationwide. Defendant argued that plaintiff was entitled only to a disgorgement of profits in the geographic areas in which the parties competed. Although the court noted plaintiff conceded at oral argument that it could not enjoin the defendant from using the plaintiff’s trademark in geographic areas where plaintiff currently had no presence, the court found this fact to be no impediment to a recovery of profits for the defendant’s nationwide operations. The court reasoned that to rule otherwise would allow a large entity with a nationwide presence to conclude it was economical to steal a small competitor's trademark and use it nationwide when its exposure was limited to disgorging a relatively small amount of profits from locations in areas where the parties competed.


45. Id. at 194.
Carlos McGee’s Iowa was aware of Carlos McGee’s Atlanta’s use of Carlos McGee’s prior to Carlos McGee’s Iowa’s adoption of that name in connection with its restaurant; 46
Carlos McGee’s Atlanta had conducted a substantial amount of advertising, much of which had been directed at travelers and some of which had reached Iowa; 47
A substantial number of travelers had been served by Carlos McGee’s Atlanta restaurants including some from Iowa; 48
Carlos McGee’s Atlanta had plans for national expansion including states neighboring Iowa, namely, Missouri and Illinois; 49
Carlos McGee’s Atlanta introduced testimony of a former manager that on one occasion a group of customers from Iowa had told him that they had eaten at “your” restaurant in Ames, Iowa; and 50
Potential investors in Carlos McGee’s Atlanta franchises outside of Iowa had backed out or demanded better terms when they found out about the existence of Carlos McGee’s Iowa. 51

Despite Carlos McGee’s Atlanta’s efforts to demonstrate an Iowa connection, the court, applying the Dawn Donut rule, held that the foregoing evidence at most demonstrated that the parties’ marks were confusingly similar “in the abstract” or “could cause confusion under some circumstances.” 52 The court added that for there to be a real likelihood of confusion, the parties’ marks, as actually used in the marketplace, must cause a “real, present likelihood of confusion in the marketplace” and that plaintiff had failed to demonstrate that Carlos McGee’s Iowa’s use of the Carlos McGee’s mark met that standard. 53 As a result, the court held that Carlos McGee’s Atlanta could not prevail on its trademark infringement claim.

Sometimes trademark owners feel compelled to file a trademark infringement action immediately upon learning of the existence of a third party’s use of a confusingly similar mark out of the concern that failing to take prompt action will result in a finding of laches and prevent the recovery of monetary and/or injunctive relief. This is one situation where Dawn Donut helps the trademark owner. During the period that the trademark owner and the alleged infringer’s operations are geographically distinct, courts have

46. Id.
47. Id.
48. Id.
49. Id.
50. Id.
51. Id.
52. Id. at 198.
53. Id. Carlos McGee’s Atlanta is by no means the only business involved in franchising that has run afoul of a Dawn Donut analysis in enforcing trademark rights. See, e.g., What-A-Burger of Va., Inc. v. WhatABurger, Inc. of Corpus Christi Tex., 357 F.3d 441, 447 (4th Cir. 2004); Pizzeria Uno Corp. v. Temple, 747 F.2d 1522, 1535–36 (4th Cir. 1984) (“Since the plaintiff has not ‘penetrated’ the area in which [the] defendant operates, it is not entitled to injunctive relief until it has so ‘penetrated.’")
historically found that there is no trademark infringement and, accordingly, the laches clock has not begun running. 54

Although delaying the institution of trademark litigation until the geographic areas in which the trademark owner and alleged infringer converge may cause the trademark owner discomfort, doing so greatly enhances the likelihood of a successful litigation effort later. 55

III. Actions Seeking Injunctive Relief for Trademark Infringement

A common species of litigation between franchisors and franchisees involves “holdover” scenarios. These arise when the franchisee’s franchise agreement and license to use the franchisor’s trademarks has expired or has been terminated and the franchisee continues operating the franchised business, or one competitive to it, using the franchisor’s trademarks or trademarks that are confusingly similar. 56 Because the franchisee is no longer licensed or otherwise authorized to use the franchisor’s trademarks, any use of such trademarks post-termination or expiration constitutes trademark infringement. 57 The Lanham Act provides franchisors with a powerful weapon to address such infringement, which in many cases includes preliminary and ultimately permanent injunctive relief. In analyzing trademark infringement, actions seeking injunctive relief often give lip service to the traditional four-factor test—which requires one seeking injunctive relief to demonstrate (1) a likelihood of success, (2) irreparable injury, (3) the threatened injury to the movant outweighs the harm the relief sought would inflict on the opposing party, and (4) the injunction would not be adverse to the public interest. However, courts have routinely concluded that the movant was entitled to injunctive relief merely upon demonstrating a likelihood of success on the merits. The reason for this is that in cases involving enforce-


55. See, e.g., Marco’s Franchising, LLC v. Marco’s Italian Express, Inc., 2007 WL 2671040 (M.D. Fla. Sept. 7, 2007) (plaintiff established concrete plans to expand into defendant’s territory and was entitled to injunctive relief); Synergistic Int’l, Inc., 66 U.S.P.Q.2d at 1942 (plaintiff had concrete plans to expand by opening a franchise in the Los Angeles area); see also Christopher P. Bussert, supra note 42 (“As perhaps best said by Judge Chamberlain Haller of My Cousin Vinny fame, the Dawn Donut Rule or Ripeness Doctrine at most operates as a ‘stay of execution’ for the alleged infringer.”).


57. See, e.g., Burger King Corp. v. Mason, 710 F.2d 1480, 1492 (11th Cir. 1983) (“Common sense compels the conclusion that a strong risk of consumer confusion arises when a terminated franchisee continues to use the former franchisor’s trademarks.”); Tim Horton’s USA, Inc. v. Tim Donut U.S. Ltd., BUS. FRANCHISE GUIDE (CCH) ¶ 16,442 (S.D. Fla., June 17, 2019); New Horizons Educ. Corp. v. Krolak Tech. Mgmt. of Syracuse, LLC, BUS. FRANCHISE GUIDE (CCH) ¶ 16,291, 2018 WL 5253070 (N.D.N.Y. Oct. 22, 2018); Mitsubishi Motors N. Am., Inc. v. Grand Auto., Inc., BUS. FRANCHISE GUIDE (CCH) ¶ 16,181, 2018 WL 2012875 (E.D.N.Y. Apr. 30, 2018); Peterbrooke Franchising of Am., LLC v. Miami Chocolates, LLC, 312 F. Supp. 3d 1325 (S.D. Fla. 2018).
ment of trademark rights under the Lanham Act, irreparable harm to the movant was “presumed” to occur as a result of the infringement.58

This landscape changed with the U.S. Supreme Court’s 2006 decision in *eBay, Inc. v. MercExchange, LLC*.59 On its face, one would not have anticipated that *eBay* would have such far-reaching implications, particularly given its subject matter. The *eBay* case was a patent infringement suit that MercExchange instituted against eBay.60 Notably, MercExchange had never practiced the method claimed in the patent, resulting in MercExchange being characterized as a “patent troll.” Although the jury found MercExchange’s patent to be valid and infringed, the district court refused to grant a permanent injunction because of “plaintiff’s willingness to license its patents” and “its lack of commercial activity in practicing the patents” sufficiently established that the harm to MercExchange would not be irreparable and could be compensated through monetary relief.61

The Federal Circuit reversed the district court, finding that, as a “general rule” in patent disputes, “a patent injunction will issue once infringement and validity have been adjudged” except in “exceptional circumstances” and where necessary “to protect the public interest.”62

At the outset, the Supreme Court found fault with both of the lower courts’ approaches to injunctive relief. According to the Court, Section 283 of the U.S. Patent Act provided that injunctions “may” issue “in accordance with the principles of equity.”63 These “principles of equity” require courts in patent cases to employ the traditional four-part test in assessing requests for injunctive relief, under which a plaintiff must demonstrate: (1) the existence of irreparable injury; (2) that remedies at law, including monetary relief, are inadequate; (3) that the balance of hardships tilts in favor of injunctive relief; and (4) that granting an injunction would not harm the public interest.64 The Court added that nothing in the Patent Act affected the application of that test and found support for its analysis in its past treatment of requests for equitable relief under the U.S. Copyright Act of 1976.65 The Court noted that it was appropriate to apply the same copyright principles in patent cases because both the Copyright and Patent Acts provided the “right to exclude others from using its property” in exchange “for benefits bestowed by the genius and mediations and skill of individuals” and provided “incentive to further efforts for the same important objects.”66

60. Id. at 390.
61. Id. at 393 (citation omitted).
63. 547 U.S. at 391–92.
64. Id. at 392.
65. Id.
66. Id. (citation omitted).
Because in the Court’s view neither the district court nor the Federal Circuit fairly applied traditional equitable principles in assessing MercExchange’s request for a permanent injunction, the Court vacated both of the lower court decisions. According to the Court, the Federal Circuit had failed to apply the traditional four-factor test in assessing injunctive relief by improperly applying a categorical rule favoring injunctions. Similarly, although the district court had recited the traditional four-part test for injunctive relief, it also improperly applied a categorical rule prohibiting injunctions if the patent entity was a nonpracticing entity and a willing licensor. Although denial of an injunction may well be appropriate in some of these settings, applying a categorical rule for injunctive relief would fail, for example, to take into account university researchers or self-made inventors who might not have the resources to practice the invention themselves, but who might very well be entitled to injunctive relief. Accordingly, the Court remanded the case to the district court with directions to reconsider its determination upon explicit application of the four-part test to the specific facts before it.

Since the Supreme Court’s *eBay* decision, there has been a growing debate as to whether its holding should be limited to patent cases or applied more broadly to other types of cases, including Lanham Act cases involving trademark infringement, unfair competition, or false advertising. Although many of the commentators that have addressed this issue have argued that *eBay* should not be applicable to Lanham Act cases, and that the presumption of irreparable harm should continue to apply, there have been some critics of that approach as well.

Court decisions have been decidedly mixed on the issue of the application of the presumption of irreparable harm in Lanham Act cases post *eBay*. Some have ignored *eBay* and found that the presumption continues to apply. Other courts have either hinted that the presumption of irreparable
harm no longer applies. Still other courts have held that, in light of *eBay*, the presumption of irreparable harm no longer applies in trademark cases and that the trademark plaintiff must provide affirmative evidence of irreparable harm to establish that factor.

As a result of *eBay*, franchisors who seek injunctive relief in trademark cases would do well to assess carefully the law of the jurisdiction in which they will be pursuing that relief, and to ascertain whether or not affirmative evidence of irreparable harm will be required as well as the types and quantity of evidence of irreparable harm courts in that jurisdiction have found will satisfy that burden. In most jurisdictions requiring affirmative evidence, franchisors/trademark owners have been found to meet that burden by providing some evidence of threatened loss of goodwill, loss of ability to control reputation, and/or a loss or confusion of customers. However, some courts have refused to find irreparable harm where the evidence submitted was deemed to be “conclusory” or otherwise insufficient.

To date, the U.S. Supreme Court has not yet examined the issue of the applicability of *eBay* to Lanham Act cases, despite the clear split in the Circuits. The intellectual property bar, and specifically the American Intellectual Property Law Association, do not appear to be anxious to leave that issue to chance with the Supreme Court and are instead seeking certainty

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71. The First Circuit raised the question whether *eBay* eliminates the presumption of irreparable injury but has declined actually to decide that question as a matter of law. Voice of the Arab World, Inc. v. MDTV Med. News Now, Inc., 645 F.3d 26 (1st Cir. 2011).

72. See, e.g., Commodores Entn’t Corp. v. McClary, 648 F. App’x 771, 777 (11th Cir. 2016) (“[I]n light of the Supreme Court’s holding in *eBay*, a presumption of irreparable harm cannot survive.”); Ferring Pharm., Inc. v. Watson Pharm., Inc., 765 F.3d 205 (3d Cir. 2014); Herb Reed Enters., LLC v. Florida Ent’n’t Mgmt., Inc., 736 F.3d 1239, 1250 (9th Cir. 2013); Salinger v. Colting, 607 F.2d 68, 80 (2d Cir. 2010). A leading commentator has criticized the Ninth Circuit’s *Herb Reed* decision as being both “superficial and deeply flawed.” 4 McCarthy, supra note 58, § 30.47.30; see also Happy’s, Inc. v. Fantinia, 2018 WL 4783969 (E.D.N.Y. Oct. 1, 2018); *Dunkin’ Donuts* Franchising, LLC v. Claudia III, LLC, 2014 WL 3900569 (E.D. Pa. Aug. 11, 2014).


74. See, e.g., Maaco Franchising, LLC v. Ghirimoldi, Bus. Franchise Guide (CCH) ¶ 15,571 (W.D.N.C. July 28, 2015) (plaintiff failed to make a clear showing of irreparable harm beyond conclusory statements); 7-Eleven, Inc. v. SoDhi, Bus. Franchise Guide (CCH) ¶ 15,697, 2016 WL 541135 (D.N.J. Feb. 9, 2016) (noting that although harm to reputation and harm to property are potential bases for showing irreparable harm, plaintiff’s evidence thereof was insufficient).
through a legislative solution. In that regard, currently working its way through Congress is the Trademark Modernization Act of 2020 (TMA). Section 6 of the TMA would amend Section 34 of the Lanham Act to provide a plaintiff seeking an injunction with a rebuttable presumption of irreparable harm upon a finding of a likelihood of success on the merits. The TMA to date has received substantial bipartisan support and could be enacted later this year.

IV. Post-Lanham Act Legislative Developments

Although at the time of its enactment the Lanham Act represented a significant advancement in terms of modernizing trademark law and codifying judicial precedent, by the 1980s, it was sorely in need of an update. Two legislative developments that resulted in important changes to the Lanham Act are of particular note. The first was the passage of the Trademark Law Revision Act (TLRA), which was enacted November 16, 1988, with an effective date of November 16, 1989. The second was the passage of the Federal Trademark Dilution Act (FTDA), which became effective on January 16, 1996, and was later amended in 2006.

Two changes were made to trademark registration procedures under the TLRA that have had a significant impact on U.S. based businesses, including those involved in franchising. The first was the addition of a prospective use registration basis under Section (1)(b). Prior to enactment of the TLRA, the only basis upon which a U.S.-based business could seek registration of a trademark was use of the trademark in commerce. Foreign-based businesses, however, had the option of pursuing registration either based on use in commerce (Section (1)(a)) or ownership of a registration of their trademark for the same goods and services outside of the United States (Section 44(d)). When the application to register was pursued on the latter basis, foreign-based businesses were not required to demonstrate use in commerce in the United States as a prerequisite to obtaining a federal registration. One of the expressed rationales for enactment of the TLRA was to eliminate the advantage foreign companies enjoyed in applying for U.S.

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77. Id. § 1051(a).
78. Id. § 1126(d).
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trademark rights. The TLRA leveled the playing field with foreign-based businesses by providing that U.S. trademark owners could also seek to register their trademarks based on a *bona fide* intent to use the trademark in commerce.

The TLRA also took steps to address another unfair advantage accorded to foreign entities relating specifically to priority of rights vis-à-vis U.S.-based businesses resulting from foreign entities’ seeking registration of their trademarks outside of the United States. Before the TLRA’s enactment, at least one court had held that foreign nationals establish constructive nationwide use for purposes of registration of their trademarks in the United States upon filing of an application for registration in their home countries. This constructive nationwide use gave the foreign applicant a right of priority for six months in seeking registration in the United States pursuant to Section 44(d). Before the TLRA’s enactment, U.S.-based businesses were hampered by the fact that constructive nationwide use did not arise until the issuance of a federal registration for the subject trademark. This proved to be a particularly inequitable result when prosecution of the U.S. entity’s trademark application took an extended period of time. The TLRA addressed this imbalance by conferring constructive use rights effective from the filing date of an application upon issuance of a federal registration based on the subject application.

Dilution is an additional layer of protection available to owners of famous trademarks. Two different types of dilution are recognized under the law: blurring and tarnishment. Dilution by blurring occurs when consumers encounter use of the famous mark by a third party in a nonconfusing way to identify goods or services different from those offered by the trademark owner (think KODAK bicycles or ROLLS ROYCE restaurants). Dilution by tarnishment occurs when a third party’s use of a famous mark tarnishes or degrades the positive association enjoyed by the mark in the mind of consumers (think STARBUCKS adult cartoons or BURGER KING X-rated

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*Foreign countries, such as Japan, which do not require actual use of marks in commerce prior to registration, can apply for registration of popular U.S. marks, such as Coca-Cola, in their home country. This effectively precludes U.S. companies from using their marks on an international basis without obtaining licenses for use of their own name abroad. By joining the countries which allow prospective use trademark filings, U.S. companies not only have a means by which they can assure that a mark is not used abroad prior to their own entry into the marketplace, but also have a retaliatory tool against foreign companies.*


82. SCM Corp. v. Langis Foods Ltd., 539 F.2d 196, 201 (D.C. Cir. 1976).

83. *Id.*

movies). Dilution nearly became incorporated in the federal trademark law as part of the TLRA, because dilution protection was included in early versions of the bill that the Senate passed. The House of Representatives, however, did not agree, resulting in the final version of the TLRA omitting any reference to dilution.

Notwithstanding the federal reluctance to enact comprehensive dilution legislation, states were more receptive to enacting such legislation. Massachusetts became the first state to adopt an antidilution statute in 1947.85 After the United States (now International) Trademark Association created a model antidilution statute in 1964, fifteen states adopted that statute into their laws.86 The United States Trademark Association amended the language of the model antidilution statute in 1992 to clarify that such protection is only available for famous marks.87

Finally, in 1996, Congress adopted a federal dilution statute with the passage of the Federal Trademark Dilution Act (FTDA), which was enacted effective January 16, 1996.88 That statute was later amended in 2006 by legislation referred to as the Trademark Dilution Revision Act (TDRA).89 The federal antidilution law did not replace or preempt state antidilution laws; it only extended an additional layer of protection to famous marks.

The 2006 amendment to federal antidilution law was prompted in great part by the U.S. Supreme Court’s decision in Moseley v. V Secret Catalogue, Inc.90 There, the owner of the VICTORIA’S SECRET trademark brought a trademark infringement and dilution action against an adult novelty store named “Victor’s Little Secret.” The district court granted summary judgment to the trademark owner on its dilution claim, which was affirmed by the Sixth Circuit. The Supreme Court, however, reversed holding that the FTDA unambiguously required the plaintiff to demonstrate actual dilution, rather than a likelihood of dilution, by objective evidence, which the plaintiff had failed to do.91

Trademark owners and the trademark bar were understandably quite upset with the holding in Moseley and, with the International Trademark Association serving as a driving force, the TDRA was passed in 2006. The TDRA made a number of significant amendments to federal antidilution law including:

- The actual dilution requirement was replaced with a less stringent requirement that only a “likelihood of dilution” be established to prevail;

85. 4 McCarthy, supra note 58, § 24.77.
86. Id.
87. Id.
91. Id. at 422–43.
• A famous mark could be diluted without establishing first a likelihood of confusion;
• The definition of marks qualifying as “famous” was amended;
• Both dilution by blurring and dilution by tarnishment were expressly defined; and
• Federal registration was not a prerequisite to invoking the FTDA. 92

Since the passage of the FDTRA and TDRA, some franchisors whose marks have been found to qualify as famous have been successful in establishing dilution claims under federal law. 93

V. Recovery of Profits for Trademark Infringement

Possibly leaving the best (but certainly the most recent) legal development for last, is the issue of whether proving willful infringement is a prerequisite to a trademark owner’s recovering an accounting of profits from the defendant in a trademark infringement action. In that regard, 15 U.S.C. § 1117(a) currently provides:

When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office, that violation of Section 43(a) or (d), or a willful violation under Section 43(c), have been established in a civil action arising under this Act, the plaintiff shall be entitled, subject to the provisions of Sections 29 and 32 and subject to the principles of equity, to recover (1) defendant’s profits . . . .

Significantly, Congress added the italicized language to that section in a 1999 amendment. Although some courts have read that amendment as clarifying only that willfulness was required to recover an accounting for claims of dilution under Section 43(c) of the Lanham Act, and not for claims of trademark infringement or unfair competition under Section 43(a), 94 others held that amendment had no effect on their existing precedent requiring willful infringement as a prerequisite for a recovery of profits under

93. See, e.g., Doctor’s Assocs., Inc. v. Patel, Bus. Franchise Guide (CCH) ¶ 16,259 (S.D.N.Y. Sept. 26, 2018) (finding SUBWAY® mark was entitled to protection under federal antidilution law); Crossfit, Inc. v. Quinnie, 232 F. Supp. 3d 1295 (N.D. Ga. 2017) (plaintiff’s CROSSFIT® mark found to be famous under federal antidilution law and entitled to protection from defendant’s “blurring” use of “Krossfit”); McDonald’s Corp. v. McSweet LLC, 112 U.S.P.Q.2d 1268, 1282 (T.T.A.B. 2014) (McDonald’s family of “MC” marks found to be famous under the federal antidilution law and an adequate basis to oppose registration of applicant’s MCSWEET mark for “pickled gourmet vegetables, namely, pickled cocktail onions, pickled garlic, and pickled, marinated olive medley and pickled asparagus” on the grounds of dilution by blurring); Marblelife, Inc. v. Stone Res., Inc., 759 F. Supp. 2d 552 (E.D. Pa. 2010) (plaintiff’s MARBLELIFE® mark held to be famous and entitled to protection under the federal antidilution statute). But see Starbucks’ Corp. v. Wolfe’s Borough Coffee, Inc., 736 F.3d 198 (2d Cir. 2013) (STARBUCK’S® mark is famous within the meaning of the federal antidilution law but no blurring or tarnishment was found as a result of third-party use of MR. CHARBUCK’S or CHARBUCK’S BLEND).
Section 1125(a). With respect to recovering an accounting of profits for traditional trademark infringement under Section 1125(a), there has traditionally been a split in the circuits as to whether there was a requirement that the trademark owner prove a defendant’s infringement was willful or intentional. For example, the First, Second, Eighth, and Ninth Circuits have stated that proof of willful infringement was a prerequisite to recover an infringer’s profits. The Federal Circuit, relying on Second Circuit law, similarly held, although, as discussed below, its holding did not withstand the Supreme Court’s scrutiny. The Sixth Circuit had not, as yet, expressly ruled on this issue. Other courts have held that, although willful infringement is not required, it is either one of several alternative bases or justifications for an award of profits or is a factor to be considered, along with others, in assessing the “principles of equity” as to whether the infringer’s profits can be recovered. As to the latter approach, the Third, Fourth, and Fifth Circuits have adopted lists of nonexclusive factors (including willfulness) that courts should consider in determining whether an accounting of profits is warranted. As the Fifth Circuit recently explained in Retractable Technologies, Inc. v. Becton Dickinson & Co.,

A court considers six non-exclusive factors in determining whether an award of profits as appropriate: “(1) whether the defendant had the intent to confuse or deceive, (2) whether sales have been diverted, (3) the advocacy of other remedies, (4) any unreasonable delay by the plaintiff in asserting his rights, (5) the public

99. PlayNation Play Sys., Inc. v. Velex Corp., 924 F.3d 1159, 1170 (11th Cir. 2019) (“An accounting of the defendant’s profits is appropriate where: (1) the defendant’s conduct was willful and deliberate, (2) the defendant was unjustly enriched, or (3) it is necessary to deter future conduct.”); Klein-Bosker, USA, LLC v. Englert, 711 F.3d 1153, 1161 (10th Cir. 2013) (“[U]nder the Lanham Act, plaintiffs must show either actual damages or willful action on the part of the defendant as a prerequisite to recover disgorgement of profits.”).
100. Retractable Techs, Inc. v. Becton Dickinson & Co., 919 F.3d 869, 883 (5th Cir. 2019) (willful infringement being an important factor which must be considered when determining whether an accounting of profits is appropriate); Synergistic Intl’, LLC v. Korman, 470 F.3d 162, 175 n.13 (4th Cir. 2006) (“We agree that willfulness is not an essential prerequisite for a [sic] damages award, but that it remains a highly pertinent factor.”); Banjo Buddies, Inc., 399 F.3d at 177–78 (willfulness is only a factor, not an indispensable prerequisite, to a recovery of profits); Roulo v. Russ Berrie & Co., 886 F.2d 931, 941 (7th Cir. 1989) (noting “no express requirement [in the Lanham Act] that the infringer ... willfully infringe ... to justify an award of profits”). The author was one of the counsel for Synergistic International, LLC.
interest in making the misconduct unprofitable, and (6) whether it is a case of palming off.”

Although over the years there have been several attempts to secure Supreme Court review of this issue, the Supreme Court only recently agreed to address the matter in Romag Fasteners, Inc. v. Fossil, Inc. There, Romag and Fossil were previously parties to an agreement under which Fossil was allowed to use Romag’s fasteners in connection with Fossil’s leather goods. Romag later discovered that factories in China were making Fossil products bearing imitations of Romag’s fasteners. As a result, Romag sued Fossil for trademark infringement under Section 43(a) of the Lanham Act. Although a jury found in favor of Romag on its trademark infringement claim and that Fossil had acted in “callous disregard” of Romag’s rights, it rejected Romag’s contention that Fossil had acted willfully as the trial court had defined that term. The Federal Circuit affirmed, holding that a prevailing plaintiff’s failure to prove willful infringement was fatal to its claim for profits.

In an opinion that Justice Neil Gorsuch authored, the Supreme Court vacated and remanded the case to the trial court, holding that Section 43(a) does not impose a “willfulness” prerequisite for awarding profits in trademark infringement actions. At the outset, the Court examined the language of 15 U.S.C. § 1117(c) and ruled that it expressly provided a showing of willfulness was only a precondition to a profits award in actions brought for trademark dilution under Section 43(c). As to actions such as Romag’s that were brought under Section 43(a), the Court observed that the statutory language “had never required a showing of willfulness to win a defendants’ profits” and that the Court was not inclined to “read into statutes words that aren’t there,” particularly where the term “willfulness” was used elsewhere in the same statutory provision.

The Court next addressed Fossil’s argument that the willfulness requirement for profits had its origin in the “principles of equity” qualification under Section 1117(a). The Court rejected Fossil’s reliance on the “principles of equity” language for two reasons. First, it determined such a reading was inconsistent with the express “mens rea” language in other sections of the Lanham Act, which expressly set forth whether certain actions were undertaken “intentionally,” or with “knowledge,” or were otherwise...
“willful.” According to the Court, Fossil’s interpretation was not “an obvious construction of the statute.” Second, contrary to Fossils’ contention, the Court found that it was “far from clear” whether past precedent had consistently required a showing of willfulness before allowing a profits remedy. Although some courts under the Lanham Act and its predecessor had treated willfulness as a prerequisite for a profits award, other cases had expressly rejected this rule. To make things even more confusing, several commentators had articulated different views about the relationship between mens rea and profits awards in trademark cases. At the end of the day, the Court was willing to conclude no more than the defendant’s mental state was a highly important consideration in determining whether an award of profits is appropriate. Yet it rejected willfulness being the inflexible precondition to recovery of profits.

So what impact will Romag have in pursuing an accounting of profits remedy in Lanham Act cases? The answer will likely depend on the jurisdiction. For actions brought in the Third, Fourth, and Fifth Circuits, which have adopted multi-factor tests including the consideration of a defendant’s mental state, nothing will likely change as the Supreme Court in Romag seemingly endorsed that approach. As to those Circuits such as the First, Second, Eighth, Ninth, and Federal, which required proof of a willful infringement as a prerequisite to recover an infringer’s profits, the precedent from those Circuits is no longer good law and these Circuits will likely end up formulating their own multifactor tests for assessing the accounting of profits remedy that includes the defendant’s mental state as one factor. Finally, as to those Circuits like the Tenth and Eleventh that have either identified willfulness as an alternative basis or separate justification for an award of an accounting of profits, any basis or justification that is not arguably predicated on a finding of willfulness on the behalf of the defendant is probably still good law.

Romag’s importance to franchising will be felt in actions franchisors may bring that assert Lanham Act claims either against franchisees or against unrelated third parties. In such actions seeking monetary relief, trademark owners often opt to pursue an accounting of profits, rather than an award of actual damages, because proving the amount of profits is, in most actions, far easier as trademark owners are required only to establish an alleged infringer’s gross revenues; the alleged infringer is then required to establish all elements of cost or deduction from that gross revenues amount. However, proof of actual damages is often a more complicated exercise that may

108. Id. (citing 15 U.S.C. §§ 1117(b), 1117(c), 1118 & 1125(d)(1)(A)(i)−1125(d)(1)(B)(i)).
109. Id. at 1496.
110. Id.
111. Id.
112. Id. at 1496–97.
113. Id.
114. Id.
require expert testimony to establish. Whether Romag will result in a significant increase in trademark litigation and/or the award of profits remains to be seen.116

Conclusion

Trademark law’s impact on franchising is undeniable. The passage of the Lanham Act, and additional legislation designed to update and modernize it and important case law developments, have resulted in franchise systems being able to develop, protect, and enforce far more robust rights in the designations that they adopt to distinguish themselves from their competition. This trend will surely continue for the foreseeable future.

116. See Bill Donahue, Will High Court’s Trademark Ruling Spark Litigation Wave? Law360 (Apr. 24, 2020, 4:45 PM EDT), https://www.law360.com/articles/1267186 (noting that although Fossil and its supporters warn that the lack of a willfulness requirement could lead to more baseless lawsuits or complicate efforts to settle even routine trademark cases, many practitioners believe empowering district courts to use plenty of discretion in awarding profits including consideration of the defendant’s mental state will avoid the “sky is falling” problems warned of by Fossil). The author is in accord with those who share the latter view.
Both Sides Now: Making the Transition from Outside to In-House Counsel

Bethany L. Appleby & Gary R. Batenhorst

I. Introduction

Many in-house lawyers for franchise companies began their careers at law firms where they gained experience representing these same franchise companies. For a variety of reasons, lawyers at various stages of their careers may find it more appealing to move to an in-house position. In this article, two long-time members of the ABA Forum on Franchising, who have worked both in-house and for law firms, discuss the differences between working for franchised companies directly as opposed to representing these companies at law firms. Although most of the discussion in this article focuses on in-house law departments for franchisors, many of the issues discussed also are relevant for in-house lawyers working in the law department of a multi-unit franchisee, including those with franchises in multiple concepts.

II. Backgrounds of the Authors

Bethany Appleby received a Bachelor of Arts degree from Yale University, magna cum laude, and graduated with highest honors from The University of Connecticut School of Law. Shortly after finishing law school, she joined the New Haven office of Wiggin and Dana LLP, where she eventually became a litigation partner and co-chaired the firm’s Franchise and Distribution Practice Group. After almost twenty years of representing the Subway® restaurant franchisor in litigation, arbitration, and other matters as outside counsel, she...
left private practice to serve as the company’s Chief Legal Officer for approximately three years. She now practices franchise and business law and litigation at Appleby & Corcoran, LLC, in New Haven, Connecticut.

Gary Batenhorst graduated magna cum laude from Creighton University with a Bachelor of Science in Business Administration. After graduating from the New York University School of Law, he began his career in franchise law in 1979 representing Godfather’s Pizza, Inc. (GPI) at an Omaha law firm. He moved in-house at GPI in 1983 where he remained until 2001, most of which time he served as General Counsel and GPI’s only in-house lawyer. Since 2001, he has worked for law firms in Omaha, serving as outside General Counsel to GPI while also representing other franchisors, multi-unit franchisees, and prospective franchisees, primarily in transactional matters.

Bethany and Gary are the two immediate past editors-in-chief of the *Franchise Law Journal* and currently serve as members of the Governing Committee of the ABA Forum on Franchising.

### III. Moving In-House: Some Changes in Mindset

By the time most lawyers move in-house from private practice, they have honed their legal skills, developed multiple areas of expertise, and have excellent oral and written communication skills. All of these are important foundations for a successful in-house career, but certain shifts in mindset are important in completing the transition.

#### A. Law Departments as Support Functions and the Importance of Risk Tolerance

In-house lawyers must develop a different mindset regarding their role within the organization. The sole reason a law firm exists is to provide legal services. As difficult as it may be for in-house lawyers to accept, law departments in companies are not the primary reason for the company’s existence. The law department is a support function, not unlike the accounting, human resources (HR), or technology departments, all of which support their fellow employees who are engaged in the selling of the company’s products and services. Understanding that role and the law department’s place within the organization are critical aspects of developing the law department’s credibility. In-house lawyers should always be seeking opportunities to make their business colleagues look good to their supervisors and peers (and share the credit for the development of successful solutions to business problems).

Some risk is inevitable in the disruptive environments in which most companies operate today. When asked in a recent survey what their boards of directors ask about most frequently, thirty percent of chief legal officers said risk issues, twenty-five percent said compliance issues, and twenty-two percent said corporate governance.\(^1\) This risk can take many forms, and it is important

for in-house lawyers to understand the proper role of risk management in the company’s decision-making process. A central part of most companies’ culture is its risk tolerance, and in-house lawyers need to understand this tolerance level in assessing and advising on risk. Businesspeople want to know the type and degree of risk involved in a potential decision and the likely outcome of proceeding in the face of this risk. One way to do this is to attempt to determine the worst-case scenario in pursuing a certain course of action and the odds of that worst-case scenario occurring, and then ask the decision makers to consider whether they can live with that outcome. The law department should work closely with inside and outside risk management professionals, whose experience with risk management issues enables them to provide valuable insights into the risk analysis process.

Along these same lines, it is important that in-house lawyers know when to acquiesce in a business decision to proceed despite the risk and when to escalate the matter to a higher authority within the company. By using the ability to escalate matters sparingly, in-house lawyers gain credibility in making these decisions, show their desire to be team players, and increase the likelihood that their input regarding risk management issues will be accepted. However, there are times when the risks of proceeding are too great. The key is for in-house lawyers to give businesspeople the information that they need regarding risk to make informed business decisions.

A recent Cambridge University study discussed a disconnect between law firms and their clients. Although this study focused on outside law firms and their clients, in-house lawyers need to be aware of the causes of this disconnect and take steps to avoid it in interactions with their business clients. The Cambridge Study identified three causes for this disconnect: (1) service offerings by law firms; (2) service quality; and (3) unpredictability of the delivery of legal services.

The disconnect involving services offerings may occur because law firms often see their role as simply providing advice that clients can use in crafting solutions to legal problems. Clients, on the other hand, are looking for solutions to their business problems. This same dilemma confronts in-house lawyers. Businesspeople are looking for practical solutions

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2. The model rules of professional conduct require that “if a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.” MODEL R. OF PROF’L CONDUCT r. 1.13(b) (AM. BAR ASS’N 1983).


4. Id. at 5.

5. Id.
to legally accomplish their business objectives. If in-house lawyers come from law firm backgrounds, they may have been trained in the “just provide advice” model. In-house lawyers will need to strive to help craft practical solutions, expressed in plain English, that will enable the businesspeople to solve business problems while maintaining the highest standards of honesty and integrity.6

One simple exercise may prove useful. In-house lawyers can set aside, temporarily, their legal hats, and put themselves for a moment in the businessperson’s shoes. Imagining the implementation of a new business initiative and the resulting increase in profits or other benefits without thinking about all the legal issues raised may increase empathy and help the lawyer enthusiastically seek out creative solutions or alternatives to accomplish the initiative’s fundamental goals.

B. Developing Strong Relationships with the Business Team and Developing Financial Literacy

One of the keys to success for in-house lawyers at any level of experience is to develop good relationships with the businesspeople at the company. Developing good relationships at the outset will give the in-house lawyer the credibility needed to increase the likelihood that businesspeople will seek out and follow their advice. Law departments have in many cases justifiably earned the reputation of being the “No’ Department” or the “Place Where Good Ideas Go to Die.” In-house lawyers will quickly learn that being able to help business colleagues find a legally and ethically appropriate path to accomplish a business objective is a critical part of the job. The more the in-house lawyer can learn about the company’s business—its products, services, markets, history, culture, management, and employees—the better position they will be in to provide solid advice to their in-house clients.

Although lawyers may believe they are leaving behind the need to do business development when moving in-house from a law firm, that is not the case. New in-house lawyers will find themselves in a different form of business development as they build and strengthen their personal and professional relationships with business counterparts. As they earn the trust of their colleagues, they will find those colleagues more willing to come to them for advice and to share information early in a project when legal advice and input can have a meaningful impact on the decision-making process. Developing these strong relationships will also make it easier to gain acceptance of law department decisions when circumstances require the lawyer to say no.

A big part of developing strong relationships is simply being visible within the company. By showing up at meetings where the lawyer’s presence is not necessarily required, at social functions, and company-sponsored community

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service events, in-house lawyers can help build credibility and strengthen these relationships. When law department members interact with individuals throughout the company, they get to know people in different departments, build these relationships, and strengthen the law department’s credibility and approachability.

In addition to serving as the company’s chief legal officer, it is often important for the general counsel to become a trusted advisor on business issues. As a result, the general counsel needs to develop good financial literacy skills. The general counsel and other in-house lawyers need to be familiar with the company’s financial statements and how they are prepared. They should know the internal and external factors that drive the company’s revenues and expenses. In-house lawyers need to develop strong relationships with the company’s internal and external accountants and have at least a basic understanding of the company’s accounting controls. Pronouncements from the Financial Accounting Standards Board (FASB) can have a significant impact on a company’s financial statements, and in-house lawyers should have at least a basic understanding of the most relevant FASB announcements for their industry. It is important, especially when working for a public company, to understand the concept of materiality, which can drive the requirement for financial statement disclosure in addition to triggering disclosures in the franchise disclosure document.

In-house lawyers should also periodically spend time observing or working in their brand’s franchised locations or business units. This is particularly important for lawyers working for brands with brick and mortar retail companies. In-house lawyers may not become ace sandwich or pizza makers, but by occasionally spending a day in the store they can improve their understanding of the company’s business and the employees who interact with customers every day. They should also regularly patronize the company’s locations or use its products or services to get a “customer’s-eye” view of the end result of the company’s efforts.

C. Budgeting and Fiscal Responsibility

Unless they are the law firm’s Chief Financial Officer, a department or practice group chair, or finance partner, outside counsel are often not deeply involved in developing their law firm’s annual budget. That is, at least in part, because many other expenses are passed on to paying clients. It is also because outside lawyers and paralegals are revenue generators, rather than

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8. The FTC Rule Compliance Guide defines the term “material” for purposes of required litigation disclosures as a “civil action is one that is likely to influence a prospective franchisee’s investment decision.” FTC, FRANCHISE RULE COMPLIANCE GUIDE 45 (2008), http://business.ftc.gov/documents/franchise-rule-compliance-guide.

9. This is different from client case or matter budgeting, with which outside counsel may be more skilled and involved.
the “cost centers” that law departments are often seen to be, and law firms would not want lawyers spending what could otherwise be billable hours poring over budget spreadsheets and calculating anticipated office supply or payroll costs. As a result, during the annual law firm budgeting process, lawyers are often involved only to the extent of requesting particular amounts for client development and continuing legal education and conferences and related travel.

Inside counsel, on the other hand, generally have more budgeting responsibilities and fiscal accountability and often must discharge these responsibilities with little or no administrative assistance. In-house lawyers are also generally responsible for tracking spending versus budget throughout the year and should discuss any possible overages with the General Counsel, Chief Legal Officer, or Chief Financial Officer, preferably before any overages actually occur.

In-house budgeting can be further complicated by the fact that the law department does not always have visibility into the anticipated initiatives of the business teams. If, for example, the digital team plans to launch a new app in the coming year but has not communicated that to the law department, how would the law department know to include anticipated outside counsel fees for that project in its budget? And if the business team is responsible for including initiative-specific legal fees in its own budget, how could it possibly know what amount to budget? Frequent and clear communication with the business teams and accounting leaders can help ensure that initiatives are properly budgeted for, without double-budgeting of outside counsel and related spend.

In-house lawyers in supervisory roles may also find themselves spending a great deal of time on HR issues, including reorganizations, reporting structure decisions, employee training, counseling, discipline, promotions, and many other tasks relating to department performance. Law firms, at least those mid-size and above, have other staff and departments handling many of these matters to help minimize encroachments on billable-hour potentials.

The selection and use of technology are also closely tied to staffing and budget considerations. Online research can be helpful in selecting technology, but in-person vendor demonstrations can be key to understanding how a platform really works. However, vendors are, of course, there to sell their products, and it can be difficult to determine what is real and what is puffery. It is important to view multiple demonstrations of different products and come prepared to ask pointed questions about integration with company systems, support, updates, etc. It is also advisable to have multiple people with different roles and skill sets view the final contenders and ask questions before a final decision is made.

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10. This is not an entirely fair assessment because well-run law departments should significantly reduce outside legal spending, thereby reducing overall company spend for legal services.
None of the tasks related to the selection and use of technology to increase law department effectiveness and efficiency is essentially “legal” in nature or taught in law school. Many law departments are choosing to develop Legal Operations functions or groups to manage some of these non-legal but fundamentally important tasks. Developing Legal Operations functions has become a hot topic in the past few years, with the goal of running the legal department more like a company business unit:

In short, Legal Operations is the business side of the corporate law department or practice of law and is the support structure for managing the corporate law department. It is devoted to analyzing and running the corporate law department the way business leaders analyze and run their non-law departments. Legal Operations functions can help break down silos, establish and communicate the “business case” for initiatives, prepare and monitor budgets, attend to in-house legal staffing, training, and technology, and help free up lawyer time to address legal matters.11

Unless the company has a well-established Legal Operations function or the lawyer was active in law firm management, they will probably spend much more time in-house on administrative issues than in private practice. Lawyers would be well-advised to learn how to use all of the various company administrative platforms and brush up on other software frequently used for administrative or financial purposes, such as Excel.

D. Preventative Law Programs

An important part of an in-house lawyer’s role is the development and implementation of preventative law programs. In-house lawyers increase their value to the company by developing and monitoring protocols, policies, and procedures designed to prevent legal issues from harming the company, rather than simply reacting to these issues when they arise. This is particularly true when certain types of potentially preventable legal problems occur within a company on a recurring basis. In-house lawyers need to learn the causes of these legal problems, particularly the reoccurring issues, and determine how to keep them from happening or at least reduce the likelihood they will occur.

A good example of preventative law is contract management. All companies enter into written or oral contracts to obtain products and services. It is important to identify the persons within an organization who have the authority to bind the organization to contracts and determine what contracts must undergo legal review, and possibly other levels of review, before being signed. Factors such as the amount and duration of the contract and the level of potential risk (e.g., contracts that involve customer personal or financial data) will impact the required level of review.

One area where standardized contracting procedures can benefit a company is automatic renewals. Many goods and services contracts provide for automatic renewal on the expiration of the initial term, either for a period equal to the length of the initial term or for an additional one-year term. Such automatic renewal provisions may be inconsistent with the duration of the agreement preferred by the company. In many instances, these provisions can be stricken from agreements. If that is not possible, the law department can help develop protocols for tracking contract renewal dates, a task made easier by increasingly sophisticated tracking technology.

Other areas where law departments can employ preventative law measures include HR matters, such as sexual harassment and wage and hour law claims. Law departments can work with HR professionals to develop training programs to lessen the likelihood that acts of sexual harassment will occur and to inform employees of how to promptly report such acts when they do. The law department should work with HR to develop reporting procedures that allow employees to bypass their supervisor when the supervisor is alleged to have engaged in acts of sexual harassment. Such programs can play a significant role in reducing the company’s exposure to sexual harassment claims. Law departments can also train managers and supervisors on the requirements of overtime pay and break laws to lessen the likelihood of these preventable but costly claims.

These are just a few areas to consider. Other areas ripe for review are arbitration clause implementation, standardization of contract forms, franchise termination procedures, and checklists or other guidelines to ensure compliance with state-specific franchise registration and relationship laws, among many others.

E. Public Relations (PR) and Crisis Response

Outside counsel, on the one hand, should never speak publicly or respond to press inquiries about any client matter without client permission. Doing so not only risks running afoul of the outside lawyer’s ethical obligations, but also could be the death knell of the lawyer-client relationship and could seriously damage the trust and relationship between the in-house lawyers and the company’s PR teams.

Inside lawyers, on the other hand, need to be key participants in the company’s crisis response and management, product recall, and cyber breach response groups. In-house lawyers should also review and approve all press releases and press inquiry responses that could have any significant legal ramifications. Although the attorney-client privilege should apply when providing internal advice regarding the legality or legal risk and ramifications of crisis management measures and PR statements, counsel should be aware

12. See e.g., Model R. of Prof’l Conduct, supra note 2, rt. 1.6, 3.6.
that lawyer involvement in these efforts does not automatically cloak them in privilege.\textsuperscript{13} In addition,

[Although] communications between a public relations firm and a law firm can be protected under the attorney-client privilege when the attorneys hire the PR firm to assist in providing legal advice to clients, ABA Section of Litigation leaders recognize that jurisdictions are split on this issue, however, and caution practitioners to be careful when engaging and communicating with public relations firms.\textsuperscript{14}

F. Training and Recruiting New Lawyers

Mid-size and larger law firms usually have organized on-campus and HR recruiting efforts and established associate training programs. Although partner training and mentoring are important and often occur in the course of handling client legal matters, formal hiring and training are often left to general firm or practice group management, rather than to individual partners. Continuing Legal Education (CLE) hours are often tracked centrally by the firm or may simply be tracked and recorded by individual lawyers. Conferences and bar association meetings and events are known for their marketing potential, meaning that it may be easy for outside counsel to justify attendance and travel for these CLE-rich events.

Conference and CLE opportunities may be even more important for in-house lawyers, at least from an educational standpoint. Outside counsel often get a breadth of exposure to legal issues and approaches by working with multiple different clients of varying sizes in different industries. They also often practice with many other lawyers in various practice areas who are available to answer questions or otherwise serve as resources. In-house counsel practice can risk becoming insular. Although they may encounter many different types of issues on a given day, in-house counsel may fall into the rut of approaching issues the way that the company always has, “because that’s how we do it here.” In addition, if a company has not experienced a particular problem, even if it is emerging as a serious risk or threat, it may not have any exposure to it and may not have developed a game plan for addressing it should it arise at the company.

To combat insularity and “silos,” in-house counsel should make sure that at least some of their required CLE units come from attending relevant meetings and conferences, such as the ABA Forum on Franchising Annual Meeting and the IFA Legal Symposium. Doing so can help them gain insight from other in-house and outside counsel about emerging threats and effective ways to meet them. The papers and presentation materials from these types of conferences can also serve as valuable resources for years to come. In-house lawyers also should be aware of the opportunities presented

\textsuperscript{13} See discussion of “two hat problem” in Section III.G.


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for obtaining CLE credit at programs sponsored by law firms that either
do work for the in-house lawyer’s company or are seeking its work. Some
firms provide high-quality programs that enable in-house lawyers to obtain
required CLE credits at no charge, either live or by webinar or similar
technology.

A recent survey conducted by consulting firm Gartner, Inc. (Gartner)
found: “The most cost-effective legal departments commit to a strategy of
continuous improvement of their in-house capabilities, including training,
standardizing legal work, and allocating more of their total legal work in
house.” In connection with the survey, Gartner’s research director noted
that “legal departments have a tendency to hand off complex work to outside
counsel, but organizations can achieve significant cost savings by bringing
this work in house.” He added, “the rate for an in-house attorney is likely
going to be significantly less than what outside counsel will bill.”

Not only do high quality conferences help in-house lawyers learn from
others and raise their legal game, but the networking opportunities can help
tremendously with recruiting new talent and increase job satisfaction and
morale.

In recruiting new lawyers, law departments can hire recent law school
graduates or hire lawyers who have gained experience in law firms or at
another in-house law department. Both authors of this article favor hiring
lawyers with relevant prior experience, particularly from firms or law depart-
ments that they know to have strong training programs and high standards
for quality of work and professional responsibility. If the company has a legal
internship program, it is also possible that interns can develop the necessary
specialized skills during the internship period and could be appropriate hires
when they graduate law school if they excel during their internship period.

G. Privilege Issues

For outside lawyers, the application of the attorney-client privilege is
almost a given. Under most formulations, client communications with out-
side counsel are generally privileged. “To invoke the attorney-client privi-
lege, a party must demonstrate that there was (1) a communication between
client and counsel, which (2) was intended to be and was in fact kept con-
fidential, and (3) made for the purpose of obtaining or providing legal
advice.” Clients rarely call their outside lawyers and pay for advice that is
not legal in nature.

15. Press Release, Gartner, Gartner Says Cost-Effective Legal Departments Invest Almost
Twice As Much in Legal Training Compared With Higher-Cost Peers (Sept. 5, 2019), https://
departments-invest--; See also MP McQueen, Most Cost-Effective Legal Departments Invest More
com/corpounsel/2019/09/05/most-cost-effective-legal-departments-invest-more-in-in-house-
training-survey-says/?slreturn=20191030141938.
16. Id.
For inside lawyers, the privilege analysis is more nuanced and complex because of what has been called the “two hat” problem. Because of in-house counsel’s familiarity with the company and its business dealings and goals, they are frequently called on to give business advice in addition to legal advice. Accordingly, they sometimes wear both business and legal hats. Unless the purpose of an internal communication is primarily for the purpose of legal advice, the privilege may not apply, and work product analyses can also be trickier. Law departments may want to develop protocols for ensuring that written communications, such as emails, that provide legal advice are confined to this legal advice only and that business advice is dispensed in separate emails. However, in the rough and tumble of daily communications, these protocols may fall by the wayside.

In-house lawyers are also frequently involved in PR and crisis management issues as well as internal investigations relating to alleged or suspected wrongdoing by company employees and others. In-house lawyers’ dual roles can also complicate the privilege and work product analyses in these situations.

IV. Some Things Might Be Less Different Than Anticipated

As discussed earlier, some shift of mindset may be required to successfully transition to in-house practice. Some areas, however, actually may be less different than they superficially appear.

A. Client Mix for In-House and Outside Lawyers

Lawyers who have worked in law firms know the challenges of meeting the needs and preferences of a variety of clients. They may believe that by moving to an in-house position they will be working with a single client. That is not the case. In-house lawyers will continue to deal with a wide variety of “clients” from different disciplines within the company. These individuals may have very different personalities and working styles. The difference for in-house lawyers is that all of these client representatives will


19. “A party asserting that a document is protected by the work-product doctrine must demonstrate that the document was prepared in anticipation of litigation. A document is prepared in anticipation of litigation when, in light of the nature of the document and the factual situation in the particular case, [it] can fairly be said to have been prepared or obtained because of the prospect of litigation. Work-product protection is not available for documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.” *In re Grand Jury Proceeding*, 79 F. App’x 476, 477–78 (2d Cir. 2003) (internal quotations and citations omitted) (emphasis in original).

20. For a short discussion about protective privilege for internal investigations, see Stephen M. Ryan, *Protecting Privilege in Internal Investigations*, 52 Houston Law. 16 (Mar./Apr. 2015).

21. Although the client technically always remains the company, *Model Rules of Prof’l Conduct* r. 1.13(a) (Am. Bar Ass’n 2020) states: “A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.”
share, or should share, a common commitment to meeting the company’s objectives and carrying out the company’s business plan.

B. Work Ethic Issues

Lawyers considering a move from a law firm to an in-house position should not assume that in-house jobs are necessarily easier than working for a law firm. Some in-house positions may provide more regular or flexible hours, but it is difficult to build a career as a successful in-house lawyer treating the position as a nine-to-five job. In-house lawyers should be as attentive to the needs of their various internal clients as private practice lawyers are when working for, and seeking additional business from, external clients. Developing the kinds of relationships discussed in this article while also providing high-quality legal services can take as much of a lawyer’s time as working in a law firm and also require at least electronic availability during evenings, weekends, and family vacations.

V. Additional Issues

A. Understanding the Company’s Culture

As discussed earlier in this article, an important objective for every in-house lawyer—whether the general counsel or an entry-level legal hire—is to develop the credibility needed so that in-house clients will accept their legal and business advice. A crucial first step in developing this credibility is to learn the company’s culture.

All companies have a company culture, whether they recognize it or not, that plays an often unacknowledged role in guiding their decisions, strategies, and tactics. This culture can be rigid or flexible, hierarchal or collaborative, formal or informal, or one that encourages or discourages innovation. Whatever the culture, it is important that in-house lawyers learn about it quickly because they will need to consider it when providing legal or business advice to a business unit. This culture may make the in-house lawyer’s job easier or harder, and may even impact hiring decisions when the law department adds lawyers. The nature of their work will cause in-house lawyers to interact with businesspeople throughout the company. That places the law department in a good position to see areas in which the company culture positively or negatively impacts the company’s ability to grow while complying with applicable laws. It also may give the law department an opportunity to be a change agent of this culture.

22. For an example of how the company’s culture had a significant impact on a major franchisor, see Heather Haddon & Suzanne Vranica, McDonald’s Aspires to Shed Party Culture, WALL ST. J., Jan. 6, 2020 at Al.
B. Structuring the Law Department

As noted earlier, in-house lawyers generally spend more time on staffing and department and team structure issues than law-firm lawyers do. Inside lawyers need to determine the most efficient structure for the teams that report to them. Everyone wants to be a direct report to the General Counsel or Chief Legal Officer, but that is not feasible. The typical law department organizational structure, at least in a large company, is also more complicated than a law firm structure. Instead of an essentially vertical structure of partner, associate, paralegal, administrative assistant, a large in-house legal team often has multiple teams and sub-teams that must work together efficiently and effectively. This structure has more involved horizontal relationships and multiple reporting layers.

It has been said that “lawyering is easy; people are hard.” The more people in a law department, the more time must be spent on training, evaluation, discipline, and many other people-related tasks. That time increases dramatically when staff members are difficult to work with, cause friction with other team members, or resist change or new technology. Time invested in staffing and structure pays dividends in reduced supervisor stress and increases efficiency and effectiveness. The key is having the right people in the right places. These determinations will require consideration of personality and individual career goals, as well as skills and training. How many reporting layers will result in the smoothest processes? Who should report to whom? What portions of various tasks can be delegated to lower level employees to free up more expensive lawyer and paralegal time? What processes can be simplified or streamlined with technology? Addressing all of these questions can be time-consuming and intellectually (and sometimes emotionally) difficult.

Transparency and clear communication can help with the human aspects of these tasks. Holding “Town Halls” or similar group meetings can help ensure that the team is all rowing in one direction and understands the “whys” behind any confusing or difficult changes. It is also important to have regular, frank discussions with team members and really listen to their concerns. What are their goals and roadblocks? Do they have suggestions for reaching those goals or removing those roadblocks?

C. Supervising and Training Other Departments

Lawyers and law departments tend to be more organized and disciplined than some other departments in a business. As a result, lawyers are often asked to supervise, either formally or informally, other departments or tasks. For example, although the collection of royalties or the consideration and approval of new franchise or franchise agreement transfer candidates are not necessarily legal in nature, these duties may reside, in whole or in part, in the law department. This will require in-house lawyers to learn about these other processes and disciplines. It is also an area where meetings with
individuals in other departments, such as accounting and finance, and networking with other in-house counsel to get their input can be useful.

D. Staffing with Inside vs. Outside Lawyers and Selecting Outside Counsel

Inside lawyers must decide what work will be done in-house versus what goes to outside firms and must continually grapple with the balance of cost between in-house and outside counsel spend. What can be done in-house for a fraction of the cost, and how does one make the best business case to the CEO or CFO for in-house hiring and retention based on this analysis? There is, of course, no easy answer. Much will depend on the nature and size of the system. As a simple rule of thumb, if you can keep a lawyer busy full-time and year-round doing work that an outside lawyer could bill for by the hour, hire the in-house lawyer. For example, a large global system will likely do a lot of in-house marketing and advertising work. Accordingly, it should be easy to justify hiring a lawyer specializing in this area when comparing the in-house compensation package to the hourly (or other arrangement) outside counsel expense. It is also possible that the system’s advertising fund could cover part or all of the in-house marketing and advertising work, because it otherwise might have had to fund the necessary outside counsel spend for those services. Some work, even if it could be done in-house, just may not be worth it. For example, pursuing and collecting judgments for unpaid royalties (at least when the franchisee does not appear to have significant assets) might be handled most efficiently and effectively by a collection company on a contingency fee basis.

Large franchise companies will generally have more specialized lawyers and may have fully staffed teams handling common issues such as employment, advertising, privacy, franchise disclosure and regulation, and litigation. Smaller systems will not have the same luxury of specialization and may also not have sufficient volume of a particular type of work to justify it. Smaller companies often hire more generalists with a broad, but sometimes shallower, range of experience and skills in many areas who more readily rely on outside counsel for thornier questions or complicated matters. However, all in-house counsel should know their limits. Regardless of company or law department size, outside counsel and other external resources will generally be needed for bet-the-company or highly specialized litigation, litigation where in-house counsel are likely to be witnesses, and procedurally complex matters with extensive e-discovery or thorny privilege or discovery issues. Certain transactional matters, particularly those with complicated tax or international law implications, will also generally require outside counsel involvement.

In the authors’ experience, established franchisors tend to have a few “go-to” firms for complicated matters and handle the rest in-house. In-house lawyer involvement in organizations such as the American Bar Association Forum on Franchising and the International Franchise Association allows these lawyers to gain exposure to talented outside lawyers and firms with
decades of experience representing franchisors and franchisees and the opportunity to network with other in-house lawyers. Law departments can rely on this exposure and referrals to learn about lawyers and law firms that might be appropriate for a particular engagement or who might be interested in responding to a request-for-proposal for legal work.

In smaller law departments, counsel often hand matters over to outside counsel completely, requiring regular updates. In larger law departments, at least in areas with specialized in-house expertise, there is sometimes a more collaborative approach, with in-house and outside counsel bouncing ideas off of each other and in-house counsel being part of the team and researching and handling some matters in coordination with outside counsel to save on external costs and fees.

In working effectively together, communication is key. There can be a significant disconnect between what in-house counsel wants and what outside counsel perceives as the client’s needs. Communication can help bridge that gap. Both inside and outside counsel should take the time up front to analyze ultimate goals, expectations, and budgetary constraints. In-house lawyers also will want to ensure that outside lawyers are familiar with and follow their clients’ reporting and communications protocols.

A classic example of a possible disconnect is the expectation for the results of legal research. Law firm associates are usually trained to find every case and consider a number of hypotheticals in formal written memos. The client, on the other hand, may want a short bullet-point email that hits all of the high points of an area of law, but perhaps does not cover every last scenario and will not want to pay for a more detailed memo. In-house counsel should not assume that the client’s needs will always be obvious to outside counsel (which is especially true in a newer client-attorney relationship) and should not be afraid to put expectations in writing to avoid misunderstandings or unpleasant conversations later. Some expectations, including expectations around electronic research charges, billing and expenses for travel, and other pass-through expenses, can be clarified in engagement letters or billing guidelines that the law firm is required to sign or acknowledge.

E. Merger & Acquisition (M&A) Involvement

Inside lawyers can play key roles in M&A transactions from running deals completely in-house to working with outside counsel who handle the transaction. In-house lawyers are heavily involved in due diligence by helping to locate documents requested by the buyer when the in-house lawyer works for the seller and in helping to identify the documents needed by the franchise company when the in-house lawyer’s company is the buyer. In-house

23. As the general counsel of a large local hospital once told one of the authors: “Don’t send me a detailed twenty-page memo I don’t have time to read.”

lawyers may also be responsible for maintenance of an electronic data room, ensuring that it is up to date to facilitate due diligence. In-house lawyers often have the institutional knowledge both to confirm the accuracy of representations, warranties, and disclosures and to confirm these representations and warranties accurately address franchise specific issues. Because of their good working relationships with their counterparts in finance, HR, and other departments, in-house lawyers often take important roles in and closing and post-closing matters. Franchise systems may be involved in similar types of M&A transactions on a reoccurring basis. These transactions are good candidates to be handled in house, reserving outside counsel for larger transactions and those with unique complex issues, such as patents, unusual purchase price calculations, and antitrust matters, including Hart Scott Rodino filings, which are required infrequently but can easily be missed and cause problems for the company.

F. Communications with Franchisees and Franchisee Associations

In representing their franchisor clients, in-house lawyers frequently communicate with franchisees and their associations. Franchisees and their associations may or may not be represented by counsel. When franchisees or their associations are represented by counsel, ethical rules prohibit both in-house and outside counsel from communicating with them regarding matters within the scope of that representation. Although no ethical prohibition exists on communicating with unrepresented franchisees or their associations, those unrepresented parties may not fully understand that the franchisor’s in-house lawyer does not represent their interest and may use admissions and other information against them. If a lawyer (inside or outside) suspects that the franchisee or association representative may misconstrue the lawyer’s involvement and loyalties, the lawyer should clarify his or her role. This is essentially the franchisee equivalent of an “Upjohn warning,” where a corporation’s lawyer advises corporate employees that they represent the corporation’s interest rather than those of any employee.


26. See, e.g., Model R. of PROF’L CONDUCT, supra note 2, r. 4.2 (Communication with Person Represented by Counsel); see also James Mulcahy & Douglas Luther, Walking the Line: When Are the Franchisor’s In-House Counsel’s Communications or Advice to a Franchisee an Ethical Violation, 37 FRANCHISE L.J., 585–86 (2018).

27. See Model R. of PROF’L CONDUCT, supra note 2, r. 4.3 (addressing dealing with unrepresented parties).

28. Mulcahy & Luther, supra note 26, at 573–74.

29. The Upjohn warning concept arose in the wake of Upjohn Co. v. United States, 449 U.S. 383 (1981), a case discussing the application of attorney-client privilege in corporate investigations. See Grace M. Giesel, Upjohn Warnings, the Attorney-Client Privilege, and Principles of Lawyer
In-house lawyers can also put themselves, and the company, at risk when communicating with franchisees and others because those communications will not likely be privileged, and the in-house lawyer may find themselves as a witness (or even a defendant) in future litigation with the franchisor.

G. Special Considerations for International Operations

Whether inside or outside counsel, lawyers have a duty of competence. It is tempting to assume that a competent lawyer on certain subjects is a competent lawyer on all subjects. However, no lawyer is competent in every area of the law. The same is, of course, true jurisdictionally, even within the United States. A lawyer cannot assume that well-established legal principles will prevail internationally or that contractual choice of law provisions will be respected. Not only can laws and their application and contract interpretation and enforceability vary dramatically by country and region, but also so can discovery rules and the application of legal privileges (particularly for in-house counsel), if any. In short, the lawyer will need to exercise reasonable judgment to “know when to hold ‘em [and] know when to fold ’em” and contact local counsel for advice and assistance.

VI. Conclusion

Practicing franchise law, whether as an in-house lawyer or with an outside law firm, presents a variety of challenges and experiences for both newly minted and seasoned lawyers. In this article, the authors, both of whom have worked both as in-house and outside lawyers—one with a litigation background and the other with a transactional background—have discussed some of the issues they believe franchise lawyers should consider when contemplating a move from the world of private law firms to an in-house position with a franchise company. The authors believe that both in-house and outside positions offer great opportunities to experience the many and varied opportunities available to franchise lawyers.

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Ethics: Achieving Harmony, 65 U. Miami L. Rev. 109, 110-12 (2010) (noting how these warnings can clarify the lawyer’s role and reduce confusion about where a lawyer’s loyalties lie).

30. See e.g., Model R. of Prof’l Conduct, supra note 2, r. 1.1.


32. See, e.g., Sara McBreachy, Obtaining Discovery in International Arbitration, Foreign Proceedings and International Arbitral Tribunals, 63 Advoc. (Texas) 46, 46 (Summer 2013) (noting that, “in most civil law jurisdictions, discovery is significantly limited in civil trials”).


Plaintiff Victoria Card (plaintiff) filed a complaint alleging various claims arising out of a business arrangement between Plaintiff and defendants the Ralph Lauren Corporation, Ralph Lauren Company West, LLC, and E.J. Victor Inc., which defendants terminated in May 2015. After considering the parties’ briefs and oral argument, the United States District Court for the Northern District of California granted Ralph Lauren Corporation’s (Ralph Lauren) motion to dismiss the Robinson-Patman Act claim, but granted plaintiff a final opportunity to amend its Robinson-Patman Act Claim.

From 2001 to 2015, plaintiff had a “contractual and partnership relationship” with Ralph Lauren to act as an approved dealer of Ralph Lauren Home products. Ralph Lauren terminated plaintiff’s account after several interactions between plaintiff and various Ralph Lauren representatives. Plaintiff asserted a Robinson-Patman Act claim against Ralph Lauren for price discrimination.

Plaintiff’s Section 2(a) Robinson-Patman Act claim was previously dismissed with leave to amend. To plausibly plead a claim for price discrimination, a plaintiff must allege: (1) two or more contemporaneous sales by the same seller; (2) at different prices; (3) of commodities of like grade and quality; (4) at least one of the sales was made in interstate commerce; (5) the discrimination had the requisite effect upon competition generally; and (6) the discrimination caused injury to the plaintiff.
Plaintiff alleged in the complaint that Ralph Lauren allowed competitors, such as One King's Lane (OKL), to sell Ralph Lauren products at a greater discount than plaintiff was permitted to sell at. Plaintiff further alleged that the price discrimination caused it injury—specifically, that long-term customers started buying from OKL instead of plaintiff because of the price. Plaintiff also alleged in its opposition brief that “[t]he 85−90% discounts granted to OKL were all for items that plaintiff and other similarly situated were selling.” Additionally, the opposition brief listed specific products that plaintiff alleges were sold to OKL at a discount that she was not offered.

The court held that plaintiff still did not allege facts plausibly suggesting that the first three counts were met. Although she identified competitors, such as OKL, that sold Ralph Lauren products at a greater discount than plaintiff alleged it was permitted to sell at, and further alleged that defendants allowed OKL to do so, plaintiff did not identify any consummated sales to these competitors of commodities of like grade and quality that defendants sold to it. Despite the several allegations made in plaintiff’s opposition brief that may have supported that the first three counts were met, these allegations did not appear in the complaint.

Because plaintiff may be able to allege facts that support a plausible inference that defendants sold products to OKL at a price lower than they sold similar products to plaintiff around the same time, the court gave plaintiff a final opportunity to amend the Robinson-Patman Act claim and dismissed with leave to amend.


Joining five other federal courts who have recently addressed the same legal issue, the United States District Court for the Eastern District of Pennsylvania denied a motion to dismiss claims that a “no-poach” provision in a franchise agreement can constitute an anticompetitive restraint of trade in violation of the Sherman Act, 15 U.S.C. §1 et seq. Although the court found that the Plaintiff Victor Fuentes (Fuentes) alleged a plausible Sherman Act claim, the court nonetheless ruled that Fuentes lacked standing to seek injunctive relief and that certain of his damage claims were barred by the Sherman Act’s four-year statute of limitations.

Fuentes is a former employee of a franchisee within the Jiffy Lube franchise system. The relevant franchise agreement contained a “no-poach” provision, which prevented a Jiffy Lube franchisee from hiring another franchisee’s employees during a set time period. Fuentes sued Royal Dutch Shell PLC (Royal Dutch), the operator of the Jiffy Lube system, for injunctive relief and damages, alleging that Royal Dutch’s no-poach provision violated the Sherman Act. Royal Dutch moved to dismiss. Noting that, in the last approximately eighteen months, six federal district courts have ruled on exactly this legal issue in the same procedural posture, and that five of those courts denied motions to dismiss, the court here ruled with the majority of
its fellow district courts. Specifically, the court held that Fuentes plausibly alleged a conspiracy that could be deemed a horizontal restraint of trade. In addition, the court declined, at the pleadings stage, to determine which mode of antitrust analysis—per se analysis, quick-look analysis, or rule of reason analysis—would apply to the case.

Despite this victory for Fuentes, the court nonetheless ruled against him in two respects. First, the court determined that Fuentes lacked standing to pursue injunctive relief. In particular, Fuentes conceded that he had not worked for Jiffy Lube for six months, did not allege that he intended to work there again, and only argued that it was possible he might return to work at a Jiffy Lube at some undefined future time. The court held that these allegations were too conjectural and hypothetical to give rise to the kind of actual and imminent threat of future injury necessary to confer standing to pursue a forward-looking injunction.

Second, the court held that the “fraudulent concealment” doctrine did not serve to toll the Sherman Act’s four-year statute of limitations for Fuentes’s class action damages claims. The court opined that Fuentes’s complaint did not allege that Royal Dutch had actively misled Fuentes about the existence of a no-poach provision, which is an essential element to asserting the fraudulent concealment doctrine. Although Fuentes pointed to certain statements on the Jiffy Lube website, the court determined that, at most, these statements implied that Jiffy Lube cares about its employees, provides a good workplace, and lets its employees “see the results” of their hard work. None of these statements, the court concluded, implied anything about the presence of a no-poach provision in Jiffy Lube’s franchise agreements, and particularly did not do so with the degree of particularity that Fed. R. Civ. P. 9(b) requires for assertions of fraud.

ARBITRATION

The United States District Court for the District of Maryland granted a hotel franchisee’s motion to vacate a judgment by confession that the franchisor had obtained and to compel arbitration with the franchisor. The court also permitted the franchisee’s attorneys to withdraw as counsel.

On September 30, 2015, Plaintiff Choice Hotels International, Inc. (Choice Hotels), entered into a franchise agreement (Agreement) with the defendants (collectively TK) for the construction, opening, and operation of a hotel in Atlanta, Georgia (Hotel). The Agreement provided Choice Hotels with a right to terminate the Agreement if, among other things, TK materially breached the Agreement and failed to cure that breach within thirty days, or if TK failed to open the Hotel in accordance with the Agreement. However, the Agreement also provided that the performance of certain acts under the Agreement would be extended for “a period equivalent to
the period of the delay” if such delay was caused by an inability to procure materials, restrictive governmental regulations, or “any other cause without the party’s fault and beyond the party’s control.” The parties also executed a promissory note (Note) by which Choice Hotels agreed to loan defendants $1,364,000 for the operation of the Hotel. The Note authorized confession of judgment against TK upon the occurrence of a default, and the Note listed several events—including termination of the Agreement—that would constitute a default on the Note. On January 14, 2016, certain Defendants agreed to guarantee TK Hospitality Group, LLC’s obligations under the Agreement and the Note.

The Agreement also provided that, with limited exceptions, “any controversy or claim” “arising out of or relating to” the Agreement or any “related agreements” was subject to arbitration before the American Arbitration Association. The guarantee similarly contained an arbitration clause.

On October 5, 2017, Choice Hotels sent a notice of default to TK, arising from TK’s failure to meet construction milestones for the Hotel. On December 6, 2017, Choice Hotels sent an additional notice, advising TK that it remained in default and indicating that the Agreement would be terminated if TK failed to open the Hotel by December 31, 2017. On January 3, 2018, Choice Hotels terminated the Agreement due to TK’s failure to meet the Hotel’s construction and opening deadlines.

On January 9, 2018, one of the defendants sent a letter to Choice Hotels requesting reconsideration of the termination, stating that the delays in construction were the fault of third-parties and asking for additional time to complete construction. Rather than granting additional time, however, Choice Hotels filed suit seeking confession of judgment based on TK’s default on the Note due to the termination of the Agreement. The court entered judgment by confession on November 9, 2018. On March 1, 2019, TK moved to vacate the judgment and compel arbitration. TK’s attorney subsequently moved for leave to withdraw as TK’s counsel.

The court granted TK’s motion, vacating the confessed judgment and ordering arbitration. The court agreed with TK that the question of whether default on the Note occurred was subject to the Agreement’s arbitration clause. The court determined that the Agreement contained clear and unmistakable evidence that the parties intended, in the Agreement, that the question of arbitrability would be decided by the arbitrator. Moreover, the court ruled that the Agreement and the Note were sufficiently related to create an issue regarding whether the parties agreed to arbitrate the question of whether TK defaulted on the Note. That issue, the court opined, was one that the parties had agreed to commit to the arbitrator. The court therefore stayed the case pending arbitration.

In addition, the court permitted TK’s attorneys to withdraw as counsel, due to TK’s “non-communication and non-payment.” For the corporate defendants, however, the court required that new counsel enter an
appearance on behalf of those defendants at such time, if any, that the court lifted its stay pending arbitration.

**CHOICE OF FORUM**


Campbell Investments, LLC (Campbell) filed suit against Dickey’s Barbecue Restaurants, Inc. (Dickey’s) in Utah state court alleging among others, violation of the Utah Business Opportunity Disclosure Act, fraudulent misrepresentation, negligent misrepresentation, and breach of fiduciary duty. The case was removed to federal court, where Dickey’s “engaged in a lengthy series of attempts to avoid having this matter to proceed in [the United States District Court for the District of Utah].” Dickey’s final motion was to transfer venue to the Eastern District of Texas, Sherman Division, pursuant to the forum selection clause in the Development Agreement between the parties. The United States District Court for the District of Utah denied the motion to transfer.

The Development Agreement at issue granted Campbell rights to develop Dickey’s restaurants in Ogden, Utah, and South Jordan, Utah. The court found that enforcement of the Development Agreement’s mandatory forum-selection clause would be unjust for the following three reasons:

1. The claims were not encompassed by the Development Agreement. The Development Agreement expressly delineated its boundaries to the development of the restaurant. The court held that Dickey’s claim arose from the operation of a restaurant rather than the development, and therefore the Development Agreement was irrelevant.
2. Dickey’s waived its right to enforce the provisions. The court held that Dickey’s failed to bring up the provision in a timely manner.
3. Enforcement of the forum-selection provision would violate Utah public policy. The court stated that enforcement would be in direct conflict with the Utah Business Opportunity Disclosure Act, which required that a seller provide any prospective purchaser with certain disclosures.

For all of these reasons, the court denied the motion to transfer.

**CHOICE OF LAW**


Denying a franchisee’s motion to dismiss based on the statute of limitations, the United States District Court for the Northern District of Alabama held that Alabama law applied, instead of Maryland law as specified in the
franchise agreement, and therefore ruled that the contractual one-year statute of limitations was unenforceable in light of an Alabama statute voiding such contractual provisions.

Defendant Laura Fabbro (Fabbro), a citizen of New Jersey, operated an urgent care facility as a franchisee of plaintiff AFC Franchising, LLC (AFC), a citizen of Alabama. Fabbro executed her original franchise agreement in 2009 (Agreement) with Doctors Express Franchising, a Maryland limited liability company. The Agreement specified Maryland law. In addition, the Agreement contained a contractual limitation that any claims arising out of or relating to the Agreement must be brought within the earlier of (a) the applicable statute of limitations, (b) one year after the date on which the party discovered, or should have discovered, the facts giving rise to the alleged claim, or (c) two years after the first act or omission giving rise to the alleged claim.

The Agreement also provided that the mark to be used as the “sole identification” in operating the franchise was “Doctors Express.” Through a series of acquisitions in 2012 and 2013, AFC ultimately assumed the rights of the original franchisor under the Agreement. In 2015, AFC decided to discontinue use of the “Doctors Express” name and mark, transitioning instead to use of the names “American Family Care” and “AFC Urgent Care” instead. Fabbro refused to use those names; he was the only remaining former “Doctors Express” franchisee nationwide that was still using the “Doctors Express” name. Fabbro continued using the “Doctors Express” name despite terms in the Agreement permitting the franchisor to order the franchisee to change its name. Fabbro even negotiated an amendment to the Agreement that required AFC to split the costs associated with any requested name change, but nonetheless repeatedly refused to use the “American Family Care” and “AFC Urgent Care” names. AFC knew as early as 2015 that Fabbro was refusing to change the name of her clinic.

In January 2017, AFC sent Fabbro a notice of default under the Agreement and gave Fabbro sixty days to cure the default. However, in July 2017, AFC withdrew the notice of default without prejudice because it believed Fabbro was negotiating to sell her urgent care clinic to another franchisee, and AFC did not want to interfere with that potential sale. When those negotiations fell through, on May 15, 2018, AFC filed suit against Fabbro in federal court in Alabama, alleging breach of the Agreement and seeking specific performance, a declaratory judgment, and reimbursement of its costs for pursuing the action.

Fabbro moved to dismiss AFC’s claims because, she argued, they clearly fell outside the contractual limitations period. She contended that AFC knew in 2015 that she was not using the “American Family Care” and “AFC Urgent Care” marks and delayed longer than one year in bringing its suit. Fabbro’s argument faced a significant problem, however: Alabama statutory law voids any agreement that provides that “the time for commencement of any action is limited to a time less than that prescribed by law for the
commencement of such action.” Ala. Code § 6-2-15. Alabama maintains a six-year statute of limitations for breach of contract claims. Id. § 6-2-34(9).

To get around this problem, Fabbro pointed to the Agreement’s Maryland choice-of-law provision, noting that Maryland law permits parties to agree, by contract, to a shorter limitations period.

The court was therefore faced with the question of which law to apply: Alabama’s or Maryland’s? That question turned on whether the issue was “procedural” (in which case Alabama would apply its own procedural law) or “substantive” (in which case Alabama would give deference to the Agreement’s choice-of-law provision specifying Maryland law). Relying on Galliber v. State Mutual Life Insurance Co., 43 So. 833 (Ala. 1907), the court held that “statutes of limitations affect the remedy, rather than the validity of the contract, and are thus procedural, rather than substantive.” The court acknowledged that an argument could be made that the Galliber court acted in error, but the court was unwilling to presume that the Alabama Supreme Court would rule differently if faced with the issue today. Feeling constrained by Galliber, the court found that the Agreement’s shorter limitations period was void, that AFC had six years within which to bring its claims, and that AFC complied with the governing statute of limitations. The court therefore denied Fabbro’s motion to dismiss on that basis.

**CONTRACT ISSUES**


The United States District Court for the Southern District of Florida granted plaintiffs’ Tim Hortons USA, Inc.’s (Tim Hortons) and Tim Donut U.S. Limited, Inc.’s (Tim Donut) motion for summary judgment as to liability on their claims for breach of the franchise agreements and subleases, trademark infringement, and defendants’ counterclaim.

Tim Hortons is engaged in the business of franchising Tim Hortons restaurants in the United States. Tim Donut is an affiliate of Tim Hortons and is the owner of real property upon which some Tim Hortons franchisees operate their restaurants.

In the spring of 2016, defendants executed franchise agreements with Tim Hortons (Franchise Agreements) to own and operate seven franchised Tim Hortons restaurants (Restaurants). They also executed leases with Tim Donut that provided for the lease or sublease of the premises upon which the Restaurants were located. Each respective Franchise Agreement granted defendants the rights to operate one Tim Hortons restaurant in a specific location and to use Tim Hortons trademarks (Marks).

In November 2017, plaintiffs sent correspondence with an attached invoice to defendants regarding an amount that Tim Hortons and Tim Donut claimed were past due. Defendants asserted that the amounts sought were inaccurate and complained that plaintiffs failed to provide appropriate
back-up data. At or around this time, during the fall of 2017, defendants indicated their intent to attempt to sell the Restaurants. Plaintiffs introduced defendants to a potential purchaser, Kava Restaurants, LLC, another franchisee in the Tim Hortons’ system.

On October 10, 2018, Tim Hortons issued a Notice of Default to defendants which stated that defendants had breached the Franchise Agreement and Subleases by failing to pay past due amounts. The Notice of Default demanded payment of a total of $523,189, including $292,747 in additional rent amounts. These additional rent amounts were charges associated with the leased premises, including property taxes, utilities, and common area maintenance. The Notices of Default advised defendants that plaintiffs would terminate the Franchise Agreements and Subleases if defendants did not cure their financial default within the time provided. Defendants did not pay any money in response to the Notice of Default and, instead, notified Tim Hortons that plaintiffs owed them nearly $82,000 in overpayments.

On November 13, 2018, plaintiffs sent Notices of Termination of the Agreements to defendants notifying them that the Subleases and Franchise Agreements terminated effective November 12, 2018, and that they must cease operation of the Restaurants by November 27, 2018. The defendants continued to operate six of the seven Restaurants.

The court started its analysis with a quick review of the summary judgment standard. Next, the court moved on to the Lanham Act Claims. Tim Hortons argued that defendants’ continued use of its Marks following the termination of the Franchise Agreement constituted trademark infringement, false designation of origin, and unfair competition. It was undisputed that plaintiffs sent Notices of Termination of the Franchise Agreements and subleases effective November 12, 2018, and that defendants continued to operate six of the seven Restaurants. Defendants did not dispute Tim Hortons had enforceable rights in the Marks or that Defendants’ use would likely confuse consumers. Thus, the only dispute was whether defendants’ continued use of the Marks was unauthorized. The court then moved to the breach of contract claims because Tim Hortons was only entitled to summary judgment on its Lanham Act Claims if it was clear that Tim Hortons was also entitled to partial summary judgment on its breach of contract claims.

Plaintiffs’ sole argument in support of summary judgment was that defendants breached the Subleases and Franchise Agreements by failing to pay outstanding additional rent amounts. The Subleases provided that defendants were obligated to pay additional rent amounts and that failure to do so within five days of the due date entitled Tim Donut to terminate the Subleases. The Subleases did not require prior notice or opportunity to cure before termination. The Franchise Agreements further provided that defendants’ failure to pay monies due to Tim Donut within three days after written notice constituted a default under the Franchise Agreements. The Franchise Agreements provided that Tim Horton’s could terminate the
Franchise Agreements immediately, without notice or prior opportunity to cure the default if the Subleases were terminated.

It was undisputed that, in November 2017, plaintiffs provided defendants written notice of amounts they claimed were past due, including additional rent amounts, which defendants did not thereafter pay. Further, defendants did not dispute that plaintiffs issued Notices of Default and subsequent Notices of Termination.

Defendants argued they did not owe additional rents for three reasons. First, defendants argued that they were not obligated to pay any additional rent amounts because of prior verbal agreement between the parties. This argument was unsuccessful because the Subleases contained an integration clause. Further, the Subleases were governed by Michigan law, and “the prevailing law in Michigan concerning integration clauses is that a contract with a merger clause nullifies all antecedent claims, including any collateral agreements that were allegedly an inducement for entering into the contract.”

Second, defendants argued that they were not obligated to pay additional rent amounts because Tim Donut did not provide sufficient documentation to confirm that defendants owed these amounts. This argument was rejected because plaintiffs submitted evidence of invoices.

Finally, defendants argued that no additional rent was due because the invoices were disputed, and they also claimed that plaintiffs previously withdrew payments from their accounts without authorization. The court rejected this argument because the defendants did not provide documentation for these assertions. Defendants were also unsuccessful in their affirmative defenses of unclean hands and prior breaches. Defendants did not identify any provision of the Franchise Agreements or Subleases that plaintiffs allegedly breached.

In sum, the court held that the undisputed facts established as a matter of law that defendants breached the Subleases and Franchise Agreements by failing to pay additional rent amounts and, therefore, plaintiffs validly terminated those agreements. The court granted partial summary judgment as to liability on the breach of contract and Lanham Act Claims, as well as entry of a permanent injunction.


The *TruAuto* case shows the danger of a prospective franchisee rushing things before signing on the dotted line with the franchisor. The United States District Court for the District of South Carolina dismissed at the pleading stage the claims brought by a prospective franchisee against a prospective franchisor, after the parties’ negotiations over a franchise sale fell through without execution of an agreement.

*TruAuto* MC, LLC and TDMC Property Holdings, LLC (Plaintiffs) were owned by Doug McElveen and Todd Smith, who expressed their interest in becoming an E-Z-Go authorized dealer of golf carts. E-Z-Go’s parent
company is Textron Specialized Vehicles (TSV). Plaintiffs were looking to buy an E-Z-Go franchise at a “Sportsman” location.

Smith texted John Creech, an E-Z-Go representative, to introduce himself. Discussions continued, and Creech advised Smith that TruAuto needed to apply for financing at Wells Fargo in order to be an approved dealer. Around December 3, 2018, Smith confirmed to Creech that the paperwork for E-Z-Go was started and requested an update on obtaining financing paperwork from Wells Fargo. Creech responded that he would process the paperwork. Around December 14, Smith informed Creech he was starting construction in two weeks.

Around February 6, 2019, Plaintiffs bought the Sportsman E-Z-Go franchise and the associated real estate and floor plan. Around February 18, 2019, TSV sent Plaintiffs a Dealer Agreement. On February 19, 2019, TSV voided the agreement. Plaintiffs continued to work with Wells Fargo on financing.

After their failure to secure an E-Z-Go franchise agreement, Plaintiffs sued TSV and White River Marine Group for breach of contract, fraud, breach of fiduciary duty, and other claims.

The court granted Defendants’ motion to dismiss all claims. First, all contract claims failed because the relationship between the parties did not rise above that of negotiations. Plaintiffs did not allege any facts describing a contract or the purported contract’s essential or material terms.

The court then dismissed Plaintiffs’ fraud and negligent misrepresentation claims. Plaintiffs alleged that Creech made assurances to Plaintiffs that they would be approved as an E-Z-Go dealership. Plaintiffs alleged they relied on said representations to purchase the real estate, personal property, floor plan, and inventory of Sportsman. Plaintiffs’ fraud-based claims against TSV failed, however, because Plaintiffs did not allege reasonable, detrimental reliance with particularity. Specifically, Plaintiffs had doubts as to whether they would become an authorized E-Z-Go dealer and that, despite these doubts, decided to buy the Sportsman location anyway.

The court next dismissed Plaintiffs’ fiduciary duty claims, as Plaintiffs cited no support for the proposition that a fiduciary relationship arises in the franchise context. The court went on to dismiss the remaining claims for negligence, promissory estoppel, and deceptive trade practices, eliminating the rest of Plaintiffs’ complaint.

**DAMAGES**


In the first opinion the U.S. District Court for the Northern District of Ohio held that a franchisee’s claims under the California Franchise Investment Law (CFIL) failed because franchisee could not show that it suffered any damages, even though the franchisor admitted that it violated CFIL by
failing to provide a correct disclosure document. In a subsequent opinion, the court entered a preliminary injunction, finding that the franchisor was likely to succeed on trade secret and noncompete claims against the franchisee and enjoined the franchisee from operating any business competitive with or similar to the franchisor’s, until the date the parties’ franchise agreement would expire in 2021.

In late March and early April 2015, Handel’s, a nationwide franchisor of ice cream parlors, submitted its proposed 2015 FDD to the California Department of Business Oversight (DBO). The DBO approved the FDD on April 13, 2015. In October 2015, Handel’s met with Kenneth Schulenburg in Ohio to discuss the possibility of purchasing Handel’s franchise in the San Diego, California, area. On October 14, 2015, Handel’s provided Schulenburg the 2015 FDD. On December 17, 2015, Schulenburg made a $5,000 payment to Handel’s as a deposit towards the franchise fee.

Meanwhile, on January 11, 2016, Handel’s submitted an application to the DBO for an amendment to its 2015 FDD, and this amendment was approved on January 11, 2016. This amendment was to allow Handel’s franchisees to qualify for Small Business Administration (SBA) financing. On this same day Schulenburg paid its remaining $45,000 of the franchise fee. On January 21, 2016, Handel’s provided Schulenburg with a copy of the 2015 FDD—not the amended 2015 FDD—and Schulenburg executed the Franchise Agreement.

On March 22, 2016, about two months after executing the 2015 FDD, Schulenburg emailed Handel’s to inquire about SBA financing. Handel informed Schulenburg that it would need to execute a new FDD. Handel’s sent Schulenburg the amended FDD, but Schulenburg never executed it. In mid-2017, Schulenburg and Handel’s had a dispute over Schulenburg’s second location when Schulenburg refused to provide Handel’s with a copy of the final lease or pay a franchise fee. The parties could not resolve their disagreements, and litigation ensued.

On March 5, 2018, Handel’s filed suit against Schulenburg, asserting claims for trademark infringement, trademark dilution, false designation of origin, unfair competition, breach of contract, misappropriation of trade secrets, fraud, fraudulent concealment, conversion, declaratory judgment, and tortious interference. Handel’s also contemporaneously sought a preliminary injunction to prevent Schulenburg from operating an ice cream parlor at 425 Market Street, San Diego, California (Cali Cream), which Handel’s claimed would be in breach of the Franchise Agreement’s covenants not to compete and would improperly use Handel’s proprietary, confidential, and trade secret information. During that time, Schulenburg opened its ice cream parlor at the disputed location. On June 22, 2018, the court granted Handel’s motion for preliminary injunction, finding that Handel’s had a strong likelihood of success on both its trade secret and non-compete claims. Schulenburg was enjoined from operating any business competitive with or similar to Handel’s, specifically including Cali Cream, until Schulenburg’s
status as a Handel’s franchisee had been resolved, but no longer than January 22, 2020. During this time, Schulenburg had also initiated litigation against Handel’s in California on January 30, 2018, for CFIL violations. After extensive motion practice, the parties filed cross motions for summary judgment with respect to Schulenburg’s CFIL claims.

Handel’s argued that summary judgment should be granted in its favor because (1) Schulenburg’s CFIL claims were barred by the statute of limitations; (2) Schulenburg failed to demonstrate how he was damaged by the specific CFIL violations at issue; and (3) Schulenburg did not demonstrate reasonable reliance on any of Handel’s’ alleged misrepresentations or omissions in the 2015 FDD. Schulenburg argued that he was entitled to summary judgment because Handel’s stipulated to, and did not dispute, any of the key facts upon which Schulenburg’s CFIL causes of action are based and because Handel’s violations were willful, which entitled Schulenburg to rescission of the Franchise Agreement under the CFIL.

The CFIL provides that any person who violates certain provisions of the CFIL “shall be liable to the franchisee or subfranchisor, who may sue for damages caused thereby, and if the violation is willful, the franchisee may also sue for rescission.” Cal. Corp. Code § 31300. The court interpreted the statutory language to mean that rescission is an additional remedy that is available only if the plaintiff first establishes that the violation damaged the plaintiff. Although Schulenburg claimed damages, such as the franchise fee, royalties, and the costs of designing and opening the franchise, Schulenburg failed to show that those damages were in any way linked to the CFIL violations. Further, the differences between the disclosure documents Schulenburg received and the correct documents related to SBA funding did not impact Schulenburg.

The court also denied Schulenburg’s motion to dissolve the preliminary injunction and granted an extension of Handel’s injunction. Schulenburg moved to dissolve the preliminary injunction previously put in place on the basis that subsequent discovery demonstrated that the injunction was improvidently granted and that the court failed to address several legal issues surrounding the enforceability of the Franchise Agreement’s non-compete provisions. Schulenburg requested that the court hold an evidentiary hearing to evaluate whether the injunction should remain in effect. Handel’s opposed Schulenburg’s motion and argued that Schulenburg had not demonstrated any changes in the facts, the law, or circumstances that would warrant dissolving the injunction.

The court denied the dissolution request, after concluding that Schulenburg failed to describe any new evidence with regard to the trade secrets or noncompete provisions or any changes in the law. The court also rejected Schulenburg’s argument that the preliminary injunction should be dissolved because Handel’s acted in bad faith by opening two locations near the Schulenburg’s store. The court found that Handel’s was not acting in bad faith because Handel’s was acting within its contractual rights and the stores were outside of the noncompete radius.
The court initially denied Handel's motion to correct the expiration date of the preliminary injunction to January 22, 2021 (rather than 2020), when the franchise agreement term was set to expire. Handel argued that the judge misunderstood the relevant dates. The court rejected that argument and reasoned that it could not be assumed that the judge misunderstood the relevant dates; rather, the court found that Handel’s request for a preliminary injunction failed to adequately address all four factors that courts consider when issuing a preliminary injunction.

Shortly thereafter, Handel’s filed its emergency renewed motion seeking to address the deficiency in its earlier motion by addressing all four of the preliminary injunction factors. In the second opinion involving the parties, the court concluded that the issuance of a new preliminary injunction was warranted. Generally, the court considers the following four factors when granting a preliminary injunction: (1) whether the movant has demonstrated a substantial likelihood of success on the merits; (2) whether the movant will suffer irreparable injury absent injunction; (3) whether a preliminary injunction would cause substantial harm to others; and (4) whether the public interest will be served by an injunction.

The court held that Handel’s was likely to succeed on the merits for its trade secret and noncompete claims. Handel claimed that its Recipe Guide, Operations Manual, and Preparation Guides were all trade secrets. The court agreed with respect to the Recipe and Preparation Guides because the information in those documents was not known outside the business, was heavily restricted with confidentiality agreements, and developed over years of the franchisor’s operating. As for the misappropriation claim, the court found sufficient evidence of actual misappropriation of trade secrets, including use of the exact or similar flavor names and preparation methods. As for the noncompete claims, the parties disputed which law applied; however, the court found that the noncompete provisions were enforceable under the law of either state. Second, there was a strong showing of irreparable harm because of market confusion and loss of fair competition and customer goodwill. Third, third the parties would not be substantially harmed by the injunction as the harm was self-inflicted. Finally, public interest was served by enforcing the injunction as public interest is always served in the enforcement of valid restrictive covenants.

**DEFINITION OF A FRANCHISE**


In denying a motion for preliminary injunction, the United States District Court for the District of Minnesota held that a distributor of burners used in manufacturing boilers was not a franchisee of the burner manufacturer under the Minnesota Franchise Act (the MFA), Minn. Stat. §§80C.01-.22, and thus could not avail itself of a lower preliminary injunction standard.
Plaintiffs Louis DeGidio, Inc., Louis DeGidio Services, Inc., James DeGidio, and Michael DeGidio (collectively, DeGidio) and Defendants Industrial Combustion, LCC and Cleaver-Brooks, Inc., or their predecessors (collectively IC) had a business relationship with one another, across three generations, lasting approximately sixty years. IC manufactured burners that are used in boilers, and DeGidio acted as IC’s distributor. In the latter stages of that relationship, DeGidio and IC were parties to an agreement, executed in 2007 (2007 Agreement). The 2007 Agreement provided, among other relevant terms discussed below, for a three-year term. After expiration of the 2007 Agreement in 2010, the parties nonetheless continued operating, until 2019, pursuant to the 2007 Agreement’s terms, and the court treated the 2007 Agreement as operative.

In May 2019, IC and DeGidio discussed sales targets for the 2020 fiscal year, and IC sent a sales target letter proposing that DeGidio aim to achieve $100,000 in sales. The parties met on August 15, 2019. During that meeting, DeGidio agreed to those target sales, but declined to increase its territory to the entire state of Minnesota. By September 3, 2019, however, DeGidio had not returned a signed sales target letter, despite IC’s repeated requests, and IC therefore gave DeGidio thirty days written notice of termination, even though the 2007 Agreement provided for sixty days written notice.

On October 10, 2019, DeGidio filed suit, seeking a declaratory judgment that the termination was improper and bringing various affirmative claims against IC. On October 11, 2019, DeGidio filed a motion for preliminary injunction on its declaratory judgment claim, seeking to enjoin IC from terminating the business relationship during the pendency of the litigation. On October 17, 2019, IC withdrew its notice of termination and issued a new sixty-day notice, effective that day. DeGidio subsequently amended its complaint to add, inter alia, claims for violations of the MFA.

The court denied DeGidio’s motion for preliminary injunction. The court held that, although the MFA relaxes the traditional preliminary injunction standard by presuming irreparable harm to a franchisee if a franchisor who failed to register with the state violated the MFA, and although DeGidio would be likely to succeed on the merits of its claims if the MFA applied, DeGidio was not a franchisee under the MFA and therefore could not avail itself of the MFA’s protections. Specifically, the court determined that DeGidio never paid IC a franchise fee, which is a necessary element to give rise to a franchise under the MFA. Although it was clear to the court that DeGidio did not pay a direct franchise fee, the court analyzed, under three different theories, whether the parties’ arrangement had given rise to an indirect franchise fee and concluded that it had not.

First, although the 2007 Agreement required DeGidio to maintain a minimum stock of burners at its place of business, Minnesota law holds that an indirect franchise fee arises in this circumstance only if a party is required to purchase an unreasonable minimum inventory. Because DeGidio did not demonstrate that IC unreasonably required DeGidio to maintain a minimum
stock, the court held that the 2007 Agreement’s minimum stock requirement did not give rise to an indirect franchise fee.

Second, the MFA provides that mandatory training fees may constitute a franchise fee, and the 2007 Agreement contained certain provisions about training. The court held, however, that DeGidio had failed to demonstrate that the training was mandatory and noted that DeGidio only attended a single training session despite the offering of multiple training sessions. The 2007 Agreement’s training provisions, therefore, also did not constitute an indirect franchise fee.

Finally, under Minnesota law, a price mark-up on goods above a bona fide wholesale price can constitute an indirect franchise fee. Here, however, the evidence established that not only did IC charge DeGidio only a bona fide wholesale price, in some instances, IC sold goods to DeGidio at the manufacturer’s cost, without any mark-up. The inflated pricing theory of an indirect franchise fee was therefore unavailing to DeGidio.

Having determined that DeGidio was not a franchisee under the MFA, the court then applied its traditional preliminary injunction factors and found DeGidio’s showing to be lacking. In particular, because IC rescinded its original thirty-day termination notice and issued a sixty-day notice, the court held that the termination appeared to be valid under the 2007 Agreement’s terms. Consequently, the court ruled that DeGidio was not likely to succeed on the merits of its breach of contract claims. The court also held that, although it was sympathetic to DeGidio’s plight in potentially losing a three-generation family business, those harms were capable of being compensated with money and, as such, DeGidio was unlikely to suffer irreparable harm absent the preliminary injunction. Because the preliminary injunction standard is a very high one and DeGidio did not meet it, the court denied DeGidio’s motion.

FRAUD


The United States District Court for the Northern District of Illinois granted a permanent injunction to franchisor BrightStar Franchising, LLC (BrightStar) and against franchisee Northern Nevada Care, representing itself pro se, after the franchisee failed to show that it had been fraudulently induced to enter into the franchise agreement on cross motions for summary judgment.

In June 2015, defendant franchisee Northern Nevada Care, Inc. and its owners entered into a franchise agreement with BrightStar to operate a BrightStar franchise providing home-health care in the Carson City, Nevada, area. Franchisee terminated the agreement and began operating a competing business in the same location. BrightStar sued for breach of contract, claiming that the new business violated multiple terms of the franchise
agreement, and moved the court for summary judgment. Notably, franchisee proceeded in this suit pro se.

Franchisee did not dispute that BrightStar proved each element of its breach of contract claim. Instead, it argued that it was fraudulently induced to enter the franchise agreement.

To prevail on this fraudulent inducement defense, the court stated that franchisee must show that (1) BrightStar made a false statement of material fact; (2) knowing it was false or in reckless disregard of its truth or falsity; (3) with intent to induce franchisee to enter into the franchise agreement; (4) franchisee reasonably believed the false statement to be true and acted in justifiable reliance on it; and (5) franchisee was damaged as a result of its reliance on the misrepresentation. JPMorgan Chase Bank, N.A. v. Asia Pulp & Paper Co., Ltd., 707 F.3d 853, 864 (7th Cir. 2013) (applying Illinois law). The court rejected all of franchisee’s arguments in support of its defense.

First, franchisee argued that BrightStar told franchisee that its Carson City-area franchise territory belonged solely to them, when in reality the territory contained several patients of a neighboring Reno franchisee. Franchisee further contended that a representative from BrightStar sent it a map showing the Reno territory in red and franchisee’s proposed Carson City territory in yellow. However, there was no indication in the record that anyone from BrightStar created the map, the map was undated, and it was submitted to the court in black and white, making it difficult to visualize franchisee’s color descriptions.

Next, franchisee argued that it was fraudulently induced to enter the agreement because BrightStar told it that the sale of the Carson City territory was predicated upon the later sale of the Reno territory. Franchisee contended that BrightStar falsely asserted that the Reno territory would be franchisee’s territory in six months and that the Carson City area was just to get them going until the entire region would be franchisee’s territory. Fatally, franchisee again failed to cite any facts or evidence to support the existence of such statements.

Franchisee also argued it was fraudulently induced to enter the agreement because BrightStar stated that it was an “expert” in the business and that it had industry-leading software to support franchisees’ medical billing and other administrative functions. According to franchisee, BrightStar knew that its software could not support the type of skilled care business that franchisee intended to operate. Again, however, franchisee failed to cite competent evidence in the record to support this argument—likely a predictable consequence of franchisee proceeding pro se.

Once the arguments for the fraudulent inducement defense were overruled, the court considered BrightStar’s request for a permanent injunction. Such a remedy would be appropriate for BrightStar if (1) it had suffered an irreparable injury; (2) legal remedies, such as monetary damages, could not adequately compensate for that injury; (3) the balance of hardships between the parties warranted an equitable remedy; and (4) a permanent injunction would not harm the public interest.
The court quickly determined that such factors heavily favored Bright-Star, as franchisee failed to present competent arguments that the equitable remedy of injunctive relief was inappropriate under the circumstances. The Court granted the relief, thus barring franchisee from conducting home-health services for eighteen months in the Carson City area and awarding BrightStar its attorneys’ fees pursuant to the franchise agreement.


This case is discussed under the topic heading “Contract Issues.”

**INJUNCTIVE RELIEF**


This case is discussed under the topic heading “Fraud.”


This case is discussed under the topic heading “Antitrust.”


This case is discussed under the topic heading “Damages.”


This case is discussed under the topic heading “Labor and Employment.”

**JURISDICTION**


In a putative class action suit brought by tax preparation employees, the United States District Court for the District of New Jersey held that franchisees of the Jackson Hewitt tax preparation franchise system were not subject to personal jurisdiction in New Jersey, even though their franchise agreements contained forum selection clauses specifying New Jersey. The court also dismissed wage and hour claims under Oklahoma law, at least as they pertained to a certain time period, finding that the relevant Oklahoma statute, which became effective November 1, 2016, did not apply retroactively to wage and hour claims arising before that date.

The plaintiffs consist of numerous individuals who served as employees of Jackson Hewitt franchisees in providing tax preparation and filing services, both in their individual capacities and on behalf of a class of others.
similarly situated. The plaintiffs alleged that, over the course of the 2013–14, 2014–15, 2015–16, and 2016–17 tax seasons, the defendants—consisting of two Jackson Hewitt corporate entities (collectively Jackson Hewitt) and various Jackson Hewitt franchisees (collectively the Franchisees)—deducted the value of certain prepaid gift cards from the revenues that plaintiffs earned during tax season, thus reducing the commission payments by which plaintiffs were compensated. The plaintiffs alleged that such activity was in breach of their employment contracts with the franchisees and various states’ wage laws. After various amendments to the pleadings, the operative complaint consisted of eleven counts, asserting claims against both Jackson Hewitt and the franchisees, and including a claim against one franchisee and Jackson Hewitt arising under Oklahoma’s wage law.

The franchisees moved to dismiss the amended complaint for lack of personal jurisdiction under Fed. R. Civ. P. 12(b)(2). In support of personal jurisdiction, the plaintiffs argued that the franchisees signed franchise agreements containing valid forum selection clauses and, therefore, consented to personal jurisdiction in New Jersey. The court disagreed. The court held that, in the forum selection clause in question, the franchisees only consented to jurisdiction and venue in New Jersey as to litigation brought by Jackson Hewitt or its “Affiliates,” which was a defined term in the governing franchise agreements. “Affiliate” was defined as “any person that, directly or indirectly, controls, is controlled by, or is under common control with, the referenced party.” The plaintiffs argued that they were “Affiliates” because, in their capacity as employees, Jackson Hewitt directly and indirectly controlled their activities. The court rejected this argument, pointing to other provisions in the franchise agreement that made a distinction between “franchisees” and “employees.” Reading the agreement in a “fair and common sense manner,” the court concluded that the plaintiffs were not Affiliates and, consequently, that the forum selection clause was not applicable as a basis for personal jurisdiction over them. Because the plaintiffs asserted no other grounds for New Jersey to exercise personal jurisdiction over the franchisees, the court dismissed the claims against the franchisees.

Jackson Hewitt also moved to dismiss one count arising under the Oklahoma Protection of Labor Act, Okla Stat. Ann. tit. 40, § 165 et seq., for failure to state a claim under Fed. R. Civ. P. 12(b)(2). One section of Oklahoma’s statute, which became effective on November 1, 2016, provided that “[a] franchisor shall not be considered the employer of a franchisee or a franchisee’s employees,” and that “[t]he employees of a franchisee shall not be considered employees of the franchisor.” Okla. Stat. Ann. tit. 59, §6005(B), (C) (Oklahoma Statute). The plaintiffs conceded that the Oklahoma Statute barred its claims for any conduct arising on or after its November 1, 2016, effective date, but did not bar claims for conduct occurring before that date. Jackson Hewitt contended, however, that the Oklahoma Statute applied retroactively to bar the claim in its entirety.
The court disagreed with Jackson Hewitt and held that the Oklahoma Statute did not apply retroactively. Interpreting Oklahoma law, the court reasoned that statutes in Oklahoma apply only prospectively unless the legislature clearly expressed a contrary intent. Jackson Hewitt argued that the context in which the Oklahoma Statute was passed—namely, in response to the National Labor Relations Board’s decisions expanding joint-employer liability to include franchisors—implied that the Oklahoma Statute was meant to apply retroactively. Additionally, Jackson Hewitt argued that the Oklahoma Statute constituted a “clarifying amendment” for which Oklahoma law permits retroactive effect. The court, however, could find not any expression from the Oklahoma legislature that the Oklahoma Statute was meant to apply retroactively and ruled that the Oklahoma Statute was “an entirely new statute addressing the employer/employee relationship as it relates to franchises,” rather than an amendment clarifying some ambiguity in an already existing statute. Consequently, the court dismissed the plaintiffs’ claims under the Oklahoma Statute as to conduct that had occurred after November 1, 2016.

LABOR AND EMPLOYMENT

The United States District Court for the Eastern District of Pennsylvania granted summary judgment in favor of a hotel franchisor, Choice Hotels International, Inc. (Choice Hotels), finding that it was not a joint employer of one of its franchisees under the Fair Labor Standards Act (FLSA).

A housekeeper employed by Rama Construction Company, Inc. (Rama) brought a class action and collective action suit against Rama and Choice Hotels, alleging that both she and other similarly situated individuals were not paid the requisite overtime wages under the FLSA. The employee worked for a Clarion hotel that was owned and operated by Rama. Under the franchise agreement between Rama and Choice Hotels, Rama was “solely responsible” for exercising control over the hotel, including its employees, and Rama was required to maintain brand standards.

Analyzing four factors outlined by the Third Circuit, the court determined that Choice Hotels was not a joint employer of the housekeepers and thus granted summary judgment in Choice Hotels’ favor. Specifically, the court considered Choice Hotels’ (1) authority to hire and fire employees; (2) authority to promulgate work rules and set conditions of employment, including compensation; (3) day-to-day supervision; and (4) control of employee records, including payroll, insurance, and taxes. The court found that all of the foregoing factors weighed in favor of Choice Hotels. Indeed, it was Rama that had the authority to hire and fire employees, developed an employee handbook, created employment policies, maintained employee records, and controlled the day-to-day operations of the hotel. Any rules,
audits, and evaluations put in place or conducted by Choice Hotels were merely implemented to maintain the hotel’s brand standards, rather than to govern the working conditions of housekeepers.

**Elsayed v. Family Fare LLC**, Bus. Franchise Guide (CCH) ¶ 16,600 (M.D.N.C. Feb. 18, 2020)

A married couple who owned a franchise brought suit against a franchisor of gas station-connected convenience stores, alleging that Family Fare, LLC (Family Fare) misclassified them as franchisees, rather than employees, in violation of the Fair Labor Standards Act (FLSA). After Family Fare terminated the franchise agreement with the plaintiffs’ franchise, the plaintiffs alleged that they were employees of Family Fare and that Family Fare failed to pay them overtime. The United States District Court for the Middle District of North Carolina agreed that the couple had adequately alleged the existence of a joint employment relationship and denied Family Fare’s motion for judgment on the pleadings.

To determine whether the plaintiffs had stated a claim to relief, the court had to determine whether the plaintiffs adequately pleaded (1) that their franchise and Family Fare were joint employers, and (2) that the plaintiffs were employees rather than independent contractors. Concluding that joint employer relationships can exist in the franchisor-franchisee context, the court held that the plaintiffs made an adequate showing of both inquiries. Specifically, Family Fare exerted control over the franchise with respect to what was sold, the price of the sale, and how to advertise. In fact, Family Fare exercised such control that the franchisee was effectively deprived of any independent managerial or decision-making capability. At one point, an employee of the franchisor told one of the plaintiffs to “learn how to obey.” The plaintiffs’ allegations, pleaded together, were sufficient to survive Family Fare’s motion for judgment on the pleadings.


A bakery products manufacturer, Flower Foods, Inc., and its affiliates (collectively, Flower Foods) asked the United States District Court for the Southern District of California to stay an action pending the California Supreme Court’s ruling on whether the “ABC Test,” a new standard to distinguish between independent contractors and employees, applies retroactively. The court granted the motion to stay.

The underlying lawsuit was brought by distributors of Flower Foods, who claim that Flower Foods intentionally misclassified them as independent contractors instead of employees, which resulted in the denial of certain rights and benefits afforded to employees. In response to Flower Foods’ request for a stay, the plaintiffs argued that they would be “severely prejudiced” because, as time passes, their memories and ability to recall facts will fade, which would result in the loss or deterioration of evidence. Further, the
plaintiffs asserted that a stay would result in prolonged harm and a delay in receiving the injunctive and monetary relief they sought to obtain. The court found the plaintiffs’ arguments unavailing. Rather, the potential of expending resources and engaging in motion practice based on the wrong standard weighed in favor of granting a stay. Further, the hardships that Flower Foods would experience in defending the lawsuit under the wrong standard outweighed the mere delay in the plaintiffs’ recovery of damages. Accordingly, the court granted Flower Foods’ motion to stay pending the California Supreme Court’s decision as to whether the “ABC Test” applies retroactively.


This case is discussed under the topic heading “Personal Jurisdiction.”


In an exhaustive opinion granting a franchisor defendant’s motion for summary judgment in its entirety, the United States District Court for the District of Connecticut held that, even if the franchise agreements at issue were construed as employment agreements, rather than independent contractor agreements, there nonetheless was insufficient evidence, as a matter of law, to establish that the franchisor had violated Connecticut’s anti-kickback statute.

Jani-King International, Inc., and its affiliates and sub-franchisors (collectively, Jani-King) operate a franchise system that provides janitorial services to commercial entities. Jani-King’s workers are classified as independent contractor franchisees. Plaintiffs Simon Mujo (Mujo) and Indrit Muharremi (Muharremi) were Jani-King franchisees, and they entered into franchise agreements with Jani-King in 2007 and 2014, respectively.

On December 5, 2016, Mujo and Muharremi filed suit against Jani-King, on behalf of themselves and a purported class of more than one hundred Jani-King franchisees (collectively, Plaintiffs). In an amended complaint, Plaintiffs alleged violations of Connecticut’s minimum wage act and that Jani-King had been unjustly enriched by conduct in violation of Connecticut’s anti-kickback statute, Conn. Gen. Stat. § 31-73(b). Following motion practice, the court dismissed the wage claims, but preserved the unjust enrichment claims. In doing so, the court held that “Plaintiffs conceivably could prove that the parties’ underlying agreement was an employment agreement that conditioned initial or continued employment on payment of a down payment or any number of other fees and is therefore void as a matter of law.” *Mujo v. Jani-King Int’l, Inc.,* 307 F. Supp. 3d 38, 51 (D. Conn. 2018). Jani-King subsequently moved for summary judgment, seeking dismissal of Plaintiffs’ claims.
The court granted Jani-King’s motion in its entirety, ruling that Plaintiffs’ unjust enrichment claims failed, as a matter of law. The court held that, for Plaintiffs to defeat summary judgment, they must show genuine issues of fact to the effect that (a) Plaintiffs were employees, and (2) the payment of franchise fees, which were the sole payments that Plaintiffs made to Jani-King, violated public or legislative policy.

As to the first issue, the court found in Plaintiffs’ favor, holding that Jani-King could not maintain, as a matter of law, that Plaintiffs were independent contractors rather than employees. The court engaged in a lengthy and detailed analysis of Connecticut law, both statutory and precedential, to hold that Connecticut’s “ABC test,” as set forth in Connecticut’s Minimum Wage Act, Conn. Gen. Stat. §31-222(a)(1)(B)(ii), was the correct standard to determine whether Plaintiffs were unlawfully classified as independent contractors, rather than as employees. The court held that, to prevail on this aspect of its summary judgment motion, Jani-King must establish the lack of a genuine dispute of fact as to all three prongs of the ABC test, but Jani-King’s evidence failed to do so as to any of the three. In particular, Plaintiffs’ evidence was sufficient to permit a reasonable factfinder to conclude that Jani-King possessed the right of control over the means and methods of Plaintiffs’ work and, indeed, that Jani-King controlled “nearly every aspect” of Plaintiffs’ cleaning business. Such control, in and of itself, was sufficient to defeat summary judgment as to the notion that Plaintiffs’ were independent contractors, rather than employees. For completeness, the court found genuine issues of fact as to the other two prongs of the ABC test as well.

However, just because Plaintiffs might be classified as employees, this did not entitle them to relief on their unjust enrichment claim. The court reasoned that, to defeat summary judgment, “Plaintiffs must do more than show that the franchise agreement is an employment agreement and then conclusorily assert that any fee or payment required by the franchise agreement is void as a matter of law.” The court ruled, however, that Plaintiffs had not identified any fees, beyond the franchise fee, that they had paid as a condition of their employment. Because franchise agreements are not per se invalid under Connecticut law, the court maintained that franchise fees have value in-and-of themselves, beyond securing the employment of those operating under them. Plaintiffs’ evidence failed to establish any payment that Plaintiffs were required to add beyond that value and, consequently, the record lacked the requisite evidence to create a disputed issue of fact as to Plaintiffs’ entitlement to unjust enrichment relief. The court therefore granted Jani-King’s motion on this basis, dismissed Plaintiffs’ claims in their entirety, and directed the clerk of court to close the case.

The latest development in the long-standing McDonald’s USA, LLC’s (McDonald’s) and National Labor Relations Board (General Counsel) saga,
in a 2-1 December 12, 2019, decision, the U.S. National Labor Relations Board (Board) vacated the ALJ’s order rejecting proposed settlements to resolve unfair labor practice complaints against McDonald’s and twenty-nine franchisees. The Board held that the administrative law judge (ALJ) misapplied the standard set forth in \textit{Independent Stave}. 287 NLRB 740 (1987). Applying that standard, the Board concluded that the settlement agreements served the policies underlying the Act as well as the Board’s long-standing policy of encouraging the amicable resolution of disputes.

As background, in December 2014, regional directors for various regions issued complaints against McDonald’s and various franchisees. The complaints alleged that, in response to the “Fight for $15,” a campaign for higher wages, McDonald’s and the franchisees were in violation of Section 8(a)(1) of the National Labor Relations Act (NLRA) by threatening employees, making false profits for benefits, interrogating them, and surveilling their protected activity. Moreover, the complaints alleged that McDonald’s of Illinois and nine franchisees violated Section 8(a)(3) and (a) by unlawfully discharging, reducing hours, or taking other punitive action in retaliation for the employees’ relation to the union.

Although the complaints did not allege that McDonald’s independently violated the Act, the complaint alleged that they “possessed and/or exercised” sufficient control over the labor relations policies of its franchisees that it was a joint employer with the franchisees and, as such, could be held jointly and severally liable for the unfair labor practices committed by its franchisees.

The complaints were consolidated, the case proceeded for several years, focused primarily on McDonald’s alleged status as a joint employer. In October 2016, the ALJ severed cases from four regions and placed them in abeyance, pending a decision from the Board in the cases from the two remaining regions. In January 2018, the ALJ granted the General Counsel’s motion to stay the hearing to discuss a global settlement of all pending NLRB charges, and to evaluate the impact of the Board’s decisions in \textit{Hy-Brand Industrial Contractors, Ltd}, 365 NLRB 156 (2017) and \textit{The Boeing Co.}, 365 NLRB 154 (2017).

In March 2018 the hearing resumed, the General Counsel and McDonald’s presented a series of informal settlement agreements resolving all of the cases. Each of the thirty proposed settlement agreements addressed the allegations of a single franchisee. The settlement agreements provided backpay, front or premium pay to three employees who were discharged, rescission of allegedly unlawful rules, expungement of discipline and discharges, and notice posting at the franchisees’ restaurants and mailing notice to former employees.

The settlement agreements did not impose joint and several liability on McDonald’s as a joint employer; however, they did impose obligations on McDonald’s to support the remedies. For example, in the event of noncompliance by a franchisee within nine months, the regional director could
reissue the relevant complaint and file a motion for default judgment either against the franchisee or against both the franchisee and McDonald’s.

On July 17, 2018, following the exchange of briefs and an oral argument, the judge issued an Order Denying Motions to Approve Settlement Agreements. In evaluating the four factors set forth in *Independent Stave*, the judge found that they did not overall favor approval of the settlement agreements.

In their briefs in support of their special appeals, the General Counsel and McDonald’s argued that the NLRB should approve the settlement agreements because they provide an immediate remedy for every substantive violation alleged in the consolidated complaints, while avoiding the cost and uncertainty of litigation. Additionally, they argued that the ALJ’s finding that the settlement agreements were “unreasonable” because they do not approximate the remedial effect of a finding of joint-employer status, the judge applied the “full remedy” standard that the NLRB previously rejected in UPMC, 365 NLRB No. 153, slip op. at 4 (2017). Further, General Counsel and McDonald’s also argued that the form and provisions of the settlement agreements comport with NLRB policy governing informal settlements.

The Board started its analysis reviewing the ALJ’s decision on the *Independent Stave* factors. Under *Independent Stave*, the following factors go into reviewing whether a settlement would effectuate the purposes of the Act:

1. Whether the charging part(ies), respondent(s) have agreed to be bound, and the position taken by the General Counsel regarding the settlement;
2. Whether the settlement is reasonable in light of the nature of the violations alleged, the risks inherent in litigation, and the stage of the litigation;
3. Whether there has been any fraud, coercion, duress by any of the parties in reaching the settlement; and
4. Whether the respondent has engaged in a history of violations of the Act or has breached previous settlement agreements.

For factor one, the Board found that the ALJ correctly found that the first factor was satisfied (the parties’ mixed support for the settlement agreements) and was inclusive in view of the General Counsel’s and McDonald’s support for the settlement agreements versus the charging parties’ strong opposition. Next, the ALJ correctly found that the third factor (the lack of fraud, coercion, or duress) and the fourth factor (history of recidivism by McDonald’s and the franchisees) weighed in favor of approval of the settlement agreements. The Board also found no evidence that fraud, coercion, or duress was involved in the negotiations of the settlement agreements or that the employers had a proclivity to violate the Act.

The Board disagreed with the ALJ’s finding that the second *Independent Stave* factor (the reasonableness of the settlement agreements in light of the nature of the violations alleged, risks of litigation, and the stage of the litigation) “strongly militates” against approval of the settlement agreements.
In evaluating the second factor, the Board reasoned that the most important consideration was that the settlement agreements would provide an immediate remedy for all 181 violations alleged in the consolidated complaints.

Ultimately, the Board vacated the ALJ’s order and remanded the case to the judge with instructions to approve the settlement agreements. The majority applied the “reasonableness” factors set forth in Independent Stave to find, contrary to the ALJ, that the settlement agreements were reasonable and provided a full remedy to all affected employees. Further, accepting the settlement agreements served the policies underlying the Act as well as the NLRB’s long-standing policy of encouraging the amicable resolution of disputes.

Plaintiffs unsuccessfully challenged California’s ability to enforce a recently enacted law related to the codification of the ABC test for worker classification because the court determined the statute was rationally related to a legitimate state interest and did not target gig economy companies or violate the Equal Protection Clause.

The district court denied a preliminary injunction sought by plaintiffs Postmates, Inc. and Uber Technologies, Inc. to prevent the state of California from enforcing against them a recently enacted state law regarding classification of employees and independent contractors. Specifically, California Assembly Bill 2 2019 (AB 5), codified the California Supreme Court’s ABC test for worker classification. Plaintiffs filed suit claiming the statute was unconstitutional and that their digital/gig economy workers should remain classified as independent contractors, rather than being classified as employees. In denying the plaintiffs’ request for preliminary injunction, the court found that the statute was rationally related to a legitimate state interest and did not target gig economy companies or violate the Equal Protection Clause. The court also found that enforcing the statute would neither prevent workers from pursuing their chosen profession nor unconstitutionally impair the plaintiffs’ right to contract. Thus, the plaintiffs failed to demonstrate a likelihood of success on the merits or a serious question regarding their claims. Additionally, the court found that individual drivers who expressed a desire to remain independent contractors showed a possibility, but not a likelihood, of irreparable harm. Finally, the court determined that the balance of equities and public interest weighed against injunctive relief.

The U.S. District Court for the Central District of California granted franchisor’s motion for summary judgment on franchisee’s employee’s joint employer claims considering plaintiffs lacked records of hours worked and their failure to put franchisor on notice of alleged improper classification.
Four 7-Eleven franchise owners (Plaintiffs) brought suit alleging, among other claims, that 7-Eleven improperly classified them as independent contractors and owed them unpaid overtime due under the Fair Labor Standards Act (FLSA) and the California Wage Order.

7-Eleven moved for summary judgment on the grounds that Plaintiffs provided no evidence that they worked overtime hours or that 7-Eleven had constructive notice that Plaintiffs worked overtime hours. Plaintiffs contended that 7-Eleven had constructive notice because the company has 24/7 access to the cameras surveilling its franchisees’ stores.

The court granted 7-Eleven’s motion for summary judgment, holding that the Plaintiffs failed to establish the elements of their overtime claims under federal or state law. The court found that Plaintiffs’ testimony, coupled with their lack of records of hours spent in the store and their failure to notify 7-Eleven of their overtime, was insufficient to establish the elements of their overtime claims. The court further held that Plaintiffs bear the initial burden of proving that they performed work for which they were not properly compensated. In response to Plaintiffs’ contentions that 7-Eleven had constructive notice through the access to Plaintiffs’ cameras, the court stated that 7-Eleven was not required to go to such extreme lengths to surveil the hours worked by each of its franchisees.

NON-COMPETE AGREEMENTS


This case is discussed under the topic heading “Fraud.”


The U.S. District Court for the Eastern District of Michigan granted Plaintiff’s JTH Tax, Inc. d/b/a Liberty Tax Service (Liberty), motion for temporary restraining order and preliminary injunctive relief. Liberty requested a temporary restraining order and preliminary injunction enforcing the post-termination obligations contained in its Franchise Agreements with former franchisee defendant Reliable Income Tax, LLC (Reliable).

On December 13, 2013, Reliable, an LLC owned by the Magnottes and Lubove Cunningham, entered its first Franchise Agreement with Liberty. The Magnottes and Ms. Cunningham agreed, on behalf of Reliable, to follow Liberty’s instructions and pay royalties in exchange for the exclusive right to use Liberty’s trademarks, confidential information, software, and other proprietary information within the territory designated MI304—a portion of Warren, Michigan. On December 7, 2016, the Magnottes and Ms. Cunningham signed two more Franchise Agreements on behalf of Reliable, for territories MI061, also in Warren, and MI112, in Clinton Township.
Each of the Franchise Agreements had the following relevant terms: “(3) a two-year post-termination covenant not to compete within a 25-mile radius around the territory; (4) a two-year post-termination covenant not to solicit any person or entity served by the Liberty franchise within a 25-mile radius around the territory for the purpose of offering tax services; and (5) post-termination obligations that include (a) selling back to Liberty equipment, signs, trade fixtures, and furnishings used in the franchise, (b) ceasing to identify or holding out as a Liberty franchisee or former franchisee or using Liberty Marks in any way. . .”

On October 4, 2017 and January 9, 2018, Liberty sent two Notices to Cure Default to Reliable, the first based on its failure to “pass IRS EFIN suitability,” and the second based on a past-due balance of $218,027.84. On January 16, 2018, Liberty terminated all three Franchise Agreements. The letter notifying Reliable of the termination also reminded the franchisee of post-termination obligations.

Despite the post-termination obligations, including the covenants not to compete or solicit, in January of 2019 Ms. Magnotte launched a Facebook page for “Phoenix Tax.” On the page, Phoenix Tax identified itself as a “Tax Preparation Service” and listed its principal place of business as 26815 Kaiser, Roseville, MI, which is the registered office address of Reliable. It is also within twenty-five miles of all three subject-territories of the Franchise Agreements. After the launch of the Facebook page, the Magnottes, under the name Phoenix Tax, sent letters to former Liberty customers saying, “We’ve done your taxes in the past and we would really love to do you [sic] taxes this year.” The letters also contained information on how to find Phoenix Tax on Facebook.

The court started its analysis with the framework for granting a preliminary injunction. When considering a motion for injunctive relief, the Court must balance the following factors: (1) whether the movant has a strong likelihood of success on the merits; (2) whether the movant would suffer irreparable injury absent preliminary injunctive relief; (3) whether granting the preliminary injunctive relief would cause substantial harm to others; and (4) whether the public interest would be served by granting the preliminary injunctive relief.

The court held that Liberty met its burden as all four factors lean in its favor. Here, the parties selected Virginia law, and the elements of breach of contract are (1) a legally enforceable obligation; (2) defendant’s violation of the obligation; and (3) damage to the plaintiff as a result of the violation. *Filak v. George*, 594 S.E.2d 610, 614 (Va. 2004). The Magnottes signed three valid contracts with Liberty and agreed to jointly and severally perform all the obligations in the agreement. Under these contracts, they had obligations to (a) return customer lists and files, the operations manual, and other confidential information; (b) stop holding themselves out as Liberty franchisees; and (c) avoid competing with Liberty or soliciting Liberty customers for two years after the termination of their Franchise Agreement.
The Magnottes did not perform these obligations, thus, violating the legally enforceable requirements of the Franchise Agreements. Their violations caused damages to Liberty of lost customer goodwill, lost profits, loss of competitive advantage, and more.

The second factor in the preliminary injunction analysis also favored Liberty. The court held that the Magnottes’ failure to fulfill their post-termination obligations and their violation of the noncompete and nonsolicitation clauses caused ongoing competitive injury to Liberty. The competitive injury, especially the loss of customer goodwill, is irreparable because losses of that nature are difficult to quantify and therefore not fully compensable with money damages. The court further reasoned that Liberty’s injury was also likely to worsen in the absence of immediate injunctive relief because the two-year terms of Liberty’s non-compete and non-solicitation clauses were set to expire and it would be a fundamental injustice to allow the Magnottes to retain Liberty’s confidential information, including customer lists and contact information, in order to use that information to compete with Liberty.

The final two factors—the harm to others and the public interest—were considered together, and the court found that both favored granting a preliminary injunction. An injunction would force the Magnottes to cede an improperly gained competitive advantage and require them to honor their freely entered contractual commitments which is not a significant hardship. Further, the court held that enforcing these contractual commitments vindicates the public interest.

Thus, the court granted in part, Liberty’s motion for temporary restraining order and preliminary injunctive relief. The Magnottes were ordered to transfer phone numbers, return all confidential materials, and were enjoined from using any confidential information obtained from the franchisor in any future tax preparation business that they might operate.

The U.S. District Court for the Northern District of Ohio granted plaintiff’s motion for summary judgment. Plaintiff, Matco Tools Corporation (Matco), markets and sells professional tools, tool boxes, service equipment, and related goods and services.

In connection with the marketing of its products and services, Matco has developed a distinctive business system (Business System). Applying these mechanisms, Matco sells its products through approximately 1,711 independent Matco Distributors throughout the United States. These registered distributors operate principally from mobile store trucks, purchasing products from Matco and reselling them to customers in a specific geographic area. Each distributor is required to enter into an agreement that governs the distribution of Matco products.
Before selling Matco’s products, its authorized distributors participate in a two-week training course, where distributors learn to utilize the benefits of the Business System. They also receive field training on Matco’s Business System. Additionally, distributors also receive a “List of Calls and Potential Customers” (List of Calls), which is “developed by Matco based on surveys of specific areas with a concentration of professional mechanics, technicians, and other service professionals who need quality tools to perform their jobs and agreed to have a Matco® Distributor come to their shop/business.” This list is updated regularly by Matco employees and is maintained in such a way that a distributor may call on customers from the list in the most efficient manner to “minimize driving time and maximize sales.” Matco undertakes measures to protect the confidentiality of its customer information. The Business System application is password protected, with a default password assigned upon installation that can be changed by each individual Matco distributor to their own selected password.

Defendant, Urquhart, entered into his Matco Distributorship Agreement on July 8, 2014. Prior to becoming a Matco distributor, Urquhart had no experience in sales or in running his own business. The Distributorship Agreement contained post-termination restrictions. Under Section 11.9.3 of the Distributorship Agreement, Urquhart agreed that he would not, for a year following the termination of his distributorship:

sell or attempt to sell any [Matco products] or any products the same as or similar to the [Matco products] to (i) any Customer who purchased one or more [Matco products] from Distributor during the twelve (12) month period immediately preceding the [termination of the distributorship], or (ii) any [potential Matco customer], located on, or identified in, the Distributor's List of Calls, as such list may have been amended as provided for in this Agreement and in accordance with Matco's policies, if Distributor had visited or made one or more sales calls to such [potential Matco customer], List of Calls, or person or business identified on the List of Calls [during that time period].

Immediately following termination of the distributorship, Urquhart was also required to, among other things, provide Matco with customer lists and other information relating to the distributorship’s customers; and return to Matco all operating manuals, software, catalogs, brochures, pamphlets, and other marketing materials and destroy all electronic versions of such information and provide verification of such destruction to Matco.

In March 2019, Urquhart stopped buying tools from Matco. On or about March 25, 2019, Matco District Manager Timothy Grunst learned from Urquhart that he was considering abandoning his Matco Distributorship to sell competing products. Grunst also obtained a copy of a receipt, dated March 19, 2019, that was issued by Urquhart to one of Matco’s customers that identified his business as “Cary Urquhart GearWrench.” Given Urquhart’s purported abandonment of his Matco Distributorship, Matco sent Urquhart a notice of immediate termination on April 29, 2019, as permitted by the Distributorship Agreement. Urquhart returned to Matco a signed “separation agreement” on April 30, 2019, but continued to sell non-Matco

tools to customers on his Matco List of Calls after his Matco Distributorship ended. Notwithstanding the termination of the distributorship, Urquhart continued to use Matco’s Marks in the operation of his competing Gear-Wrench business. In deposition testimony, Urquhart conceded that, for two days after the distributorship’s termination, he continued to display the Matco name and registered mark on his mobile store truck while selling competitive products to the customers on his List of Calls.

On May 6, 2019, Matco filed suit in federal court. In its verified complaint, Matco raised two claims of breach of contract: Count I addressed Urquhart’s alleged violation of the post-termination non-solicitation clause, and Count II addressed Urquhart’s alleged violation of his post-termination obligations relating to the return of Matco property. On July 8, 2019, following a hearing on Matco’s request for preliminary injunctive relief, the parties entered into a final stipulation regarding the customers and potential customers that Urquhart could and could not solicit and the customer information Urquhart could retain on his laptop. Thus, Count II was rendered moot.

The court’s analysis of Count I started with the standard for enforceability of a non-solicitation/non-compete clause. A covenant against competition is enforceable if it seeks to protect a legitimate business interest and is reasonable. Economou v. Physicians Weight Loss Ctrs. of Am., 756 F. Supp. 1024, 1031 (N.D. Ohio 1991). “Under Ohio law, a non-compete covenant is reasonable if it (1) is no greater than is required for the protection of the employer; (2) does not impose undue hardship on the employee[s]; and (3) is not injurious to the public.” Handel’s Enters., Inc. v. Schulenburg, 765 F. App’x 117, 123 (6th Cir. 2019).

The court held that Matco had a legitimate business interest in protecting its goodwill and preventing franchisees from using its business system and customer list to engage in unfair competition. The one-year duration and the scope of the restrictive covenant were reasonable, as they were based on protecting existing customer relationships while allowing the franchisee to pursue other customers. Urquhart clearly breached the agreement by soliciting Matco customers from the call list, and as a result of the breach Matco suffered lost profits. Thus, Matco was entitled to judgement as a matter of law on Count I.

STATUTE OF LIMITATIONS

This case is discussed under the topic heading “Choice of Law.”

This case is discussed under the topic heading “Antitrust.”
This case is discussed under the topic heading “Unfair Competition/Unfair and Deceptive Practices.”

**TERMINATION AND NONRENEWAL**


This case is discussed under the topic heading “Definition of Franchise.”


The Board of the Texas Department of Motor Vehicles (Board) found that Nissan North America, Inc. (Nissan) failed to establish good cause for terminating its dealership agreement with Bates Nissan (Bates), Nissan's only franchised dealer in the greater area of Killeen, Texas, due to alleged poor sales performance and purported violations of accepted accounting practices. After the district court in Travis County affirmed the Board’s order, Nissan appealed. In a lengthy, fact-specific opinion, the Court of Appeals of Texas affirmed, finding that Nissan wrongfully terminated Bates’s dealership.

Bates had been a franchised dealer for Nissan, or its predecessor, for more than forty years. In the timeframe relevant to this dispute, Nissan and Bates operated pursuant to a 1989 dealer sales and service agreement (Agreement). In July 2010, Nissan issued a notice of default due to Bates’s alleged failure to meet sales obligations under the Agreement. Nissan worked with Bates over the next three years, but Bates’s sales performance did not improve to Nissan’s satisfaction. On December 23, 2013, Nissan issued a notice of termination based on Bates’s poor sales performance. A year later, Nissan issued a supplemental notice of termination, alleging that Bates had willfully falsified tax returns and knowingly submitted false financial statements to Nissan. Bates filed protests with the Board. Analyzing the seven pertinent factors outlined in the Texas Occupations Code, Tex. Occ. Code Ann. § 2301.455(a)(1)–(7), the Board ruled that Nissan's termination of Bates was not supported by good cause and therefore was improper.

Nissan appealed, challenging the Board’s application of the sixth factor, namely that “the parties’ compliance with the franchise, except to the extent that the franchise conflicts with this chapter.” Tex. Occ. Code Ann. § 2301.455(a)(6). Specifically, Nissan asserted that it was error, as a matter of law, for the Board to conclude (1) that Bates’s sales performance did not breach the Agreement, (2) that Bates’s accounting practices did not breach the Agreement, and (3) that Bates’s sales performance after Nissan issued its notices of termination should be taken into account. The appeals court, however, rejected Nissan’s contentions and affirmed the Board.
First, the court determined that Nissan’s use of the “Regional Sales Effectiveness” (RSE) metric as its sole criterion for sales performance was unreasonable. Finding that this matter was an issue of fact, rather than law, the court applied the deferential substantial evidence standard of review to the Board’s evaluation of Nissan’s reasonableness in relying entirely on RSE. Reviewing the underlying Board decision, the court found that substantial evidence supported the Board’s finding that Nissan’s reliance solely on RSE as a measure of Bates’s performance under the Agreement was unreasonable and affirmed the Board in that regard.

Second, the court held that the Board did not err in finding that Bates did not willfully fail to comply with tax laws and regulations. In particular, the Board applied Texas law’s standard that willfulness requires “evil intent,” and found, as a factual matter, that Bates’s conduct did not rise to that level. Although Nissan argued that the Agreement’s California choice-of-law provision should govern and that California law has a lower willfulness standard, the Board and the court disagreed and maintained that the application of Texas law was appropriate. Similarly, the Board and the court found that Bates’s accounting practices did not amount to making false financial statements to Nissan, and, therefore, this assertion of error was not sustained.

Third, the court held that the Board did not err by considering Bates’s conduct under the Agreement after receiving Nissan’s notice of termination. Because the Texas statute required the Board to “consider all existing circumstances” without limitation, Tex. Occ. Code Ann. § 2301.455(a), the court held that the Board did not err by considering Bates’s post-notice conduct. This ruling, according to the court, comported with both existing case law and administrative law procedure in Texas.

Having found no error in the Board’s ultimate determination, the court affirmed the Board’s ruling that Nissan’s termination of Bates’s dealership was not supported by good cause under Texas law.

UNFAIR COMPETITION/UNFAIR AND DECEPTIVE PRACTICES

The Hashmi case outlines Illinois state law related to the possibility of a franchisee being a “consumer” for the purposes of consumer protection laws, while also serving as a warning to franchisees who do not pay close attention to the statute of limitations. The court held that the franchisee was not a consumer.

Rehan Hashmi was a career operator of 7-Eleven franchises. In February 2010, Hashmi entered into an agreement with 7-Eleven to operate a store in Yorkville, Illinois. Eventually, Hashmi started to voice criticisms that 7-Eleven had escalated control over the day-to-day operation of franchise stores and maximized its corporate profit level in a way that would squeeze store-level profit.
7-Eleven announced that it would not renew the lease on his Yorkshire store. Under the Illinois Franchise Disclosure Act, a franchisor must have good cause to terminate a franchisee’s lease. Hashmi argued it was obvious that 7-Eleven declined to renew the lease in retaliation for his criticism, violating the Franchise Act in the process.

When 7-Eleven informed Hashmi about the non-renewal, it gave him about a year to transfer to another store. Every time Hashmi picked a store he was interested in, however, 7-Eleven refused to authorize the transfer. By that time, however, the relevant statute of limitations for the Franchise Act had expired. Hashmi then filed suit accusing 7-Eleven of unfair business practices under the Illinois Consumer Fraud and Deceptive Business Practices Act (ICFA).

7-Eleven moved to dismiss the ICFA claims, and the court granted the motion. The court, evaluating Illinois law, concluded that the ICFA only governs consumer transactions or those having a consumer nexus. Here, the leases, licenses, and services that Hashmi purchased from 7-Eleven were prerequisites for his business, not obtained for purposes of use or consumption. A franchise purchase is a business purchase, and such a purchase did not make Hashmi a consumer within the purposes of the ICFA.
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