STATEMENT OF IDENTIFICATION

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From the Editor-in-Chief

Daniel J. Oates

Fresh off the success of the forum’s crown-jewel event, the annual forum on franchising in Denver, I find myself both exhausted and elated at the state of our organization. As an initial matter, as senior appointed leadership to the governing committee, part of my job at the forum is to evaluate every aspect of every event, presentation, or meeting, looking for ways to improve the product for the membership, like Santa Claus pronouncing via summary edict who is naughty and who is nice. While the event hit a handful of inevitable snags, the forum was largely a smashing success.

If I am being perfectly honest with myself, however, there is at least one area where I feel our organization and our members can continue to improve: mentorship of junior members. As has been a consistent theme in my columns, it is no secret that our membership is aging and that the average age is steadily rising. To secure our future as an organization, as well as our legacy as responsible stewards, we must devote the time and resources needed to train and nurture the next generation of franchise lawyers.

1. Or my preferred iteration/companion of Kris Kringle: Krampus, the eastern European horned half-goat, half-demon who punishes children that have misbehaved by stuffing them into a sack and taking them away to be tortured and eaten. Hats off to the Austrian parent that got tired of threatening a lump of coal for bad behavior and instead decided to turn up the knob up to 11 with the threat of a demonic serial killer kidnapping you in the middle of the night. One can only imagine the maddening and unceasingly sassy behavior that prompted that threat.
2. You know who you are. Welcome fellow malefactor!
3. I strongly suspect that no one who has made it a custom to read this column falls into this category.
4. It is worth noting that there are simply too many people that deserve praise for making this event a success. In particular, the co-chairs Bethany Appleby and K Whitner deserve kudos for working themselves to the bone to put on the event. And the same holds true for Heather Carson-Perkins, Trishanda Treadwell, and Jason Adler for writing an entire book and putting on a hilariously entertaining program for Annual Developments.

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Now, I’m probably the last person on the planet that should be opining about teaching the next generation of lawyers what it means to be professional, courteous, and excellent. I confess that when the concept of professional mentorship first wormed its way into my consciousness, I was stuck with the mental image of Mr. Miyagi. At the time, in my mind at least, mentorship as a concept was limited to children and Joseph Campbell’s mythical hero’s journey.\(^5\) It was never intended to be a practical, everyday item on my to-do list, much less a veritable necessity for the practice of law. And yet that is precisely what it is; a terrible burden and a privilege.

A lawyer is only as good as his or her team. And to those solo practitioners out there, this is not intended as a slight against you. By “team,” I refer not only to those that practice law with us, although (at least for me) they form the backbone of this contingent;\(^6\) I also refer to the collection of individuals that make up our support community. This includes junior attorneys that look up to us for guidance, mentorship, and training in the practice of law, and in the course of community involvement and organizational activities like the Forum on Franchising.

So what have you done to foster the development of your junior colleagues? I, for one, acknowledge that keeping junior attorneys in mind is a constant struggle that requires patience, commitment, and hard work. As the editor-in-chief of the *Journal*, I can offer some helpful (and not at all self-serving) suggestions on things you can do to support your junior colleagues. First, as you may have heard, the Forum specifically rewards junior attorneys that produce excellent work product with its annual Edward Wood Dunham Rising Scholar Award. Candidly, submissions are often sparing. It is one of my everlasting regrets that I never submitted something to the *Journal* myself, in part because I never knew about the opportunity. This is a problem that you can fix; spread the word and encourage your colleagues to write. Anyone less than seven years out of law school is eligible, and submissions are due by July 15, 2020. Get them drafting; glory awaits.

Second, encourage your junior colleagues to attend the Forum in Phoenix. There are steep discounts for first-time attendees and junior attendees at the Forum, and it presents an excellent opportunity to get them acquainted with our collegiality and depth of experience. There is no other venue that provides the depth of understanding of franchise law, and therefore no greater

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5. You know, where the mentor almost invariably dies for the literary purpose of teaching the budding hero a lesson that gives them the final push needed to self-actualize and accept their role as hero? See *Joseph Campbell & Bill Moyers, The Power of Myth* (1988). Examples abound. See, e.g., Obi-Wan Kenobi, Qui-Gon Jinn, Han Solo (Star Wars is full of these), Marvel, Uncle Ben, Dr. Abraham Erskine, Yinsin (Marvel is also full of these), Kyle Reese, Odin, Grandma Tala, Jor-El, Chuibs Peterson, Captain John H. Miller, Mufasa, Albus Dumbledore, etc. Except, of course, the example that I actually used: Mr. Miyagi—he’s too cool to die. Also, sorry if anyone lives under a rock and hasn’t seen any of those deaths yet—spoiler alert, I guess?

6. For me, that is the associates that work with me. We form an indivisible team; stronger together than we could ever be apart. Like Batman and Robin, Abbot and Costello, Siegfried and Roy, Amos and Andy, Bonnie and Clyde, NSYNC, James and the giant peach. You get the picture. Wait, not NSYNC; that was all Timberlake.
From the Editor-in-Chief

opportunity to learn about the benefits afforded by franchising, and the need for fresh talent in our niche area of practice. Also, they get to come to beautiful Phoenix,\(^7\) land of exploding birds\(^8\) that are reborn out of the ashes of their fiery demise.

Finally, you need to make a conscious effort to prioritize mentorship in your daily routine. It isn’t an easy task. For years, each summer, I have taped a piece of paper above my computer monitor at work that reads “What about the summers?” This is a physical reminder to me to always consider our most recent class of summer associates when thinking about my daily activities. Sometimes that is what it takes to keep the concept of mentorship at the cusp of your prefrontal cortex. That or an incessant mentee that craves guidance like Cookie Monster\(^9\) craves delicious baked goods.\(^10\) But those are admittedly rare. In most cases, the burden rests with the experienced professionals to guide their junior colleagues, a task that requires a level of mindfulness that can be difficult to maintain when we are constantly worried about things like billable hours, client satisfaction, and business development, not to mention the demands of our personal lives.

We will not succeed in our goal of preserving the Forum for future generations without thoughtful planning and concerted effort. But if we do our job well, we hope that the next generation of franchise lawyers will surpass us. That should be our goal: for our successors to exceed us and improve beyond anything we even thought possible. Indeed, “We are what they grow beyond. That is the burden of all masters.”\(^11\)

\(^7\) The city is only a short drive from a variety of world wonders: the Grand Canyon, a rebuilt London Bridge shipped over from Great Britain, Giganticus Headicus, huge saguaro cactus groves, etc. Also tacos.

\(^8\) This also works as a great reference to Hall of Fame pitcher Randy Johnson, who once famously detonated a bird on live television with a 100-mph fastball. Where? Phoenix, Arizona, of course; home of his then-present squad, the Arizona Diamondbacks. The video will haunt your dreams.

\(^9\) Yep, that’s actually a registered trademark.

\(^10\) I recognize that some of you undoubtedly fall into the mentee category. You should not only seek guidance from those with more experience, you should demand it (within reason). With apologies to any astrophysicists in the audience, there is no more powerful force in the universe than professional inertia. So, in many cases, it may require prompting to get your senior colleagues to provide mentorship.

Franchise Law Jury Instructions

David Gurnick

I. Introduction

There currently is no widely available set of published jury instructions specifically for franchise law cases.1 The author hopes these instructions may have both practical value in cases and academic value in the field of franchise law. The hoped-for practical value is as a form that litigators and courts may use as a starting point for tailoring more specific instructions in jury trials. They may also be useful in evaluating a potential claim, preparing a case for trial, and assessing merits of a case with a client. The hoped-for academic value is as a reference for scholars and practitioners to aid in understanding rules that courts and juries apply in franchise law cases.

These instructions are for many of the most common franchise law claims and defenses. Each instruction is accompanied by an explanatory note. Each instruction includes citations to statutory and decisional authorities from various jurisdictions.

The instructions are generalized with the idea that they are widely applicable and convenient to edit to incorporate more specific definitional elements, differences, and nuances of a particular state’s law. In using these instructions, it is imperative to review and compare them to the specific statutory, regulatory, and case law definitions that apply in the particular state(s) whose laws are at issue. The instructions will need editing for each particular case. They are intended as a starting point to advance the practitioner’s work in this regard.

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1. Only Arkansas and Michigan have published jury instructions that concern franchising. See Ark. Model Jury Instr. (published by Arkansas Supreme Court Committee on Jury Instructions), Civil AMI §§ 2800–2807 (Claim for Damages Based on Termination, Cancellation, or Failure to Renew Franchise); Mich. Model Civ. Jury Instr. (published by Michigan Supreme Court Committee on Model Civil Jury Instructions), ch. II2 (Franchise Investment Law). One treatise includes a chapter with civil jury instructions having applicability to franchise cases, such as for breach of the covenant of good faith, antitrust, misrepresentation, wrongful termination, and the like, and includes some franchise-specific instructions, such as the definition of a franchise. 12 Bus. & Com. Litig. Fed. Cts. (4th ed.) (ch. 129).

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Franchising encompasses a broad range of business activities. These instructions concern the laws of about thirteen states that require presale registration to lawfully offer and sell a franchise, or presale disclosure of material information in a Franchise Disclosure Document (FDD). In those states that require it, the FDD typically must meet requirements stated in the Federal Trade Commission Franchise Rule as well as requirements of state laws. The state laws typically track the FTC Rule in their disclosure requirements. These instructions also address laws in about twenty-four states and territories that restrict franchisors from terminating or not renewing a franchise without having good cause to do so, commonly known as Franchise relationship laws.

Other areas, wherein these instructions may have some use, or be adapted for use, include cases involving franchises in specific industries, such as sales of motor vehicles, petroleum products, beer and wine, and farm and construction equipment, laws concerning so-called “Business Opportunities” or “Seller


4. 16 C.F.R. § 436.1 et seq.


Assisted Marketing Plans,8 and laws providing protections generally to sales representatives, wholesalers, and distributors of products and services.9  

Many issues arise in cases involving franchise companies, for which this article does not present instructions. Franchisors and franchisees may allege, and juries may decide, claims of breach of contract (breach of the franchise agreement), breach of the covenant of good faith and fair dealing, a wide range of other business claims (common-law misrepresentation, trademark infringement, interference with contract, as examples) and defenses, for example, waiver, estoppel, and sufficiency of the plaintiff’s efforts to mitigate damages. None of these kinds of instructions is provided in this article. The instructions provided here are limited to instructions that arise almost exclusively in franchise law cases.

II. The Challenge of Statutory Circularity in Franchise Law Jury Instructions

A particular challenge for practitioners preparing jury instructions in franchising cases comes from the circularity of many of the definitions contained in the various applicable statutes. A circular definition uses the term being defined as a part of the definition10 or assumes a prior understanding of the term being defined.11 Typically, such definitions define a franchise and elements of a franchise by using the term “franchise.”

The statutes repeatedly use the words “franchise,” “franchisor,” and “franchisee” in the definitions of “franchise” and other terms that use the word “franchise,” such as “franchise fee.” For example, California’s definition of a “franchise,” includes as one element an agreement in which a “franchisee” has a right to operate under a marketing plan prescribed in substantial part by a “franchisor.”12 A “franchisee” is a person to whom a “franchise”
A “franchisor” is a person who grants a “franchise.” Another element in the definition of a “franchise” is the requirement that the “franchisee” pay a “franchise fee.” A “franchise fee” is defined as a fee or charge that a “franchisee” pays for the right to enter into a business under a “franchise agreement.” The same circular style infects definitions under many state franchise registration and disclosure laws and franchise relations acts.

A problem of circular definitions is that they do not accomplish the purpose of definitions. They may, in the words of several courts, “explain nothing.” Or, as one commentator put simply, “circular reasoning, after all, is inherently suspect.” Yet, courts are often asked to construe meanings of words where the statute containing the word term does not help to define it. And in a jury trial the jury must be instructed based on the statute.

Jury instructions typically follow statutory language. But the circular definitions in the franchise context place an additional burden on practitioners and courts in preparing jury instructions. To make instructions understandable to jurors, care must be used to avoid circularity. This means changing words to avoid circularity, while retaining the intended meaning of the statute.

III. Usages

Several things to note about these proposed jury instructions.

Bracketed language indicates information to be filled in. In many cases, the type of information to be filled in is apparent from the context, and then there is no bracketed instruction.

Many of the instructions include alternatives that depend on circumstances. Where alternatives are presented, they are bracketed. In some cases, particular instructions are followed by the name of one or more states in brackets. This format indicates that the law of the particular state(s) has that instruction or an instruction of similar wording or import.

13. Id. § 31006.
14. Id. § 31007.
15. Id. § 31005(a)(3).
16. Id. § 31011.
20. Darden, 503 U.S. at 302 (“We have often been asked to construe the meaning of “employee” where the statute containing the term does not helpfully define it.”). For broader discussions of circularity, see, e.g., Wendy Gerwick Couture, Materiality and a Theory of Legal Circularity, 17 U. Pa. J. Bus. L. 453 (2015).
Each instruction largely, though often not exactly, tracks statutory language with an effort made to reduce the use of unnecessary statutory formalities and anachronistic language and provide some simplification of the language. Each instruction then includes an example making greater use of plain English. For the practitioner, the process of tailoring instructions to a specific case will often make it possible to eliminate words that are unnecessary given the facts of that case.

By removing excess words, the proponent of the instruction has in effect narrowed the instruction, thus providing a smaller range of activity that the jury could find to be a franchise or constitute wrongdoing. For this reason, the opponent may not object to the revised instruction. The proponent’s trade-off for making the proposed instruction more attractive to the proponent is that the revised language is simpler and easier for the jury to follow and understand, because it avoids extraneous words that are not helpful to the jury’s analysis.

For example, a standard instruction on the definition of a franchise might appear as follows:

That in the agreement [name of Defendant] granted [name of Plaintiff] the right to engage in business offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by [name of Defendant].

It is possible that a specific case in which it is claimed a relationship was a franchise involves a business dealing only in goods, not services, and selling from a fixed location, such as a quick service restaurant. The alleged franchisor might have prepared a document called a “marketing plan.” The proponent of this instruction might therefore choose to omit the words “offering,” “distributing,” “services,” “system,” and “substantial part,” thereby simplifying the instruction to read as follows:

That in the agreement [name of Defendant] granted [name of Plaintiff] the right to engage in business selling goods under a marketing plan prescribed by [name of Defendant].

Many of the instructions are lengthy, far lengthier than would be used at trial. Practitioners should remove paragraphs and other portions that address facts or issues that are not applicable. For example, several state franchise laws exclude the following from the definition of a franchise: Payments to a trading stamp company by a person issuing trading stamps in connection with retail sales of goods or services are not a franchise fee. This exclusion appears in several franchise registration and disclosure laws, presumably to avoid treating issuers of trading stamps as franchisors. Today it is

21. This exclusion is in the franchise laws of California, Illinois, Indiana, Maryland, Michigan, New York, North Dakota, Rhode Island, Washington, and Wisconsin.

22. Issuers of trading stamps, such as “Blue Chip Stamps” and “S & H Green Stamps,” sold trading stamps to merchants. Merchants distributed the stamps to retail customers at a specified ratio of stamps to amount of money spent. (e.g., one stamp for each 10 cents of purchase). Customers collected the trading stamps and could then redeem collected stamps for
anachronistic, since few retailers make use of trading stamps. It is not necessary to consume time and energy or to confuse the jury with such instructions. Therefore, this portion of the instruction regarding the definition of a franchise could be excluded.

These instructions are based on statutes that are similar in some ways. But many of the statutes also have significant variations. Different states use different words to express concepts that are seemingly the same or similar. Some states omit elements of a claim that appear in the laws of other states; some states add elements. These instructions are intended to be an aid, but they are not a substitute for careful reference to the franchise statute, applicable case law, and regulations of the particular state(s) whose law applies in the case.

Authorities are provided for each instruction. The practitioner can make use of the authorities that are pertinent to the jurisdiction where a case is pending, and remove other authorities.

IV. Franchise Law Jury Instructions

A. Definitions

1. Instruction on Definition of Franchise—Marketing Plan Definition

   Instruction:

   [Name of Plaintiff] claims the relationship between [name of Plaintiff] and [name of Defendant] [is] [was] a “franchise.” To prove the relationship was a franchise, [name of Plaintiff] must prove all the following:

   (1) That [name of Plaintiff] and [name of Defendant] entered into a contract or agreement with each other, either orally or in writing, either expressed or implied.

   (2) That, in the agreement, [name of Defendant] granted [name of Plaintiff] the right to engage in business offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by [name of Defendant].

   (3) That the operation of [name of Plaintiff]’s business under the plan or system [is] [was] substantially associated with [name of Defendant]’s trademark, service mark, trade name, logo, advertising or other commercial symbol designating [name of Defendant] or its affiliate.

   (4) That [name of Plaintiff] [is] [was] required to pay, directly or indirectly, a franchise fee.

   Only if all these components are present may a franchise be found to exist.

Sample of the Instruction in Plain English:

[Name of Plaintiff] claims the relationship with [name of Defendant] [is] [was] a “franchise.” To prove this, [name of Plaintiff] must prove all the following:

5. [Name of Plaintiff] and [name of Defendant] entered into an agreement with each other, oral or written, expressed or implied.

6. In the agreement, [name of Defendant] granted [name of Plaintiff] the right to do business offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by [name of Defendant].

7. Operation of [name of Plaintiff]’s business under the plan or system [is] [was] substantially associated with [name of Defendant]’s trademark.

8. [Name of Plaintiff] [is] [was] required to pay, directly or indirectly, a franchise fee.

All of these must be present for a franchise to exist.

Comment:

This instruction is for cases under state laws that define a franchise to include a marketing plan or system. This contrasts with state laws that define a franchise to include a community of interest in the business of offering, selling or distributing goods or services.

Circumstances obviously vary in which a party may claim the business relationship was a franchise. The claim might be that a now-terminated franchise was originally offered and sold in violation of the state’s franchise registration and disclosure law or that the party’s relationship was wrongfully terminated by the franchisor. Or a claim might be that a present, ongoing relationship is a franchise that was sold unlawfully, or that misrepresentations were made in establishing the relationship, or that injunctive relief is needed to prevent wrongful termination.

Almost always, the party claiming that the relationship was or is a franchise, will be the party claiming to be or to have been the franchisee. This is because franchise laws grant rights to franchisees, but offer little in the way of rights or benefits to franchisors. Therefore, it is rare that a franchisor has a reason in court to claim that a relationship was a franchise.

 Authorities:

Comment on Some State Variances:

The statutory definitions vary among the states. As examples, Connecticut’s definition does not require payment of a fee. Conn. Gen. Stat. § 42-133e. Illinois’s and Rhode Island’s definitions add the element that the franchise fee must be $500 or more. 815 Ill. Comp. Stat. § 705/3(1)(c); 19 R.I. Gen. Laws § 19-28.1-3(g). Under the structure of New York’s definition, in addition to the franchise fee element, either (1) the right to distribute goods or service under a marketing plan, or (2) the right to distribute goods or services substantially associated with the franchisor’s trademark, needs to be established, but not both. N.Y. Gen. Bus. Law § 681.3. Oregon replaces the franchise fee element with the requirement for “valuable consideration.” Or. Rev. Stat. § 650.005(4). Virginia limits the scope of the definition by requiring that the right granted to engage in business be for offering, selling, or distributing goods or services at retail. Va. Code Ann. § 13.1-559.

2. Instruction on Definition of Franchise—Community of Interest Definition Instruction:

[Name of Plaintiff] claims the relationship between [name of Plaintiff] and [name of Defendant] [is] [was] a “franchise.” To prove the relationship was a franchise, [name of Plaintiff] must prove all the following:

(1) That [name of Plaintiff] and [name of Defendant] entered into a contract or agreement with each other, either orally or in writing, either expressed or implied.

(2) That in the agreement [name of Defendant] granted [name of Plaintiff] a license to use a trade name, service mark, trademark, logo, or related characteristic.

(3) There is a community of interest in the business of offering, selling, or distributing goods or services at wholesale or retail, leasing, or otherwise.

(4) That [name of Plaintiff] [is] [was] required to pay, directly or indirectly, a franchise fee.

Only when all these components are present may a franchise be found to exist.

Sample of the Instruction in Plain English:

[Name of Plaintiff] claims the relationship with [name of Defendant] [is] [was] a “franchise.” To prove this, [name of Plaintiff] must prove all the following:
(5) [Name of Plaintiff] and [name of Defendant] entered into an agreement, oral or written, expressed or implied.

(6) The agreement granted [name of Plaintiff] a license to use a trademark.

(7) They have/had a community of interest in the business of offering, selling or distributing goods or services, at wholesale or retail, leasing, or otherwise.

(8) [Name of Plaintiff] [is] [was] required to pay, directly or indirectly, a franchise fee.

All these components must be present for a franchise to exist.

Comment:

This instruction is for cases under state law definitions that include a community of interest in the business of offering, selling, or distributing goods or services. This contrasts with state laws that define a franchise to include a marketing plan or system.

Authorities:


3. Instruction on Definition of Franchise—Significant Control Definition

Instruction:

[Name of Plaintiff] claims the relationship between [name of Plaintiff] and [name of Defendant] [is] [was] a “franchise.” To prove the relationship was a franchise, [name of Plaintiff] must prove all the following:

(1) That [name of Plaintiff] and [name of Defendant] [are] [were] in a continuing commercial relationship or arrangement.

(2) That the offer or the contract specifies or that [name of Defendant] promised or represented, orally or in writing, that:

   (a) [Name of Plaintiff] will obtain the right to operate a business identified or associated with [name of Defendant]’s trademark or to offer, sell or distribute goods or services or commodities identified or associated with [name of Defendant]’s trademark; and

   (b) [Name of Defendant] will exert or had authority to exert a significant degree of control over [name of Plaintiff]’s method of operation or provide significant assistance in [name of Plaintiff]’s method of operation.

(3) As a condition of obtaining or starting operation, [name of Plaintiff] makes a required payment or commits to make a required payment to [name of Defendant] or [name of Defendant]’s affiliate.

Only when all these components are present may a franchise be found to exist.
Sample of the Instruction in Plain English:

[Name of Plaintiff] claims the relation with [name of Defendant] [is] [was] a “franchise.” To prove this, [name of Plaintiff] must prove all the following:

(4) [Name of Plaintiff] and [name of Defendant] [are] [were] in a continuing commercial relationship or arrangement.

(5) The offer or the contract says, or [name of Defendant] promised or represented, orally or in writing, that:

(a) [Name of Plaintiff] will get the right to operate a business associated with [name of Defendant]’s trademark or offer, sell or distribute goods or services associated with [name of Defendant]’s trademark.

(b) [Name of Defendant] will exert or had authority to exert significant control over [name of Plaintiff]’s operation or provide significant help in [name of Plaintiff]’s operation.

(6) As a requirement, [name of Plaintiff] made a required payment or committed to make a required payment to [name of Defendant] or [name of Defendant]’s affiliate.

All these components must be present for a franchise to exist.

Comment:

This instruction is for cases under South Dakota law.

Authorities:

S.D. Codified Laws § 37-5B-1(11).

4. Instruction on Definition of a Franchise Fee

Instruction:

One of the elements [name of Plaintiff] must prove is that the relationship with [name of Defendant] required the payment to [name of Defendant] of a franchise fee. I will now instruct you on what is and what is not a “franchise fee.”

A franchise fee is any fee or charge that [name of Plaintiff] is or was required to pay or agreed to pay for the right to enter the business relationship with [name of Defendant] including any payment for goods or services.

- A franchise fee may be payable in a lump sum or installments. Installment amounts may depend on gross receipts or net profits in the form of a royalty, or may be charged on units of merchandise ordered or sold by [name of Defendant]. A franchise fee may be in the price charged by [name of Defendant] or its affiliate for goods or services supplied to [name of Plaintiff] or in a rental fee payable by [name of Plaintiff] for business premises or equipment rented from by [name of Defendant] or its affiliate. [Cal.]
• A franchise fee may be an initial capital investment fee, any fee or charges based on a percent of gross or net sales, whether or not called a royalty, any payment for goods or services, or any training fees or training school fees or charges. [Minn.; Wash.]

• A franchise fee is a direct or indirect payment to purchase or operate a business that is a franchise. [R.I.]

• A franchise fee may be present regardless of the name given to it or its form, whether it is payable in a lump sum or installments, definite or indefinite in amount or partly or wholly contingent on future sales, profits or purchase for the franchise business or the sale or transfer of the franchisee’s business. [Ill.]

• To be a “franchise fee,” [name of Plaintiff] must have been required or agreed to pay [name of Defendant] a fee for the right to enter into business under the agreement; there must have been a transfer of wealth from [name of party claiming to be franchisee] to [name of Defendant]. [Mich.]

Sample of the Instruction in Plain English:

For a franchise to exist, [name of Plaintiff] must prove [he] [she] [it] was required to pay [name of Defendant] a franchise fee. I will now tell you rules on what is and what is not a “franchise fee.”

A franchise fee is any fee or charge [name of Plaintiff] is or was required to pay or agreed to pay for the right to enter into the business relationship with [name of Defendant] including any payment for goods or services.

• A franchise fee may be payable in a lump sum or installments. Installment amounts may depend on gross receipts or net profits in the form of a royalty, or may be charged on units of merchandise ordered or sold by [name of Defendant]. A franchise fee may be in the price charged by [name of Defendant] or its affiliate for goods or services supplied to [name of Plaintiff] or in a rental fee payable by [name of Plaintiff] for business premises or equipment rented from by [name of Defendant] or its affiliate. [Cal.]

• A franchise fee is a direct or indirect payment to buy or operate a business that has the other elements of a franchise. [R.I.]

• A franchise fee may exist no matter what name it is given or its form, whether it is a lump sum or installments, whether the amount is set specifically or is indefinite, even if it is all or partly contingent on future sales, profits or purchases or on the franchisee’s business being sold or transferred. [Ill.; Wis.]

• To be a “franchise fee,” [name of Plaintiff] must have been required or agreed to pay [name of Defendant] a fee for the right to enter into business under the agreement; there must have been a transfer of wealth from [name of Plaintiff] to [name of Defendant]. [Mich.]
Comment:

This instruction identifies the payments that constitute a franchise fee.

The statutory definition of a “franchise fee” varies from state to state, sometimes in subtle, nuanced ways. For example, Hawaii and Minnesota define a franchise fee as a payment “for the right to enter into a business or to continue a business under a franchise agreement.” Haw. Rev. Stat. § 482E-2 (emphasis added); Minn. Stat. § 80C.01(9) (emphasis added). Illinois defines a franchise fee as payment “for the right to enter into a business or sell, resell, or distribute goods or services or franchises under an agreement.” 815 Ill. Comp. Stat. § 705/3 (emphasis added). By regulation, in Illinois, the amount must exceed $500 to be a franchise fee. Ill. Admin. Code tit. 14, § 200.105. Indiana defines a franchise fee as payment “for the right to conduct a business to sell, resell, or distribute goods, services or franchises. . . .” Ind. Code § 23-3-2-2.5-1 (emphasis added).

South Dakota does not use the term “franchise fee,” but instead uses the phrase “required payment,” defined as “any consideration that the franchisee must pay to the franchisor or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the franchise.” S.D. Codified Laws § 37-5B-1(26).

Authorities:


5. Instruction on Payments That Are Not a Franchise Fee

Instruction:

Some payments are deemed to not be a franchise fee. The following [is] [are] not a franchise fee:

The purchase or agreement to purchase goods at a bona fide wholesale price is not a franchise fee, so long as no obligation was imposed on the

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purchaser to purchase or pay for more goods than a reasonable businessperson normally would buy as a starting inventory or supply or to maintain an ongoing inventory or supply. [Cal.; Haw.; N.D., S.D.; Va.]

“Bona fide wholesale price” means the price at which goods are purchased and sold by a manufacturer or wholesaler to a wholesaler or dealer where there is an open and public market where sales of the goods are made to consumers of the goods. “Bona fide wholesale price” does not apply to goods which have no open and public market. [Cal.]

The purchase or agreement to purchase at a bona fide wholesale price, goods purchased for resale, for which there is an established market if the price charged is a fair payment for goods purchased at a comparable level of distribution and no part of the price is for the right to enter into the business. [Ill.]

The purchase or agreement to purchase goods at a bona fide wholesale price. [Ind; Md.; Mich.; Minn.; N.Y.; Wash.; Wis.]

An agreement to purchase at a bona fide wholesale price, a reasonable quantity of tangible goods for resale. [R.I.]

The purchase or agreement to purchase goods by consignment; if the proceeds turned over by [name of Plaintiff] from any such sale reflect only the bona fide wholesale price of such goods. [Haw.; Md.; Minn.; Wash.; Wis.]

A bona fide loan to [name of Plaintiff] from [name of Defendant]. [Haw.; Wis.]

Repayment of a bona fide loan that [name of Defendant] made to [name of Plaintiff]. [Md.; Minn.; Wash.]

The purchase or agreement to purchase goods for which there is an established market at a bona fide retail price subject to a bona fide commission or compensation plan. [Ill.]

The purchase or agreement to purchase goods at a bona fide retail price subject to a bona fide commission or compensation plan that reflects only a bona fide wholesale transaction. [Haw.; Md.; Minn.; Wash.; Wis.]

Payment for fixtures necessary to operate the business. [Ill.]

The purchase or agreement to purchase [Wash. and Wis. add: “or lease”] at fair market value, supplies or fixtures necessary to enter into the business or to continue the business. [Haw.; Md.; Minn.; Va.; Wash.; Wis.]

The purchase or lease or agreement to purchase or lease, at fair market value, real property necessary to enter into the business or continue the business under the agreement. [Haw.; Md.; N.Y.; Va.; Wash.; Wis.]

Payment of rent that reflects payment for the economic value of the property. [Ill.]
Payment made to [name of Defendant] or its affiliate for equipment, materials, real estate services or other items, if the purchase was not required by [name of Defendant] or if [name of Plaintiff] was permitted to purchase the items from sources other than [name of Defendant] or its affiliates and the item was available from such other sources. [Ill.]

The amount paid by [name of Plaintiff] for sales demonstration material and equipment, sold at no profit by [name of Defendant] for use in making sales and not for resale. [Md.]

Payments made for the lease or agreement to lease a business operated by [name of Plaintiff] on the premises of [name of Defendant], so long as the business is incidental to the business conducted by [name of Defendant] at such premises. [Mich.; N.Y.]

Payment of a fee not more than $500 annually; for sales materials having a value at least equal to the amount of the payment. [N.Y.]

Purchase of sales demonstration equipment and materials furnished at cost for use in making sales and not for resale. [N.Y.]

Payment of a reasonable service charge to the issuer of a credit card by an establishment accepting or honoring that credit card is not a franchise fee. [Cal.; Ill; Ind.; Md.; Mich.; N.Y.; N.D.; R.I.; Wis.]

Payments to a trading stamp company by a person issuing trading stamps in connection with retail sales of goods or services are not a franchise fee. [Cal.; Ill.; Ind.; Md.; Mich.; N.Y.; N.D.; R.I.; Wash.; Wis.]

If the total franchise fee is $500 or less on an annual basis, then it is not a franchise fee. [Cal.]

Up to $1,000 annually for the purchase or rental of fixtures, equipment or other tangible property to be used in and necessary for the operation of the business, so long as the price does not exceed the cost that would be incurred by the franchisee acquiring the item or items from someone else or in the open market. [Cal.]

A transfer fee is not a franchise fee if it represents reasonable expenses incurred in connection with the transfer. [Ill.]

Sample of the Instruction in Plain English:

Some payments are not a franchise fee. The following [is] [are] not a franchise fee:

Buying or agreeing to buy goods at a true wholesale price is not a franchise fee, if the buyer had no obligation to buy or pay for more goods than a reasonable businessperson normally would buy as a starting or ongoing inventory or supply. [Cal.; Haw.; N.D.; S.D.; Va.]
The true wholesale price means the price at which goods are bought and sold by a manufacturer or wholesaler to a wholesaler or dealer where there is an open, public market for the goods. True wholesale price does not include the price of goods that have no open and public market, and where the goods are sold mainly to someone engaged in redistribution. [Cal.]

Buying or agreeing to buy at a true wholesale price, goods for resale, if there is an established market for the goods and the price is fair compared to goods bought at a similar level of distribution and none of the price is for the right to enter into the business. [Ill.]

Buying or agreeing to buy goods at a true wholesale price. [Ind.; Md.; Mich.; Minn.; N.Y.; Wash.; Wis.]

Agreeing to buy at a true wholesale price, a reasonable amount of goods for resale. [R.I.]

Buying or agreeing to buy goods by consignment; if the money paid by [name of Plaintiff] from the sale reflects only a true wholesale price of the goods. [Haw.; Md.; Minn.; Wash.; Wis.]

A true loan to [name of Plaintiff] from [name of Defendant]. [Haw.; Wis.]

Repayment of a true loan that [name of Defendant] made to [name of Plaintiff]. [Md.; Minn.; Wash.]

Buying or agreeing to buy goods at a true retail price subject to a true commission or compensation plan that reflects only a true wholesale transaction. [Haw.; Md.; Minn.; Wash.; Wis.]

Buying or agreeing to buy goods for which an established market exists, at a true retail price, subject to true commission or compensation plan. [Ill.]

Payment for fixtures needed for the business. [Ill.]

Buying or agreeing to buy [Wash. and Wis. add: or lease] at fair market value, supplies or fixtures needed to enter into or continue the business. [Haw.; Md.; Minn.; Va.; Wash.; Wis.]

Buying or leasing or agreeing to buy or lease, at fair market value, real property needed to enter into the business or continue the business under the agreement. [Haw.; Md.; N.Y.; Va.; Wash.; Wis.]

Paying rent that reflects paying for the economic value of the property. [Ill.]

Paying [name of Defendant] or its affiliate for equipment, materials, real estate services or other items, if the purchase was not required by [name of Defendant] or if [name of Plaintiff] was permitted to buy the items...
from someone other than [name of Defendant] or its affiliates and the item was available from the other sources. [Ill.]

Payment(s) from [name of Plaintiff] for sales demonstration material and equipment, sold at no profit by [name of Defendant] for use in making sales and not for resale. [Md.]

Payments to lease or agreeing to lease a business operated by [name of Plaintiff] on the premises of [name of Defendant], if the business is incidental to the business conducted by [name of Defendant] at such premises. [Mich.; N.Y.]

Paying up to $500 annually; for sales materials having a value equal or more than the payment. [N.Y.]

Buying sales demonstration equipment and materials sold at cost for use in making sales and not for resale. [N.Y.]

[Name of Plaintiff] paying a reasonable service charge to the issuer of a credit card. [Cal.; Ill.; Ind.; Md.; Mich.; N.Y.; N.D.; R.I.; Wis.]

[Name of Plaintiff] paying a trading stamp company for trading stamps used in [name of Plaintiff]’s business. [Cal.; Ill.; Ind.; Md.; Mich.; N.Y.; N.D.; R.I.; Wash.; Wis.]

If the total franchise fee is $500 or less annually, it is not a franchise fee. [Cal.]

Up to $1,000 annually to buy or rent fixtures, equipment, or other tangible property to be used in and needed to operate the business, so long as the price does not exceed the cost that would be incurred by [name of Plaintiff] to get the item or items from someone else or in the open market. [Cal.]

A transfer fee is not a franchise fee if it represents reasonable expenses incurred in connection with the transfer. [Ill.]

Comment:

Not every payment that may be made by a claimed franchisee to a claimed franchisor is a “franchise fee.” See, e.g., Thueson v. U-Haul Int’l, Inc., 50 Cal. Rptr. 3d 669, 144 Cal. App. 4th 664, 675 (2006) (noting that ordinary business expenses are not a franchise fee). This instruction identifies types of payments that are deemed not to be a franchise fee. The instruction would be tailored to identify those items that are at issue in the particular case.

Authorities:


6. Instruction on Definition of a Marketing Plan

Instruction:

To prove the parties’ relationship was a franchise, one of the elements [name of Plaintiff] must prove is that there was a “marketing plan.” That is, [name of Plaintiff] must prove that [name of Defendant] granted [name of Plaintiff] the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by [name of Defendant].

Now I will instruct you on what is and what is not a “marketing plan.”

A “marketing plan” is a plan or system concerning an aspect or aspects of conducting business. A marketing plan may include one or more of the following:

- Price specifications, special pricing systems, or discount plans;
- Designating or providing sales or display equipment or merchandising devices;
- Providing selling techniques;
- Providing advertising or promotion materials or cooperative advertising;
- Providing training regarding promotion, operation, or management of the business;
- Providing operational, managerial, technical, or financial guidelines or assistance;
- Making a promise of support;
- Providing assistance in advertising;
- Supplying food and supplies and menu planning;
- Supplying manuals;
- Actions by [name of Defendant] to present multiple businesses to the public as a unit or marketing concept with the appearance of centralized

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management, and uniform standards regarding quality, prices of goods, price of services, and other material aspects of the business;

Establishing an area-wide or nationwide distribution grid;

Multiple levels of oversight, such as regional and local distributorships;

Control reserved by the supplier or licensor over terms of payment by customers;

Control reserved by the supplier or licensor over credit practices, warranties, and representations in dealings between the party claiming to be a franchisee, and that party’s customers;

Suggestion or claim of having a uniform marketing plan;

Provisions about collateral services, that may or may not be provided, or prohibiting or limiting sales of competing or non-competing goods are consistent, though not necessarily decisive, about a prescribed marketing plan;

Requirements to follow directions from [name of Defendant] or obtaining [name of Defendant]’s approval of location, use of trade names, advertising, signs, sales pitches, and sources of supply, or concerning the appearance of [name of Plaintiff]’s premises and fixtures and equipment, employee uniforms, hours of operation, housekeeping, and similar decorations may be indicative of a marketing plan;

Procedures for inspection by [name of Defendant] or reporting to [name of Defendant] about conduct of the business, and the right of [name of Defendant] to take corrective measures, possibly at [name of Plaintiff]’s expense, are indicative of [name of Defendant]’s control over [name of Plaintiff]’s operations and, thus, of a marketing plan;

A comprehensive advertising or other promotion program by [name of Defendant], with or without an obligation by [name of Plaintiff] to bear part of the expense of the program, is indicative of a marketing plan prescribed by the franchisor, especially if the advertising or promotion identifies locations of franchisees, and more so if individual advertising or promotion activities are prohibited or require prior approval of [name of Defendant];

Any ability of [name of Defendant] to control essential decision making of [name of Plaintiff], such as through majority ownership interest in the business or by appointing a majority of the members of a committee that makes important decisions on sales, marketing, merchandising, personnel, etc., indicates a marketing plan;

Advertising by [name of Defendant] that claimed to have available a successful marketing plan, establishes a presumption that a marketing plan was present. [Name of Defendant] could overcome that presumption by establishing that no marketing plan was present;
A marketing plan may exist even though not fully developed when the franchise was sold. If [name of Defendant] represented that the relationship would be a franchise with a marketing plan or system, then this element is satisfied.

Sample of the Instruction in Plain English:

To prove there was a franchise, one element that [name of Plaintiff] must prove is that there was a “marketing plan.” That is, [name of Plaintiff] must prove that [name of Defendant] granted [name of Plaintiff] the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by [name of Defendant]. I will tell you what is and what is not a “marketing plan.”

A “marketing plan” is a plan or system concerning an aspect or aspects of doing business. A marketing plan may include one or more of the following:

- Price specifications, special pricing systems or discount plans;
- Designating or providing sales or display equipment or merchandising devices;
- Providing selling techniques;
- Providing advertising or promotion materials or cooperative advertising;
- Providing training on promotion, operation, or management of the business;
- Providing operational, managerial, technical, or financial guidelines or assistance;
- Making a promise of support;
- Providing help in advertising;
- Supplying food and supplies and menu planning;
- Supplying manuals;
- Actions by [name of Defendant] to present multiple businesses to the public as a unit or marketing concept with the appearance of central management, and uniform standards of quality, prices of goods, price of services, and other material aspects of the business;
- Establishing an area-wide or nationwide distribution grid;
- Multiple levels of oversight, like regional and local distributorships;
- Control by the supplier or licensor over customer payment terms;
- Control by the supplier or licensor over credit practices, warranties, and representations in dealings between [name of Plaintiff] and [name of Plaintiff]’s customers;
- Suggestion or claim of having a uniform marketing plan;
Provisions about collateral services, which may or may not be provided, or [name of Defendant] prohibiting or limiting [name of Plaintiff] from making sales of competing or non-competing goods, are consistent, though not necessarily decisive, about a prescribed marketing plan;

Requirements to follow directions from [name of Defendant] or obtaining [name of Defendant]'s approval of location, use of trade names, advertising, signs, sales pitches, and sources of supply, or concerning the appearance of [name of Plaintiff]'s premises and fixtures and equipment, employee uniforms, hours of operation, housekeeping, and similar decorations may indicate a marketing plan;

Procedures for inspection by [name of Defendant] or reporting to [name of Defendant] about conduct of the business, and the right of [name of Defendant] to take corrective measures, possibly at [name of Plaintiff]'s expense, indicate [name of Defendant]'s control over [name of Plaintiff]'s operations and, thus a marketing plan;

Comprehensive advertising or promotion by [name of Defendant] with or without an obligation by [name of Plaintiff] to pay some of the expense, indicates a marketing plan prescribed by [name of Defendant], especially if the advertising or promotion identifies franchisee locations, and more if individual advertising or promotion activities are prohibited or require prior approval of [name of Defendant];

Any ability of [name of Defendant] to control key decision making of [name of Plaintiff], like having majority ownership in the business or appointing a majority of the members of a committee that makes important decisions on sales, marketing, merchandising, personnel, etc., indicates a marketing plan;

Advertising by [name of Defendant] that claimed to have a successful marketing plan, establishes a presumption that a marketing plan was present. [Name of Defendant] could overcome that presumption by establishing that no marketing plan was present;

A marketing plan may exist even though not fully developed when the franchise was sold. If [name of Defendant] represented that the relationship would be a franchise with a marketing plan or system, then this element is satisfied.

Comment:

Many kinds of assistance, support, guidance, instruction, supervision, or control may constitute or indicate a marketing plan.

Authorities:

People v. Kline, 168 Cal. Rptr. 185, 110 Cal. App. 3d 587, 594 (1980) (advertising of a marketing plan creating a presumption that a marketing plan existed)
plan is present); Cal. Dep’t of Corps., Release 3-F, *When Does an Agreement Constitute a “Franchise”* (rev. June 22, 1994), Bus. Franchise Guide (CCH) ¶ 5,050.45; 815 Ill. Comp. Stat. § 705/3 (18); Iowa Code § 523H.1(7); 19 R.I. Gen Laws § 19-28.1-3(12); Wash. Rev. Code § 19.100.010(11); *Boat & Motor Mart v. Sea Ray Boats*, 825 F.2d 1285 (9th Cir. 1987) (marketing plan established where supplier of boats provided distributor with sales directions and sales requirements); *Chem-Tek, Inc. v. Gen. Motors Corp.*, 816 F. Supp. 123, 129 (D. Conn. 1993) (control over hours and days of operation, advertising, financial support, auditing of books, inspection of premises, control over lighting, employee uniforms, prices, trading stamps, hiring, sales quotas, and management training being factors for consideration in determining existence of a marketing plan); *Crone v. Richmond Newspapers, Inc.*, 384 S.E.2d 77 (Va. 1989) (distribution plan provided by alleged franchisor being a marketing plan); *Aristacar Corp. v. Attorney Gen.*, 541 N.Y.S.2d 165 (N.Y. Sup. Ct. 1989) (supplying radio equipment, customers, and billing services, and dictating dress code and type of car to be driven, were a marketing plan in a car service business); *Master Abrasives Corp. v. Williams*, 469 N.E.2d 1196 (Ind. Ct. App. 1984) (exclusive marketing areas, right to approve hiring of sales employees, mandatory sales training, sales quotas, and policies for attracting customers was a marketing plan). The statutes differ from state to state. For example, in Iowa and Rhode Island, the phrase “material aspect” is included with regard to conducting business.

7. Instruction on Elements That Are Not a Marketing Plan

Instruction:

Some elements or aspects are not a marketing plan. I will describe some examples:

A marketing plan is not present just because an agreement imposes procedures or techniques that are customary in business in the particular trade or industry, even though the operator’s freedom of action or discretion may be restricted.

An obligation imposed on a distributor to use best efforts to make or increase sales of a licensor’s or supplier’s product is not by itself a marketing plan.

A requirement to maintain liability insurance in a certain amount is not by itself a marketing plan.

Where a royalty is paid, a requirement to keep records and accounts for verification of the royalty due is not a marketing plan.

These requirements in and of themselves are not a marketing plan.

25. See authorities cited supra note 23.
Sample of the Instruction in Plain English:

Some things are not a marketing plan. Here are some examples:

A marketing plan is not present just because an agreement imposes procedures or techniques that are customary in the business or particular trade or industry, even though the operator’s freedom may be restricted.

An obligation of best efforts to make or grow sales of a licensor’s or supplier’s product is not by itself a marketing plan.

A requirement to maintain insurance in a certain amount is not by itself a marketing plan.

Where a royalty is paid, a requirement to keep records and accounts for verification of the royalty due is not a marketing plan.

These requirements in and of themselves are not a marketing plan.

Comment:

Requirements or procedures that are customarily followed in an industry or in business generally do not indicate a plan offered, provided, or imposed by one party and therefore are not considered a marketing plan for purposes of the franchise laws.

Authorities:

Cal. Dep’t of Corps., Release 3-F, *When Does an Agreement Constitute a “Franchise”* (rev. June 22, 1994), Bus. Franchise Guide (CCH) ¶ 5,050.45; *James v. Whirlpool Corp.*, 806 F. Supp. 835, 842−43 (E.D. Mo. 1992) (though supplier provided products for resale and supplied policies and procedures, no marketing plan existed because distributor was expected to create its own marketing processes, train employees how it preferred and control its daily operations); *Sorriso v. Lenox*, 701 F. Supp. 952, 960 (D. Conn. 1988) (instructions regarding training, display of products and product promotion were not a marketing plan when alleged franchisee carried brands other than alleged franchisor’s brands); *Lads Trucking Co. v. Sears, Roebuck & Co.*, 666 F. Supp. 1418, 1420 (C.D. Cal. 1987) (delivery of merchandise to retailer’s customers according to method of operation determined by retailer, in trucks bearing retailer’s brand, was not a marketing plan because packages were delivered for the retailer, not sold under a marketing plan dictated by the retailer); *Richard I. Spiece Sales Co., Inc. v. Levi Strauss N. Am.*, 19 N.E.3d 345, 357 (Ind. Ct. App. 2014) (no marketing plan where defendant had no control over products sold by plaintiff; defendant suggested, but did not require, particular advertising methods; defendant lacked control over advertising, pricing, and products); *East Wind Exp., Inc. v. Airborne Freight Corp.*, 974 P.2d 369, 373 (Wash. Ct. App. 1999) (transporting goods for another company did

not establish marketing activities amounting to a marketing plan); *Kennedy v. Lomei*, 570 N.Y.S.2d 338, 339 (N.Y. App. Div. 1991) (no marketing plan existing between bakery and baked goods wholesaler because wholesaler did not regulate or control bakery’s sales activities, and only fifty percent of products sold by bakery were provided by wholesaler).

8. Instruction on Substantial Association with Trademark

Instruction:

To prove the parties’ relationship was a franchise, one of the elements [name of Plaintiff] must prove is that the operation of [name of Plaintiff]’s business was substantially associated with [name of Defendant]’s trademark, service mark, trade name, logo, advertising, or other commercial symbol designating [name of Defendant] or its affiliate.

Substantial association requires more than use of the trademark, service mark, trade name, logo, advertising, or other commercial symbol. The association must be substantial.

If [name of Plaintiff] was granted an unrestricted right to use [name of Defendant]’s trademark, service mark, trade name, logo, advertising, or other commercial symbol, this requirement is satisfied, even if [name of Plaintiff] was not obligated to display it.

Use of a commercial symbol by [name of Defendant] only on invoices or in advertising to resellers such as [name of Plaintiff], but which [name of Defendant] did not or does not permit [name of Plaintiff] to show in dealing with customers, is not substantial association with the operation of [name of Plaintiff]’s business.

You may consider if the commercial symbol was or is brought to the attention of [name of Plaintiff]’s customers to such an extent that the customers regard [name of Plaintiff]’s business as one in a chain identified with [name of Defendant].

Sample of the Instruction in Plain English:

To prove a franchise, [name of Plaintiff] must prove is that operation of [name of Plaintiff]’s business was substantially associated with [name of Defendant]’s trademark, service mark, trade name, logo, advertising, or other commercial symbol of [name of Defendant] or its affiliate.

Substantial association means more than use of the trademark, service mark, trade name, logo, advertising, or other commercial symbol. The association must be substantial.

This trademark element is proven if you find that [name of Plaintiff] was granted an unrestricted right to use [name of Defendant]’s trademark, service mark, trade name, logo, advertising, or other commercial symbol, even if [name of Plaintiff] was not obligated to display it.

Use of a commercial symbol by [name of Defendant] only on invoices or in advertising to resellers such as [name of Plaintiff], but which [name of Defendant] did not or does not permit [name of Plaintiff] to show in dealing
with customers, is not substantial association with the operation of [name of Plaintiff’s] business.

You may consider if the commercial symbol was or is brought to the attention of [name of Plaintiff’s] customers so much that customers regard [name of Plaintiff’s] business as part of a chain identified with [name of Defendant].

Comment:

Approximately fifteen states include in their definition of a franchise a requirement that the operation of franchisee’s business must be “substantially associated” with the franchisor’s trademark or other symbol designating the franchisor.27

Authorities:


9. Instruction on Effect of Parties’ Label of Relationship

Instruction:

The parties may have given a name or label to their relationship or stated that the relationship is or is not a certain type of relationship. You the jury


28. See authorities cited supra note 23.
may consider what the parties said or agreed about their relationship as evidence of what they intended. But you are not bound by any statement the parties made about the nature of their relationship. The nature of the relationship is for you to determine from the evidence.

Sample of the Instructions in Plain English:

The parties may have called their relationship something or said they were or were not in a certain kind of relationship. You the jury may consider what the parties said about their relationship as evidence of their intent. But you are not bound by any statement the parties made about the nature of their relationship. The nature of the relationship is for you to determine from the evidence.

Comment:

The parties’ label for a relationship does not bind the court, or prevent the court from finding the relationship to be a franchise. Though the parties’ characterization of the relationship does not bind the court, it can have some relevance. A federal district court noted that the word “franchise” did not appear in the parties’ agreement. While this was not dispositive, it was “probative of what type of agreement was reached.”

Authorities:

*Jerome-Duncan, Inc. v. Auto-By-Tel, LLC*, 989 F. Supp. 838, 842 (E.D. Mich. 1997) (absence of word “franchise” from agreement was probative of parties’ intent), *aff’d*, 176 F.3d 904 (6th Cir. 1999); *Contractors Home Appliance, Inc. v. Clarke Distrib. Corp.*, 196 F. Supp. 2d 174, 177 (D. Conn. 2002) (noting that “label given to the relationship by the parties, while relevant, is not determinative of the existence of a franchise relationship”). *But see Shab v. Racetrac Petroleum Co.*, 338 F.3d 557, 562, 575 (6th Cir. 2003) (Where parties called their relationship a lease, and stated in the agreement that it was not a franchise, contract language did not bar judicial determination that a franchise existed; how the parties described relationship was irrelevant. It would defeat the purpose of the statutes if parties could opt out by declaring that the law would not apply to their transaction. If the relationship between Plaintiffs and Defendant qualifies as a “franchise relationship,” how the parties describe their relationship is irrelevant.).

B. Prohibitions

1. Instructions on Offer or Sale of a Franchise Without Registration

Instruction:

On/in [relevant date or time] it was unlawful to offer or sell a franchise in this state unless the offer was registered with [name of state agency]

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which registers franchises; see list below*) [if Defendant asserts that Defendant was exempt from registration, add the following] or was exempt from registration.

[Name of Plaintiff] claims that [name of Defendant] offered or sold a franchise to [name of Plaintiff] in this state on/in [relevant date or time period] without being registered with [name of state agency which registers franchises; see list below*].

To prove this claim, [name of Plaintiff] must prove that [name of Defendant] offered or sold a franchise to [name of Plaintiff] in this state on/in [relevant date or time period] and must prove that at the time [name of Defendant] offered or sold a franchise that [name of Defendant] was not registered with [name of state agency which registers franchises; see list below*].

*California Department of Business Oversight
Hawaii Department of Commerce and Consumer Affairs
Illinois Attorney General
Indiana Securities Commissioner
(Maryland) Securities Commissioner in the Office of the Maryland Attorney General
Minnesota Department of Commerce
New York Department of Law
North Dakota Securities Commissioner
Rhode Island Department of Business Regulation
South Dakota Division of Insurance, Securities Regulation
Virginia State Corporation Commission
Washington State Department of Financial Institutions
Wisconsin Department of Financial Institutions

Sample of the Instruction in Plain English:

On/in [relevant date or time] it was unlawful to offer or sell a franchise in this state unless the offer was registered with [name of state agency which registers franchises; see list above*] [if Defendant asserts that Defendant was exempt from registration, add the following] or was exempt from registration.

[Name of Plaintiff] claims that [name of Defendant] offered or sold a franchise to [name of Plaintiff] in this state on / in [relevant date or time period] without being registered with [name of state agency which registers franchises; see list above*].
To prove this claim, [name of Plaintiff] must prove that [name of Defendant] offered or sold a franchise to [name of Plaintiff] in this state on/in [relevant date or time period] and that that [name of Defendant] was not registered at the time with [name of state agency which registers franchises; see list above].

Comment:

In states that have a franchise registration and disclosure law, it is unlawful to offer or sell a franchise without being registered, at the time of the offer or sale, with the agency designated to administer the state’s franchise law, unless the franchisor or the transaction is exempt. Plaintiff has the burden of proving Defendant offered or sold a franchise in the state and was not registered at the time of offering or selling the franchise. This instruction mentions the possibility of an exemption. Exemption is an affirmative defense that Defendant has the burden of pleading and proving.\(^{30}\)

Depending on the facts of the transaction or claimed transaction, it is possible that the laws of multiple states may be involved and that instructions under multiple states may be necessary.\(^{31}\) The parties’ agreed choice of law does not supersede the state’s franchise law. Sheldon v. Munford, Inc., 950 F.2d 403, 407 (7th Cir. 1991).

Authorities:


2. Offer or Sale Made “in This State”

Instruction:

To prove its/his/her claim, [name of Plaintiff] must prove that a franchise was offered or sold by [name of Defendant] to [name of Plaintiff] in this state.


[Name of Defendant] made an offer in this state if [name of Defendant] made an offer to sell in this state.

[Name of Defendant] made a sale in this state if [name of Plaintiff] accepted an offer to buy in this state.

[Name of Defendant] made an offer or sale in this state if [name of Plaintiff] was domiciled in this state and the business was operated in this state or was going to be operated in this state.

[Name of Defendant] made an offer to sell in this state if [name of Defendant] made an offer that originated from this state.

[Name of Defendant] made an offer to sell in this state if [name of Defendant] directed an offer to this state and the offer was received by [name of Defendant] at the place where [name of Defendant] directed it.

[Name of Plaintiff] accepted an offer in this state if [name of Plaintiff] communicated acceptance to [name of Defendant] in this state.

[Name of Plaintiff] communicated acceptance to [name of Defendant] in this state if [name of Plaintiff] made an offer that originated from this state and [name of Defendant] reasonably believing [name of Defendant] to be in this state and [name of Defendant] received the communication at the place where [name of Plaintiff] directed it.

In considering if there was an offer or sale in this state, you may consider advertising in a newspaper, or on radio, or on television [or Internet].

But an offer is not made in this state merely because [name of Defendant] circulates or someone circulated on [name of Defendant]’s behalf in this state a true newspaper or other publication of general, regular, and paid circulation which had more than two-thirds of its circulation outside this state in the prior 12 months, or a radio or television program originating outside this state is received in this state.

Sample of the Instruction in Plain English:

[Name of Plaintiff] has the burden to prove that a franchise was offered or sold by [name of Defendant] to [name of Plaintiff] in this state.

An offer was made in this state if [name of Defendant] made an offer to sell in this state.

A sale was made in this state if [name of Plaintiff] accepted an offer to buy in this state.

An offer or sale was made in this state if [name of Plaintiff] [resided/lived] in this state and the business was operated in this state or was going to be operated in this state.

An offer to sell was made in this state if [name of Defendant] made an offer that came from this state.

An offer to sell was made in this state if [name of Defendant] directed an offer to this state and it was received by [name of Plaintiff] where [name of Defendant] directed it.

An offer was accepted in this state if [name of Plaintiff] communicated acceptance to [name of Defendant] in this state.
[Name of Plaintiff] communicated acceptance to [name of Defendant] in this state if [name of Plaintiff] directed acceptance to [name of Defendant] in this state reasonably believing [name of Defendant] to be in this state and [name of Defendant] received the communication where [name of Plaintiff] directed it.

In considering if there was an offer or sale in this state, you may consider advertising in a newspaper, or on the radio, or on television [or Internet]. But an offer is not made in this state just because [name of Defendant] or someone else circulated in this state a newspaper or other publication of general, regular, and paid circulation that had over two-thirds of its circulation outside this state in the prior 12 months, or a radio or television program originating outside this state was received in this state.

Comment:

A state can of course regulate activity in or affecting the state. A state does not, however, have authority to regulate activity occurring outside the state. Each state's franchise registration and disclosure laws apply to offers and sales of franchises that take place in the state. Several state franchise registration and disclosure laws have provisions describing when an offer or sale is deemed to have occurred in the state.

The statutes provide that an offer is not made in this state merely because of specified newspaper, radio, or television advertising originating outside the state. The Internet reference is in brackets because the statutes, having originally been enacted before the advent of the Internet, do not mention the Internet, but Internet communication could be considered an example of a publication of general, regular, and possibly paid circulation.

Authorities:


3. Offer or Sale of Franchise Without Providing FDD

Instruction:

A party who sells a franchise must provide the franchise buyer a copy of the franchise disclosure document (FDD) with a copy of all proposed

agreements. The franchise seller must provide this copy at least [state applicable number of days*] before the buyer signs any agreement, or at least [state applicable number of days*] before the seller receives any payment, whichever is first.

This copy may be provided in paper, or by electronic means.

[Name of Plaintiff] claims that [name of Defendant] sold [name of Plaintiff] a franchise without providing [name of Plaintiff] the franchise disclosure document with a copy of all agreements, at least [state applicable number of days*] days before [name of Plaintiff] signed an agreement/paid money to [name of Defendant].

*California—14 days
Hawaii—7 days
Illinois—14 days
Indiana—10 days
Maryland—14 days or when prospective franchisee makes a reasonable request
Michigan—10 business days
Minnesota—7 days
New York—10 business days or first face-to-face meeting held for the purpose of discussing the sale or possible sale of a franchise);
North Dakota—7 days
Rhode Island—14 days
South Dakota—14 days
Virginia—number of days not specified
Washington—14 days
Wisconsin—14 days

To prove this claim [name of Plaintiff] must prove that at the time when [name of Plaintiff] signed an agreement or paid money to [name of Defendant], [name of Plaintiff] had not had the franchise disclosure document with all agreements for at least [state applicable number of days*].

Sample of the Instruction in Plain English:

A franchise seller must provide the buyer the franchise disclosure document and a copy of all proposed agreements. The franchise seller must provide these at least [state applicable number of days*] before the buyer signs any agreement, or at least [state applicable number of days*] before the seller receives any payment, whichever is first.
This may be provided in paper, or electronically.

[Name of Plaintiff] claims [name of Defendant] sold [name of Plaintiff] a franchise without providing [name of Plaintiff] the franchise disclosure document and all agreements, at least [state applicable number of days*] before [name of Plaintiff] signed an agreement/paid money to [name of Defendant].

*California—14 days
Hawaii—7 days
Illinois—14 days
Indiana—10 days
Maryland—14 days or when prospective franchisee makes a reasonable request
Michigan—10 business days
Minnesota—7 days
New York—10 business days or first face-to-face meeting held for the purpose of discussing the sale or possible sale of a franchise);
North Dakota—7 days
Rhode Island—14 days
South Dakota—14 days
Virginia—number of days not specified
Washington—14 days
Wisconsin—14 days

To prove this claim [name of Plaintiff] must prove that when [name of Plaintiff] signed an agreement or paid money to [name of Defendant], [name of Plaintiff] had not had the franchise disclosure document with all agreements for at least [state applicable number of days*].

Comment:

There may be different ways to formulate the last paragraph, depending on the nature of the factual dispute. For example, in one scenario, the plaintiff may claim to have never received an FDD, but the franchisor claims it was delivered long before the franchise agreement was signed. That dispute is not so much whether the specified number of days was satisfied, but whether an FDD was delivered at all. In another scenario, both parties agree the FDD was delivered, and agree when the franchise agreement was signed, but dispute when the FDD was delivered. Then the issue is whether delivery occurred more than or less than the required number of days before signing of an agreement. In another scenario, there is no dispute about when the
FDD was delivered, but the parties dispute when the agreement was signed, or when money was paid to the franchisor. Each scenario may call for a formulation of the instruction that focuses on the particular issue in dispute.

A typical franchise relationship may involve a variety of agreements. The principal agreement might be a Franchise Agreement, Master Franchise Agreement, Area Development Agreement, or Area Representative Agreement. A variety of ancillary agreements are possible. Examples include a Confidentiality Agreement, Deposit Agreement (if the prospective franchisee will pay a monetary deposit), Non-Competition Agreement, Personal Guaranty, Site Selection Agreement, Lease or Sublease for premises, Collateral Assignment of Lease (sometimes called a Conditional Assignment of Lease), Software License, Promissory Note, or Asset Purchase Agreement.\(^{33}\)

Another factual scenario may concern whether one of these agreements was entered into before the franchisee was in possession of an FDD for the specified number of days. Then a jury instruction might simply address the issue of what agreement was signed and when.

The Federal Trade Commission Franchise Rule requires delivery of the FDD at least 14 days before signing a binding agreement or payment of any consideration. 16 C.F.R. § 436.2(a). See, e.g., *Caudill v. Keller Williams Realty, Inc.*, 828 F.3d 575, 576 (7th Cir. 2016) (noting FTC requires FDD to be sent to prospective franchisee 14 days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate connected with the sale of a franchise); *Presidential Hospitality, LLC v. Wyndham Hotel Grp., LLC*, 333 F. Supp. 3d 1179, 1191 n.2 (D.N.M. 2018) (“The FDD is a document that the franchisor must disclose to the franchisee at least 14 calendar days before the franchisee signs a binding agreement with the franchisor.”). However, only the FTC can pursue an action in court to remedy a violation; no private cause of action may be asserted for violation of the FTC Rule. See, e.g., *Yumilicious Franchise, LLC v. Barrie*, 819 F.3d 170, 176 (5th Cir. 2016); *Morrison v. Back Yard Burgers, Inc.*, 91 F.3d 1184, 1187 (8th Cir. 1996); *A Love of Food I, LLC v. Maoz Vegetarian USA, Inc.*, 70 F. Supp. 3d 376, 382 (D.D.C. 2014); *Senior Ride Connection v. ITNAmerica*, 225 F. Supp. 3d 528, 531 (D.S.C. 2016).

Authorities:

Cal. Corp. Code § 31119 (14 days); Haw. Rev. Stat. § 482E-3(a) (7 days); 815 Ill. Comp. Stat. § 705/5(1) (14 days); Ind. Code § 23-2-2.5-9(2) (ten days); Md. Code Ann. Bus. Reg. § 14-223 (14 days or when requested by the prospective franchisee); Mich. Comp. Laws § 445.1508(1) (10 business days); Minn. Stat. § 80C.05(5) (7 days); N.Y. Gen. Bus. Law § 683.8 (10 business days or first face-to-face meeting held for the purpose of discussing

the sale or possible sale of a franchise); N.D. Cent. Code § 51-19.04(c) (7 days); 19 R.I. Gen Laws § 19-28-1.8(a)(2) (14 days); S.D. Codified Laws § 37-5B-17(1) (14 days); Va. Code Ann. § 13.1-563(4) (number of days not specified); Wash. Rev. Code § 19.100.080(1) (14 days); Wis. Stat. § 553.27(4) (14 days); *Long John Silver's Inc. v. Nickleson*, 923 F. Supp. 2d 1004, 1014 (W.D. Ky. 2013) (noting that failure to deliver most current FDD more than 7 days in advance of payment potentially violated delivery requirement of Minnesota Franchise Law).

4. Offer or Sale of Franchise Based on Material False Information (Misrepresentation) in FDD

Instruction:

It is unlawful to make any untrue statement of a material fact in a statement required to be disclosed in writing to the prospective franchisee.

[Name of Plaintiff] claims that [name of Defendant] made an untrue statement of material fact in a statement required to be disclosed in writing to [name of Plaintiff] and that this caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] made an untrue statement.

The statement was or concerned a material fact.

The statement was required to be in the Disclosure Document given to [name of Plaintiff].

[Name of Plaintiff] received that statement

[Name of Plaintiff] relied on that statement.

[Name of Plaintiff]’s reliance on the statement was reasonable.

[Name of Plaintiff] suffered damages as a result.

Sample of the Instruction in Plain English:

It is unlawful to make a false statement of something important in a statement required to be given in writing to the prospective franchisee.

[Name of Plaintiff] claims [name of Defendant] made a false statement about something important in a statement required to be given in writing to [name of Plaintiff] and that this caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] made a false statement.

The statement was about an important fact.

The statement was required to be in the Disclosure Document given to [name of Plaintiff].
[Name of Plaintiff] received the statement.
[Name of Plaintiff] relied on the statement.
[Name of Plaintiff]'s reliance on the statement was reasonable.
[Name of Plaintiff] suffered damages as a result.

Comment:
The franchise statutes are intended to prohibit misrepresentations more broadly than common law fraud. See, e.g., Cal. Corp. Code § 31302 (noting that fraud and deceit are not limited to common law fraud or deceit.). For a discussion comparing the scope of state franchise laws to common law fraud, see Peter C. Lagarias & Bruce J. Napell, Lessons from Thucydides on Distinguishing Statutory from Common Law Fraud in Franchise Disclosure Actions, 35 Franchise L.J. 601 (2016).

Unlike in fraud claims, there may be no scienter requirement for misrepresentation under at least some state franchise laws. That is, there is no requirement to prove that a franchisor that made a misrepresentation knew or should have known the information was incorrect. See, e.g., Enservco, Inc. v. Ind. Secs. Div., 623 N.E.2d 416, 423 (Ind. 1993) (“[C]ulpability is not an element of a violation.”).

There is sometimes a question whether reliance is an element of a claim for damages arising from false disclosure under state franchise laws. Where reliance is an element, there is sometimes a question whether reliance must be reasonable or justifiable.


But not all jurisdictions require that reliance be reasonable or justifiable. See, e.g., Randall v. Lady of Am Franchise Corp., 532 F. Supp. 2d 1071, 1086 (D. Minn. 2007) (holding that “justifiable reliance—like scienter—is not an element of a claim under the statute”; also noting that while, a number of federal courts “have interpreted other states’ franchise statutes to implicitly require the franchisee to demonstrate reliance that is justifiable or reason- able,” but adding that “no Minnesota court has read such a requirement into the Minnesota Franchise Act’s prohibition on misrepresentations by franchisors”).
Regarding materiality, an item of information is material if “there is a substantial likelihood that a reasonable investor would have viewed the information as having significantly altered the total mix of available information.” *Enservco, Inc. v. Ind. Secs. Div.,* 623 N.E.2d 416, 423 (Ind. 1993) (internal punctuation omitted).

Authorities:


5. Offer or Sale of Franchise Based on Material Omission in FDD Instruction:

It is unlawful to omit from the Franchise Disclosure Document (or FDD) any material fact which is required to be stated therein.

[Name of Plaintiff] claims that [name of Defendant] omitted to state a material fact in the FDD and that this caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] omitted to state a fact in the FDD.

The omission was or concerned a material fact.

The omitted fact or statement was required to be in the FDD given to [name of Plaintiff].*

[Name of Plaintiff] received the FDD.

[Name of Plaintiff] relied on the omission of that statement.

[Name of Plaintiff]’s reliance on the omission was reasonable.**

[Name of Plaintiff] suffered damages as a result.

Sample of the Instruction in Plain English:

It is unlawful to leave out of the Franchise Disclosure Document (or FDD) any important fact that is required to be stated therein.

[Name of Plaintiff] claims [name of Defendant] left out an important fact from the FDD and that caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] left a fact out of the FDD.

The omission was or concerned an important fact.
The omitted fact or statement was required to be in the FDD given to [name of Plaintiff].*

[Name of Plaintiff] received the FDD.
[Name of Plaintiff] relied on the omission of that statement.
[Name of Plaintiff]'s reliance on the omission was reasonable.**
[Name of Plaintiff] suffered damages as a result.

Comment:

*When a plaintiff claims that a material fact or statement that was required to be disclosed was omitted from the FDD, an issue may be whether the statement was required to be disclosed. Therefore, this instruction may need to be paired with an instruction concerning the particular FDD disclosure requirement. The Federal Trade Commission Trade Regulation Rule on Franchising sets forth twenty-three categories of information that the FTC requires to be disclosed. The regulation contains detailed instructions and subparts setting forth requirements for disclosure of numerous kinds of information, as set forth in 16 C.F.R. §§ 436.5 to 436.7. Additional sources of disclosure requirements may be in a state’s franchise registration and disclosure law, or regulations of the state agency that administers the law. The court may need to instruct the jury on the particular disclosure requirement at issue. Instruction 15 is an example for illustration of a further instruction concerning a disclosure requirement.

**In an action alleging material omission, proof of nondisclosure of a material fact may establish a presumption of reliance. The defendant may rebut the presumption by proving the plaintiff would have purchased the franchise even if the material omitted fact had been disclosed. See, e.g., Morris v. Int'l Yogurt Co., 729 P.2d 33, 42 (Wash. 1986) (proof of nondisclosure of a material fact establishes presumption of reliance which the defendant may rebut by proving that the plaintiff would still have purchased the franchise even if the material fact had been disclosed).
6. Example, for Illustration, of an Instruction Concerning an FDD Disclosure Requirement

In this example, the plaintiff, after entering into a franchise agreement, leasing real estate, and paying for buildout of the location, learned from a government inspector that a law of the state would mean substantial additional difficulties and costs to complete the buildout, open for business, and operate. The franchisee claims that information about the law was material and that the franchisor failed to disclose information about this law in Item 1 of the FDD. The franchisor claims that information about the law was described generally and that the general description was sufficient to satisfy the FDD disclosure requirement. The court has given the preceding instruction on the offer and sale of a franchise based on material omission in the FDD. The court will also give this instruction.

Instruction:

[Name of Defendant] was required to disclose, in general terms, any laws or regulations specific to the industry in which the franchise business operates.

Comment:

In this example, the statement of the required disclosure consists of the portion of the FTC Franchise Rule that states the disclosure requirement. In this instance, this portion is 16 C.F.R. § 436.5(a)(6)(v), which states that the franchisor must disclose “[i]n general terms, any laws or regulations specific to the industry in which the franchise business operates.” A similar approach may be used to state other disclosure requirements.

Authorities:

For this example, 16 C.F.R. § 436.5(a)(6)(v). For disclosure requirements generally, see 16 C.F.R. §§ 436.5–436.7.

7. Offer or Sale of Franchise Based on Material False Information Outside FDD

Instruction:

It is unlawful to offer or sell a franchise by means of a communication, written or oral, that includes an untrue material fact.

[Name of Plaintiff] claims that [name of Defendant] made an untrue statement of material fact in [offering] [selling] a franchise to [name of Plaintiff] and that this caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] offered or sold a franchise to [name of Plaintiff].

In offering or selling the franchise to [name of Plaintiff], [name of Defendant] made an untrue statement whether orally or in writing.
The statement was or concerned a material fact.
[Name of Plaintiff] received that statement.
[Name of Plaintiff] relied on that statement.
[Name of Plaintiff]'s reliance on the statement was reasonable.
[Name of Plaintiff] suffered damages as a result.

Sample of the Instruction in Plain English:

It is unlawful to offer or sell a franchise by saying something, written or oral, that is false.

[Name of Plaintiff] claims [name of Defendant] made a false statement of something important in [offering] [selling] a franchise to [name of Plaintiff] and that this caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] offered or sold a franchise to [name of Plaintiff].

In offering or selling the franchise, [name of Defendant] said something false whether orally or in writing.

The statement was or concerned a material fact.

[Name of Plaintiff] received the statement.

[Name of Plaintiff] relied on the statement.

[Name of Plaintiff]'s reliance on the statement was reasonable.

[Name of Plaintiff] suffered damages as a result.

Comment:


But not all jurisdictions require that reliance be reasonable or justifiable. See, e.g., Randall v. Lady of Am. Franchise Corp., 532 F. Supp. 2d 1071, 1086 (D. Minn. 2007) (holding that “justifiable reliance—like scienter—is not an element of a claim under the statute”; also noting that while, a number of federal courts “have interpreted other states’ franchise statutes to implicitly
require the franchisee to demonstrate reliance that is justifiable or reasonable,”
but that “no Minnesota court has read such a requirement into the Minnesota
Franchise Act’s prohibition on misrepresentations by franchisors”).

Regarding materiality, an item of information is material if “there is a
substantial likelihood that a reasonable investor would have viewed the
information as having significantly altered the total mix of available informa-
punctuation omitted).

 Authorities:


8. Offer or Sale of Franchise Based on Material Omission Outside FDD
Instruction:

It is unlawful in offering or selling a franchise to omit to state a material
fact that is necessary to make the statements made, in the circumstances, not
misleading.

[Name of Plaintiff] claims that [name of Defendant] in [offering] [selling]
a franchise, omitted to state a material fact that was necessary in the circum-
stances, to state, to make the statements made not misleading and that this
caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] offered or sold a franchise to [name of Plaintiff].

In offering or selling the franchise to [name of Plaintiff], [name of Defen-
dant] omitted to state a material fact.

It was necessary for [name of Defendant] to make that omitted statement
for the statements that were made not to be misleading.

The omission was or concerned a material fact.

[Name of Plaintiff] relied on the omission of that statement.

[Name of Plaintiff]’s reliance on the omission was reasonable.

[Name of Plaintiff] suffered damages as a result.

Sample of the Instruction in Plain English:

It is unlawful in offering or selling a franchise to leave out an important
fact that is necessary to make the statements made, in the circumstances, not
misleading.
[Name of Plaintiff] claims [name of Defendant] in [offering] [selling] the franchise, left out an important fact that was necessary, in the circumstances, to state to make the statements made not misleading and that this caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] offered or sold a franchise to [name of Plaintiff].

In offering or selling the franchise, [name of Defendant] left out an important fact.

It was necessary for [name of Defendant] to make that omitted statement for the statements that were made not to be misleading.

The omission was or concerned an important fact.

[Name of Plaintiff] relied on the omission of that statement.

[Name of Plaintiff]’s reliance was reasonable.

[Name of Plaintiff] suffered damages as a result.

Comment:

In an action alleging material omission, proof of nondisclosure of a material fact may establish a presumption of reliance. The defendant may rebut the presumption by proving the plaintiff would have purchased the franchise even if the material omitted fact had been disclosed. See, e.g., Morris v. Int’l Yogurt Co., 729 P.2d 33, 42 (Wash. 1986) (proof of nondisclosure of a material fact establishing presumption of reliance which the defendant may rebut by proving that the plaintiff would still have purchased the franchise even if the material fact had been disclosed).

Authorities:


9. Offer or Sale of Franchise Based on Use of Device, Scheme or Artifice to Defraud

Instruction:

It is unlawful in the offer, sale or purchase of a franchise, to employ* any device, scheme, or artifice to defraud.
[Name of Plaintiff] claims that [name of Defendant] used a device, scheme or artifice to defraud [name of Plaintiff] in [offering] [selling] a franchise to [name of Plaintiff] and that this caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] offered or sold a franchise to [name of Plaintiff].

In offering or selling the franchise to [name of Plaintiff], [name of Defendant] used a device, scheme, or artifice to defraud [name of Plaintiff].

[Name of Plaintiff] suffered damages as a result.

Sample of the Instruction in Plain English:

It is unlawful in the offer, sale, or purchase of a franchise, to use any device, scheme, or artifice to defraud.

[Name of Plaintiff] claims [name of Defendant] used a device, scheme or artifice to defraud [name of Plaintiff] in [offering] [selling] a franchise to [name of Plaintiff] and that this caused damage to [name of Plaintiff].

To prove this claim, [name of Plaintiff] must prove all the following:

[Name of Defendant] offered or sold a franchise to [name of Plaintiff].

In offering or selling the franchise to [name of Plaintiff], [name of Defendant] used a device, scheme or artifice to defraud [Plaintiff].

[Name of Plaintiff] suffered damages as a result.

Comment:

*Some states add the phrase directly or indirectly, thus making the statute prohibit directly or indirectly employing a device, scheme, or artifice to defraud.

Authorities:

they would turn a profit soon after opening, despite knowing that franchises would fail financially may have engaged in a “scheme” to defraud).

C. Liability of Directors, Officers, and Employees

1. Individual Liability of Director, Officer, or Employee of Franchisor

   Instruction:

   An individual who directly or indirectly controls an entity that is liable, or a partner in a firm that is liable, or a principal executive officer or director of an entity that is liable, or an employee who materially aided in the act or transaction that violated the law, is also liable with and to the same extent as the entity or firm.

   [Name of Plaintiff] claims that [name(s) of individual director(s), officer(s), partner(s), employee(s) of Defendant entity] is/are liable along with [name of Defendant entity]. If you find that [name of Defendant entity] is liable to [Name of Plaintiff], you must decide if [name(s) of individual director(s), officer(s), partner(s), employee(s) of Defendant entity] is/are also liable. Each individual is liable if that individual either directly or indirectly controlled [name of Defendant] or if that individual was a partner of [name of Defendant] or if that individual was a principal executive officer of [name of Defendant] or if that individual was an employee of [name of Defendant] and if an employee, that individually materially aided in the act or transaction that violated the law.

   Sample of the Instruction in Plain English:

   Someone who directly or indirectly controls an entity that is liable, or a partner in a firm that is liable, or a principal executive officer or director of an entity that is liable, or an employee who materially aided the act or transaction that violated the law, is liable the same as the entity or firm. [Name of Plaintiff] claims [name(s) of individual director(s), officer(s), partner(s), employee(s) of Defendant entity] is/are liable along with [name of Defendant entity]. If you find that [name of Defendant entity] is liable to [Name of Plaintiff], you must decide if [name(s) of individual director(s), officer(s), partner(s), employee(s) of Defendant entity] is/are also liable. Each individual is liable who directly or indirectly controlled [name of Defendant] or was a partner of [name of Defendant] or was a principal executive officer of [name of Defendant] or was an employee of [name of Defendant] and if an employee, he or she materially aided in the act or transaction that violated the law.

   Comment:

   Several state franchise laws make individual directors, officers, partners, and employees jointly and severally liable with the entity for franchise law violations. See, e.g., Coraud LLC v. Kidville Franchise Co., LLC, 109 F. Supp. 3d 615 (S.D.N.Y. 2015); A.J. Temple Marble & Tile v. Union Carbide Marble
Care, No. 11, 87 N.Y.2d 574 (N.Y. 1996). Individuals may be liable even if the franchisor entity is not a defendant. See, e.g., Courtney v. Waring, 237 Cal. Rptr. 233, 191 Cal. App. 3d 1434, 1442 (1987) (noting that imposition of secondary liability does not require the plaintiff to successfully sue the franchise seller but only that the plaintiff establish in the action against the secondary defendant that liability could have been imposed on the seller).

The instruction can be shortened to address just the applicable position(s) of the particular individual defendant(s). An affirmative defense may be available for such individuals who lacked knowledge of the violation. See infra Sec. D, Instruction 14 (Defense by Individual Director, Officer or Employee of Lack of Knowledge). For a discussion of individual liability, see Cynthia M. Klaus, Personal Liability of Franchisor Executives and Employees Under State Franchise Laws, 29 Franchise L.J. 99 (2009), and Edward Wood Dunham, Liability of Shareholders, Officers, Directors, and Employees for Franchise Law Violations, 13 Franchise L.J. 101 (1994).

Authorities:

D. Defenses

1. Defense of Statute of Limitations—Specified Number of Years from Act or Transaction Constituting the Violation

Instruction:

[Name of Defendant] contends that [name of Plaintiff]’s lawsuit was not filed within the time set by law. To succeed on this defense, [name of Defendant] must prove that the act or transaction constituting the violation occurred before [insert date from applicable statute of limitation].

Sample of the Instruction in Plain English:

[Name of Defendant] claims [name of Plaintiff]’s lawsuit was not filed within the time set by law. To succeed on this defense, [name of Defendant] must prove that the act or transaction that violated the law occurred before [insert date from applicable statute of limitation].

Comment:

The statute of limitations is an affirmative defense that normally must be pled by the defendant or it is waived. See, e.g., Neptune Soc’y Corp. v. Longamecker, 240 Cal. Rptr. 117, 194 Cal. App. 3d 1233, 1243–44 (1987) (statute of limitations defense is a personal privilege that must be affirmatively pled;
if it appears on face of complaint, it must be raised by demurrer; otherwise, it must be pleaded in the answer, or it is waived; defendant waived statute of limitations defense by failing to plead the defense in its answer and failing to raise it by demurrer. But see Gre-Ter Enters., Inc. v. Mgmt. Recruiters Int'l, Inc., 329 F. Supp. 3d 667, 681 n.10 (S.D. Ind. 2018) (statute of limitations defense may be entertained if its predicates are established by the complaint).

This instruction concerns time limits often referred to as statutes of limitations. But because the statutes in this instruction run for fixed periods of time, not affected by discovery, they are more accurately referred to as statutes of repose. A statute of limitations governs the time in which lawsuits may be brought after a cause of action accrues. A statute of repose extinguishes an action after a fixed period of time, regardless of the plaintiff’s knowledge of the claim. Putzier v. Ace Hardware Corp., 50 F. Supp. 3d 964, 977 (N.D. Ill. 2014) (holding that Illinois three-year period is a statute of repose because it commences upon the actions that constitute the franchise law violation and does not incorporate the discovery rule as a basis for tolling the time when a claim can be brought). But, in some cases, whether by statute or common law rule, tolling may apply even with regard to statutes of repose, where the defendant concealed the claim. See, e.g., Toyz, Inc. v. Wireless Toyz, Inc., 799 F. Supp. 2d 737, 743–44 (E.D. Mich. 2011) (applying tolling to claim otherwise barred by Michigan's franchise law statute of repose where plaintiff alleged defendant wrongfully concealed actions, plaintiff did not discover the facts within the statute of limitations, and plaintiff exercised due diligence until discovery of the facts). A cause of action accrues, and the applicable statute of limitations begins to run, when a party has a right to apply to a court for relief. U.S. Oil Ref. Co. v. Dep’t of Ecology, 633 P.2d 1329 (Wash. 1981).

Authorities:

Cal. Corp. Code § 31300 (four years from act or transaction constituting the violation); Cal. Corp. Code § 31301 (two years from violation); Haw. Rev. Stat. § 482E-10.5 (five/seven years from date of violation); 815 Ill. Comp. Stat. § 705/27 (three years from act or transaction constituting the violation); Md. Code Ann. Bus. Reg. § 14-227(e) (three years from the grant of the franchise); Mich. Comp. Laws § 445.1533 (four years from act or transaction constituting the violation); Minn. Stat. § 80C.17(5) (three years from when cause of action accrues); N.Y. Gen. Bus. Law § 691.4 (three years from act or transaction constituting the violation); 19 R.I. Gen Laws § 19-28.1-22 (four years from act or transaction constituting the violation); S.D. Codified Laws § 37-5B-50 (in an action for rescission, within one year; in an action for damages, costs, attorney and expert fees, within three years, after the violation occurred); Va. Code Ann. § 13.1-571 (four years after the cause of action arose upon which the claim suit is based); Wash. Rev. Code § 4.16.130 (an action must be commenced within two years after the cause
of action has accrued); Wis. Stat. § 553.51(4) (three years after the act or transaction constituting the violation); see also JM Vidal, Inc. v. Texdis USA, Inc., 764 F. Supp. 2d 599, 611 (S.D.N.Y. 2011) (Washington’s “catch-all” statute of limitations of two years applies to Washington Franchise Investment Protection Act claims); People ex rel. Dep’t of Corps. v. Speedee Oil Change Sys., Inc., 116 Cal. Rptr. 2d 497, 95 Cal. App. 4th 709, 727 (2002) (“Once the four-year . . . period expires, a plaintiff’s belated discovery of the fact constituting the violation cannot serve to extend the statute of limitations. In other words, the four-year ban in section 31303 . . . [is] absolute.”).

2. Defense of Statute of Limitations—Specified Number of Years from Discovery of Facts Constituting the Violation

Instruction:

[Name of Defendant] contends that [name of Plaintiff]’s lawsuit was not filed within the time set by law. To succeed on this defense, [name of Defendant] must prove that [name of Plaintiff] discovered the act or transaction constituting the violation before [insert date from applicable statute of limitation].

Sample of the Instruction in Plain English:

[Name of Defendant] claims [name of Plaintiff]’s lawsuit was not filed in the time set by law. To succeed on this defense, [name of Defendant] must prove [name of Plaintiff] discovered the facts of the violation before [insert date from applicable statute of limitation].

Comment:

The statute of limitations is an affirmative defense that normally must be pled by the defendant or is waived. See, e.g., Neptune Soc’y Corp. v. Longamecker, 240 Cal. Rptr. 117, 194 Cal. App. 3d 1233, 1243–44 (1987) (statute of limitations defense is a personal privilege that must be affirmatively pled; if it appears on face of complaint, it must be raised by demurrer; otherwise, it must be pleaded in the answer or is waived; defendant waived statute of limitations defense by failing to plead the defense in its answer and failing to raise it by demurer). But see Gre-Ter Enters., Inc. v. Mgmt. Recruiters Int’l, Inc., 329 F. Supp. 3d 667, 681 n.10 (S.D. Ind. 2018) (statute of limitations defense may be entertained if its predicates are established by the complaint).

A discovery-based statute of limitation may start to run when the plaintiff knew the facts constituting the violation, even if not aware of the legal significance of the facts. See, e.g., Powell v. Coffee Beanery, Ltd., 932 F. Supp. 985, 987 (E.D. Mich. 1996) (The one-year limitation began to run when claimant discovered fact constituting the violation even though claimant was not aware that the facts constituted a violation. The legislature chose to start the limitations period when the claimant became aware of facts constituting the violation, regardless of whether claimant knew the facts constituted a violation.).
Authorities:
Cal. Corp. Code §§ 31300, 31301 (one year from discovery by the plaintiff of the act or transaction constituting the violation); Haw. Rev. Stat. § 482E-10.5 (two years from discovery of facts constituting the violation); 815 Ill. Comp. Stat. § 705/27 (one year from becoming aware of the facts or circumstances reasonably indicating the plaintiff may have a claim); Ind. Code § 23-2-2.5-30 (three years after discovery by the plaintiff of the facts constituting the violation); N.D. Cent. Code § 51-19-12(5) (five years from date that plaintiff knew or reasonably should have known about the facts that are the basis for the alleged violation); S.D. Codified Laws § 37-5B-50 (in an action for damages, costs, attorney and expert fees, within two years after discovery of the facts constituting the violation).

3. Instruction Regarding Time of Discovery [California]
Instruction:
By law, a person who has actual notice of circumstances sufficient to put a prudent person upon inquiry as to a particular fact is deemed to have notice of the fact itself that, by such inquiry, he or she might have learned that fact.

Sample of the Instruction in Plain English:
By law, a person, who has notice of things that would cause a prudent person to investigate, is deemed to know the facts he or she would have learned from investigating.

Comment:
This instruction is for use in California. It advances the time when a plaintiff is deemed to be on notice of facts constituting a violation to earlier in time when the plaintiff had notice of circumstances sufficient to cause a prudent person to make inquiry about a particular fact. In such circumstances, the plaintiff is deemed to know everything that the plaintiff would have learned by investigating the fact. In Ellering v. Sellstate Realty System Network, Inc., 801 F. Supp. 2d 834, 841–42 (D. Minn. 2011), a court indicated that a plaintiff may even be deemed to be on notice of facts in the public record, noting that a franchisor’s registration status was a public record, ascertainable at the state regulatory agency’s website.

Authorities:
Cal. Civ. Code § 19; Cal. Corp. Code §§ 31300, 31301 (one year from discovery by the plaintiff of the act or transaction constituting the violation).

4. Defense of Statute of Limitations—Specified Number of Days from Notice Disclosing Violation
Instruction:
[Name of Defendant] contends that [name of Plaintiff]’s lawsuit was not filed within the time set by law. To succeed on this defense, [name of
Defendant] must prove that [name of Defendant] delivered to [name of Plaintiff] a written notice disclosing the violation before [insert date from applicable statute of limitation].

Sample of the Instruction in Plain English:

[Name of Defendant] claims [name of Plaintiff]'s lawsuit was not filed in the time set by law. To succeed on this defense, [name of Defendant] must prove [name of Defendant] delivered to [name of Plaintiff] a written notice disclosing the violation before [insert date from applicable statute of limitation].

Comment:

This instruction applies for states that set a shorter statute of limitations following a franchisor's delivery of notice to the franchisee that the franchisor violated the state’s franchise law.

Authorities:

Cal. Corp. Code § 31303 (90 days from delivery to the plaintiff of written notice, approved as to form by the Commissioner of Business Oversight, disclosing the violation); 815 Ill. Comp. Stat. § 705/27 (90 days from delivery to Plaintiff of written notice disclosing the violation); S.D. Codified Laws § 37-5B-50 (within 90 days after receipt by plaintiff of a rescission offer in a form approved by the director of the Division of Insurance); Wis. Stat. § 553.51(4) (within 90 days after delivery to plaintiff of written notice disclosing discloses any violation and is filed with the Wisconsin Division of Securities).

5. Defense of Statute of Limitations—Specified Number of Days from Making Rescission Offer

Instruction:

[Name of Defendant] contends that [name of Plaintiff]’s lawsuit was not filed within the time set by law. To succeed on this defense, [name of Defendant] must prove that [name of Defendant] delivered to [name of Plaintiff] an offer of rescission before [insert date from applicable statute of limitation].

Sample of the Instruction in Plain English:

[Name of Defendant] claims [name of Plaintiff]’s lawsuit was not filed in the time set by law. To succeed on this defense, [name of Defendant] must prove [name of Defendant] delivered to [name of Plaintiff] a rescission offer before [insert date from applicable statute of limitation].

Comment:

The statute of limitations is an affirmative defense that normally must be pled by the defendant or is waived. See, e.g., Neptune Soc'y Corp. v. Langanenker, 240 Cal. Rptr. 117, 194 Cal. App. 3d 1233, 1243–44 (1987) (statute
of limitations defense is a personal privilege that must be affirmatively pled; if it appears on face of complaint, it must be raised by demurrer; otherwise, it must be pled in the answer or is waived; defendant waived statute of limitations defense by failing to plead the defense in its answer and failing to raise it by demurer). But see Gre-Ter Enters., Inc. v. Mgmt. Recruiters Int’l, Inc., 329 F. Supp. 3d 667, 681 n.10 (S.D. Ind. 2018) (noting that statute of limitations defense may be entertained if its predicates are established by the complaint).

The Rhode Island statute requires that the rescission notice be approved by the Director of Business Regulation. This element is omitted from the instruction on the basis that it is not likely to be disputed. The North Dakota statute is more detailed, and thus the instruction may need editing to address such detail.

Authorities:

N.D. Cent. Code § 51-19-12(4) (after plaintiff received a written offer, submitted to the Securities Commissioner at least 15 days prior to submission to the plaintiff, provided to the plaintiff before the action was commenced, at a time when plaintiff owned the franchises, to refund the consideration paid and interest at seven percent per annum from the date of purchase, less the amount of income received on the franchise, conditioned only on tender by the plaintiff of all items received for the consideration and not sold, and reciting the provisions of North Dakota Centennial Code § 51-19-12(4), and plaintiff did not accept the offer within 30 days, and meeting other terms of the statute); 19 R.I. Gen. Laws § 19-28.1-22 (90 days after receipt by plaintiff of a rescission offer in a form approved by the Director of Business Regulation).

6. Defense of Exemption from Registration Requirement—Preliminary Instruction; Burden of Proof of Exemption

Instruction:

[Name of Defendant] claims it was exempt from the requirement to be registered. Once [name of Plaintiff] proves that [name of Defendant] sold a franchise that was not registered, then [name of Defendant] has the burden to prove that he/she/it qualified for an exemption.

Sample of the Instruction in Plain English:

[Name of Defendant] claims it was exempt from being required to register. If [name of Plaintiff] proves [name of Defendant] sold a franchise that was not registered, then [name of Defendant] has the burden to prove he/she/it met the requirements to be exempt.

Comment:

The franchisor has the burden to plead and prove the facts establishing an exemption. Cal. Corp. Code § 31153; Haw. Rev. Stat. § 482E-5(d); 815 Ill.

**Authorities:**


7. Defense of Exemption for Sale of Franchise by Franchisee for Own Account

Instruction:

Earlier, I instructed you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale of a franchise by a franchisee for his or her or its own account is exempt from the requirement to be registered, if the offer and sale is not effected by or through a franchisor. [Name of Defendant] claims he/she/it was a franchisee who/that offered and sold the franchise to [name of Plaintiff] for [name of Defendant]'s own account. To prove this defense, [name of Defendant] must prove (1) that [name of Defendant] was a franchisee of the [name of the franchise] franchise that was offered and sold; (2) [name of Defendant] offered and sold the [name of the franchise] franchise to [name of Plaintiff] for [name of Defendant]'s own account; and (3) the offer and sale were not effected by or through [a franchisor] or [the franchisor, [name of franchisor]].

A sale is not effected by or through [a franchisor or name of particular franchisor in the case] merely because [a franchisor or name of particular franchisor in the case]: [Cal.; Ill; Ind.; Md.; Minn.; R.I.; Va.; Wash.; Wis.—has a right to approve or disapprove a different franchisee] [Ill.; Or.; R.I.; Va.; Wash.—requires payment of a reasonable transfer fee] [Wis.: has the right to impose a fee or charge to reimburse [the franchisor or name of particular franchisor in the case] for reasonable and actual expenses incurred with the sale [Ill.; R.I.—requires the new franchisee to execute a franchise agreement on terms not materially different from the existing franchise agreement] [Or.—requires execution of appropriate documentation].

Sample of the Instruction in Plain English:

Earlier, I told you the offer or sale of a franchise must be registered with [name of agency]. But a franchisee's offer or sale of [his/her/its] own
franchise is exempt from having to be registered, if the offer and sale does not go through a franchisor. [Name of Defendant] claims he/she/it was a franchisee who/that offered and sold the franchise to [name of Plaintiff] for [name of Defendant]'s own account. To prove this defense, [name of Defendant] must prove (1) [name of Defendant] was a franchisee of the [name of the franchise] franchise that was offered and sold; (2) [name of Defendant] offered and sold the [name of the franchise] franchise to [name of Plaintiff] for [name of Defendant]'s own account; and (3) the offer and sale was not done by or through [a franchisor] or [the franchisor, [name of franchisor]].

A sale is not done by or through [a franchisor or name of particular franchisor in the case] just because [a franchisor or name of particular franchisor in the case]: [Cal.; Ill.; Ind.; Md.; Minn.; R.I.; Va.; Wash.; Wis.—has a right to approve or disapprove a different franchisee] [Ill.; Or.; R.I.; Va.; Wash—requires payment of a reasonable transfer fee] [Wis.: has the right to impose a fee or charge to reimburse [the franchisor or name of particular franchisor in the case] for reasonable and actual expenses incurred with the sale] [Ill.; R.I.—requires the new franchisee to execute a franchise agreement on terms not materially different from the existing franchise agreement] [Or.—requires execution of appropriate documentation].

Comment:

The sale of an existing franchise by a franchisee for his or her or its own account is exempt from registration in several states. The exemption permits a franchisee to sell his or her or its existing franchised business to a third-party purchaser. Typically, a franchisor reserves the right to approve the proposed buyer. In several states, the franchisor's exercise of this right does not result in the sale being effected by the franchisor. See, e.g., Fox v. Ehrmantraut, 28 Cal. 3d 127, 141–42 (Cal. 1980) (“Mere franchisor participation in the sale by furnishing information, referring prospective purchasers of the franchise, or approving purchasers does not deprive a franchisee of his exemption.”).

Authorities:

Cal. Corp. Code 31102; Haw. Rev. Stat. § 482E-4(7) (requiring that the sale be isolated and not part of a plan of distribution of franchises); 815 Ill. Comp. Stat. § 705/7; Ind. Code § 23-2-2.5-4; Md. Code Ann. Bus. Reg. § 14-214(c); Mich. Comp. Laws § 445.1506(1)(f) (requiring that the sale be isolated and not part of a plan of distribution of franchises and that the franchisee provides the prospective buyer full access to the books and records related to the franchise in the selling franchisee’s possession; additionally, under Michigan's exemption, Mich. Comp. Laws § 445.1506(2), if defendant had a disclosure document, a condition of the exemption is to have provided that to the plaintiff at least 10 business days before signing of any agreement or receipt of any consideration; Minn. Stat. § 80C.03 (limit of one such sale during any 12 consecutive months); N.Y. Gen. Bus. Law § 684.5
(requires that the sale be isolated and not part of a plan of distribution and the franchisee must furnish the franchisor’s offering prospectus at least one week before receipt of any consideration); N.D. Cent. Code § 51-19-04(2); Or. Admin. R. § 441-325-0030(4) (requiring that the sale be isolated and not part of a plan of distribution and franchisor does not aid in the sale: 19 R.I. Gen Laws § 19-28.1-6(2) (franchisee cannot be an affiliate of the franchisor); S.D. Codified Laws § 37-5B-1(28); 21 Va. Admin. Code § 5-110-75 (franchisee cannot be an affiliate of the franchisor; must sell the entire franchise); Wash. Rev. Code § 19.100.030(1) (franchisee cannot be an affiliate of the franchisor and must sell the entire franchise); Wis. Stat. § 553.23; see also Godfrey v. Schroekenthaler, 501 N.W.2d 812, 815 (Wis. Ct. App. 1993) (proof established defense based on claim that franchisee’s offer to sell a Dairy Queen franchise was exempt from registration as an offer of sale for its own account); Uncle John’s of Hawaii v. Mid-Pacific Rests., 794 P.2d 614, 616 (Haw. 1990) (noting the exemption, but finding it inapplicable).

8. Defense of Exemption for Offer or Sale by Experienced/High Net Worth Franchisor

Instruction:

Earlier, I instructed you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale of a franchise is exempt from the requirement to be registered if [name of Defendant] satisfied certain requirements regarding its worth, experience, providing certain information, and notifying the state. [Name of Defendant] claims it met these requirements. Now I will instruct you on the requirements [name of Defendant] must prove it met to qualify for this exemption.

First, I will instruct you on the requirement about its worth. For [name of Defendant] to have been exempt from being required to register its franchise [name of Defendant] must prove that it met one or more of the following requirements regarding its worth:

[Name of Defendant] had net worth on a consolidated basis of at least five million dollars according to its audited financial statement for the year [year at issue].

or

[Name of Defendant] had net worth of at least one million dollars and a parent entity—that is, an entity that owned at least eighty percent of [name of Defendant]—had a net worth of at least five million dollars, according to the audited financial statement(s) of [name of Defendant] and of the parent for the year [year at issue].

or

[Name of Defendant] had net worth of at least one million dollars according to an audited or unaudited financial statement and a parent
entity—that is, a corporation that owned at least eighty percent of [name of Defendant]—had a net worth of at least five million dollars, according to the parent’s audited financial statement for the year [year at issue], and the parent absolutely and unconditionally guaranteed to assume the duties and obligations of [name of Defendant] under the franchise agreement if [name of Defendant] became unable to perform its duties and obligations.

Next, I will instruct you on the experience requirement. For [name of Defendant] to have been exempt from being required to register its franchise, [name of Defendant] must prove, in addition to the worth requirement that I just described, that it met any one or more of the following experience conditions:

[Name of Defendant] must prove it met one or more of the following experience conditions at all times during the five-year period before the offer and sale of the franchise. [Name of Defendant] did not have to meet the same condition during the entire five years, but could meet one of the following conditions some of the time, and one or more other of these conditions during the rest of the time.

That [name of Defendant] had at least twenty-five franchisees conducting business that was the subject of the franchise.

or

That [name of Defendant] conducted business that was the subject of the franchise.

or

[Name of Defendant]’s parent—that is, an entity that owned at least eighty percent of [name of Defendant]—had at least twenty-five franchisees conducting business that was the subject of the franchise.

or

That [name of Defendant]’s parent—that is, an entity that owned at least eighty percent of [name of Defendant]—conducted business that was the subject of the franchise.

Now I will instruct you on the requirement to have provided the franchisee certain information. For [name of Defendant] to have been exempt from being required to register its franchise [name of Defendant] must prove, in addition to the worth and experience requirement that I just described, that it disclosed in writing to each prospective franchisee, at least 14 days before the signing by the prospective franchisee of any binding agreement or at least 14 days before receiving any consideration, all the following information:

(1) [Name of Defendant]’s name, the name under which it was doing or intended to do business, and the name of any parent or affiliated company that would engage in business transactions with franchisees.
(2) [Name of Defendant]’s principal business address and the name and address of its agent in California authorized to receive service of process.

(3) The business form of [name of Defendant], whether corporate, partnership, or otherwise.

(4) The business experience of [name of Defendant], including how long [name of Defendant] conducted a business of the type to be operated by [name of Plaintiff]; how long [name of Defendant] granted franchises for such business; and how long [name of Defendant] granted franchises in other lines of business.

(5) A copy of the typical franchise contract or agreement proposed for use or in use in this state.

(6) A statement of the franchise fee charged, the proposed use of the proceeds of such fee by [name of Defendant], and, if the fee was not the same in all cases, the formula for how the amount of the fee was determined.

(7) A statement describing any payments or fees other than franchise fees that [name of Plaintiff] was required to pay to [name of Defendant], including royalties and payments or fees which [name of Defendant] collected in whole or in part on behalf of a third party or parties.

(8) A statement of the conditions under which the franchise agreement could be terminated or renewal refused, or repurchased at the option of [name of Defendant].

(9) A statement whether, by the terms of the franchise agreement or by other device or practice, [name of Plaintiff] was required to buy from [name of Defendant] or [name of Defendant]’s designee, any services, supplies, products, fixtures, or other goods relating to the establishment or operation of the franchise business, together with a description thereof.

(10) A statement whether, by the terms of the franchise agreement or other device or practice, [name of Plaintiff] was limited in the goods or services offered by [name of Plaintiff] to [name of Plaintiff]’s customers.

(11) A statement of the terms and conditions of any financing arrangements when offered directly or indirectly by [name of Defendant] or [name of Defendant]’s agent or affiliate.

(12) A statement of any past or present practice or of any intent of [name of Defendant] to sell, assign, or discount to a third party any note, contract, or other obligation of [name of Plaintiff] in whole or in part.

(13) If any statement of estimated or projected franchisee earnings was used, a statement of such estimation or projection and the data on which it was based.
(14) A statement whether franchisees or subfranchisors received an exclusive area or territory.

(15) A copy of the financial statement or statements that established [name of Defendant’s] worth.

(16) If [name of Defendant] relied on the guaranty to meet the worth requirement, a copy of the guaranty.

Now I will instruct you on the notice requirement.

For [name of Defendant] to have been exempt from being required to register its franchise, [name of Defendant] must prove, in addition to the worth and experience and disclosure of information requirements that I just described, that it filed a Notice of Exemption with the California Commissioner of Business Oversight and paid the required fee, before any offer or sale of a franchise in this state in the calendar year when one or more franchises were sold.

Sample of the Instruction in Plain English:

Earlier, I told you the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale of a franchise is exempt from having to be registered if [name of Defendant] met requirements about its worth, experience, providing certain information, and notifying the state. [Name of Defendant] claims it met these requirements. Now I will tell you the requirements [name of Defendant] must prove it met to qualify for this exemption.

First, I will tell you the requirement about its worth. For [name of Defendant] to have been exempt from having to register its franchise, [name of Defendant] must prove it met one or more of the following requirements regarding its worth:

[Name of Defendant]’s net worth on a consolidated basis was at least five million dollars according to its audited financial statement for the year [year at issue].

or

[Name of Defendant]’s net worth was at least one million dollars and its parent—that is, an entity that owned at least eighty percent of [name of Defendant]—had net worth of at least five million dollars, according to the audited financial statement(s) of [name of Defendant] and of the parent for the year [year at issue].

or

[Name of Defendant] had net worth of at least one million dollars according to an audited or unaudited financial statement and its parent—that is, an entity that owned at least eighty percent of [name of Defendant]—had net worth of at least five million dollars, according to the parent’s audited
financial statement for the year [year at issue] and the parent absolutely and unconditionally guaranteed to assume the duties and obligations of [name of Defendant] under the franchise agreement if [name of Defendant] became unable to perform its duties and obligations.

Next, I will tell you the experience requirement. For [name of Defendant] to have been exempt from having to register its franchise, [name of Defendant] must prove, in addition to the worth requirement that I just described, that it met any one or more of the following experience conditions:

[Name of Defendant] must prove that it met one or more of the following experience conditions at all times during the five years before offering and selling the franchise. [Name of Defendant] did not have to meet the same condition for the whole five years, but could meet one of the conditions some of the time, and one or more other conditions during other times.

That [name of Defendant] had at least twenty-five franchisees in the business that was the subject of the franchise.

or

That [name of Defendant] was in the business that was the subject of the franchise.

or

[Name of Defendant]’s parent—an entity that owned at least eighty percent of [name of Defendant]—had at least twenty-five franchisees in the business that was the subject of the franchise.

or

That [name of Defendant]’s parent—an entity that owned at least eighty percent of [name of Defendant]—did the business that was the subject of the franchise.

Now I will tell you the requirement to have provided the franchisee information. For [name of Defendant] to have been exempt from having to register its franchise, [name of Defendant] must prove, in addition to the worth and experience requirements that I just described, that it told each prospective franchisee in writing, at least 14 days before the prospective franchisee signed any binding agreement or at least 14 days before [name of Defendant] received anything of value, all the following information:

(1) [Name of Defendant]’s name, the name that it used or intended to use to do business, and the name of any parent or affiliated company that would engage in business with franchisees.

(2) [Name of Defendant]’s principal address and the name and address of its agent in California authorized to receive service of process.
(3) [Name of Defendant]’s business form, whether corporate, partnership, or otherwise.

(4) How long [name of Defendant] conducted business of the type to be done by [name of Plaintiff]; how long [name of Defendant] granted franchises for that business, and how long [name of Defendant] granted franchises in other businesses.

(5) Copy of the typical franchise contract or agreement proposed for use or in use in this state.

(6) The fee charged and proposed use of the fee by [name of Defendant], and, if the fee was not the same for everyone, the formula how the amount of the fee was determined.

(7) Description of payments or fees other than franchise fees [name of Plaintiff] had to pay to [name of Defendant], including royalties and payments or fees that [name of Defendant] collected in whole or in part for others.

(8) A statement of conditions in which [name of Defendant] could decide to terminate the franchise agreement or refuse to renew it or buy back the franchise.

(9) A statement whether [name of Plaintiff] was required to buy from [name of Defendant] or [name of Defendant]’s designee, services, supplies, products, fixtures, or other things relating to the franchise, and a description.

(10) A statement whether there was some restriction on goods or services [name of Plaintiff] could offer to customers.

(11) A statement of the terms of any financing offered directly or indirectly by [name of Defendant] or [name of Defendant]’s agent or affiliate.

(12) A statement of any past or present practice or intent of [name of Defendant] to sell, assign, or discount to a third party any note, contract, or other obligation of [name of Plaintiff] in whole or in part.

(13) If any estimate or projection of franchisee earnings was used, a statement of the estimate or projection and data it was based on.

(14) A statement whether franchisees or subfranchisors got an exclusive area or territory.

(15) A copy of the financial statement or statements that established [name of Defendant’s] worth.

(16) If [name of Defendant] relied on the guaranty to meet the worth requirement, a copy of the guaranty.

Now I will tell you the notice requirement. For [name of Defendant] to have been exempt from having to register its franchise [name of Defendant] must prove, in addition to the worth and experience and disclosure of
information requirements I just described, that it filed a Notice of Exemption with the California Commissioner of Business Oversight and paid the required fee, before any offer or sale of a franchise in this state in the calendar year when one or more franchises was sold.

Comment:

This instruction is based on California’s exemption for large, experienced franchisors. Cal. Corp. Code § 31101. Similar exemptions, often with fewer requirements, appear in statutes or regulations in Illinois, Indiana, New York, North Dakota, Rhode Island, Virginia, and Washington. The instruction would need to be revised to align with the statute or regulation of the applicable state and for several such states the revision will be shorter.

The California statute uses the term “corporation” in describing the parent. The statute was originally enacted in 1970 before limited liability companies existed. As a statute creating an exemption, it possibly would be interpreted narrowly and strictly to exclude other kinds of entities. See, e.g., Morris v. Int'l Yogurt Co., 729 P.2d 33, 35–36 (Wash. 1986) (noting that exemptions are normally construed narrowly and require strict compliance); City of Hesperia v. Lake Arrowhead Cnty. Servs. Dist., 250 Cal. Rptr. 3d 82, 37 Cal. App. 5th 734, 750 (2019) (statutory exemptions must be narrowly construed); Board of Med. Quality Assurance v. Andrews, 260 Cal. Rptr. 113, 211 Cal. App. 3d 1346, 1355 (1989) (“[S]tatutes conferring exemptions from regulatory schemes are narrowly construed.”). However, a treatise on exemptions suggests the policy behind the provision should apply to other entities such as limited liability companies. Susan Grueneberg & Josh Piper, Exemptions and Exclusions Under Federal and State Franchise Registration and Disclosure Laws 25 (Leslie D. Curran & Beata Krakus eds., 2017). Also, under the rule, one of the categories of information to be given to a prospective franchisee is the defendant’s business form “whether corporate, partnership, or otherwise,” Cal. Corp. Code § 31101(c)(1)(C), which indicates that other types of entities are possible.

In Dollar System, Inc. v. Avcar Leasing System, Inc., 673 F. Supp. 1493, 1501–02 (C.D. Cal. 1987), the district court ruled that a franchisor did not qualify for an exemption under the laws of California, and Maryland, because, prior to selling the franchise, the franchisor failed to file required exemption notices required by each state. The decision was affirmed in part and reversed in part on other grounds. Dollar Sys., Inc. v. Avcar Leasing Sys., Inc., 890 F.2d 165 (9th Cir.1989).

The instruction lists multiple conditions that might need to be satisfied and sixteen categories of information required to be disclosed. The instruction could be shortened by omitting portions of the instruction that concern issues not in dispute.

Authorities:


9. Defense of Exemption for Offer or Sale to High Net Worth Franchisee

Instruction:

Earlier, I instructed you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale of a franchise was exempt from registration if certain conditions were present concerning the franchisee. [Name of Defendant] claims the conditions for the offer or sale to be exempt were present. To prove this defense, [name of Defendant] must prove that:

Every purchaser of the franchise was in one of the following categories. It need not have been the same category for all purchasers:

One category is a partner, executive officer, or director of [name of Defendant], or an executive officer of [name of Defendant]’s corporate general partner if [name of Defendant] is a partnership, or a manager, if [name of Defendant] is a limited liability company.

Another category is an entity with assets over five million dollars according to its financial statements. For this category, [name of Defendant] must prove that the entity was not formed for the purpose of acquiring the franchise. For this category, [name of Defendant] must prove that the financial statements were prepared according to rules and requirements of the United States Securities and Exchange Commission or according to generally accepted accounting principles and, if [name of Defendant] had consolidated subsidiaries, that the financial statements were prepared on a consolidated basis. For this category, [name of Defendant] must prove that the financial statements were dated within 90 days of the earlier of the date the first purchaser signed a binding agreement or the date [name of Defendant] received any money or other consideration from the first purchaser.

Another category is a natural person whose net worth, or joint net worth with that person’s spouse, was more than one million dollars at the time the person purchased the franchise, not counting that person’s personal residence, retirement, or pension plan accounts or benefits, home furnishings, and cars.

Another category is a natural person whose gross income exceeded three hundred thousand dollars per year in each of the two most recent years before buying the franchise, or whose joint gross income with that person’s spouse exceeded five hundred thousand dollars per year in each of the two most recent years before buying the franchise, and who reasonably expected to reach the same income level or more in the year of the purchase of the franchise.

Another category is an entity in which all the equity owners were persons or entities who met the conditions in one or more of the prior categories.
Apart from each person being in at least one of the categories that I just described, to prove the defense of this exemption, [name of Defendant] must prove that each and every purchaser had knowledge and experience in financial and business matters, either alone or with professional advisers who were not affiliated with, and not directly or indirectly compensated by, [name of Defendant] or by an affiliate or selling agent of [name of Defendant], so that [name of Defendant] reasonably believed, based on reasonable inquiry before the sale, that each and every purchaser had the capacity to evaluate the merits and risks of, and protect their own interests in, the franchise investment.

For this exemption to apply, [name of Defendant] must also prove that each and every purchaser purchased the franchise for the purchaser’s own account, or a trust account if the purchaser was a trustee, for the purpose of conducting the business as a franchise and not with a view to, or for a sale in connection with, any resale or distribution of the franchise or any interest in the franchise.

If the purchaser was a natural person, then for this exemption to apply [name of Defendant] must also prove that the immediate cash payment required from the purchaser was not more than ten percent of that person’s net worth or joint net worth with that person’s spouse, not counting the person’s personal residence, retirement, or pension accounts or benefits, home furnishings, and cars.

There is also a notice requirement. For [name of Defendant] to have been exempt from being required to register its franchise, [name of Defendant] must prove, in addition to the other requirements that I have described, that [name of Defendant] filed a Notice of Exemption with the California Commissioner of Business Oversight and paid the required fee, before any offer or sale of a franchise in this state for which this exemption was claimed in the calendar year when one or more franchises was sold.

[Name of Defendant] must also prove that [name of Defendant] and its officers, directors, employees, or agents did not form, organize, engage, or assist [name of Plaintiff] to buy a franchise for resale or distribution in order for [name of Defendant] to avoid the registration requirements.

Sample of the Instruction in Plain English:

Earlier, I told you the offer or sale of a franchise must be registered with [name of agency]. But it was exempt if certain conditions were present. [Name of Defendant] claims these conditions were present. To prove this defense, [name of Defendant] must prove that:

Every buyer of the franchise was in one of the following categories. It does not have to be the same category for everyone:

One category is a partner, executive officer, or director of [name of Defendant], or an executive officer of [name of Defendant]’s corporate general partner if [name of Defendant] is a partnership, or a manager if [name of Defendant] is a limited liability company.
Another category is an entity with assets over five million dollars according to its financial statements. For this category, [name of Defendant] must prove that the entity was not formed to buy the franchise. For this category, [name of Defendant] must prove that the financial statements were prepared according to rules of the United States Securities and Exchange Commission or according generally accepted accounting principles, and if [name of Defendant] had consolidated subsidiaries, that the financial statements were on a consolidated basis. For this category, [name of Defendant] must prove the financial statements were dated within 90 days of when the first purchaser signed a binding agreement or [name of Defendant] received any money or other consideration.

Another category is a natural person whose net worth, or joint net worth with that person’s spouse, was over one million dollars when the person bought the franchise, not counting any personal residence, retirement or pension plan, home furnishings, and cars.

Another category is a natural person whose gross income exceeded three hundred thousand dollars per year in each of the two years before buying the franchise, or whose joint gross income with the person’s spouse exceeded five hundred thousand dollars per year each of the two years before buying the franchise, and who reasonably expected to reach the same income level or more in the year of buying the franchise.

Another category is an entity, in which all the owners were persons or entities who met the conditions in one or more of the prior categories.

Apart from each person being in at least one of the categories that I just described, to prove this defense, [name of Defendant] must prove that each and every buyer had knowledge and experience in financial and business matters, alone or with professional advisers who were not affiliated with, and not directly or indirectly compensated by, [name of Defendant] or by an affiliate or selling agent of [name of Defendant], so that [name of Defendant] reasonably believed, based on reasonable inquiry before the sale, that each and every buyer had the ability to evaluate the merits and risks and protect their interests.

For this exemption to apply, [name of Defendant] must also prove that each and every buyer purchased the franchise for the buyer’s own account, or a trust account if the buyer was a trustee, to run the business as a franchise and not to resell it or sell ownership interests in it.

If the buyer was a natural person, then [name of Defendant] must also prove the payment required from the buyer was not more than ten percent of the buyer’s net worth or joint net worth with that person’s spouse, not counting personal residence, retirement plan, home furnishings, and cars.
For [name of Defendant] to be exempt, [name of Defendant] must also prove that [name of Defendant] filed a Notice of Exemption with [name of agency] and paid the required fee, before offering or selling any franchise in this state for which this exemption was claimed that year.

[Name of Defendant] must also prove that [name of Defendant] and its officers, directors, employees, or agents did not help [name of Plaintiff] buy the franchise for resale or to sell ownership interests in it.

Comment:

This instruction is based on California’s exemption for large franchisees. Cal. Corp. Code § 31109. Similar exemptions appear in statutes or regulations in Illinois, Rhode Island, South Dakota, and Washington. The instruction would need to be revised to align with the statute or regulation of the applicable state and for several states will be much shorter.

The California statute provides: “No franchisor or any of its officers, directors, employees, or agents shall form, organize, engage, or assist any person to purchase a franchise for resale or distribution to avoid the registration requirements.” Cal. Corp. Code § 31108(f). It is not clear if this states a prohibition or element of proof to establish the franchise. The language suggests it may be a prohibition, rather than an element of proof. If so, then the last paragraph of the instruction could be omitted. If it is an element of proof, then consistent with the burden of proof (see instruction 6, above) the burden of proof is assigned to the Defendant.

Authorities:


10. Defense of Exemption for Offer or Sale of Franchise to Existing Franchisee

Instruction:

Earlier, I instructed you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale of a franchise was exempt from registration if the offer or sale was of an additional franchise made to an already existing franchisee of [name of Defendant]. [Name of Defendant] claims the offer and sale of the franchise was made to an already existing franchisee. To prove this defense, [name of Defendant] must prove that:

At the time [name of Defendant] offered and sold the franchise to [name of Plaintiff], [name of Plaintiff] was already an existing franchisee of [name of Defendant].

[Name of Defendant] could alternatively prove this defense by proving that [name of Defendant]’s offer or sale of the franchise was made to an
entity and one or more of the entity’s officers, directors, managing agents, or owners of at least twenty-five percent of the entity, was an existing franchisee of [name of Defendant].

[Name of Defendant] must prove that for 24 months or more, the existing franchisee or the qualifying person was engaged in a business that offered products or services substantially similar to those offered by [name of Defendant].

There is also a notice requirement. For [name of Defendant] to have been exempt from being required to register its franchise, [name of Defendant] must prove that it filed a Notice of Exemption with the California Commissioner of Business Oversight and paid the required fee, all no later than 15 days after the sale of the franchise.

Sample of the Instruction in Plain English:

Earlier, I told you the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale was exempt if it was an additional franchise sold to an already existing franchisee of [name of Defendant]. [Name of Defendant] claims this exemption applies. To prove this defense, [name of Defendant] must prove that:

When [name of Defendant] offered and sold the franchise to [name of Plaintiff], [name of Plaintiff] was already a franchisee of [name of Defendant].

Or, [name of Defendant] could prove this defense by proving that [name of Defendant] offered and sold the franchise to an entity and one or more of the entity’s officers, directors, managing agents or owners of twenty five percent or more of the entity, was a franchisee of [name of Defendant].

[Name of Defendant] must prove that for two years or more, the franchisee or qualifying person was in a business that offered products or services substantially similar to those offered by [name of Defendant].

For [name of Defendant] to have been exempt [name of Defendant] must prove it filed a Notice of Exemption with [name of state agency] and paid the required fee, all no later than 15 days after the sale of the franchise.

Comment:

This instruction is based on California’s exemption for the sale of a franchise to an existing franchisee. Similar exemptions appear in statutes or regulations in Hawaii, Maryland, Minnesota, Michigan, New York, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. The instruction would need to be revised to align with the statute or regulation of the applicable state and for several such states the instruction will be shorter.

In Minnesota, for example, the exemption does not apply if the additional franchise varies substantially from the franchise that is already possessed by the franchisee. Minn. R. § 2860.1100(4). Substantial variation refers to different products, services, fees, duties, obligations, or required investment.
Variations of terms or provisions in an agreement to recognize individual differences in time, geography, market, volume, size, or costs for goods, materials, and supplies incurred by the franchisor are not considered substantial variations. Minn. R. § 2860.1100(2). In Michigan and New York, the existing franchisee must have actively operated the franchise for the prior 18 months, and the additional franchise must be for investment (Michigan); to operate the business (New York) and not for resale. Mich. Comp. Laws § 445.1506(1)(g); N.Y. Gen. Bus. Laws § 684(3)(d). Under Michigan's exemption, if the franchisor had a disclosure document, a condition of the exemption is to have provided that to the plaintiff at least 10 business days before the signing of any agreement or receipt of any consideration. Mich. Comp. Laws § 445.1506(2). New York also requires a specified report to the New York Department of Law within 15 days of the sale. N.Y. Gen Bus. Laws § 684(3)(d)(iii). Rhode Island and South Dakota require that the franchisee operated the existing franchise for at least two years. 19 R.I. Gen. Laws § 19-28.1-6(5); S.D. Codified Laws § 37-5B-14(1). Virginia and Washington require that the franchise be sold on the franchisee's own account, two years of operation of the existing franchise, and that the prior franchise was sold pursuant to a franchise offering that was registered or exempt in the state. 21 Va. Admin. Code § 5-110-75(3); Wash. Rev. Code § 19.100.030(6).

Authorities:

11.  Defense of Exemption for Offer or Sale of Franchise to Person Affiliated with Franchisor

Instruction:
Earlier, I instructed you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale of a franchise was exempt from registration if the offer or sale was made to someone who had certain kinds of affiliation with the franchisor. [Name of Defendant] claims that [name of Defendant] qualifies for this exemption on the ground that [name of Plaintiff] had the required affiliation with [name of Defendant].

To prove this defense, [name of Defendant] must prove that when [name of Defendant] offered and sold the franchise, someone who owned at least fifty percent of [name of Plaintiff] was, within 60 days before the sale, an officer, director, managing agent, or owner of at least a twenty-five percent interest in [name of Defendant] for at least two years.

To prove this defense, [name of Defendant] must also prove that such person was not controlled by [name of Defendant].
There is also a notice requirement. For [name of Defendant] to have been exempt from being required to register its franchise, [name of Defendant] must prove, in addition to the other requirements that I have described, that [name of Defendant] filed a Notice of Exemption with [name of agency] and paid the required fee, no later than 15 days after the sale of the franchise.

Sample of the Instruction in Plain English:

Earlier, I told you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale was exempt from registration if it was made to someone who had certain kinds of affiliation with [name of Defendant]. [Name of Defendant] claims [name of Defendant] qualifies for this exemption.

To prove this defense, [name of Defendant] must prove that when [name of Defendant] offered and sold the franchise, someone who owned at least fifty percent of [name of Plaintiff] was, within 60 days before the sale, an officer, director managing agent or owner of at least a twenty-five percent interest in [name of Defendant] for at least two years.

To prove this defense, [name of Defendant] must also prove that such person was not controlled by [name of Defendant].

To prove this defense, [name of Defendant] must also prove that it filed a Notice of Exemption with [name of agency] and paid the required fee, no later than 15 days after the sale of the franchise.

Comment:

This instruction can likely be shortened to eliminate text on matters that are not in dispute and to fill in the name of the relevant person. Thus, the instruction's first three paragraphs might be revised to read:

Earlier, I instructed you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale of a franchise was exempt from registration if the offer or sale was made to someone who had certain kinds of affiliation with the franchisor. [Name of Defendant] claims that [name of Defendant] qualifies for this exemption on the ground that [name of Plaintiff] had the required affiliation with [name of Defendant].

To prove this defense, [name of Defendant] must prove that, when [name of Defendant] offered and sold the franchise, [name of Defendant]. owned at least fifty percent of [name of Plaintiff] and that [name of Defendant]. was, within 60 days before the sale, an officer, director, managing agent, or owner of at least a twenty-five percent interest in [name of Defendant] for at least 24 months.

To prove this defense, [name of Defendant] must also prove that [name of Defendant]. was not controlled by [name of Defendant].

The states other than California do not require filing a notice with the state.
12. Defense of Exemption for Offer or Sale of Fractional Franchise

Instruction:

Earlier, I instructed you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale of a franchise was exempt from registration if certain conditions were present that the law calls a “fractional franchise.” [Name of Defendant] claims that the conditions were present for the offer and sale to be exempt as a “fractional franchise.” To prove this defense, [name of Defendant] must prove all the following:

For at least the 24 months before the date of sale of the franchise, [if Plaintiff is an individual, [name of Plaintiff]] [if Plaintiff is an entity, an officer, director, or managing agent of [name of Plaintiff] who held that position with [name of Plaintiff]] for at least the 24 months before the sale] was engaged in a business offering products or services substantially similar or related to those [to be] offered by the franchised business.

The new product or service added by the franchise was substantially similar or related to the product or service already being offered by the previously existing business.

[Name of Plaintiff]’s business under the franchise [was to be] operated from the same business location as [name of Plaintiff]’s previously existing business.

[Name of Plaintiff] and [name of Defendant] anticipated, in good faith, at the time the agreement establishing the franchise relationship was reached, that sales resulting from the franchised business would not represent more than twenty percent of the total dollar volume of sales of [Plaintiff] annually.

[Name of Plaintiff] was not controlled by [name of Defendant].

[Name of Defendant] filed a Notice of Exemption with the California Commissioner of Business Oversight and paid the required fee, in or for the calendar year, but before the offer and sale of any franchise that year, in which this exemption was claimed.

Sample of the Instruction in Plain English:

Earlier, I told you the offer or sale of a franchise must be registered with [name of agency]. But it was exempt if certain conditions were present called a “fractional franchise.” [Name of Defendant] claims this was a “fractional franchise.” To prove this defense, [name of Defendant] must prove all the following:

For at least two years before the sale of the franchise, [if Plaintiff is an individual, [name of Plaintiff]] [if Plaintiff is an entity, an officer, director, or managing agent of [name of Plaintiff]] who held that position with
[name of Plaintiff] for at least two years months before the sale was in a business offering products or services substantially similar or related to those [to be] offered by the franchised business.

The new product or service added by [name of Plaintiff] was substantially similar or related to the product or service already being offered by the previously existing business.

[Name of Plaintiff]’s business under the franchise [was to be] operated from the same business location as [name of Plaintiff]’s previously existing business.

[Name of Plaintiff] and [name of Defendant] anticipated, in good faith, when they made their agreement, that sales from the franchised business would not be more than 20 percent of the total dollar volume of sales of [Plaintiff] annually.

[Name of Plaintiff] was not controlled by [name of Defendant].

[Name of Defendant] filed a Notice of Exemption with [name of agency] and paid the required fee, in or for the calendar year, but before the offer and sale of any franchise that year.

Comment:
In Illinois, Indiana, Virginia, and Wisconsin, the fractional franchise is an exception from the definition of a franchise, rather than an exemption. Under Michigan’s exemption, if the franchisor had a disclosure document, a condition of the exemption is to have provided that to the Plaintiff at least 10 business days before signing of any agreement or receipt of any consideration. Mich. Comp. Laws § 445.1506(2).

Authorities:

13. Defense of Exemption for Isolated Sale; Offer or Sale of a Single Franchise

Instruction:
Earlier, I instructed you that the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale is exempt from the requirement to be registered if the franchisor sells no more than one franchise in any 24-month period. [Name of Defendant] claims that this exemption applies. To prove this defense, [name of Defendant] must prove that [name of Defendant] has not sold more than one franchise in any 24-month period.
Sample of the Instruction in Plain English:

Earlier, I told you the offer or sale of a franchise must be registered with [name of agency]. But the offer or sale is exempt if the franchisor sells no more than one franchise in any 24-month period. [Name of Defendant] claims this exemption applies. To prove this defense, [name of Defendant] must prove that [name of Defendant] has not sold more than one franchise in any 24-month period.

Comment:

In Minnesota, the exemption is limited to no more than one sale of a franchise pursuant to the exemption in any period of 12 consecutive months; the franchisor must not have advertised the franchise for sale, fees paid by the franchisee must be escrowed, and the franchisor must provide to the Commissioner of Commerce, at least 10 days before the sale, a written notice of intention to offer or sell a franchise pursuant to the exemption. Minn. Stat. § 80C.03(e). New York’s exemption permits an offer to not more than two persons, the franchisee is not granted a right to subfranchise, no commission is paid for soliciting the prospective franchisee in the state, and the franchisor is domiciled in the state or filed with the New York Department of Law a consent to service of process. N.Y. Gen. Bus. Laws § 684(3)(c). The Washington exemption permits granting up to three franchises in Washington, if the franchisor provides the prospective franchisee the franchise disclosure document at least 14 days before signing of any agreement or receipt of any consideration; has not granted any franchises outside Washington; does not publicly advertise or engage in general solicitation of the franchise offering; the franchisee is advised or represented by independent legal counsel or a certified public accountant; and the franchisor has not been found by a court having jurisdiction to have violated Washington's franchise law or Consumer Protection Act or similar federal statutes within seven years prior to the offer or sale of franchises in Washington. Wash. Rev. Code §§ 19.100.030(4)(b)(ii), 19.100.030(4)(c).

In Illinois, the regulation providing the exemption permits the sale of one or two franchises in the ensuing 12 months.

Authorities:


14. Defense by Individual Director, Officer, or Employee of Lack of Knowledge

Instruction:

Earlier, I instructed you that an individual who directly or indirectly controls an entity that is liable, or a partner in a firm that is liable, or a principal executive officer or director of an entity that is liable, or an employee who materially aids in the act or transaction that violates the law, is also liable with
and to the same extent as the entity or firm. This is true unless the individual who is so liable had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist. [Name of individual Defendant(s)] each claim(s) that he/she had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist. [You must consider this defense individually as to each individual]. If you find that [name of individual Defendant] had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist, then you must find that individual is not liable along with [name of Defendant entity].

Sample of the Instruction in Plain English:

Earlier, I told you an individual who directly or indirectly controls an entity that is liable, or a partner in a firm that is liable, or a principal executive officer or director of an entity that is liable, or an employee who materially aids the act or transaction that violates the law, is also liable just like the entity or firm. This is true, unless the individual did not know and had no grounds to suspect the facts that are the basis of the entity’s liability. [Name of individual Defendant(s)] each claim(s) he/she had no knowledge or reason to suspect the facts that are the basis for the claim against [name of entity Defendant]. [You must consider this defense individually as to each individual]. If you find that [name of individual Defendant] had no knowledge or reason to suspect these facts, then you must find that individual is not liable along with [name of Defendant entity].

Comment:

Under some statutes, lack of knowledge of the violation may sometimes be an affirmative defense. California imposes liability on directors, officers, controlling persons, and employees of an entity that is liable under the state’s franchise registration and disclosure law unless the individual “had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.” Cal. Corp. Code § 31302. Lack of knowledge is an affirmative defense that the individual must plead and prove. Spahn v. Guild Indus. Corp., 156 Cal. Rptr. 375, 94 Cal. App. 3d 143, 157 n.4 (1979); Eastwood v. Froehlich, 131 Cal. Rptr. 577, 60 Cal. App. 3d 523, 531 (1976). For a discussion of the lack of reasonable knowledge defense, see Cynthia M. Klaus, Personal Liability of Franchisor Executives and Employees Under State Franchise Laws, 29 Franchise L.J. 99, 103 (2009).

Authorities:

15. Defense of Integration Clause or Disclaimers

Instruction:

As I instructed you earlier, [name of Plaintiff] claims [name of Defendant] made misrepresentations outside the documents, and [name of Plaintiff] claims to have reasonably relied on those statements. [Name of Defendant] claims that there could be no reasonable reliance because, according to [name of Defendant]’s claim, [the parties agreed in their written agreement that no representations were made, or relied on, outside the written words of the contract, sometimes called an “integration” clause] [the claimed misrepresentations were disclaimed in the written documents].

The existence of [an integration clause] [disclaimers of representations] in a franchise agreement makes claimed reliance on [contradictory statements] [statements outside the agreement] unreasonable. To succeed in this defense, [name of Defendant] has the burden to prove that the agreement contained a [disclaimer] [provision that said there were no representations made, or relied on, outside the written words of the contract]. If [name of Defendant] proves that such a clause was part of the agreement, then you must find there was no reasonable reliance by [name of Plaintiff] on claimed representations outside the documents.

Sample of the Instruction in Plain English:

As I said earlier, [name of Plaintiff] claims [name of Defendant] made misrepresentations outside the documents and [name of Plaintiff] claims [he/she/it] reasonably relied on the statements. [Name of Defendant] claims there could be no reasonable reliance because, according to [name of Defendant]’s claim, [the parties’ agreement said no representations were made, or relied on, outside the written words of the contract] [the claimed misrepresentations were disclaimed in the written documents].

Words in an agreement [saying that it is the entire agreement] [disclaiming representations] makes claimed reliance on [contradictory statements] [statements outside the agreement] unreasonable. To succeed in this defense, [name of Defendant] must prove that the agreement contained a [disclaimer] [provision saying there were no representations made or relied on, outside the written contract]. If [name of Defendant] proves this, then you must find there was no reasonable reliance by [name of Plaintiff] on claimed representations outside the documents.

Comment:

This instruction applies if the there is a question whether such clause was included as part of the agreement, so that the court allows the issue of an integration clause and its effect on reliance to be tried to the jury.
Authorities:

*Andy Mohr Truck Ctr., Inc. v. Volvo Trucks N. Am.*, 869 F.3d 598, 608 (7th Cir. 2017) (where parties reduced their agreement to a written document and included an integration clause that the written document embodies the complete agreement, the parol evidence rule prohibits parol or extrinsic evidence to vary or add to the terms of the written contract); *Cook v. Little Caesar Enters., Inc.*, 210 F.3d 653, 659 (6th Cir. 2000) (“The existence of an integration clause in the franchise agreements made [plaintiff’s] alleged reliance unreasonable.”); *Motor City Bagels, LLC v. Am. Bagel Co.*, 50 F. Supp. 2d 460, 472 (D. Md. 1999) (considering plaintiffs’ experience and sophistication, their representation by counsel in negotiating the franchise agreements, and unambiguous language of the integration clause in the franchise agreements and disclaimer in the disclosure document, reliance on statements about level of sales was unreasonable); *Rosenberg v. Pillsbury Co.*, 718 F. Supp. 1146, 1153 (S.D.N.Y. 1989) (where a disclaimer or integration clause is specific and clear, communications outside the four corners of the contract may not provide the basis for a fraud claim). *But see Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Assn.*, 151 Cal. Rptr. 3d 93, 55 Cal. 4th 1169, 1183 (2013) (parol evidence rule did not preclude evidence of misrepresentation contradicting terms of written agreement).

16. Defense of Reliance on Regulatory Opinion

Instruction:

A defense to a violation of the Franchise Investment Law is that the franchisor acted [or omitted to act] in good faith following a rule, form, order, or written interpretive opinion of the Commissioner of Business Oversight or opinion of the Attorney General [even if the rule, form, order, or opinion later turned out to be incorrect or invalid or was later changed or withdrawn]. [Name of Defendant] claims that it acted in good faith [omitted to act] in reliance on [specify Commissioner of Business Oversight rule, form, order, or written interpretive opinion or Attorney General opinion that Defendant claims to have acted in reliance on]. To succeed in this Defense, [name of Defendant] must prove that it acted in good faith, that in good faith it followed what was said in that [rule, form, order, or opinion].

Sample of the Instruction in Plain English:

[Name of Defendant] claims the action [omission] that it is accused of, that is [specify the act or omission Defendant is accused of] was done in good-faith reliance on [specify Commissioner of Business Oversight rule, form, order, or written interpretive opinion or Attorney General opinion that Defendant claims to have acted in reliance on]. If you find that [name of Defendant] acted in good faith, relying on and following that [rule, form, order or opinion], then [name of Defendant] is not liable for the action it is accused of.
Comment:

In California, the statute permits the defense of good-faith reliance on any written interpretive opinion of the commissioner or Attorney General, but “it does not create a defense for good faith reliance on private counsel.” People v. Gonda, 188 Cal. Rptr. 295, 138 Cal. App. 3d 774, 780 (1982).

Authorities:


E. Relations Act Instructions—Wrongful Termination, Nonrenewal, Interference with Succession or Sale

1. Instruction on Wrongful Termination of a Franchise—Termination without Good Cause

Instruction:

A franchisor may not terminate a franchise before the expiration of its term, except for good cause. [Name of Plaintiff] claims that [name of Defendant] terminated the franchise [without having good cause]. To succeed on this claim, [name of Plaintiff] must prove that [name of Defendant] terminated the franchise before the end of its term, without having good cause to do so. Next, I will instruct you on what is good cause.

Sample of the Instruction in Plain English:

[Name of Defendant] was not allowed to terminate the franchise before its term ended, unless it had good cause. [Name of Plaintiff] claims [name of Defendant] terminated the franchise before the end of its term, without having good cause. To succeed on this claim, [name of Plaintiff] must prove that [name of Defendant] terminated the franchise before the end of its term, without having good cause. Next, I will instruct you on what is good cause.

Comment:

Ordinarily, the allegation of facts allocates the burden of proof to the party pleading them. Though the terminated franchisee, as plaintiff, normally has the burden to prove the elements of the claim, some statutes and courts require the franchisor to affirmatively prove good cause for termination. See, e.g., Kealey Pharmacy v. Walgreen Co., 761 F.2d 345, 350, 362 (7th Cir. 1985) (applying Wisconsin statute); Hartford Elec. Supply Co. v. Allen-Bradley Co., Inc., 736 A.2d 824, 839 (Conn. 1999) (franchisor having burden of proving good cause to terminate franchise, even if franchisee is the plaintiff).

The structure of the Indiana and Michigan statutes does not precisely prohibit termination without good cause, but makes it unlawful for a franchise agreement to permit unilateral termination or nonrenewal without

Good cause for termination is an objective standard in the sense that it looks to whether cause, as defined by statute or agreement existed, and whether such cause was the reason for the termination; not at whether the termination meets an objective standard of reasonableness that goes beyond the provisions of the statute or agreement. Sheldon v. Munford, Inc., 950 F.2d 403, 407 (7th Cir. 1991).

Authorities:


2. Instruction on Wrongful Refusal to Renew a Franchise—Nonrenewal without Good Cause

Instruction:

A franchisor may not refuse to renew a franchise at the end of its term, except for good cause. [Name of Plaintiff] claims that [name of Defendant] refused to renew the franchise without having good cause. To succeed on this claim, [name of Plaintiff] must prove that [name of Plaintiff] wanted to renew, [told [name of Defendant] that [name of Plaintiff] wanted to renew], but that [name of Defendant] refused to renew the franchise at the end of its term, without having good cause. Next, I will instruct you on what is good cause.

Sample of the Instruction in Plain English:

[Name of Defendant] was not allowed to refuse to renew the franchise when it ended, unless it had good cause. [Name of Plaintiff] claims [name of Defendant] refused to renew the franchise when it ended, without having good cause. To succeed on this claim, [name of Plaintiff] must prove that [name of Plaintiff] told [name of Defendant] that he/she/it wanted to renew but that [name of Defendant] refused to renew the franchise when its term ended, without having good cause. Next, I will instruct you on what is good cause.

Comment:

If additional conditions to renew need to be satisfied, they will need to be stated in the instruction. For example, possible additional conditions could be that the plaintiff had the financial or other capability to renew, such as retaining a lease for premises and sufficient financial condition.
The structure of the Indiana and Michigan statutes does not precisely prohibit nonrenewal without good cause, but makes it unlawful for a franchise agreement to permit nonrenewal without good cause or in bad faith. Ind. Code §§ 23-2-2.7-1(8); Mich. Comp. Laws §§ 445.1527(d)–(e). The Washington statute does not prohibit nonrenewal without good cause, but rather prohibits nonrenewal without compensating the franchisee for the fair market value of the franchise, inventory, supplies, equipment, and furnishings and goodwill. Wash. Rev. Code § 19.100.180(2)(i).

Authorities:

3. Notice and Opportunity to Cure

Instruction:
[Name of Defendant] was not permitted to [terminate/nonrenew] the franchise unless [name of Defendant] provided [name of Plaintiff] with written notice of the claimed [breach/default] and at least ___ days to cure the [breach/default] [at least ___ days’ notice of the nonrenewal]. [Name of Plaintiff] claims he/she/it was not provided written notice of the claimed [breach/default] and at least ___ days to cure the claimed [breach/default] [at least ___ days’ notice of the nonrenewal]. If you find that [name of Defendant] did not provide [name of Plaintiff] with written notice of the claimed [breach/default] and at least ___ days to cure the claimed [breach/default] [at least ___ days’ notice of nonrenewal], then you must find that the franchise was not lawfully [terminated/nonrenewed].

Sample of the Instruction in Plain English:
To [terminate/nonrenew] the franchise, [name of Defendant] was required to provide [name of Plaintiff] at least ___ days’ written notice and opportunity to cure the claimed [breach/default]. If [name of Defendant] did not provide this amount of written notice [and opportunity to cure], then you must find that [name of Defendant] did not lawfully [terminate/nonrenew] the franchise.

Comment:
The statutes of many states also include as a condition to termination that the franchisor provide the franchisee notice and an opportunity to cure the breach or default and may specify a minimum length of time that must be provided. Some states require a reasonable opportunity to cure and may
state that the opportunity need not be more than a specified number of days. See, e.g., Mich. Comp. Laws § 445.1527(c) (requiring reasonable opportunity to cure “which in no event need be more than 30 days”). The parties’ agreement may also require notice and an opportunity to cure. The franchisor may need to satisfy both the contractual and statutory requirements to avoid the termination or nonrenewal being found to be wrongful.

California’s statute states details of the form, content, and manner of delivery of notice of termination or nonrenewal. Cal. Bus. & Prof. Code § 20030. Some statutes state grounds that are good cause for immediate termination without providing the franchisee an opportunity to cure. See, e.g., Cal. Bus. & Prof. Code § 20021 (stating grounds for which immediate notice of termination without an opportunity to cure is deemed to be reasonable). Many state franchise relationship laws also provide franchisees other rights and protections in addition to protection from unjust termination or nonrenewal.

In *Seahorse Marine Supplies, Inc. v. Puerto Rico Sun Oil Co.*, 295 F.3d 68, 79 (1st Cir. 2002), the First Circuit ruled that it was not error for the trial court to refuse to instruct a jury on whether a petroleum franchisor gave proper notice “under the circumstances,” when the evidence plainly showed, and the trial court correctly determined as a matter of law, that the franchisor failed to comply with the Petroleum Marketing Practices Act’s notice requirement (15 U.S.C. § 2804) for termination of a petroleum franchise. For an instruction concerning the notice of termination in the context of an automobile dealership governed by a state motor vehicle franchise law, see *Powerhouse Motorsports Group, Inc. v. Yamaha Motor Corp., U.S.A.*, 16 Cal. Rptr. 3d 811, 221 Cal. App. 4th 867, 882 (2013).

Authorities:


4. Definitions Relevant to Good Cause

Instruction:

[Name of Defendant] claims it had good cause to [terminate/nonrenew] the franchise. To succeed in this defense, [name of Defendant] must prove that it had good cause to terminate or nonrenew the franchise. The following are good cause for termination of the franchise before expiration of its term.

[Insert applicable statutory statement of good cause from the state’s statute. Here are some examples:]

- [Name of Plaintiff] abandoned the franchise by failing to operate for 5 consecutive days that [name of Plaintiff] was required to operate the business under the terms of the franchise, or shorter period, after which it
was reasonable in the circumstances for [name of Defendant] to conclude that [name of Plaintiff] did not intend to continue operating, [unless the failure was due to fire, flood, earthquake, or similar causes beyond [name of Plaintiff]'s control]. [Cal. Bus. & Prof. Code § 20021(b)]

• [Name of Plaintiff] repeatedly violated one or more requirements of the franchise, whether or not [name of Plaintiff] corrected them after notice. [Cal. Bus. & Prof. Code § 20021(g)]

• That [name of Plaintiff] was convicted of a felony or other criminal misconduct is relevant to operation of the franchise. [Cal. Bus. & Prof. Code § 20021(i)]

• [Name of Plaintiff] failed to pay a franchise fee or other amount due to [name of Defendant] or [name of Defendant]'s affiliate within 5 days after receiving written notice that the fee or other amount was overdue. [Cal. Bus. & Prof. Code § 20021(j)]

• [Name of Defendant] made a reasonable determination that continued operation of the franchise by [name of Plaintiff] would result in imminent danger to public health or safety. [Cal. Bus. & Prof. Code § 20021(k)]

• [Name of Plaintiff] [refused/failed] to substantially comply with a material and reasonable obligation of the franchise agreement. [Conn. Gen. Stat. § 42-133f]

• [Name of Plaintiff] materially violated the franchise agreement. [Ind. Code § 23-2-2.7-1(7)]

• [Name of Plaintiff] received at least 24 hours’ notice to cure a default under the franchise agreement that materially impaired the goodwill of [name of Defendant]'s trademark and failed to cure the default. [Minn. Stat. § 80C.14(3)(3)]

Sample of the Instruction in Plain English:

The following are good cause for termination of the franchise before expiration of its term.

[Insert applicable statutory statement of good cause from the state’s statute. Here are some examples:]

• [Name of Plaintiff] abandoned the franchise by failing to operate for 5 consecutive days that [name of Plaintiff] was required to operate the business under the terms of the franchise, or shorter period after which it was reasonable in the circumstances for [name of Defendant] to conclude that [name of Plaintiff] did not intend to continue operating, [unless the failure was due to fire, flood, earthquake, or similar causes beyond [name of Plaintiff]'s control]. [Cal. Bus. & Prof. Code § 20021(b)]

• [Name of Plaintiff] repeatedly violated one or more requirements of the franchise, whether or not [name of Plaintiff] corrected them after notice. [Cal. Bus. & Prof. Code § 20021(g)]
• That [name of Plaintiff] was convicted of a felony or other criminal misconduct is relevant to operation of the franchise. [Cal. Bus. & Prof. Code § 20021(i)]

• [Name of Plaintiff] failed to pay a franchise fee or other amount due to [name of Defendant] or [name of Defendant]’s affiliate within 5 days after receiving written notice that the fee or other amount was overdue. [Cal. Bus. & Prof. Code § 20021(j)]

• [Name of Defendant] made a reasonable determination that continued operation of the franchise by [name of Plaintiff] would result in imminent danger to public health or safety. [Cal. Bus. & Prof. Code § 20021(k)]

• [Name of Plaintiff] refused/failed to substantially comply with a material and reasonable obligation of the franchise agreement. [Conn. Gen. Stat. § 42-133f]

• [Name of Plaintiff] materially violated the franchise agreement. [Ind. Code § 23-2-2.7-1(7)]

• [Name of Plaintiff] received at least 24 hours’ notice to cure a default under the franchise agreement that materially impaired the goodwill of [name of Defendant]’s trademark and failed to cure the default. [Minn. Stat. § 80C.14(3)(3)]

Comment:
States have widely varying definitions or descriptions of good cause, or just cause or other justification, to terminate a franchise before expiration of its term or to refuse to renew the franchise at the end of its term. Reference to the particular state’s statute is essential. Good cause is an objective standard in the sense that it looks to whether cause, as defined by statute or agreement existed, and whether such cause was the reason for the action taken; not at whether the action meets an objective standard of reasonableness that goes beyond the provisions of the statute or agreement. Sheldon v. Munford, Inc., 950 F.2d 403, 407 (7th Cir. 1991); Century 21 Real Estate LLC v. All Prof. Realty, Inc., 889 F. Supp. 2d 1198, 1225 (E.D. Cal. 2012) (“Good cause” is defined in the California Franchise Relations Act; the Act “makes no mention of a ‘good faith’ requirement.”).

Authorities:
5. Instruction on Interference with Sale or Transfer

Instruction:

It is unlawful for a franchisor to refuse to permit a transfer of ownership of a franchise or the entity that is a franchisee, except for good cause. [Name of Plaintiff] claims that [name of Defendant] refused to permit [name of Plaintiff]’s proposed sale of [name of Plaintiff]’s [brand name of franchise] franchise and that [name of Defendant] did not have good cause for this refusal.

Good cause means:* 

(1) The proposed transferee failed to meet a reasonable qualification or standard of the franchisor;
(2) The proposed transferee or any affiliated person of the proposed transferee is a competitor of the franchisor;
(3) The proposed transferee is unable or unwilling to agree in writing to comply with and be bound by all lawful obligations imposed by the franchise, including, without limitation, instruction and training, and to sign the franchisor’s current form of the franchise agreement.
(4) The franchisee or proposed transferee failed to pay money owing to the franchisor and to cure any default in the franchise agreement or other agreement with the franchisor.

A franchisor or subfranchisor has 30 days after being notified in writing of a proposed transfer to approve or disapprove in writing the proposed transfer and must state its reason for disapproval.

If a franchisor or subfranchisor fails to approve or disapprove a proposed transfer in writing within 30 days, it is deemed to have approved the transfer.

*This list consists of examples. A state’s franchise relationship statute, or the parties’ agreement, may specify fewer, additional, and/or different circumstances that constitute good cause.

Sample of the Instruction in Plain English:

A franchisor may not refuse consent to a transfer of ownership of a franchise or the entity that is a franchisee, except for good cause. [Name of Plaintiff] claims [name of Defendant] refused to permit [name of Plaintiff]’s proposed sale of [name of Plaintiff]’s [brand name of franchise] franchise and that [name of Defendant] did not have good cause to refuse.

Good cause means:* 

(5) The proposed transferee did not meet a reasonable qualification or standard of the franchisor;
(6) The proposed transferee or an affiliated person of the proposed transferee is a competitor of the franchisor;
(7) The proposed transferee is unable or unwilling to agree in writing to comply with and be bound by all lawful obligations of the franchise,
including without limitation instruction and training, and to sign the franchisor’s current franchise agreement.

(8) The franchisee or proposed transferee failed to pay money owed to the franchisor and to cure a default in an agreement with the franchisor.

A franchisor has 30 days after being notified in writing of a proposed transfer to approve or disapprove in writing the proposed transfer and must state its reason for disapproval.

If a franchisor fails to approve or disapprove a proposed transfer in writing within 30 days, it is deemed to have approved the transfer.

Comment:

The structure of the Michigan statute does not precisely prohibit interference with a franchisee sale but makes it unlawful for a franchise agreement to permit the franchisor to refuse to permit a transfer of ownership except for good cause. Mich. Comp. Laws § 445.1527(g); see also Minn. Stat. § 80C.14(5).

Authorities:


6. Instruction on Interference with Succession to Spouse, Heirs, or Estate

Instruction:

A franchisor is required to allow [a deceased franchisee’s surviving spouse, heirs, or estate] [the surviving spouse, heirs, or estate of a deceased majority shareholder of the franchisee] a reasonable time to take over the ownership interest in the franchise of the person who died. During this time, the surviving spouse, heirs, or estate must be given the opportunity to meet the franchisor’s qualifications or sell, transfer, or assign the franchise to someone who meets the qualifications. The franchisor is permitted to require, during this time, that the surviving spouse, heirs, or estate maintain all the standards and obligations of the franchise.

[Name of Plaintiff] claims that [he/she/it] is the [surviving spouse/heir/estate] of [name of person who died] and that [name of Defendant] failed to allow [name of Plaintiff] a reasonable time to take over [name of person who died]’s ownership interest in the [name of the franchise] franchise. To succeed in this claim, [name of Plaintiff] must prove that (1) [name of person who died] owned [an interest in the [name of franchise] franchise was the majority shareholder of the franchisee entity]; (2) [name of Plaintiff] is the surviving spouse, heir, or estate of [name of person who died] (3) [name of Defendant] did not give [name of Plaintiff] a reasonable time after [name of person who died] died, to [take over] [sell, transfer or assign] the ownership
Sample of the Instruction in Plain English:

A franchisor must give the surviving spouse, heirs, or estate of [the deceased franchisee] a reasonable time to take over the ownership of the person who died. During this time, the franchisor must give the surviving spouse, heirs, or estate the chance to meet the franchisor’s qualifications or sell the franchise to someone who meets the qualifications. During this time, the franchisor can require the surviving spouse, heirs, or estate to maintain the standards and obligations of the franchise.

[Name of Plaintiff] claims [he/she/it] is [name of person who died]’s [surviving spouse/heir/estate] and claims [name of Defendant] did not allow [name of Plaintiff] a reasonable time to take over [name of person who died]’s ownership in the [name of the franchise] franchise. To succeed in this claim, [name of Plaintiff] must prove that (1) [name of person who died] owned [an interest in the franchise] franchise was majority shareholder of the franchise entity; (2) [name of Defendant] is the surviving spouse, heir, or estate of [name of person who died] (3) [name of Defendant] did not give [name of Plaintiff] a reasonable time after [name of person who died] died, to [take over] [sell, transfer, or assign] the ownership of [name of person who died]; (4) [name of Plaintiff] [was qualified] [had the ability to become qualified] [had a buyer or transferee who was qualified] to become the franchisee; and (5) during the time needed to qualify to [take over] [sell, transfer, or assign] the ownership interest of [name of person who died], [name of Plaintiff] maintained all the standards and obligations of the franchise.

Comment:

An unpublished decision of a U.S. District Court in Indiana held that Indiana’s statute requires only that a franchisor allow the family/heirs/estate of a deceased franchisee the opportunity to wind down the franchisee’s business. Ayers v. Marathon Ashland Petroleum LLC, 2007 WL 3171445, at *4 (S.D. Ind. Oct. 26, 2007). However, the Ayers decision concerned a petroleum franchise, and it noted that the Indiana statute is preempted by the Petroleum Marketing Practices Act, 15 U.S.C. § 2801 et seq.

Authorities:

7. Defense to Claim of Interference with Succession to Spouse, Heirs, or Estate

Instruction:

[Name of Defendant] claims that [name of Plaintiff] was allowed a reasonable time to take over the ownership interest or to sell, transfer, or assign the interest, but that [name of Plaintiff] was not, during this time, able to meet [name of Defendant]’s qualifications to be an owner of that interest in the franchise and was not able to sell, transfer, or assign the ownership interest of [name of person who died] to someone who could meet the qualifications. [[Name of Defendant] also claims that during the time allowed for [name of Plaintiff] to qualify to take over, sell, transfer, or assign the ownership interest, [name of Plaintiff] failed to maintain all the standards and obligations of the franchise.]

To succeed in this defense, [name of Defendant] has the burden to prove that [name of Plaintiff] was allowed a reasonable time to take over the ownership interest or sell, transfer, or assign the interest, but [name of Plaintiff] did not, during this time, meet [name of Defendant]’s qualifications to be an owner of that interest in the franchise and did not sell, transfer, or assign the ownership interest of [name of person who died] to someone who met the qualifications. [[Name of Defendant] has the burden to prove that during the time allowed for [name of Plaintiff] to qualify to take over, sell, transfer, or assign the ownership interest, [name of Plaintiff] failed to maintain all [name of Defendant]’s standards and obligations of the franchise.]

Sample of the Instruction in Plain English:

[Name of Defendant] claims [he/she/it] gave [name of Plaintiff] a reasonable time to take over ownership or to transfer ownership. [Name of Defendant] claims [name of Plaintiff] was not able to meet [name of Defendant]’s qualifications to be the owner and was not able to transfer [name of person who died]’s interest to someone who could meet the qualifications. [[Name of Defendant] claims [name of Plaintiff] failed to maintain all the standards and obligations of the franchise.]

To succeed in this defense, [name of Defendant] must prove that it allowed [name of Plaintiff] a reasonable time to take over ownership or transfer the interest, but [name of Plaintiff] did not meet [name of Defendant]’s qualifications to be the owner of that interest and did not transfer [name of person who died]’s interest to someone who met the qualifications. [[Name of Defendant] must prove that in the time allowed for [name of Plaintiff] to qualify to take over or transfer the ownership interest, [name of Plaintiff] failed to maintain all [name of Defendant]’s standards and obligations of the franchise.]

Comment:

In the absence of statutory or contractual protection, the death of a franchisee may permit the franchisor to terminate the franchise. See, e.g., Iannuzzi
v. Exxon Co., U.S.A., Div. of Exxon Corp., 572 F. Supp. 716, 721 (D.N.J. 1983) (noting that “a franchise agreement is a contract of a personal nature and in the absence of a provision that it survives the death of the franchisee, it terminates upon the death of the franchisee”). But a franchisee has often developed a business with a meaningful, potentially substantial, value. When a franchisee or principal owner of a franchisee entity dies, the business does not stop; and a desire of the late franchisee may have been that heirs could continue to operate the business or sell it and receive the financial value. Some states provide statutory protection for this interest. The franchisor has an interest in the franchise being operated according to the franchisor’s standards. Therefore, in states that assure heirs a right to operate or sell the interest of the deceased franchisee, a reasonable, but not unlimited, time is allowed to take over ownership and meet the franchisor’s qualifications or transfer the business to someone who meets the qualifications.

Authorities:

F. Relations Act Remedies
1. Measure of Damages for Wrongful Termination
Instruction:
A franchisor that wrongfully terminates or nonrenews a franchise is liable for the damages caused thereby. The [terminated/nonrenewed] franchisee’s damages are the actual or reasonable value of the franchisee’s business when the franchisor cuts off the franchise.

The franchise is to be valued as of the date when the franchisee stopped operating the franchise.

Sample of the Instruction in Plain English:
A franchisor that wrongfully terminates or nonrenews a franchise is liable for the damages caused. The [terminated/nonrenewed] franchisee’s damages are the actual reasonable value of the franchisee’s business when the franchisor cuts off the franchise. The franchise is to be valued as of the date when the franchisee stopped operating the franchise.

Comment:
Franchise relations statutes in several states specify the elements of damages for a wrongfully terminated franchise. Where the remedy is to compensate the terminated franchisee for the value of the business, traditional valuation methods and instructions on value apply, but are not specific to franchising. See, e.g., Cooper Distrib. Co., Inc. v. Amana Refrigeration, Inc., 63 F.3d 262, 278 (3d Cir. 1995) (noting that “courts allow a plaintiff to recover either the present value of lost future earnings or the present market...
value of the lost business, though not both”). The valuation is an objective, not a subjective, measure. It is “that price upon which willing parties, buyer and seller, would agree for the sale of the franchisee’s business as a going concern,” not the subjective value to the parties themselves. Cooper Distrib. Co., Inc. v. Amana Refrigeration, Inc., 180 F.3d 542, 547 (3d Cir. 1999). A California court held that damages for wrongful termination of a franchise were limited to breach of contract damages. JRS Prods., Inc. v. Matsushita Elec. Corp. of Am., 8 Cal. Rptr. 3d 840, 115 Cal. App. 4th 168, 183 (2004) (terminated franchisee’s remedy for wrongful termination of its franchise was limited to contract damages).

Authorities:

“Esports” describes the multi-billion-dollar industry of computer facilitated competition, typically through computerized games. This community is a worldwide phenomenon, with countries such as Germany, China, Russia, and South Korea investing heavily in the development of professional Esports players and infrastructure. In fact, in November 2018, almost 100 million unique viewers watched the final match of the League of Legends, an Esports video game, which was more than the viewership of the 2018 Super Bowl. Yet, the Esports industry is very much in its infancy in terms of organization, business opportunity, and mainstream appeal.

Development of the Esports ecosystem has historically lagged in the United States, trailing behind its European and Asian counterparts. However, certain cities in the United States have robust and thriving grassroots communities and traditional sports powerhouses investing heavily in infrastructure and development of professional Esports athletes and teams. One of those cities is Dallas, Texas, where moguls such as Dallas Mavericks’ owner

Mark Cuban,5 oil magnate Kenneth Hersh,6 and Dallas Cowboys’ owner Jerry Jones7 are investing in Esports teams and developing community infrastructure, bringing gaming culture and viewership to the mainstream.

This article provides a survey of the Esports landscape, with a discussion of how the franchising model has brought stability and structure to this new industry. It covers the basics about franchising as a legal and business structure, traditional professional sports franchising, franchising of Esports leagues, and franchising of ancillary entertainment and training services. It also notes challenges faced by Esports athletes.

I. Background

A. The Traditional Franchising Infrastructure

To set the stage for the adoption of franchising in Esports, a primer on traditional franchising is necessary. Arguably, the birth of franchising could be attributed to Isaac Merritt Singer, the founder of Singer Sewing Machines.8 He devised a way to offer convenient repair services for his sewing machines through a license to repair engineers for use of his parts and trademarks. These repair engineers could rely on that trademark to provide repair services to a wider range of sewing machine customers in geographic areas not readily accessible by Mr. Singer.9 This licensing framework has developed into a defined yet flexible infrastructure that spans restaurants, personal and commercial services, entertainment services, and product production.

Simply put, a franchise is a license from the franchisor to a third-party, a franchisee, for use of the franchisor’s trademarks, business format, operating system, and other protected and proprietary information for the operation of a franchised business by the franchisee.10 The franchise agreement establishes the relationship between the franchisor and the franchisee. It is the contractual agreement between a franchisor and franchisee for the provision of certain rights and obligations to develop and operate a franchised business in a specified location or territory. This franchise agreement contains components of a license to use intellectual property, general business requirements, nondisclosure and restrictive covenants, dispute resolution requirements, and other contractual provisions that may vary depending on the franchisor and the type of business.

9. Id.
10. See Principe v. McDonald’s Corp., 631 F.2d 303, 309 (4th Cir. 1980).
Mr. Singer utilized the core component of a franchise—the trademark license agreement. A key element in franchising is an effective, registrable trademark or set of trademarks. There is enormous value in a trademark, and it can often be a franchisor's most valuable asset. For example, McDonald's' trademarks are valued at $43 billion, and they have brand recognition around the world. The value of a trademark is goodwill in the marketplace, which a franchisee can immediately exploit when operating its own franchised location in its territory. The franchisor, through this trademark license, increases its presence in other locations without having to invest the resources typically required for corporate-owned locations. In this way, the franchise relationship is mutually beneficial for the franchisor and franchisee.

In addition to the trademarks, the franchisor also licenses its standards and systems to franchisees as part of the franchise relationship and contractually maintains a certain level of control over how the franchisee operates its franchised business to ensure brand standards are met. These trade secrets and business knowledge contain historically successful strategies for business development and success, and they comprise a part of the ongoing benefits the franchisee receives under the franchise agreement. So the franchisor not only licenses its trademarks to publicly incorporate the franchisees into the franchise system, but also licenses its business systems and trade secrets so that franchisees uniformly have the ability to operate their franchised businesses. In a traditional franchisor-franchisee relationship, leadership and control over system standards flow from the franchisor to the franchisee.

Complicating matters somewhat is that franchising is a regulated business strategy, both at the federal and state level. The Federal Trade Commission (FTC) regulates franchising through the Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising (as amended, the Franchise Rule). The Franchise Rule prescribes the offer and sale of a franchise everywhere in the United States and its territories. The FTC periodically publishes compliance guides and other explanatory directives regarding applicability of the Franchise Rule, disclosure requirements, and other guidance.

Federal law requires franchisors to prepare a franchise disclosure document (FDD) that contains prescribed disclosures for the offer and sale of their franchises in all fifty states and U.S. territories. The FDD is required to describe the franchise system, its principals, financial health, trademarks and other intellectual property, list of franchisees, and other pertinent

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11. Id.
13. Sasser v. Carvel Corp., 332 F.2d 505, 516-17 (2d Cir. 1964) (noting that “the cornerstone of a franchise system must be the trademark or trade name of a product”).
14. 16 C.F.R. § 436 et seq.
information that may be helpful for potential franchisees for evaluating the franchise opportunity and the business risk associated with the investment.\textsuperscript{17} Additional franchise-related requirements may exist at the state level, per state statute, including registrations, filings, and state-specific contractual terms.

Some exceptions and exemptions from the FTC regulation apply to certain business systems. Specifically, employer-employee relationships and general partnerships, cooperative organizations, testing or certification services, and single trademark licenses are not considered franchises under the Franchise Rule.\textsuperscript{18} Further, the Franchise Rule allows certain exemptions from compliance, including, but not limited to, sales in which a buyer pays less than $570 for a franchise; sales requiring a large investment in which the franchisee pays at least $1,143,100, excluding the cost of unimproved land and any franchisor (or affiliate) financing; and sales to large entities that have been in business for at least five years and have a net worth of at least $5,715,500.\textsuperscript{19} The FTC adjusts these thresholds every four years based on the Consumer Price Index.\textsuperscript{20}

B. Franchising in Professional Sports

Professional sports teams are typically organized in two ways: the promotion and relegation system found in European sports leagues (often called open leagues) and the franchising model found in the United States (referred to as closed leagues).\textsuperscript{21}

In an open-league system, such as the European soccer leagues, the results from the competition between teams determine which teams advance to a particular league.\textsuperscript{22} The teams with the lowest points are relegated to second-tier leagues, and teams with higher points are promoted to first-tier leagues.\textsuperscript{23} This system provides all teams an opportunity to reach the first-tier divisions and play against the best teams.\textsuperscript{24} One of the biggest disadvantages of this open league system is that it brings uncertainty as to which teams may be promoted or relegated, which significantly affects the value and revenue of the teams.\textsuperscript{25} Therefore, certain associations provide parachute payments to teams relegated to lower divisions to subsidize the drop

\textsuperscript{17} See id.  
\textsuperscript{18} 16 C.F.R. § 436.2(a)(4)(i)−(iv).  
\textsuperscript{19} Press Release, Federal Trade Comm’n, FTC Adjusts Monetary Thresholds for Three Exemptions in Franchise Rule, (May 16, 2016), https://www.ftc.gov/news-events/press-releases/2016/05/ftc-adjusts-monetary-thresholds-three-exemptions-franchise-rule. The application of exceptions and exemptions is a lengthy analysis and beyond the scope of this article.  
\textsuperscript{20} Id.  
\textsuperscript{22} Id.  
\textsuperscript{23} Id.  
\textsuperscript{25} Id.
in revenue, and relegated teams continue to receive a share of the higher division’s revenues for the time period that they are relegated.26

In a closed league or franchise system found in the United States, team owners purchase rights in a geographic area, which includes the right to be in a league regardless of competitive results.27 The National Football League (NFL), 28 National Basketball Association (NBA), 29 and Major League Baseball (MLB) 30 subscribe to this franchise model. Generally speaking, each league has a determined set of teams, each considered a franchise, with exclusive territories that typically cover large metropolitan areas with no local rivals. For example, the NFL is an association of thirty-two separately owned and operated teams that partake in the NFL’s revenue to a certain extent.31 By nature of the franchise relationship, each team has the right to participate and be a part of the NFL, and utilize the NFL’s logo.32 In the early 1990s, the member teams formed National Football League Properties (NFLP), which is a separate corporate entity that develops, licenses, and markets the intellectual property that each team owns, such as their respective logos, trademarks, and other indicia.33 Using this collective bargaining power, the NFLP negotiates brand deals, such as with Reebok and Nike, for use of the teams’ trademarks.34

So, why is this relationship called a franchise? Sports leagues utilize the key element of all franchising relationships, which is the licensing of its trademarks. Each team’s owner must follow a business model dictated by the league to which they belong.35 All team owners also follow a certain rulebook for gameplay.36

Unlike a traditional franchise, sports associations like the NFL utilize the collective bargaining power of their members to obtain favorable licensing and broadcasting contracts with third parties, the revenue of which
flows down to their member teams. Typically in a traditional franchisor-franchisee relationship, franchisees do not partake in any of the franchisor’s revenue. The NFLP does not own or negotiate licensing deals on behalf of its players. Instead, the NFL Players, Inc., the licensing and marketing subsidiary of the NFL Players Association, a labor organization representing NFL players, assists with licensing agreements for NFL players. In a typical franchisor-franchisee relationship, the franchisor’s control usually does not extend to the franchisee’s employees or independent contractors.

Further, unlike a traditional franchise system with a franchisor-franchisee relationship, closed leagues have a bottom-up leadership structure. For example, the NFL is a financed by its member teams. It has three officers: the commissioner, who is elected by team owners, appoints the secretary and the treasurer. Entrance of a new team may require a vote from all of its current team owners, unlike the open league system, and requires a large franchise fee. For example, franchise fees for an NFL team in the 1920s may have been around $100, but they can be more than $1 billion today. In a traditional franchisor-franchisee relationship, franchisees typically have no contractual right to dictate the franchisor’s leadership, and franchisees have no right to dictate acceptance of any other franchisees into the franchise system. The franchise relationship described in a closed league system may fall outside the scope of the federal franchise laws due to the allowable FTC exemptions described above (such as the large investment or large franchisee exemption), but may be subject to state franchise law.

The players are another integral component to this closed franchise system. In most sports leagues, the players are employees of the team owners, not the league itself. Players may belong to a collective bargaining organization separate from the league in which they play. These collective bargaining organizations are instrumental in obtaining favorable employment terms


40. NFL Constitution, supra note 35.


42. Geeter, supra note 28.

for their members. For example, NFL players are employed by the team for which they perform services, as defined in their respective employment contracts. NFL players also belong to the NFL Players Association (NFL-PA) which, most recently in 2011, negotiated an NFL collective bargaining agreement (CBA) with the NFL. The CBA classified distribution of the league’s revenues, negotiated health and safety standards, and established medical and retirement benefits for all players in the NFL. The 2011 CBA has no opt-out clause and a ten-year term, which expires at the end of the 2020 season.

II. Esports Leagues

A. How an Esports Franchise Works

Esports has adopted the professional sports franchising model to stabilize and bring structure to this relatively new industry. The core element to Esports franchising revolves around licensing of the trademarks and the games themselves, much like in the closed-league system used by professional sports teams in North America. As discussed in Section III, the traditional franchising model has also been utilized to support infrastructure for ancillary Esports services.

Game developers play a pivotal role in Esports. They own and develop the games, the rules, the trademarks, and the ecosystem generally, and solely determine who participates therein. In this way, game developers’ level of control is unlike the control exercised within sports leagues or in a traditional franchisor-franchisee relationship. Although there is great variation among the titles as to the level of control within the licensing relationship, it appears that control typically flows down from game developers to team owners, which is unlike the bottom-up relationship between the league associations and member teams in traditional sports franchising. For example,

45. See About the NFLPA, NFLPA, https://www.nflpa.com/about.
47. See id.
48. See id. at 1. The no-opt provision binds both players and the team owners to a firm ten-year agreement, as opposed to the previous 2006 collective bargaining agreement, which allowed either side to terminate two years before the expiration of the same. Id. at 233; Collective Bargaining Agreement, Nat’l Football League 240–42 (Mar. 6, 2006), http://static.nfl.com/static/content/public/image/cba/nfl-cba-2006-2012.pdf. The NFL opted out of the 2006 CBA early in 2008, putting player salaries in flux and leading to the 2011 player lockout, which necessitated negotiation of the current CBA. See Brian McIntyre, NFL Lockout and How We Got Here: Timeline to a New CBA, SBNATION (July 25, 2011), https://www.sbnation.com/nfl/2011/7/25/2292223/nfl-lockout-labor-cba.
49. Panel Interview with Daniel Herz, Esports Executive, and Andrew Cooley, Cofounder of Esports Performance Academy, moderated by Joe Clemko, Esq., Exec Esports Panel + VR Networking—Bringing Your Gaming Skills into the Boardroom (Oct. 30, 2019).
50. Id.
the equivalence of the level of control would be if the NFL owned the game of football and the ball itself, and determined solely who could play football anywhere in the world.\textsuperscript{51} In a traditional franchise relationship, the level of control and dominance would be as if only one entity owned the concept of operating a restaurant and who ate within it, and no one else in the entire world would have the right to do the same without permission from that franchisor. Certainly, this is a very unique power dynamic.

Regardless, investors are buying stakes within these gaming ecosystems. Currently, game developers are utilizing the closed-league franchise system to parcel out team ownership with geographic rights.\textsuperscript{52} Games such as Overwatch, League of Legends, and Call of Duty (individual games are referred to as titles) are being franchised in this way.\textsuperscript{53} However, no parent organization governs game developers or serves as a collective bargaining organization on their behalf.

For example, League of Legends, which is a multi-player battle arena online video game run by Riot Games, has ten franchise teams that comprise the League of Legends Championship Series (LCS) in the United States and Canada.\textsuperscript{54} LCS has some structural similarities to traditional sports leagues such as the NFL. LCS is a Delaware limited liability company that establishes certain rules for League of Legends gameplay within its member teams.\textsuperscript{55} Although LCS’s contractual terms with its team owners are shrouded in secrecy, its interactions with players and teams are governed by the published rules and the Summoner’s Code, found in the Riot Games’ end user license agreement.\textsuperscript{56} Each season of LCS is divided into spring and summer split game series, which conclude with a playoff tournament between the top six teams. The winner of the LCS then qualifies for the annual League of Legends World Championship, which, in the latest 2019 season, pitted twenty-four international teams against one another on a worldwide stage.\textsuperscript{57} The winning team was awarded a champion title, a seventy-pound Summoner’s Cup, and a $2 million championship prize.\textsuperscript{58}

Although purchasing an Esports franchise is not as expensive as a traditional sports team franchise, it still demands an investment. Joe Jacob,
co-owner of the Golden State Warriors, recently purchased an LCS franchise for $13 million.\textsuperscript{59} Activision Blizzard, the game developer of Call of Duty, a first-person shooter video game franchise, is offering franchises for $25 million per team slot.\textsuperscript{60} Either of these opportunities may seem like a bargain after the Overwatch League offered its current twelve team owners expansion slots for $30 million to $60 million each.\textsuperscript{61} Because of these large investments, the sale of this franchise opportunity falls under the FTC exemptions described above, much like franchising in traditional sports.

The relegation and promotion system of European sports is utilized internationally by certain leagues. Aside from tournaments hosted by game developers, independent third-party organizations may provide an infrastructure to host several game titles. For example, the World Cyber Games is an international competition which hosts Esports athletes from all over the world to compete in several game titles, including Clash Royale, CrossFire, and Honor of Kings.\textsuperscript{62} Samsung initially owned the World Cyber Games, before selling it to Korean game publisher Smilegate, and returned as a sponsor in 2019.\textsuperscript{63} World Cyber Games utilizes the European promotion and relegation system for its tournament structure. Likewise, the Premier League, which is an international professional league exclusively for Dota 2, also uses a promotion and relegation system for its ten teams.\textsuperscript{64}

Licensing is at the core of the relationship between game developers and any third party. In spite of the hefty franchise fees, team owners have limited rights beyond participating in competition with other league members within a game, such as hosting their own tournaments.\textsuperscript{65} However, local third-party tournament organizers may obtain a license for such rights from game developers in order to organize amateur and semi-professional qualifier, regional, and national tournaments.\textsuperscript{66} For example, universities and secondary education systems interested in hosting tournaments using a particular game may obtain a license from game developers to do so.\textsuperscript{67} In these situations, game developers are much less concerned about inking a lucrative deal with educational institutions who are instrumental to developing a

\textsuperscript{59}. Chang, supra note 52.
\textsuperscript{63}. Id.
\textsuperscript{65}. Interview with Christian Gross, Esports Consultant and Vice President of Institutional Development at American Esports, Inc. (Nov. 4, 2019).
\textsuperscript{66}. Id.
\textsuperscript{67}. Id.
pipeline of players and increasing a game's popularity, and are more flexible in the terms and conditions for such unsponsored tournaments.  

B. Gaming Centers, Training Dojos, and Restaurants

Gaming centers and stadiums are becoming increasingly popular and serve as a community meeting point for gaming enthusiasts. Cities and larger investors are developing gaming pavilions, which are designed to hold large crowds for Esports tournaments or serve as the home for professional Esports teams. The city of Arlington, in the Dallas-Fort Worth metropolex, converted its old convention center to a $10 million Esports stadium designed to hold tournaments and other Esports centered events. Mark Cuban developed a gaming center devoted to hosting Mavs Gaming, which is one of the original seventeen NBA 2K League teams, located just south east of downtown Dallas.

On a smaller scale, gaming centers provide high-end computers, light-speed Internet connections, and a gaming-friendly atmosphere for the general public. Large players such as WeWork and Five Below are investing in gaming centers in various cities with large gaming hubs. Smaller neighborhood gaming centers have been ripe for franchising, which offers a unique opportunity for gaming enthusiasts as newcomers to the industry. Franchising from an established gaming center franchisor may mitigate operating risk and plug a new franchise into an otherwise exclusive community, providing access to a demographic not otherwise accessible.

Playlive Nation and Contender Esports Gaming Center (Contender) both offer the franchised gaming center opportunity. These business offerings are traditional franchising opportunities subject to the FTC Franchise Rule and state franchising laws. For a potential franchisee who may not have a background in gaming centers, Playlive Nation and Contender may provide the necessary business know-how with their system. For example, a typical

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68. Id.


gaming center requires display monitors, gaming consoles, gaming chairs, servers and systems, gaming gear, and other industry-specific materials and equipment.\textsuperscript{76} Without a franchisor providing direction about these materials, it may be difficult for a business owner to obtain suitable equipment to be competitive in the Esports gaming center market, especially given the lack of publicly available resources for the establishment and operation of Esports gaming centers. Further, franchisees benefit from brand recognition from use of the respective trademarks.\textsuperscript{77}

In the same vein, Esports training facilities are gaining appeal. These training facilities could be one of the services offered by gaming centers,\textsuperscript{78} but can also be stand-alone centers.\textsuperscript{79} Digital Dojo Gaming is one provider of franchise opportunities for a coaching gaming facility.\textsuperscript{80} Trainers at these centers provide coaching for all levels of Esports athletes.\textsuperscript{81} These training facilities are becoming a transitional career for retiring professional gamers, either as owners of such facilities or as coaches working within the training dojos.\textsuperscript{82}

Esports-themed bars and restaurants are becoming more common in the United States,\textsuperscript{83} mirroring European trends.\textsuperscript{84} Meltdown is a European restaurant and bar focused on providing an Esports-friendly environment for gaming enthusiasts, with thirty-four locations around the world.\textsuperscript{85} It provides a franchise opportunity combining Esports culture with food and drink.\textsuperscript{86} The Grid, based in Copenhagen, is experiencing success as an Esports bar, broadcasting tournaments for the enjoyment of its patrons.\textsuperscript{87} Either of these concepts represents viable franchise opportunities for potential franchisees who may be interested in adding an Esports-themed business to their portfolio.

### III. Challenges of Esports Players

Because of the typical age of Esports athletes and lucrative nature of a professional career, numerous legal issues converge. The average age of an Esports professional athlete is between fifteen and twenty-four years old, and cash prizes for winning a tournament (such as the Dota 2 International

\textsuperscript{76} Id. at 11; see also Playlive Nation, supra note 74.

\textsuperscript{77} For those interested, FDDs for both Playlive Nation and Contender Esports may be obtained by contacting the franchisors directly.


\textsuperscript{79} Esports Performance Academy (Nov. 1, 2019), https://epa.gg.

\textsuperscript{80} Digital Dojo Gaming, supra note 78.

\textsuperscript{81} Id.

\textsuperscript{82} Interview with Andrew Cooley, Co-Founder and Chief Executive Officer, Esports Performance Academy (Sept. 3, 2019).

\textsuperscript{83} See Outrage (Nov. 1, 2019), https://outragepdx.bar.


\textsuperscript{85} Meltdown (Nov. 1, 2019), http://meltdown.bar.

\textsuperscript{86} Opening a Bar, MELTDOWN (Nov. 1, 2019), http://meltdown.bar/franchise.

\textsuperscript{87} Jackson, supra note 84.
in August 2018) can be $25.5 million or higher for the winning team.\textsuperscript{88} Although previously a professional Esports athlete’s career lasted approximately five years, careers are now expected to last up to twelve years with proper nutrition and training, and the entry of games based on skill and strategy rather than mechanical, reflex oriented games (for which ability may decline with age).\textsuperscript{89} Over the course of their career, players may encounter employment contracts with team owners and streaming platforms, provide coaching and consulting services, and even face immigration challenges. And, if the player is a minor, additional legal challenges may be present.

As the infrastructure around Esports grows, more thought is being provided to the organization of professional athletes. Currently, there is no overarching players’ association, as exists for traditional sports leagues such as the NFL and NBA.\textsuperscript{90} However, title-specific players’ organizations are being formed, such as the Counter-Strike Union and League of Legends Players Association, in order to advocate for players’ rights and establish some uniformity within the community.\textsuperscript{91}

Many traditional athletes may raise an eyebrow at the concept that video game players are athletes. But, the top Esports athletes are treated as professional athletes for the purposes of game performance and identity. Practice, training, exercise, and diet are becoming a reality and a necessity for the top gamers, as stakeholders and sponsors invest millions into their success.\textsuperscript{92} The life of a professional athlete can be difficult. Although accommodations, chef-provided meals, and amenities are typically provided, a professional Esports player’s day may start around 9:30 am and end at midnight, and every aspect of their lives may be devoted to competition.\textsuperscript{93} To protect their investment, team owners negotiate contracts for athletes’ services, which include a salary and benefits, but also contain certain overarching rights, licenses to their persona, and other atypical clauses not found in other professional sports contracts.\textsuperscript{94}

Unlike contracts in professional contact sports, Esports contracts between team owners and players normally include the ability for the team to negotiate a player’s sponsorships with a third-party.\textsuperscript{95} For example, an NBA team


\textsuperscript{89} Interview with Christian Gross, supra note 65.


\textsuperscript{91} Id.

\textsuperscript{92} Interview with Andrew Cooley, supra note 82.

\textsuperscript{93} Eli Blumenthal, A Six-Figure Career Playing Video Games? Welcome to the World of Professional Esports, USA Today (Mar. 18, 2019), https://www.usatoday.com/story/tech/2019/03/18/playing-league-legends-Esports-video-games-can-become-six-figure-career/2288351002.


may negotiate a sponsorship with Nike; however, a player on that team may be able to negotiate a separate sponsorship deal with Adidas. 96 In Esports, team owners often control the team’s and the players’ sponsorships, and these bundled intellectual property rights allow team owners to reach a more attractive sponsorship deal. 97 Although this may initially seem efficient, some players’ personas may grow to carry more value individually rather than in connection to a team, and players risk missing out on lucrative individual licensing deals. 98

One such gamer contract is currently being litigated. Turner Tenney, a popular Fortnite professional gamer, sued FaZe Clan, a California-based Esports team (FaZe), for breach of his Gamer Agreement with FaZe. 99 Tenney signed this Gamer Agreement with FaZe when he was twenty, which entitled FaZe up to eighty percent of all revenue paid by third parties for Tenney’s services. 100 This Gamer Agreement also contained restrictive covenants that prevented Tenney from providing services to any other gaming company or brand and otherwise restricted his ability to license his persona for sponsorship deals. 101 This Gamer Agreement also provided FaZe the right to receive and distribute any compensation from third parties. 102 Tenney is suing to release himself from restrictive covenants in the Gamer Agreement, as well as to collect on unpaid amounts due to him under the Gamer Agreement, among other claims. 103 This litigation is ongoing and may hold precedential value for future gamer agreements across the United States, not just in California.

Tenney’s circumstance is just one example of an employment contract gone sour, as there is great variation in player contracts across the United States. 104 Esports athletes may or may not be represented by professional agents, depending on the game and the region in which they participate, who could advocate on their behalf. 105 Currently, no collective bargaining association exists, such as the NFLPA for all Esports athletes. However, certain Esports athletes are forming players associations organized by title, such as the Counter-Strike Professional Players’ Association (CSPPA) and the North American League of Legends Championship Series Players Association (NALCSPA). 106 These Esports player associations are bargaining for players’ rights and establishing some uniformity within the industry. 107 Unlike the NFLPA, the Counter-Strike players union is organized on an

96. Id.
97. Id.
98. See id.
99. Id.
100. See Complaint, supra note 94.
101. Id.
102. Id.
103. Id.
104. Interview with Christian Gross, supra note 65.
105. Id.
106. Evans, supra note 90.
107. Id.
international level and arguably may not have as much negotiation leverage as the NFLPA in the United States.108 Alternatively, Riot Games surprisingly championed creation of the NALCSPA, which recruited Hal Biagas, who has thirteen years’ experience with the NBA Players Association (NBAPA), as its first executive director.109 Unlike the NBAPA, the NALCSPA struggles with dealing with the young age of its players as well as labor relations on behalf of its players not located in North America. In fact, half of its players are not from the United States or Canada.110

Regardless of collective bargaining, most professional Esports athletes that compete in Tier 1 games make well over $100,000 a year, in addition to receiving a portion of tournament prizes,111 and some players earn as much as $400,000 a year.112 Because of the heavy monetary investment in franchise fees and player development, most U.S. Esports teams have not yet made a profit on their venture and are currently sustained by investors.113 One of the main reasons for this economic situation is lack of proper infrastructure and weak viewership in the United States, which is lagging behind Europe and Asia.114 Even Mark Cuban admits that he “had no idea how bad a business it was,” when discussing his investment into Mavs Gaming.115

Further, as the United States is starting to invest in the Esports industry, it is opening an immigration channel for importing overseas talent as well as hosting international players for tournaments. If international Esports athletes do not utilize the correct visa, they may expose themselves and their teams to possible denial of entry into and removal from the United States. Under the current immigration framework, professional athletes are permitted to enter the United States on a business visitor visa called a B-1, but they are prohibited from receiving a salary or payment other than prize money.116 This restriction presents a challenge because most Esports athletes are provided a salary in addition to prize money.117 For those Esports athletes, a P-1 athlete visa may be more suitable, which the U.S. Citizenship and Immigration Service (USCIS) approved to include an Esports competitor entry to the United States for the first time in 2013.118

108. Id.
110. Id.
111. Interview with Christian Gross, supra note 66.
113. Id.
114. Id.
117. Id.
118. Id.
The P-1 visa policy, however, can be challenging because it is a fragmented avenue that is found in a number of statutes, regulations, and the Foreign Affairs Manual. Although the USCIS has been willing to expand the definition of athlete to include Esports competitors, it has wide discretion to determine the boundaries of the P-1 visa and may be subject to political influence. Complicating matters further, each P-1 visa application is considered on a case-by-case basis which may vary from game to game. For example, Swedish Super Smash Brothers Melee professional competitor William Hjelte reported that his P-1 visa was initially denied because the USCIS did not consider Super Smash Brothers Melee to be a legitimate sport, even though it was a high-profile game with tournament events offering considerable cash prizes. Hjelte’s visa was finally approved almost a year later, but the uncertainty of the P-1 visa is still an issue for the growth of Esports tournaments in the United States.

As professional gamers retire, coaching serves as one avenue to develop the next phase of their careers. Most Esports athletes retire by age twenty-five, as their fine motor skills and reaction time decline with age. Coaches play an integral role in developing the next generation of professional Esports athletes and enthusiasts, as well as serving as a resource to educational facilities looking to integrate an Esports program and local city governments looking to develop a pipeline for Esports talent. Transitioning players are faced with the challenge of creating a post-professional career that has longevity in a sport that does not yet have the infrastructure in place to support retired players.

IV. What’s Next?

The Esports industry is still evolving, and it is hard to say what the landscape may look like in another five years. China and South Korea may offer a glimpse into the future of Esports in the United States. Several high
schools and universities offer Esports as part of their academic disciplines. The Chinese government has officially recognized “Esports professionals” and “Esports operators” as official job titles, and Esports-related majors have been added to the curriculum of several universities. Germany, recognizing that immigration might stifle growth, has proposed new legislation that would more easily allow professional Esports athletes that live outside of the European Union to live and work in Germany.

Currently in the United States, Esports enthusiasts and investors are investing heavily in building infrastructure to support a ballooning industry. Grassroots campaigns are being launched at the primary, secondary, and collegiate levels to ensure a pipeline of players for a variety of titles. Cities are revitalizing old stadiums and event halls to host Esports tournaments, and building other community meeting places, to entice a more robust gaming culture locally. On a national and international scale, the number of national and international teams are growing, as well as the intensity of competition. Meanwhile, game developers are creating game extensions and new games to entice old and new players to continue game play. Professional athletes are also breaking new ground during their career, and after retirement, as they try to create new opportunities. As the last piece to the Esports growth formula, immigration reform is integral to continued growth of Esports in the United States, especially to reduce the time it takes for Esports players to obtain the necessary visas to play in the United States.

One thing is certain, Esports are here to stay.

131. Interview with Christian Gross, supra note 65.
132. Id.
In Support of a New Uniform Franchise Disclosure Act; If Not Now, When?

Stanley M. Dub

The centerpiece of franchise law is the concept that prospective franchisees should be given an opportunity to make an informed investment decision by receiving relevant business disclosures before making their investment.

Since 1979, the Federal Trade Commission (FTC) has required franchisors to provide prospective franchisees with a franchise disclosure document (FDD) before selling them a franchise. However, if a franchise seller violates the FTC Rule, there is no private right of action, and the FTC will rarely take action on behalf of an injured franchisee. In some states, laws require registration or notice of franchise offerings before sale, and these laws may provide for a private right of action for disclosure violations, or grant police powers to a state agency charged with enforcement of the law. A few other states have laws that do not require registration, but which may provide a remedy to injured franchisees for disclosure violations. However, a majority of states do not have any law requiring pre-sale disclosures in the sale of franchises. While the FTC Rule still applies in these states, no specific statutory remedy is available to a

2. See, e.g., Freedman v. Meldy’s, Inc., 587 F. Supp. 658, 661–62 (E.D. Pa. 1984) (finding that no private right of action was granted by Congress under the FTC Act and that the FTC’s views regarding the desirability of a private right of action are not sufficient to create such a right in the absence of congressional action).
5. Fourteen non-registration states have business opportunity laws that do not apply to sale of “franchises,” and eighteen other states do not have any franchise or business opportunity

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franchisee whose franchisor fails to provide a required FDD, or provides an FDD but commits material violations of the FTC Rule in connection with its content or delivery.6

This article proposes to fill the gap in franchise disclosure regulation with a standardized state law that would require franchisors to provide prospective franchisees with pre-sale disclosures. A proposed act (i.e., the Uniform Franchise Disclosure Act (the Act)) for this purpose is attached at Appendix A and discussed below.

This is not the first attempt to enact a standardized state franchise disclosure law. The Uniform Franchise & Business Opportunities Act (Uniform Act) was drafted in the late 1980s, and an alternative Model Franchise Investment Act (Model Act) was proposed subsequently, but no state enacted either act.7 Each of these proposals attracted criticism for their approach to the issue of state registration.8 The Act proposed in this article avoids these criticisms by taking a less restrictive approach.

I. The Need for Franchise Disclosures

The FTC Rule was promulgated in 1978 after several years of public involvement through comment and hearings. In its comments supporting passage of the FTC Rule, the FTC cited congressional testimony of a former franchise executive to support the need for pre-sale disclosure requirements:

This emotional dream, the desire of every American to own his own business, to be his own boss, has many pitfalls. He is easy prey for the hot-shot promoter because the stakes are so high here. These small businessmen very often scrape up every dime they can borrow, beg or steal in a lifetime of earnings, and put it all on one dream and hope of a franchise concept that very likely could have been misleading and fraudulent. For that reason, I think that [the government] should take some positive action to protect the small businessman. After all, he is the one that is going to get hurt, not the franchisor, because the franchisee is the one who puts up all the money and all the labor in order to develop the business concept.9


6. In states without disclosure laws, a franchisee may sometimes have a cause of action under general common law theories, such as fraud. However, such claims are often unsuited to the facts of a franchise disclosure claim. They would typically not apply, for example, to a failure to provide any disclosure document, or to a claim based on use of outdated financial statements or investment estimates in a FDD. Even where an Item 19 financial disclosure was subsequently shown to be false or misleading, a claimant relying on a fraud theory might be unable to prove the misrepresentation was intentional.


8. The Uniform Act would have eliminated franchise registration requirements in states that currently impose them, while the Model Act would have imposed franchise registration requirements in every state that adopted it. See Douglas Berry, David Byers & Daniel Oates, State Regulation of Franchising: The Washington Experience Revisited, 32 Seattle U. L. Rev. 811, 820–26 (2009).

The FTC Rule was amended in 2007 after further public comment and hearings. In the Statement of Basis and Purpose published with the 2007 amendments, the FTC explained the need for pre-sale disclosures as follows:

Based upon the [1978] rulemaking record, the Commission found widespread deception in the sale of franchises and business opportunities through both material misrepresentations and nondisclosures of material facts. Specifically, the Commission found that franchisors and business opportunity sellers often made material misrepresentations about: the nature of the seller and its business operations, the costs to purchase a franchise or business opportunity and other contractual terms and conditions under which the business would operate, the success of the seller and its purchasers, and the seller’s financial viability. The Commission also found other unfair or deceptive practices pervasive: franchisors’ and business opportunity sellers’ use of false or unsubstantiated earnings claims to lure prospective purchasers into buying a franchise or business opportunity, and franchisors’ and business opportunity sellers’ failure to honor promised refund requests. The Commission concluded that all of these practices led to serious economic harm to consumers.10

Public comments on the 2007 amendments overwhelmingly supported the continuing need for the FTC Rule.11 The FTC sought comments again on the continued need for the FTC Rule in early 2019.12 Forty-one comments were submitted in response, representing both franchisor and franchisee spokesmen, including comments from the International Franchise Association and the Coalition of Franchisee Associations.13 These comments were unanimous in their support for continuation of the FTC Rule.14

As these comments demonstrate, support for the concept of pre-sale business disclosures in franchise transactions remains virtually unanimous today, forty years after promulgation of the original FTC Rule.

II. Federal Regulation of Franchise Disclosures Today

The FTC Rule applies to sellers of franchises if the franchise will be located anywhere in the United States.15 As a practical matter, however, the threat of FTC enforcement is nothing more than a paper tiger. Attempts to involve the FTC in individual cases of franchise disclosure violations are rarely successful.16 The FTC obviously lacks the resources and staff to

11. Id. at 15,447.
14. Id. at 4.
15. 16 C.F.R. § 436.2.
prosecute all disclosure violations nationwide, but the FTC has seemingly abdicated its role as even a potential enforcer of individual FTC Rule violations by failing for so long to investigate claims or bring such actions.\textsuperscript{17} Under the circumstances, the FTC’s approach to enforcement takes on a cynical aspect when viewed by injured franchisees. The FTC Rule requires that every FDD include the following: (a) an invitation on the cover page for prospective franchisees to contact the FTC for help in understanding the document; and (b) an instruction in the receipt to report Rule violations to the FTC.\textsuperscript{18} The implication that the FTC will somehow assist franchisees injured by disclosure violations is itself a significant misrepresentation. Not uncommonly, franchisees are recent immigrants for whom English is a second language, and frequently they sign their franchise agreements without engaging an attorney to review the FDD.\textsuperscript{19} While these franchisees must bear ultimate responsibility for their failure to get legal help, the FDD’s required language implies that the FTC plays an ongoing role in protecting prospective franchisees against disclosure violations, which is simply not the case.

III. State Regulation of Franchise Disclosures

Without any hope of enforcement of the FTC Rule by the FTC, injured franchisees are left with only the remedies provided by state franchise disclosure laws, or by common-law remedies in states without franchise disclosure laws. The extent to which particular state laws or common-law remedies provide these protections is beyond the scope of this article. However, in thirty-two states, currently no law requires franchisors to provide prospective franchisees with any disclosure document.\textsuperscript{20} Common-law remedies can be useful in cases of fraud or fraudulent misrepresentations, but those remedies reach only a fraction of the situations in which franchisees may be injured as a result of disclosure violations.\textsuperscript{21}

\textsuperscript{17} See GAO Report, supra note 16.
\textsuperscript{18} 16 C.F.R. §§ 436.3(e)(4), 436.5(w)(1).
\textsuperscript{19} In an early study of the fast food industry cited by the FTC, thirty-nine percent of the franchisees did not consult an attorney before signing their franchise agreement. 1978 Statement of Basis and Purpose, 43 Fed. Reg. 59,614 n.20. More recently, an informal study of 253 franchisees found that fifty-two percent had not consulted an attorney to review their FDD or franchise agreement before buying their first franchise. Caroline Fichter, Andrew Malzahn & Adam Matheson, Don’t Tread on Me: A Defense of State Franchise Regulation, 38 Franchise L.J. 23, 30 (2018).
\textsuperscript{20} See Dub, supra note 5 at 117.
\textsuperscript{21} See discussion supra, note 6.
IV. Previous Attempts to Enact Uniform Franchise Laws

Before promulgation of the FTC Rule in 1979, it seemed clear that no private right of action existed for violation of the FTC Act (the Act on which the FTC Rule is based). However, franchisees were emboldened by the FTC’s comments in the Statement of Basis and Purpose accompanying the Rule:

The Commission believes that the courts should and will hold that any person injured by a violation of the Rule has a private right of action against the violator. . . . The existence of such a right is necessary to protect the members of the class for whose benefits the [FTC Act] was enacted . . . and is necessary to the enforcement scheme established by Congress in that Act and to the Commission’s own enforcement efforts.

Those beliefs and hopes were subsequently dashed, however, as courts have consistently declined to follow the FTC’s express intent and imply a private right of action for violation of the Rule.

Motivated by the absence of a private remedy for violation of the FTC Rule, the National Conference of Commissioners on Uniform State Laws (NCCUSL) proposed the Uniform Act in 1983. After several years of debate and revision, NCCUSL approved the Uniform Act in 1987. However, the Uniform Act never gained traction and was never enacted by any state. The primary objection to the Uniform Act was seemingly its intention to eliminate state franchise registration requirements. States with existing franchise registration requirements were reluctant to do away with them, and franchisees in those states were unwilling to eliminate the state agency tasked with protecting their interests.

The North American Securities Administrators Association (NASAA) later drafted and promoted a uniform state law. Commonly known as the Model Franchise Investment Act (Model Act), this proposal took the opposite approach on the question of registration requirements; under this law, franchisors would be required to register their franchise offerings in every state where they intended to do business. Any state proposing to enact this statute would therefore be required to establish a new state agency with its related staff, facilities, and budget commitments. As with the Uniform Act, no state actually enacted this legislation.

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22. See, e.g., Holloway v. Bristol-Myers Corp., 485 F.2d 986 (D.C. Cir. 1973) (holding that Congress did not authorize a private right of action in connection with passage of the FTC Act, the legislation which created the Commission).


25. See Berry et al., supra note 8, at 820.


27. See Berry et al., supra note 8 at 822–24.

28. See id.

These previous attempts at uniform state franchise regulation were seemingly doomed by their failure to demonstrate to states that there was widespread support for their goals. Support for requiring pre-sale franchise disclosures could be, and has been, demonstrated, but there was no consensus for either eliminating existing registration requirements in states that had them, or imposing universal registration requirements in states that did not. The Model Act’s drafters likely failed in their endeavor because they created obstacles—namely, the requirement that states allocate resources to a new franchise bureaucracy without any broad consensus for this among constituents.

It is worth considering what a private right of action to enforce the FTC Rule would have looked like, and how a prototypical state franchise law might provide franchisees with similar protections, without additionally requiring states to allocate resources to creating a new state agency.

V. The Current Proposed Uniform Franchise Disclosure Act

The Act, attached at Appendix A, is intended to provide a private right of action for violation of pre-sale disclosure obligations in states where no such right currently exists. It would not (1) eliminate registration requirements in any state where they currently exist; (2) require any state to hire personnel, establish a new state agency or authorize any expenditures; or (3) require franchisors to make changes to their existing documents or procedures to comply with the Act. The Act incorporates existing requirements of the FTC Rule, while creating a private right of action for FTC Rule violations. In this way, the Act provides the private right of action that the FTC intended, as expressed in its original Statement of Basis and Purpose. The most pertinent provisions of the Act are discussed below.

• Section 100.6(A) of the Act provides what the FTC has always intended: private enforcement for violations of the FTC Rule. If the franchisor commits a material violation, the private right of action allows the franchisee to rescind a transaction, recover his damages (or $25,000, if greater), or institute a class action. Attorney fees may be awarded to a successful franchisee, or to the franchisor where a franchisee is found to bring a claim in bad faith. Additional remedies are available to the state attorney general, including injunctive relief.

• The Act’s definitions are taken almost verbatim from the FTC Rule, with only minor exceptions. For example, a definition has been added for “located in this state” to clarify that the disclosure obligation does
not relate to franchisees located outside the state, regardless of which state’s law is selected in the franchise agreement.36

- The Act incorporates all of the existing exemptions in the FTC Rule, insuring that a franchisor choosing not to make disclosures in reliance on an FTC Rule exemption will likewise be exempt under the Act.37
- The basic disclosure obligations of the FTC Rule are incorporated into the Act without change, along with the specific FTC Rule requirements for content of the disclosure document.38
- Various additional prohibitions are included (Section 100.4) and parrot the FTC Rule’s “Additional prohibitions” in 16 C.F.R. § 436.9.39
- The General Provisions section includes several additional items.40 These include a four-year statute of limitations on claims,41 a provision making controlling shareholders or members jointly liable for violations,42 and a requirement that any mediation, arbitration, or litigation be subject to the law of the franchisee’s state, and be conducted in the franchisee’s state, if the dispute involves a claim under the Act.43

36. See id. § 100.1(n).
37. See id. § 100.2.
38. See id. §§ 100.2, 100.3.
39. See id. § 100.4.
40. See generally id. § 100.7.
41. See id. § 100.7(A).
42. See id. § 100.7(C). Joint liability of controlling owners of a franchisor entity is necessary to address instances of noncompliance involving new or insolvent businesses. Relaxed financial statement reporting requirements for new franchisors in the FTC Rule cause most first-time franchisors to organize new entities to act as the franchisor. These entities may be started with nothing more than a trademark license, shared use of common office space, and $500 in the bank. If the franchisor entity receives $100,000 in franchise fees, there is generally no legal barrier to its owners paying this amount to themselves as salaries, thereby rendering their entity effectively judgment-proof in any subsequent litigation.

An Ohio state court case illustrates why these provisions are necessary. See Jori, LLC v. B2B Int’l, LLC, 2018 WL 1571936 (Ohio Ct. App., Mar. 30, 2018) (recounting the procedural history prior to trial). In that case, the plaintiff purchased rights to operate a restaurant under a license agreement without receiving any disclosure document. Id. at *1. The transaction was later found to violate Ohio’s Business Opportunity Act. Id. at *4. The seller was operating three other restaurants under the same mark, but the existing restaurants and the franchise business were each operated under separate corporate entities, and the licensor entity had only recently been created, with a $500 initial capitalization. The licensor entity had previously distributed the $20,000 initial franchise fee to its shareholder, leaving it essentially insolvent. The jury found for the plaintiff, granted plaintiff’s request for rescission of the transaction, and entered a monetary award for the plaintiff, but decided that the circumstances did not satisfy Ohio’s difficult test for piercing the corporate veil. In other words, the plaintiff won the battle but lost the war because it won a jury verdict, but was left with only an uncollectible judgment.

Franchisees should not be required to rely on common-law rules for piercing the veil in such cases, since recovery under that theory is notoriously difficult and unpredictable. Owner liability is already imposed under some state franchise laws, and the concept of joint liability does not increase the franchisor’s liability in such cases; it only prevents a franchisor from organizing a new entity to conduct the franchising business as a shield to its own liability.

43. See Appendix A § 100.7(F). This provision would not invalidate dispute resolution provisions requiring prior mediation, or arbitration, but would simply dictate the forum for these procedures. In the past, franchisors have sometimes used their dispute resolution and forum-selection clauses to prevent or deter franchisees from bringing claims. See, e.g., Nagrampa v.
VI. Conclusion

Since the FTC Rule was passed in 1979, the concept of pre-sale franchise disclosures has formed the cornerstone of franchise law practice. However, there is no private right of action for violation of the FTC Rule, and a majority of states still do not have any laws requiring franchise sellers to provide a disclosure document to residents of their state who purchase a franchise. Franchisors thus have no accountability in those states because franchisees have no cause of action if a franchisor provides a defective disclosure document, otherwise violates disclosure rules, or fails to give them any disclosure document at all.

This article provides the text of an Act to require pre-sale franchise disclosures. Passage of the Act would not require any state to create a new state agency or allocate budgetary resources to franchise law enforcement, but would give injured franchisees the tools needed to protect themselves against noncomplying franchisors. Franchisees in at least thirty-two states currently lack such protections, and it is hoped that some or all of these states will adopt the proposed Act.

Thirty years ago, the franchise bar’s esteemed recently departed colleague, Rupert Barkoff, wrote an article describing his efforts to enact the Uniform Act. His closing comments in that article resonate as strongly today as they did then:

At the 1982 Forum meeting in Williamsburg, I suggested to those present that we, as franchise lawyers, should lessen the emphasis on where the law is and instead focus on where the law should be. . . . [This] presents us with the opportunity to shape the future of our field in a constructive, positive manner. We must not let this opportunity pass us by.

Mailcoups, Inc., 469 F.3d 1257 (9th Cir. 2006) (holding contract provision unconscionable where it required a California direct mail advertising franchisee to arbitrate her dispute in Massachusetts); Zounds Hearing Franchising, LLC v. Bower, 2017 WL 4399487, at *12 (D. Ariz. Sept. 19, 2017) (holding that Ohio’s Business Opportunity statute invalidated contract clauses selecting an out-of-state forum or application of another state’s law, where the claim was based on violation of the statute).

While there are legitimate business reasons for franchisors to prefer to conduct litigation only in their home states, franchisors are generally better able than franchisees to bear the cost of contesting litigation in distant locations. Franchisors in such circumstances have previously made an affirmative choice to sell their franchises in the franchisee’s state, while the franchisee operating a franchise in its home state has made no such choice regarding the franchisor’s state. Furthermore, laws in several states already require litigation to be contested under the law of their states, or at a forum within their state. See, e.g., ILL. COMP. STAT. § 705/1 et seq.; IND. CODE § 23-2-2.3-1 et seq.; MD. CODE ANN. BUS. REG. § 14-201 et seq.; MICH. COMP. LAWS § 445.1501 et seq.; MINN. STAT. § 80c.01 et seq.; N.D. CENT. CODE § 51-19-01 et seq.; OHIO REV. CODE §1334.15; R.I. GEN. LAWS § 19-28.1-1 et seq.; WASH. REV. CODE § 19.100.010 et seq. These requirements can be effected through provisions in the laws, requirements for state-specific contract amendments, or both.

44. Rupert Barkoff, Walking the Uniform Franchise and Business Opportunities Act to and Through the State Legislatures, 7 FRANCHISE L.J. 7 (1988).
Appendix A

An Act for the Regulation of Franchise Disclosures

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF _________________:

Section 1. As used in sections ___________ of the [laws of __________],

CHAPTER 100: Franchise Disclosure Obligations

Subpart A—Definitions

§ 100.1 Definitions.

Unless stated otherwise, the following definitions apply throughout Chapter 100 (“this Act”):

(a) Action includes complaints, cross claims, counterclaims, and third-party complaints in a judicial action or proceeding, and their equivalents in an administrative action or arbitration.

(b) Affiliate means an entity controlled by, controlling, or under common control with, another entity.

(c) Confidentiality clause means any contract, order, or settlement provision that directly or indirectly restricts a current or former franchisee from discussing his or her personal experience as a franchisee in the franchisor’s system with any prospective franchisee. It does not include clauses that protect franchisor’s trademarks or other proprietary information.

(d) Disclose, state, describe, and list each mean to present all material facts accurately, clearly, concisely, and legibly in plain English.

(e) Financial performance representation means any representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states—expressly or by implication—a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.

(f) Fiscal year refers to the franchisor’s fiscal year.

(g) Fractional franchise means a franchise relationship that satisfies the following criteria when the relationship is created:
(1) The franchisee, any of the franchisee's current directors or officers, or any current directors or officers of a parent or affiliate, has more than two years of experience in the same type of business; and

(2) The parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.

(h) **Franchise** means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

(1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;

(2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation; and

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

(i) **Franchisee** means any person who is granted a franchise.

(j) **Franchise seller** means a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor’s employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.

(k) **Franchisor** means any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes subfranchisors. For purposes of this definition, a “subfranchisor” means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.

(l) **FTC Rule** means the body of regulations promulgated by the United States Federal Trade Commission for the regulation of pre-sale franchise disclosures and published at 16 C.F.R. § 436, as may be amended from time.

(m) **Leased department** means an arrangement whereby a retailer licenses or otherwise permits a seller to conduct business from the retailer's location where the seller purchases no goods, services, or commodities directly or indirectly from the retailer, a person with whom the retailer requires the
seller to do business, or a retailer-affiliate if the retailer advises the seller to do business with the affiliate.

(n) **Located in this state** means that a business is operated primarily from a fixed location in this state, or operated from a mobile location or vehicle, where the mobile location or vehicle is intended to operate in this state to a greater extent than in any other state. If the business operates primarily over the Internet, or through other means not requiring use of any specific physical location, the business shall be deemed located in this state if one or more individuals who control the business have their primary residence in this state.

(o) **Parent** means an entity that controls another entity directly, or indirectly through one or more subsidiaries.

(p) **Person** means any individual, group, association, limited or general partnership, corporation, or any other entity.

(q) **Plain English** means the organization of information and language usage understandable by a person unfamiliar with the franchise business. It incorporates short sentences; definite, concrete, everyday language; active voice; and tabular presentation of information, where possible. It avoids legal jargon, highly technical business terms, and multiple negatives.

(r) **Predecessor** means a person from whom the franchisor acquired, directly or indirectly, the major portion of the franchisor’s assets.

(s) **Principal business address** means the street address of a person’s home office in the United States. A principal business address cannot be a post office box or private mail drop.

(t) **Prospective franchisee** means any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship.

(u) **Required payment** means all consideration that the franchisee must pay to the franchisor or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the franchise. A required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.

(v) **Sale of a franchise** includes an agreement whereby a person obtains a franchise from a franchise seller for value by purchase, license, or otherwise. It does not include extending or renewing an existing franchise agreement where there has been no interruption in the franchisee’s operation of the business, unless the new agreement contains terms and conditions that differ materially from the original agreement. It also does not include the transfer of a franchise by an existing franchisee where the franchisor has had no significant involvement with the prospective
transferee. A franchisor’s approval or disapproval of a transfer alone is not deemed to be significant involvement.

(w) **Signature** means a person’s affirmative step to authenticate his or her identity. It includes a person’s handwritten signature, as well as a person’s use of security codes, passwords, electronic signatures, and similar devices to authenticate his or her identity.

(x) **Trademark** includes trademarks, service marks, names, logos, and other commercial symbols.

(y) **Written or in writing** means any document or information in printed form or in any form capable of being preserved in tangible form and read. It includes typeset, word-processed, or handwritten documents; information on computer disk or CD-ROM; information sent via email; or information posted on the Internet. It does not include mere oral statements.

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**Subpart B—Franchisors’ Obligations**

**§ 100.2 Obligation to furnish documents.**

In connection with the offer or sale of a franchise to be located in this state, unless the transaction is exempted under § 436.8 of the FTC Rule, or the transaction concerns [activities separately regulated by motor vehicle, liquor, gas station, or other dealer legislation], it is a violation of this Act:

(a) For any franchisor to fail to furnish a prospective franchisee with a copy of the franchisor’s current disclosure document, as described in the FTC Rule, 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.

(b) For any franchisor to alter unilaterally and materially the terms and conditions of the basic franchise agreement or any related agreements attached to the disclosure document without furnishing the prospective franchisee with a copy of each revised agreement at least seven calendar-days before the prospective franchisee signs the revised agreement. Changes to an agreement that arise out of negotiations initiated by the prospective franchisee do not trigger this seven calendar-day period.

(c) For purposes of paragraphs (a) and (b) of this section, the franchisor has furnished the documents by the required date if:

(1) A copy of the document was hand-delivered, faxed, emailed, or otherwise delivered to the prospective franchisee by the required date;

(2) Directions for accessing the document on the Internet were provided to the prospective franchisee by the required date; or
(3) A paper or tangible electronic copy (for example, computer disk or CD-ROM) was sent to the address specified by the prospective franchisee by first-class United States mail at least three calendar days before the required date.

Subpart C—Contents of a Disclosure Document

§ 100.3 Content of a Disclosure Document.

The Disclosure Document required by this Act shall conform to the requirements specified for preparation and updating of disclosures in §§ 436.3–436.5 of the FTC Rule, as further explained by the instructions contained in §§ 436.6 and 436.7 of the FTC Rule, and the various Appendices included in the FTC Rule.

Subpart D—Additional Prohibitions

§ 100.4 Additional prohibitions.

It shall be unlawful for any franchise seller covered by this Act to:

(a) Make any claim or representation, orally, visually, or in writing, that contradicts the information required to be disclosed by this part.

(b) Misrepresent that any person:

   (1) Purchased a franchise from the franchisor or operated a franchise of the type offered by the franchisor.

   (2) Can provide an independent and reliable report about the franchise or the experiences of any current or former franchisees.

(c) Disseminate any financial performance representations to prospective franchisees unless the franchisor has a reasonable basis and written substantiation for the representation at the time the representation is made, and the representation is included in the franchisor’s disclosure document. In conjunction with any such financial performance representation, the franchise seller shall also:

   (1) Disclose the information required by §§ 436.5 of the FTC Rule if the representation relates to the past performance of the franchisor’s outlets.

   (2) Include a clear and conspicuous admonition that a new franchisee’s individual financial results may differ from the result stated in the financial performance representation.

(d) Fail to make available to prospective franchisees upon reasonable request, written substantiation for any financial performance representations made in the franchisor’s disclosure document.
(e) Fail to furnish a copy of the franchisor’s disclosure document to a prospective franchisee earlier in the sales process than required under the FTC Rule, upon reasonable request.

(f) Fail to furnish a copy of the franchisor’s most recent disclosure document and any quarterly updates to a prospective franchisee, upon reasonable request, before the prospective franchisee signs a franchise agreement.

(g) Present for signing a franchise agreement in which the terms and conditions differ materially from those presented as an attachment to the disclosure document, unless the franchise seller informed the prospective franchisee of the differences at least seven days before execution of the franchise agreement.

(h) Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments. Provided, however, that this provision is not intended to prevent a prospective franchisee from voluntarily waiving specific contract terms and conditions set forth in his or her disclosure document during the course of franchise sale negotiations.

(i) Fail to return any funds or deposits in accordance with any conditions disclosed in the franchisor’s disclosure document, franchise agreement, or any related document.

Subpart E—Enforcement by the State

§ 100.5 Actions by the Attorney General Authorized.

A. If the Attorney General has reasonable cause to believe that a person has engaged in an act or practice that violates this Act, he or she may bring any of the following actions:
   a. An action to obtain a declaratory judgment that the act or practices violates provisions of this Act;
   b. An action to obtain a temporary restraining order, preliminary injunction, or permanent injunction to restrain the act or practice. On motion of the attorney general, or on its own motion, the court may impose a civil penalty of not more than twenty thousand dollars for each violation of a temporary restraining order, preliminary injunction or permanent injunction issued under this section.
   c. A class action on behalf of franchisees damaged by a violation of this Act.

B. On motion of the attorney general and without bond, in an attorney general’s action under this section, the court may make appropriate
orders, including appointment of a referee or a receiver, for sequestration of assets, to reimburse franchisees found to have been damaged, to carry out a transaction in accordance with the franchisee’s reasonable expectations, to strike or limit the applicability of unconscionable clauses of agreements so as to avoid an unconscionable result or to grant other appropriate relief.

C. In addition to the other remedies provided in this section, the attorney general may request, and the court may impose, a civil penalty of not more than twenty thousand dollars for each violation found by the court.

Subpart F—Enforcement by a Franchisee

§ 100.6 Remedies.

A. For a material violation of this Act, a franchisee has a cause of action and may seek any or all of the following:

a. To rescind the transaction and recover all sums paid to the franchise seller, less the fair market value at the time of delivery of any goods supplied by the franchise seller that are not returned by the franchisee;

b. To recover the amount of the franchisee’s damages, or twenty-five thousand dollars, whichever is greater;

c. To recover damages or other appropriate relief in a class action under Civil Rule 23.

B. The court may award the prevailing party a reasonable attorney fee, if either of the following apply:

a. The franchisee alleging violations of this Act has brought an action that is groundless or brought in bad faith;

b. The franchise seller committed an act or practice found to constitute a material violation of this Act.

Subpart G—General Provisions

§ 100.7 General Provisions.

A. The courts of common pleas and municipal courts within their respective monetary jurisdiction, have jurisdiction over claims brought with respect to Acts or practices governed by this Act.

B. No action under this Act may be brought after the earlier of

(i) four years from the date of the act or practice claimed to violate this Act, or

(ii) four years from the date on which the franchisee and franchise seller executed the related agreement.
C. For purposes of this Act, a person who directly or indirectly controls a person (including a corporation, LLC or similar entity) who violates this Act is also jointly and severally liable with and to the same extent as the controlled person.

D. In any case alleging that a transaction is exempt under §100.2 of this Act, the person claiming entitlement to the exemption has the burden of proof as to the application of the exemption.

E. The legislature declares that it is the intent of this Act to protect purchasers of franchises by requiring that sellers provide them with the necessary disclosures to permit them to make an intelligent investment decision. The legislature further declares that the provisions of this Act represent a fundamental public policy of this state.

F. Any provision of an agreement between a franchisee and a franchise seller that
   (i) requires that claims be mediated, arbitrated or adjudicated at a location outside this state, or
   (ii) specifies application of the laws of a different state, is void and unenforceable as it relates to claims asserted under this Act.

G. Any waiver or attempted waiver by a franchisee of the provisions of this Act is void and unenforceable.
The Tripartite Relationship: 
Issues Following Default 
by a Master Franchise Holder

Terrence Dunn

Perhaps the key element in any long-term contract is the language governing defaults and remedies. It is the parties’ opportunity at the outset to agree to a set of procedures, remedies, and processes for how to handle breach and termination. The franchisor-franchisee relationship has its own set of considerations, many of which require special attention in the event of a default, including protection of intellectual property, such as trademarks and confidential information; possible preservation and support of a specific ongoing enterprise; and continuation of an unimpaired franchise brand, system, and the goodwill associated with it.

Franchisors often address these considerations in the franchise agreement with provisions that provide the franchisor with rights if a franchisee defaults. There is no such thing as a “standard” franchise agreement, but any competently drawn franchise agreement contains certain types of default-related terms. Those terms invariably include the franchisor reserving rights and providing remedies to protect the essence of its business model. However, for reasons discussed below, the master franchise model poses special challenges in a default scenario.

A master franchise agreement is an agreement in which a franchisor grants rights that allows a party to, among other things, sell unit franchises in a franchisor’s system and enter directly into unit franchise agreements with unit franchisees. To avoid confusion, this article will refer to the potential involved parties as follows: (a) the primary franchisor as the master franchisor; (b) the subfranchisor as the master franchisee; and (c) the ultimate franchise operator as the unit franchisee. The paper will examine what happens when a default of a master franchise agreement occurs. It will answer questions, like what happens if the master franchisee defaults and is subsequently terminated for a failure to cure such defaults? What issues are raised that concern the master franchisor when the master franchisee defaults? What effect does the default have on the master franchisor and its relationships with each unit franchisee? (After all, each unit franchisee has various rights under

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its franchise agreement, and the unit franchisee may now be looking to the master franchisor when enforcing those rights.

Before reaching these questions, this article will first provide background on what a master franchise agreement is and how it differs from a normal franchisor/unit franchisee arrangement. Next, it will discuss how the federal and state regulatory regime for franchising applies in the context of a master franchise. The article will then discuss the contract and intellectual property law issues that arise when a master franchisee is terminated. Finally, the article will provide practical advice on how best to draft franchise contracts when a master franchisee is involved.

I. How Does a Master Franchise Agreement Differ from Other Forms of Franchise Agreements?

There are a variety of types of franchise relationships and accompanying agreements. The most common, and simplest, franchise relationship is the single unit franchise. For a single unit franchise, the franchisor will enter directly into a franchise agreement with the franchisee for the operation of a single location. The next level is a multi-unit franchise relationship, which occurs when the franchisee plans to open and operate more than one franchise unit. The accompanying agreements often are for a predetermined number of franchise units and usually within a certain territory. Typically, the franchisor and franchisee sign a multi-unit agreement that contains terms related to the sequencing and development of the multiple locations. They will, for example, often have a development schedule for the franchisee that sets out the number of units that the franchisee is required to open in an assigned territory within a certain amount of time. In addition, as the multi-unit owner opens each individual franchise, the parties will sign a single unit franchise agreement that specifically governs the operation of that location.

An area development franchise agreement is somewhat similar: it allows for a franchisee to open and operate a number of units in a given area during a specific amount of time. Like the multi-unit relationship, the franchisee signs a single development agreement and then a separate franchise agreement for the operation of each location. The major difference between the multi-unit franchise structure and area development structure is exclusivity. In an area development franchise agreement, the franchisee is usually granted the exclusive right to develop all franchise locations within an assigned area.

1. See Barbara Beshel, An Introduction to Franchising 7 (2010).
2. See id.
5. See Beshel, supra note 1, at 7.
Another franchise development vehicle is the area representative or development agent concept\(^6\) in which the representative recruits unit franchisees and provides certain services in exchange for a fee, which is typically a portion of the initial franchise fee and ongoing royalties charged to the unit franchisees by the franchisor. However, the area representative/development agent is not required to be a franchisee (though they often own unit franchisees too) and is not a franchisor.\(^7\)

The master franchise agreement is a significantly different arrangement from all of those just discussed. A true master franchise agreement grants the right to another person or entity, the master franchisee (also commonly referred to as a “subfranchisor”), not only to operate a franchised business, but also to recruit franchisees and sell unit franchises to other persons or entities, known as unit franchisees (also commonly referred to as “subfranchisees”), in a predetermined geographical area.\(^8\) The terms of this arrangement are spelled out in the master franchise agreement between the master franchisor and the master franchisee. The master franchise agreement often requires the master franchisee to pay a very large initial fee to the master franchisor. Master franchise arrangements are frequently used when the master franchisor is located in a geographically remote location from the master franchisee and the market is less desirable or would otherwise be difficult to administer. For this reason, among others, master franchise arrangements are commonly used by many international master franchisors. Ideally, master franchisees will provide familiarity and knowledge about a given market area that the remote master franchisor does not have.

It is also worth noting that the term “master franchise” is often used informally to describe a number of different business arrangements that do not meet this definition. Many times, the term is used colloquially to refer to an arrangement that is described more accurately as a multi-unit or area development relationship. That is not surprising—all three structures have some similarities. The master franchisor structure also resembles an area representative or development agent arrangement because, in both, the contracting party is recruiting franchisees. But unlike any of the other arrangements, the master franchisee is both a franchisee (of the master franchisor) and a franchisor (to the unit franchisee).\(^9\)

Master franchising can be an advantageous business strategy for several reasons. In utilizing master franchising, the master franchisor gains the benefit of growing a presence in a market where it may not otherwise be feasible

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\(^8\) See *Int’l Law Group*, supra note 4.

to accomplish the logistics of making local unit franchise sales or providing sufficient support to develop unit franchises or the system as a whole. Next, master franchisors can generate more upfront revenue from the larger initial fee charged to the master franchisee for the right to operate and sell franchises than it could by waiting for the sale (which could never materialize) of unit franchisees in the future. Additionally, cost savings are often associated with delegating to the master franchisee the obligations typically assumed by a franchisor. While a master franchisor may provide training and other forms of support to the master franchisee, it is typically up to the master franchisee to search for and service its own unit franchisees in its designated local market. On the one hand, in most ways, the master franchisee steps into the shoes of a franchisor, absorbing responsibilities, risk, and control, in order to properly maintain, manage, develop, and support its unit franchisees. On the other hand, the master franchisee also obtains much of the upside that a master franchisor otherwise would have, including keeping the lion’s share of the fees earned for selling franchises and receiving a substantial portion of the royalty revenues generated in its region.

But the model has some undesirable qualities as well. Disadvantages of a master franchising arrangement include overcoming the challenges of adapting an already established franchise system to meet the local needs—including those driven by customs, laws, regulations, and consumer preference—that could alter the way the system would usually run. While any franchise system of a certain scale faces this challenge, with the master franchising structure, a new layer of complexity is added: the master franchisor has now placed a middleman in between itself and the operating franchisees. In doing so, the master franchisor forfeits a significant portion of its control over the unit franchisees. The existence of this middleman opens the door for a disconnect between the master franchisor and the unit franchisees. This disconnect can become problematic in a number of ways, such as in communicating system standards, rules, and goals to unit operators, and in efforts to enforce those standards.

Because of the above, the master franchisor’s evaluation and selection of the master franchisee is vital. The abilities and access to resources of the master franchisee may determine whether the system succeeds or fails in a particular region, notwithstanding the quality of the system or the efforts of the unit franchisees.

The selection of unit franchisees is equally crucial, but this task will be left mostly to the master franchisee. Significant and specific issues arise if a unit franchisee misbehaves. In that case, the master franchisor must rely on the master franchisee to enforce rights that may directly impact the value and integrity of the system and the brand elsewhere. This reality underscores the importance of selecting a quality master franchisee. A strong master franchisee is likely to make good unit franchisee selection decisions. A weak master

10. See Levaton, supra note 7.
franchisee is more likely to select unit franchisees that are ultimately low performing, dishonest, or otherwise problematic.

However, the divide between unit franchisees and the master franchisor is of greatest concern when the master franchisee defaults. There, the lack of a direct contractual privity between the master franchisor and the unit franchisees often creates significant issues. The master franchisor has been depending upon the master franchisee for administration, training, support, and the like for the development of the system in the territory. A default by the master franchisee can cripple development in the territory. What’s more, the master franchisor may struggle to remedy the situation if the contracts between it and the master franchisee, or the master franchisee and unit franchisees, were poorly drafted or did not sufficiently anticipate the effects of a default.

Before addressing how best to prepare for and deal with this type of situation, it is necessary to understand the legal and regulatory frameworks that govern—or in some cases do not govern—the master franchisor/master franchisee relationship.

II. Master Franchises and the FTC Rule

The Federal Trade Commission’s Franchise Rule, as amended in 2008 (FTC Rule), regulates what a franchisor is required to disclose to a prospective franchisee in its franchise disclosure document (FDD). The FTC Rule requires that a FDD consist of twenty-three specific items of disclosure that will allow a prospective franchisee to make a fully informed decision on whether to invest in purchasing the franchise. If a material change to any representation in the FDD occurs, for example a significant litigation involving the franchisor, the franchisor must update the FDD to reflect the change.

These general requirements apply to an FDD involving the grant of a master franchise. Generally, the master franchisor gives a prospective master franchisee a FDD that is specific to the master-franchisee relationship. Master franchisees are themselves, in turn, required to create and issue their own FDD in connection with their sale of unit franchises (often referred to as a “subfranchisor FDD” or “SFDD”). The SFDD must satisfy the same requirements under the FTC Rule that a franchisor has to satisfy. Thus, the SFDD must include all twenty-three disclosure items required by the FTC Rule, as those items relate to the master franchisee. What’s
more, the SFDD must contain a number of pieces of information about the master franchisor. The more important items requiring disclosure of information for both the master franchisor and master franchisee include Items 1 (identify of franchisor and affiliates), 2 (business experience), 3 (litigation), 4 (bankruptcy), 8 (restrictions on source of products and services), 11 (franchisor’s assistance, advertising, computer systems, and training), 12 (territory), 13 (trademarks), 14 (patents, copyrights, and proprietary information), and 20 (outlets).17 For example, Item 20 of an SFDD, regarding outlets and franchisee information, must have two separate sets of charts outlining information for both the master franchisees’ outlets and outlets in the master franchisor’s entire system.18 In addition, a master franchisee must disclose the financial information of any master franchisor in its SFDD.19

III. Registration States

Most states have not chosen to enact franchise specific legislation and are instead content to let the requirements of the FTC Rule govern the sale of franchises in their state. Thirteen states have adopted their own disclosure laws, which apply if the franchise will be located within the state. Each of the registration states also has additional criteria besides franchise location that may mandate registration. For instance, in New York, if the offer for the sale of a franchise is made within the state, accepted in the state, or the prospective franchisee is a resident of the state, state disclosure laws apply even when the franchise itself is ultimately located outside of New York.20 These thirteen registration states are California, Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.21 Several other states have filing or notice requirements but do not require the registration of a franchise’s FDD: Connecticut, Florida, Kentucky, Maine, Nebraska, North Carolina, South Carolina, South Dakota, Texas, and Utah.22 None of the registration or notice states has specific rules to govern master franchise agreements other than what the FTC Rule provides, but each of the master franchisor

18. Id.
and the master franchisee must file and complete FDD registrations for each of the master FDD and SFDD.\footnote{23}

Additionally, a number of other states, as well as Puerto Rico, have franchise relationship laws.\footnote{24} These relationship laws do not require registration, but govern certain aspects of the franchise relationship, most often termination (such as in New Jersey, where the franchisor cannot terminate a franchise without cause).\footnote{25} None of those laws sets forth requirements that are specifically or exclusively directed at the master franchisor-master franchisee relationship.\footnote{26}

In short, neither federal nor state statutes and regulations regarding the sale of franchises specifically address the differences that make the master franchise relationship distinct, such as the tripartite relationship and the lack of privity. Thus, general contract principles govern those distinctions and issues.

**IV. Contract Law**

When a master franchisor terminates a master franchise agreement, absent specific contractual provisions, a unit franchisee’s position can be in a state of limbo. As stated above, the franchise statutes and regulations do not provide requirements or guidance on how the tripartite relationship between the master franchisor, the master franchisee, and unit franchisees should be governed. Similarly, there is a paucity of caselaw specifically addressing the nuances of the tripartite relationship that constitutes the master franchise structure. Thus, basic contract principles are the proper framework for assessing the issues that arise in the instance of a terminated master franchise agreement.

A contract analysis requires a two-step approach in determining the relative positions of the master franchisor and the unit franchisee if the master franchise agreement is terminated.

The first step is to determine if specific clauses in the relevant contracts (i.e., the master franchise agreement and the unit franchise agreement) address the respective rights of the unit franchisee and the master franchisor when a master franchise agreement terminates or expires. For example, the master franchise agreement could provide for various enforcement rights to the master franchisor in the event of the termination or expiration of the master franchise agreement. In addition, the unit franchise agreement could

have terms that trigger upon termination or expiration of the master franchise agreement, such as (1) the termination of the rights of the unit franchisee to use the trademark (see the discussion of trademarks and licensing below); (2) a mandatory or optional right for the master franchisor to step into the shoes of the master franchisee to ensure the continued operation of the system; and/or (3) the right of the master franchisor to substitute another master franchisee to continue in that role in the event the initial master franchise agreement is terminated or expires, and a requirement that the unit franchisees must honor the appointment of the new master franchisee. If any potentially applicable contractual terms exist, the primary dispute will revolve around whether the terms are enforceable, as discussed below. If they are, then the outcome is clear: the contract is followed. If they are not (or there are no contractual terms to begin with), then the second step of the approach comes into play.

If there are no applicable contractual terms (either because they do not exist or are not enforceable), then the evaluation of the rights of the parties likely will depend upon generally applicable contractual doctrines, most notably privity and third-party beneficiary, that impact three-party contract arrangements.27

A. Privity

The existence of privity of contract between parties often controls whether a party can enforce rights or have a claim under a contract. “Privity of contract is that connection or relationship which exists between two or more contracting parties.”28 It is typically created by an executed agreement to which the parties are signatories. Master franchisors and unit franchisees, however, are almost never a party to a contract that includes the other. As explained above, master franchisors contract with master franchisees, who then contract separately with unit franchisees. Given the definition of “privity” and how privity is created, it may seem like a simple solution to have a master franchisor, a master franchisee, and a unit franchisee all sign a contract or agreement creating and acknowledging privity between the three parties. However, that is not how typical master franchise arrangements work. In fact, it is often an intentional choice, and it is often beneficial to the master franchisor, for liability purposes, to not have privity with unit franchisees. However, in the event of a master franchisee default resulting in the termination of its master franchise agreement, absent specific protective contract provisions, both remaining parties may attempt to establish privity to protect itself: (1) the master franchisor to enforce rights against the unit franchisee to protect its trademark, brand, system, and goodwill through either requiring the unit franchisee to continue performance under the unit

27. It is beyond the scope of this article to address legal concepts under international law, including whether any particular country has applicable franchise relationship laws.

franchise agreement or to cease operations; and (2) the unit franchisee to continue its business operations. On its face, the answer seems simple: a lack of privity prevents either party from succeeding in its argument. But the reality is more nuanced.

A lack of privity can be overcome if a court finds it necessary to restrict one party’s actions to protect the superior rights of another. An example is a master franchisor seeking to enforce its intellectual property and contractual rights under a master franchise agreement, especially when the rights of the unit franchisee are ultimately derived from that agreement. In *Jay Bharat Developers, Inc. v. Minidis*, the master franchisor terminated the master franchisee for breaching several contractual provisions of the master franchise agreement, including failing to pay royalty fees, allowing a state registration to lapse, and operating franchises outside of its defined territory.29 Undeterred, the master franchisee continued to service its unit franchises and collect royalties from them, which it then withheld from the franchisor. In response, the master franchisor sought an injunction against the master franchisee and the unit franchisees.30 The court applied contract principles to determine whether a master franchisor could be granted an injunction to prevent the master franchisee and unit franchisees from continuing to use the master franchisor’s trademarks and system information. The court ultimately found that an injunction was proper:

Under basic contract principles, when one party to a contract feels that the other contracting party has breached its agreement, the non-breaching party may either stop performance and assume the contract is avoided or continue its performance and sue for damages. Under no circumstances may the breaching party stop performance and continue to take advantage of the contract's benefits.31 Here, the master franchisee was taking advantage of the master franchise agreement’s benefits by using the entire business system and trademark without otherwise performing on the contract. As such, the court ultimately entered an injunction in the master franchisor's favor that prevented the master franchisee from continuing to use the marks and system.32 The court extended this injunction to the unit franchisees, despite the lack of privity between those parties, because once the master franchisor properly terminated the master franchisee’s agreement, it extinguished any rights in the system that the unit franchisees had.33 While this result is somewhat surprising at first blush, it is consistent with trademark law. As discussed below, a trademark holder’s rights to protect its trademark give it the ability to enjoin the actions of parties with whom it is not in privity.

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30. Id.
31. Id. at 443 (quoting S & R Corp. v. Jiffy Lube Int’l, Inc., 968 F.2d 371, 376 (3d Cir. 1992)) (emphasis and internal quotation marks omitted).
32. Id. at 437.
33. Id.
B. Third-Party Beneficiary

Third-party beneficiary is a contractual doctrine that allows a person or entity who is not a party to the particular contract at issue to assert claims pursuant to that contract. Considering that a unit franchise agreement ultimately benefits the master franchisor and vice versa, an argument exists that a unit franchisee can assert third-party beneficiary rights in a master franchise agreement against either the master franchisee or master franchisor and that a master franchisor can assert third-party beneficiary rights in a unit franchise agreement directly against the unit franchisee.

To assert third-party beneficiary rights, a party must demonstrate that there was an intent by the contracting parties for the third party to benefit from the agreement. As one court explained, “[A party that is] not a party to an express contract may bring an action on the contract if the parties to the agreement intended to benefit the non-party, provided that the benefit claimed is a direct and not merely an incidental benefit of the contract.”

On their face, the arguments going both ways have an intuitive appeal. Master franchise agreements grant a master franchisee the right to grant its own unit franchises. The master franchisee’s primary purpose, in turn, is to recruit unit franchisees to grant to them the right to open and operate unit franchises under the master franchisor’s brand. If master franchisees explicitly intend in the master franchise agreement to contract with unit franchisees and through those unit franchise agreements expand the master franchisor’s brand using intellectual property originating from the master franchisor, it can be argued that the unit franchisees intend and are intended to benefit from the master franchise agreement. While this circumstance does not create privity between master franchisors and unit franchisees, it does create a connection between the two that is not expressly addressed in the master franchise agreement and could allow for application of the third-party beneficiary doctrine. Similarly, the master franchisor enters into the master franchise agreement for one purpose: to monetize its intellectual property by capturing the upfront fees paid by the master franchisee and, depending on the terms of the agreement, capture some portion of the royalties paid by the unit franchisees. Because the unit franchise agreements allow for use of the master franchisor’s intellectual property and create a direct financial benefit for the master franchisor, it can be argued that the master franchisor is a third-party beneficiary of the unit franchise agreement. Of course, one solution to the issue of third-party beneficiary uncertainty is to have the master franchise agreement or unit franchise agreement explicitly provide for such rights or benefits to be granted to the master franchisor in the unit franchise agreement. Alternatively, if a master franchise agreement explicitly excludes the possibility of the unit franchisee being a third-party beneficiary of the master franchise agreement, it is unclear if courts would honor that

language or use the aforementioned test to protect a potential third party who believes they are an intended beneficiary.

1. Master Franchisor as Intended Beneficiary

In Torres v. Simpatico, Inc., the United States District Court for the Eastern District of Missouri found that a master franchisor, Stratus Franchising LLC (Stratus Franchising), and a number of its non-signatory master franchisees were the intended third-party beneficiaries to the unit franchise agreement between a master franchisee and unit franchisee and were therefore permitted to enforce the arbitration agreement in that contract. In the case, the unit franchisee sued several defendants in a putative class action asserting claims under the Racketeer Influenced and Corrupt Organizations Act (RICO). Plaintiff alleged that the defendants, which included Stratus Franchising, the plaintiff’s master franchisee, and master franchisees from other territories who did not have a direct relationship with the plaintiff, were part of a RICO enterprise. The non-signatory master franchisees and the master franchisor sought to have the claims asserted against them by the unit franchisee sent to arbitration due to the arbitration agreement in the unit franchise agreement between the plaintiff and its direct master franchisee.

The court first focused on the arbitration clause in the unit franchise agreement, which expressly stated that it is “intended to benefit and bind certain third-party non-signatories.” The court determined that this phrase meant that the parties intended to benefit identified non-signatories under the arbitration clause. The court then explained that the unit franchise agreement required the unit franchisee to purchase insurance policies naming Stratus Franchising as an additional insured and also required indemnification of Stratus Franchising and other franchisees. Relying on these references, the court determined that that both Stratus Franchising and other master franchisees were identified parties and therefore had third-party beneficiary rights in both the indemnification and arbitration language of the plaintiff’s unit franchise agreement. Therefore, the court compelled arbitration on dual grounds that (1) the arbitration agreement reflected the contracting parties’ intent to bind some third parties, and (2) the unit franchise agreement clearly conferred benefits upon Stratus Franchising and other master franchisees, such that Stratus Franchising and other master franchisees may enforce the arbitration agreement.

36. Id. at 1057.
37. Id.
38. Id.
39. Id.
40. Id.
41. Id. at 1065.
42. Id.
43. Id.
In Collins v. International Dairy Queen, Inc., unit franchisees who had contracted directly with a master franchisee brought claims against a master franchisor for breach of contract and violation of the antitrust law. The unit franchisees argued that the master franchisor could not enforce the mandatory arbitration agreements found in each unit franchise agreement because the master franchisor was not a signatory. The United States District Court for the District of Maryland rejected this argument. It found that the master franchisor was a third-party beneficiary of the unit franchise agreements and could invoke the arbitration clauses therein. In reaching this conclusion, the court noted several factors demonstrated an intent by the unit franchisees to benefit the master franchisor, including, inter alia, that the unit franchise agreements required the unit franchisees to operate their unit franchises according to the master franchisor’s specifications, the unit franchise agreements required master franchisor approvals, and the master franchisor was given inspection rights.

With respect to Collins and Torres, it should be noted that both cases result in enforcement of arbitration provisions. The United States Supreme Court recently reaffirmed in Epic Systems Corp. v. Lewis that the Federal Arbitration Act (FAA) clearly instructs courts to enforce arbitration agreements according to their terms. Although the Supreme Court was addressing a different issue than the one at hand, the holding in Epic Systems again emphasized the Court’s view that the FAA evinces a strong federal policy in favor of enforcing arbitration agreements. While neither Collins nor Torres references this consideration, it cannot be ruled out as a factor in any judicial determination regarding the enforcement of an arbitration provision, which could make other factors in those cases less compelling.

In Vapor Corporation v. Welker, the patent holder to “Flow Regulator,” Welker Engineering Company (Welker), entered into an agreement referred to by the court as a franchise agreement with Vapor Corporation (Vapor), whereby Welker would receive a five percent royalty from the sale of products covered by the patent. Vapor subsequently entered into a manufacturing agreement with a different party, Heeco Limited (Heeco), authorizing it to sell products based on the patent in exchange for the payment of royalties, which would be ultimately directed to Welker, based on sales. When Welker then created and began selling a “Welker Jet,” another version of the Flow Regulator, Vapor claimed that this product was an “improvement” to the Flow Regulator and that Vapor was entitled to sell it. Welker argued

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45. Id.
46. Id.
47. Id.
48. Id. at 1469.
51. Id.
52. Id. at 860.
that it was a different product entirely. While it was not the crux of the dispute (the court ultimately found the Welker Jet was not an “improvement” to the Flow Regulator), in analyzing a counterclaim for unpaid royalties, the court determined that, although Welker was not a party to the Vapor-Heeco manufacturing agreement, the agreement specifically acknowledged royalties due under the agreement and authorized direct payment of royalties to Welker. Based on this fact, the court held that Vapor and Heecco intended for royalty payments to be paid to Welker, and concluded that Welker was a third-party beneficiary of the manufacturing contract.

2. Unit Franchisees as Intended Beneficiaries

But what of the rights of the unit franchisees when a master franchisee defaults? In that scenario, the unit franchisee will often need to seek injunctive relief in an effort to protect their rights when a master franchise agreement is either facing termination, or has been terminated. If a unit franchisee can obtain an injunction to maintain the status quo of its unit franchise agreement when the master franchise agreement is no long in effect, the unit franchisee can continue operations while figuring out alternative solutions or can create sufficient leverage with the master franchisor to reach an palatable settlement (at least to the unit franchisee). Whether or not an injunction is proper in this situation starts with the four familiar factors for determining injunctive relief:

1. the likelihood that the [the petitioner] will succeed on the merits;
2. the ‘balance of convenience,’ determined by whether greater injury would be done to the [respondent] by granting the injunction than would result from its refusal;
3. whether [the petitioner] will suffer irreparable injury unless the injunction is granted; and
4. the public interest.

Proving a likelihood of success on the merits—and specifically an ability to enforce its rights under the unit franchise agreement against the master franchisor directly—will likely control the outcome of these cases.

Unit franchisees have been found to be third-party beneficiaries of master franchise agreements. In Hawkinson v. Bennett, a unit franchisee brought an action against the master franchisor for breach of fiduciary duty and tortious interference after the master franchisee failed to provide various support and services to the unit franchisee. The court held, *inter alia*, that the unit franchisee was a third-party beneficiary of a master franchise agreement.

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53. Id.
54. Id. at 861.
55. Id. at 862.
between the master franchisor and master franchisee because the master franchise agreement provided language that obligated the master franchisee to “provide administrative and marketing support . . . for those franchises that are established in the Master Franchise area.” In reaching its decision, the court explained that “the intent to benefit a nonparty does not need to be expressly accounted for in the master franchise agreement so long as the intent is apparent from the terms therein, the surrounding circumstances, or both.” As such, the court held the master franchisor liable to the unit franchisee for breach of the master franchise agreement because the unit franchisee was the intended beneficiary of that agreement.

In DMF Leasing, Inc. v. Budget Rent-A-Car of Maryland, Inc., a unit franchisee sought a preliminary injunction to prohibit a master franchisee and master franchisor from terminating its three rental car franchises. The unit franchise agreement stated that if the master franchise agreement were to terminate, the unit franchise agreements would terminate as well. In response to this provision, the unit franchisee informed its master franchisee that it did not intend to renew its unit franchise agreement at the end of its term. The master franchisee, in response, threatened to terminate the unit franchise agreement, thereby triggering certain post termination obligations that would not be triggered by a nonrenewal. The two parties ultimately entered into a settlement agreement that included language that led the unit franchisee to believe its risk of being terminated due to the termination of the master franchise agreement was eliminated. The master franchisor then sought to terminate the master franchise agreement, and the unit franchisee was not provided sufficient assurances that its unit franchise agreement would not be terminated too. This action prompted the unit franchisee to pursue a preliminary injunction against both the master franchisor and master franchisee that was denied by the trial court. The appellate court reversed this decision. The appellate court noted that if the master franchise agreement in question was ultimately terminated, the unit franchisee would be left “vulnerable” and that a premature termination of the unit franchise agreement would cause more harm to the unit franchisee than to the master franchisor. It then instructed the lower court on remand to issue a preliminary injunction for the unit franchisee in order to maintain the status quo of the unit franchise agreement until a final determination on the

58. Id. at 468.
59. Id. at 450–51.
60. Id.
62. Id.
63. Id. at 645.
64. Id.
65. Id. at 642.
66. Id. at 646.
67. Id.
68. Id. at 653.
69. Id.
merits of other issues were determined. The court recognized that the unit franchisee had legitimate possible third-party beneficiary rights so that its position should be preserved until the issues were resolved.

V. Trademarks and Licensing

Franchise systems are typically built on trademarked brand names. A master franchisor who is seeking to regain control of its brand and who is willing to shut down the unit franchisees will argue that the unit franchisee no longer has a right to use the trademark and therefore must cease operation. The master franchisor will specifically assert that the termination of the master franchise agreement terminated all sublicenses that originate from it. The unit franchisees will claim that they obtained a sublicense to the trademark through their unit franchise agreement and that sublicense cannot be terminated absent malfeasance on their part.

No cases that specifically address the trademark law rights and obligations that form a part of the master franchise three-part relationship, but some cases address sublicensing and indirect licenses from outside the franchise universe that provide guidance about how trademark issues will be resolved in the master franchise context.

In *First Flight Associates, Inc. v. Professional Golf Co., Inc.*, a manufacturer and its foreign sales representative had an informal agreement, evidenced by letters, that granted the sales representative a trademark license in exchange for the payment of royalties to the manufacturer for sales of golf-related products using the trademark. The foreign sales representative then granted trademark sublicenses to other parties without passing any royalties it received under those sublicenses onto the manufacturer. In analyzing a claim for inducement of contract breach, one of the several claims and counterclaims in this suit, the United States Court of Appeals for the Sixth Circuit found that because the underlying trademark license had expired by its terms, the licensee thereafter had nothing to sublicense to the sublicensees. In its analysis, the appellate court indicated that a court could find that the sublicense agreements had been concurrently terminated with the original license agreement. This case certainly supports the proposition that the termination of the master franchise agreement terminates any underlying trademark licenses granted by the master franchisee, including any trademark rights granted in the unit franchise agreements.

In *E.G.L. Gem Lab Limited v. Gem Quality Institute, Inc.*, trademark owners brought an action against sublicensees for, *inter alia*, trademark infringement...
and dilution. There, the sublicensee, after disputes with the sublicensor, created its own company and trademarks to compete with the sublicensed trademarks, often comingling the marks in advertisements and promotions. Though the trademark owner was not a party to the sublicense agreement between the sublicensor and sublicensee, the United States District Court for the Southern District of New York found that the trademark owner was an intended third-party beneficiary of that sublicense agreement and that under New York law, the trademark owner was entitled to enforce the sublicensor’s (i.e., its direct license) contract with the sublicensee. Further, the sublicensee’s commingling of the sublicensed trademark with its own in connection with the operation of its business was a breach of the sublicense agreement. The court then issued an injunction in the trademark owner’s favor, which prohibited the sublicensee from associating its own trademark with the sublicensed trademark.

Similarly, in Major League Baseball Promotion Corp. v. Colour-Tex, Inc., the copyright and trademark owner filed an infringement action against sublicensees and the sublicensees counterclaimed for, inter alia, wrongful seizure under trademark laws. The license agreement at issue between the trademark owner and the direct licensee required the direct licensee to obtain the trademark owner’s written approval in order to sublicense. Against this backdrop, the United States District Court for the District of New Jersey found that a trademark owner may enforce its trademark rights against a sublicensee where the sublicense agreement between the sublicensee and the direct licensee was invalid because the direct licensee did not obtain the contractually required prior written approval to sublicense. The court went on to hold that, absent a valid and enforceable sublicense, use of the trademarks by the sublicensee amounted to infringement of the trademark. The court ruled in favor of the trademark owner and entered an order allowing it to seize products bearing its trademarks and copyrights.

Conversely, the result was different in an international case in Germany regarding the rights to a copyrighted music composition, “Take Five.” In that case, the court addressed whether a terminated master license resulted in the termination of all sublicensees. The Federal Supreme Court of Germany,
applying German law, protected the rights of the sublicensee in determining that the termination of the master license agreement does not necessarily terminate the sublicense agreements.\textsuperscript{86} The decision was made, in part, by analyzing succession protections as applicable to copyright laws, and it was determined that the holder of a licensed right should be protected and able to recover its investment in said right.\textsuperscript{87} The court also weighed the interests of both parties and found that the interests of the sublicensee outweighed the interests of the licensor.\textsuperscript{88} On the issue of unaccounted for license fees, the court found that the licensor would not suffer a financial loss because it can assert a claim directly against the main licensee for an assignment of the main licensee’s rights to receive license fees from the sublicensee.\textsuperscript{89} While this analysis and conclusion may seem straightforward enough, it may not necessarily be applicable towards master franchise agreements in the United States. First, German law appears to take a somewhat different view of sublicense rights than United States courts. Second, master franchise agreements grant rights that go well beyond the use of a single trademark or copyrighted item like a song. Master franchise agreements outline a complete and confidential system for operating a business. As such, a court should conduct a significantly more in-depth scrutiny of the agreement arrangement and parties’ rights than what appears to have been done in the cases discussed above.\textsuperscript{90}

Accordingly, in the event of a default by a master franchisee (the underlying premise of this article), both the master franchisor and the unit franchisee could assert claims related to their positions derived from their rights as a trademark licensor and trademark sublicensee, respectively. While the “Take Five” case suggests an argument for seeking to protect rights granted to a sublicensee in good standing, the \textit{E.G.L. Gem} and \textit{Major League Baseball} cases suggest that a trademark owner’s rights will be given primary consideration and that the sublicensee will likely lose its rights if the original license is invalidated.

\textbf{VI. Practical Advice for Attorneys}

\textbf{A. Advice for Master Franchisor Attorneys}

The attorney for the master franchisor should focus on providing the master franchisor with the broadest rights possible so that the master franchisor has every option available if a master franchisee defaults. The master franchisor ideally will have specific provisions in the master franchise

\textsuperscript{86} Id.
\textsuperscript{88} Id.
\textsuperscript{89} Id.
\textsuperscript{90} See id.
agreement enabling it to take specific actions, and those provisions will need to be binding upon the unit franchisee. How can that be done?

First, a master franchisor can require in its master franchise agreement that the unit franchise agreements between the master franchisee and the unit franchisee contain certain provisions. Those provisions would permit the master franchisor to assert contractual rights or take certain actions against the unit franchisee to protect the master franchisor’s interests (see the discussion of privity above).

Below are some possible provisions or terms that a master franchisor may want to include:

1. have the master franchisor actually be a party or named third-party beneficiary to each unit franchise agreement, with a list of enumerated rights that the master franchisor has in event the master franchisee is no longer in good standing;

2. provide in the master franchise agreement that the master franchisor may, at its option, be deemed to have taken an assignment of all (or some, if it wants to be selective) of the unit franchisee agreements in the event the master franchise agreement is terminated; when taking this approach, the unit franchise agreements should also permit the master franchisee to make assignments, including by operation of law, without the consent of the unit franchisee, and require the unit franchisee to honor any such assignments.

A sample provision would be:

Franchisor may, but shall not be obligated to, require the master franchisee, within ten (10) days of expiration or termination (regardless of the cause for termination) of the master franchise agreement, to: (1) Terminate all or any number of current unit franchisee agreement(s) that master franchisee has entered into with any and all unit franchisees, except that master franchisor, or its nominee, may, but is not obligated to, elect to enter into a unit franchise agreement with each unit franchisee for the unexpired portion of the respective term of each unit franchise agreement, in which event master franchisee shall cause each such unit franchisee to enter into such unit franchise agreement; or (2) Assign to the master franchisor, or a nominee of the master franchisor, at the sole discretion of master franchisor or its nominee, all or any number of current unit franchisee agreements that master franchisee has entered into with unit franchisees.

This kind of approach could result in the master franchisor being in contract with the unit franchisee, which may not be to the advantage of the master franchisor, particularly if the manner of the master franchisee’s default has created defaults in the obligations to the unit franchisees. The master franchisor may not want to step into that situation.

Thus, a second possible approach is to have a right of assignment, but to also have the master franchisor, master franchisee, and each unit franchisee execute individual collateral assignments in favor of the master franchisor that permit the master franchisor to designate a successor assignee (a new master franchisee). This type of collateral assignment permits the assignment by the master franchisor of the master franchise agreement to a new
master franchisee, with all of the same rights and obligations of the master franchisee, and provides in the unit franchise agreement that the unit franchisee will honor that assignment. In that case, if the master franchisor is able to designate a new master franchisee before invoking its right to an assignment of the unit franchise agreements, the assignments may be effectuated in a manner that binds the unit franchisees but without binding the master franchisor to the possibly disgruntled unit franchisees.

Before including a master franchisor’s right to assign the master franchise agreement to itself, the master franchisor must be made aware of the assumption of risk and the added responsibility and support it would have to give the unit franchisees. If master franchisor is unsure of its actual ability to take on the added responsibility and support, consider drafting clauses that permit for reduced services in exchange for reduced fees, as an alternative to outright termination for unit franchisees as discussed above. Additionally, attorneys should advise franchisors that it is imperative to have proper liability and indemnification provisions in the master franchise agreement to protect the master franchisor from claims by unit franchisees that are terminated as a result of a master franchisee default.

Clauses that the attorney for the master franchisor can include in the master franchise agreement to address these liability issues could read such as the following, as to exposure with the unit franchisee:

Master franchisee shall cause each and every unit franchise agreement to provide that unit franchisee waives any and all actions or claims for liability or damage ("Claims") against the master franchisor and shall indemnify and hold harmless master franchisor from any and all Claims in connection with or arising from the termination (regardless of the cause for termination) of the unit franchise agreement as a result of the termination (regardless of the cause for termination) of the master franchise agreement. Further, unit franchisee agrees and acknowledges that unit franchisee shall have no Claims whatsoever against master franchisor. Moreover, unit franchisee agrees and acknowledges that unit franchisee fully understands and accepts the risks associated with the structure of this relationship (whether or not such risks have been expressed to unit franchisee by master franchisee or master franchisor) and the underlying premise of the unit franchise agreement.

Another variation would be to address the master franchisee’s indemnification obligations directly:

Master franchisee shall indemnify and hold harmless master franchisor from any and all Claims in connection with or arising from any legal actions initiated by the unit franchisees or other third parties in connection with or arising from (1) the termination (regardless of the cause for termination) of the master franchise agreement and/or (2) the termination (regardless of the cause for termination) of a unit franchise agreement as a result of the termination (regardless of the cause for termination) of the master franchise agreement.

Some master franchisors may not want the option to assign the master franchise agreement to itself, or anyone else. This could be due to the area’s remote geographic location, lack of market knowledge, or the lack of resources and local management. The attorney should alert the master
franchisor to these issues. If this is the case, then another approach is for the master franchisor to require that the master franchisee include an automatic termination or notice of termination clause for the unit franchisees that is triggered by master franchisee’s default.

B. Advice for Master Franchisee Attorneys

Attorneys representing master franchisees are in a different negotiating position than the master franchisor. They should try to draft the master franchise agreement in such a way that the master franchisee will retain as many rights as possible in the event of termination of the agreement. If a master franchisee has established unit franchisees before termination, it is possible to negotiate the right to continue operating the unit franchisees that it has established, as long as the default is not based upon any kind of egregious conduct. Stated differently, this term would allow the master franchisee to remain the master franchisee of the units already in existence, but to surrender the right to develop further unit franchises. A similar term that can be negotiated is that the master franchisee surrenders his or her master franchise rights, but is allowed to keep operating all of the unit franchises that he or she personally owns.

Additionally, and similarly to the liability provisions suggested for master franchisors, master franchisees should have unit franchisees waive potential claims against the master franchisee in the event of termination of the master franchise agreement by the master franchisors or through no fault of the master franchisee. This way, the master franchisee has some protection from liability to the unit franchisees in the event of a termination of its franchise rights for reasons outside of its control.

C. Advice for Unit Franchisee Attorneys

Last, attorneys representing a unit franchisee must educate their client on the nature of the derivative structure of the master franchise arrangement and the risk that their rights to operate the franchise business could be terminated by default through no fault of their own. This risk inherently comes along with being a unit franchisee subject to a master franchise agreement. An attorney’s best bet is to try and negotiate the right for the unit franchisee to have the master franchisor become its direct franchisor in the event of the master franchisee’s default, which, of course, is dependent on the master franchisor’s ability and willingness to step into the shoes of the master franchise.

Even if their rights to operate are preserved, unit franchisees should be alerted to the issues that will arise in the event of a master franchisee’s termination: lack of management, no access to suppliers, and possible issues with vendors and landlords. If faced with these risks, the unit franchisee may want the option to close.
VII. Conclusion

The title of this paper speaks of issues that face the master franchisor in dealing with unit franchisees in the event of a master franchisee default. As discussed above, there is a three-way relationship that is complicated by variables such as (1) whether or not the master franchise agreement and unit franchise agreement address the issues arising from such a termination and, if so, how completely; and (2) what law will govern the parties in the event the agreements are silent, incomplete, or unsatisfactory to a particular party. These laws relate to arguments based on third-party beneficiary, privity, and equity. The master franchisor's issues are also defined by the master franchisor's goals. Does the master franchisor want to keep the system alive in the master franchisee's area, or is the master franchisor inclined to accept the failure and move on? Keeping the system alive raises challenges that we have discussed, including finding a new master franchisee and dealing with unit franchisee claims. The decision to walk away may not be so simple. Even in the face of language to the contrary, unit franchisees may pursue claims based upon third-party beneficiary and other theories to seek compensation for the businesses that they will have to de-identify if the system is closed. Like many things in franchising, the best approach is to have robust and properly worded contracts which address what is to be done if the master franchisee defaults.
Compliance with franchise law involves both state and federal regulatory regimes, usually working in complementary ways, but at times in conflict. This article identifies an aspect of the conflict that has not been extensively studied: applications for registration of a franchise disclosure document (FDD) that are rejected by state regulators over a mismatch between the date of issuance on the cover page of the FDD and the same issuance date mentioned on the auditor’s consent form.

Before the article explores this conflict further, and offers a solution, some basic terms must first be explained and defined.

I. Federal and State Regulation of Franchise Offerings

The Federal Trade Commission Franchise Rule (FTC Rule) sets a baseline for regulation of franchise offerings in all U.S. jurisdictions.¹ The FTC Rule requires franchisors to disclose information about their offering to prospective franchisees using an FDD.² The FTC Rule’s disclosure requirement helps ensure that prospective franchisees and their professional advisors can make well-informed decisions. The FTC Rule also prohibits fraud and lesser forms of deception in the franchise sales process.³ The FTC Rule requires each FDD to include its date of issuance both on the cover page and on the receipt page (Issuance Date).⁴

The FTC Rule does not require franchisors to file copies of their disclosure documents, but it allows individual states to adopt additional regulations, so long as these additional regulations are at least as protective

¹. 16 C.F.R. § 436.1 et seq.
². Id. § 436.2 (requiring disclosures using FDD in specified format).
³. Id. § 436.9 (defining violations of the FTC Rule as deceptive or unfair trade practices).
⁴. Id. §§ 436.3(e)(6) (Issuance Date on cover page), 436.5(c)(5) (Issuance Date on receipt).
of franchisees as the FTC Rule. Certain states (Registration States) have adopted a regulatory regime based on guidelines promulgated by the North America Securities Administrators Association (NASAA Guidelines). Registration States prohibit franchise sales in the state until the FDD has been filed with a state agency and (in a subset of states) reviewed for compliance. After such filing and review, if the Registration State approves, the offering is registered in that state and sales may begin. The franchisor’s application to the Registration State must include a form signed by the franchisor’s independent auditor, stating that the auditor consents to the use of the audit report as part of the FDD (Auditor’s Consent or Form F). The instructions for Form F say the form of consent must include “the Federal Trade Commission issuance date of the Franchise Disclosure Document.”

II. Overview

This article is about applications for registration of franchise offerings that are rejected by Registration States over a mismatch between the Issuance Date on the cover page of the FDD, as determined by the FTC Rule, and the same Issuance Date mentioned on the Auditor’s Consent. This article illustrates how an application for franchise registration may be rejected over a mismatch of the Issuance Dates; explores the purposes of the FTC Rule’s requirement for an Issuance Date and the inclusion of the Issuance Date in the Auditor’s Consent; examines possible public policy reasons for such rejections; and argues that Registration States should recognize that the Auditor’s Consent may be prospective, which means it looks forward in time by stating that the consent will remain effective, even if the FDD is amended. In NASAA’s own sample form of Auditor’s Consent, the auditor acknowledges that the FDD will be amended by the franchisor. This article concludes that Registration States should not reject prospective Auditor's Consents because they refer to an earlier Issuance Date than the Issuance Date on the FDD’s cover page.

III. An Illustration of the Problem

Under the FTC Rule, the Issuance Date, as its name suggests, is meant to convey to the prospective franchisee the last date of the FDD’s revision and
the currency of the information being disclosed. Registration States sometimes require the Issuance Date mentioned in the Auditor’s Consent to be the same as the Issuance Date on the FDD cover page. The Issuance Date, a creature of federal law, co-exists with the date on which a Registration State deems a proposed FDD qualified for registration and in-state usage (Effective Date).

The following hypothetical illustrates the problem of the unneeded rejection of applications for franchise registration over mismatching Issuance Dates.

Suppose that, in February 2018, a franchisor makes its annual updates to the FDD, and in March of 2018, the auditor completes its audit report. The auditor executes a consent form stating that the audit report may be used with “the FDD issued on March 15, 2018, as it may be amended.” In April 2018, the franchisor registers or renews the offering in States A and B. On June 15, 2018, the franchisor updates the FDD with new information: a new trademark registration has issued and three new locations have opened. Accordingly, the franchisor restates the Issuance Date as June 15, 2018. In July of 2018, the franchisor wants to offer the franchise in registration State C as soon as possible and submits the latest version of the FDD (with the June 15, 2018, Issuance Date) and a copy of the original Auditor’s Consent (referring to the March 15, 2018, Issuance Date). State C’s examiner finds the FDD and supporting documentation otherwise unobjectionable, but rejects the application on the grounds that the Issuance Date on the Auditor’s Consent does not match the Issuance Date on the cover page and elsewhere in the updated FDD. State C’s examiner follows the state agency’s policy in issuing this rejection.11 The examiner cites the NASAA Guidelines, instructions to Form F, which say consent must include “the Federal Trade Commission issuance date of the Franchise Disclosure Document.”12 In rejecting the application, however, State C gives insufficient weight to NASAA’s own sample form of Auditor’s Consent. The sample language is:

(Name of Accountant) consents to the use in the Franchise Disclosure Document issued by (name of Franchisor) on (issuance date of Franchise Disclosure Document), as it may be amended, of our report dated (date of accountant’s report), relating to the financial statements of Franchisor for the period ending _______________.13

The sample includes the words “as it may be amended” (referring to the FDD), proving NASAA is well aware that, when an FDD is amended, its Issuance Date changes too.

Fetching an updated Auditor’s Consent might seem like a minor inconvenience, and the franchisor could, in theory, ensure that every initial and renewal application includes an Auditor’s Consent with an Issuance Date

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11. Not all franchise examiners in all of the Registration States listed supra, note 6, will issue this rejection.
13. Id.
matching the one on the submitted FDD. But repeated transactions with auditors impose unnecessary and avoidable costs.

In the hypothetical, the franchisor’s alternatives to obtaining a new Auditor’s Consent are not promising. Changing the Issuance Date on the cover page back to match the Issuance Date on the Auditor’s Consent is not a viable option, because failing to disclose the updates (new locations and trademark registration) might support a franchisee’s claim for misrepresentation by omission. Submitting the updated version of the FDD, but using the March 15, 2018, Issuance Date on the cover page, risks misrepresenting that all the information in the FDD was true as of March 15, 2018. Re-using the original Auditor’s Consent, but changing “Issued March 15, 2018,” on the FDD cover page to “Issued March 15, 2018, and amended June 15, 2018,” is potentially confusing to prospective franchisees. None of these alternatives is better than the Registration State simply honoring a prospective Auditor’s Consent.

Beyond the bare fact that the NASAA Guidelines’ instructions for Form F can be read (against the implication of the prospective language on the sample form) to require an exact match between the Issuance Date on the FDD cover page and the one mentioned on the Auditor’s Consent, there are two possible policy justifications for rejecting applications with mismatched Issuance Dates. First, if mismatched Issuance Dates rendered the auditor’s consent per se invalid, then Registration States would have good reason to reject the application. Second, if rejecting applications forced all franchisors in that state to engage their auditor more frequently than annually for a substantive supplemental financial review, it would presumably result in better disclosures. In fact, neither of these reasons justifies the rejection of applications with mismatched Issuance Dates. As explained later, prospective and even mismatched consents continue to serve their legal purpose, helping courts define the potential duty of the auditor to prospective franchisees. Moreover, auditors may (and usually do) update the Auditor’s Consent or issue a prospective Auditor’s Consent without a substantive re-engagement. When the auditor updates the Auditor’s Consent without re-engaging, enforcing the rule against prospective Auditor’s Consents with mismatched Issuance Dates accomplishes nothing beyond delaying registration and impeding commerce in the state.

14. For a discussion of cases involving claims of fraud and misrepresentation, see, for example, Elliot Ginsburg & Carmen Caruso, Fraud by Omission: An Argument for Broader Disclosures and Renewed Enforcement, 35 Franchise L.J. 1, 2 (2015).
16. In correspondence with the author, some practitioners reported success with this formulation. Its merits are discussed in Part VII.
17. See NASAA Guidelines, supra note 7, at 21 (instructing franchisors to “insert the Federal Trade Commission issuance date of the Franchise Disclosure Document”).
18. See infra Parts IV.A, IV.B.
IV. Basis and Requirements for Issuance Date

Each usage of the Issuance Date required by the FTC Rule is meant to identify a version of the FDD by its latest amended date. As noted above, the FTC Rule requires franchisors to indicate the currency of the FDD by disclosing the Issuance Date on its cover page. The Issuance Date on the cover page must be the same as the Issuance Date on the receipt page. The Issuance Date also determines the ten-year look-back period for litigation and insolvency events and the ten-week look-back period for franchisees not communicating with the franchisor.

The FTC’s 2008 Franchise Rule Compliance Guide (FTC Guide) instructs franchisors to treat the Issuance Date as “very flexible, meaning any date upon which the franchisor finalizes that version of the disclosure document for future use.” Thus, the Issuance Date is supposed to be the same as the FDD’s last amended date, and the “very flexible” terminology confirms that the FTC Rule allows for updates of the FDD at the franchisor’s discretion, subject to state law. Under the FTC Rule, updates to the franchisor’s financial statements are not required more frequently than quarterly. However, the FTC Rule encourages franchisors to update other parts of the FDD at any time as needed, to reflect any changes in the franchise offering and avoid misrepresentations or omissions. “Very flexible” does not mean “devoid of legal significance.” As demonstrated above, the Issuance Date is supposed to inform the prospective franchisee of the currentness of the information in the FDD. Unless the franchisor supplements the FDD by stating that a new version is in the works and will be provided when available, the Issuance Date will be the prospective franchisee’s point of reference for the currency of the document.

19. 16 C.F.R. § 436.3(c)(6).
20. See id. § 436.5(w)(5) (in which the sample form of receipt says “I received a disclosure document dated [Issuance Date]”).
21. A franchisor is required to disclose certain litigation and insolvency events, going back ten years from the Issuance Date. See id. §§ 436.5(c)(iii) (litigation), 436.5(d)(i)(i) (bankruptcy).
22. Id. § 436.5(s)(5).
24. See id. at 127 (“Franchisors are always free to update their disclosure documents more frequently than the Rule requires.”).
25. See 16 C.F.R. § 436.7(b).
27. See id., FAQs 14, 24 (approving a franchisor’s provision of a dated FDD while amendments are pending, which California expressly allows (see Cal. Corp. Code § 31107 (requiring close coordination between franchise sales persons and counsel)); Schubenberg v. Handel’s Enterprises, Inc., 2018 WL 4282637 (S.D. Cal. Sept. 7, 2018) (denying motion to dismiss over franchise sale closed days after new FDD became effective).
V. Relation of FDD Issuance Date to State Effective Date

A. Both Relate to Currency of the FDD

When a Registration State approves an application to register a franchise offering, the state declares the offering effective as of the date of approval (Effective Date). The Issuance Date and the Effective Date both function to notify the prospective franchisee about the currency of the FDD, but they refer to different aspects of its currency. The Issuance Date conveys currency in terms of the last amendment to the FDD by the franchisor, whereas the Effective Date conveys currency in terms of the version last approved by the state. Because of their overlapping functions, the Issuance Date and the Effective Date have always fit together imperfectly.

As noted earlier, the FTC Rule allows individual states to impose additional regulations that afford equal or greater protection for prospective franchisees. When a Registration State has accepted an FDD for registration, sometimes after a close reading by a state examiner, the state will declare the state-approved version of the FDD effective as of a date specified by the examiner (Effective Date). Also, an FDD has two cover pages: the federal cover page and the state cover page. The federal cover page appears first and contains the Issuance Date. The state cover pages appear immediately after and contain the Effective Date, or refer to a table of Effective Dates.

Regulators in Registration States may perceive the Issuance Date as largely irrelevant, because its function in those states is partially usurped by the state-issued Effective Date. This tendency to perceive the Issuance Date as irrelevant possibly explains why regulators in Registration States sometimes reject prospective forms of Auditor’s Consent that refer to Issuance Dates earlier than the one on the FDD’s cover page: because the “very flexible” nature of the Issuance Date is at odds with the rigid nature of the Effective Date.

B. The Effective Date Cannot Fully Replace the Issuance Date

The FTC’s own guidance on the relation between the Issuance Date and Effective Dates is confusing, illustrating an unresolved conflict between the federal and state regulatory regimes. The rejection of an Auditor’s Consent with a mismatched Issuance Date is a by-product of this conflict. The FTC Guide says that in a Registration State “the franchisor may use, in lieu of an issuance date, an ‘effective’ date consistent with state approval of the document.” The phrase “in lieu” means “instead of” or “in place of,” but it is not obvious exactly how the Effective Date could entirely replace the

28. 16 C.F.R. § 436.10(b) (partial preemption of state laws by the FTC Rule).
29. See 16 C.F.R. § 436.3(a)–(f) (specifications for federal cover page); 16 C.F.R. § 436.3(g) (“Franchisors may include additional disclosures on . . . a separate cover page . . . to comply with state pre-sale disclosure laws.”)
Prospective Auditor’s Consents: Form F & the FTC Issuance Date

Issuance Date. Presumably, the guidance applies to the federal cover page (where the Issuance Date appears) and means that an FDD for use in a particular state could replace the Issuance Date on the federal cover page with the Effective Date. Without a separate Issuance Date, the Effective Date would convey the currency of the FDD. With respect to the cover page, the FTC’s guidance about replacing the Issuance Date with the Effective Date seems workable at first glance.

Making the Issuance Date the same as the Effective Date also works for material changes to the FDD, in states where all such changes by definition must be filed and reviewed before an Effective Date issues. However, Registration States also allow franchisors to make non-material updates without first obtaining their approval. In such cases, the Issuance Date remains necessary to inform the prospective franchisee about the currency of the document, because Effective Dates are not “very flexible” like the Issuance Date and cannot be changed by the franchisor to signal prospective franchisees that the FDD was updated. Moreover, using an Effective Date in place of the Issuance Date does not work for computing the ten-year and ten-week look-back periods, nor can an Effective Date replace the Issuance Date required by NASAA and the Registration States on the Auditor’s Consent and on the franchisor’s certification form. Franchisors cannot use an as-yet-undetermined Effective Date to compute the look-back periods, or to fulfill the other functions of the Issuance Date. For these reasons, most franchisors do not entirely replace the Issuance Date with an Effective Date; instead, franchisors use the Issuance Date on the federal cover page and the Effective Date on the state cover page. The fact that franchisors cannot fully implement the FTC’s own guidance on replacing the Issuance Date with a state-issued Effective Date demonstrates the imperfect fit between the way the FTC Rule handles the currency of the FDD and the way Registration States handle it.

C. The Preemptive Force of the FTC Rule on the Issuance Date

The FTC’s suggestion that a franchisor in a Registration State could use the Effective Date in place of the Issuance Date is consistent with the way that the FTC Rule in general sets a floor, not a ceiling, for franchise regulation. Still, the FTC Rule’s deference to state law is not total. If any

32. See, e.g., CAL. CORP. CODE § 31123 (filing of amendments required only for “material changes”); 815 ILL. COMP. STAT. § 705/11 (same); 13 N.Y.C.R.R. § 200.3 (same, with examples of material changes).
33. NASAA Guidelines, supra note 7, at 8–9 (Form A). Using this form, the franchisor certifies and swears that all the information in the FDD is true and complete as of the Issuance Date.
34. See NASAA Guidelines, supra note 7, at 22–24 (Form G, state cover page).
35. See 16 C.F.R. § 436.10(b) (“The FTC does not intend to preempt the franchise practices laws of any state or local government, except to the extent of any inconsistency with part 436. A law is not inconsistent with part 436 if it affords prospective franchisees equal or greater protection, such as registration of disclosure documents or more extensive disclosures.”) (emphasis added).
36. Id.
Registration State used or approved use of the term “Issuance Date” in a way misleading to prospective franchisees, it would be inconsistent with and preempted by the FTC Rule. A misleading use of the term “Issuance Date” is possible because nothing in the FTC Rule, related agency guidance, NASAA Guidelines, or laws and regulations of any Registration State requires a franchisor to define or explain to prospective franchisees the difference between the Effective Date and Issuance Date, or how the terms are related. This silence suggests that these two terms are self-explanatory to prospective franchisees; thus, it is up to the states and franchisors to ensure that these terms have clear meanings.

When state examiners reject an FDD because the Issuance Date on the cover page differs from the Issuance Date on the Auditor’s Consent, the rejection occurs because of the differences between the Issuance Date and the Effective Date. Examiners that reject an FDD are necessarily failing to follow the FTC’s directive to treat the Issuance Date as “very flexible” and are instead placing more weight on the NASAA Guidelines’ specifications for Form F than those specifications can bear.

VI. Basis for Auditor’s Consent Requirement

A. Securities Law Origins and NASAA Guidelines

Long before franchise regulation, the Securities Act of 1933 first instituted an annual audit requirement for stock offerings.\(^{37}\) Unless exempt, companies issuing shares to investors must have their financial statements audited annually for the prospectus, and publicly traded companies must have their quarterly supplemental reports reviewed (but not audited) by their auditor.\(^{38}\) As for franchisors, although the FTC Rule requires them to supplement the audit report with unaudited interim financials once the report is more than ninety days old, neither the FTC Rule nor any state requires the kind of formal quarterly review that public companies must undergo.\(^{39}\)

The Auditor’s Consent is required in Registration States by virtue of the NASAA Guidelines. Like the other forms submitted to the Registration States with an application for franchise registration, it is not mentioned in the FTC Rule and is not part of the FDD. NASAA’s instructions for the Auditor’s Consent are sparse, emphasizing that they are just “a guide to drafting.”\(^{40}\) This weighs in favor of the argument that state examiners should


\(^{38}\) See 15 U.S.C. § 78m(a) (authorizing SEC to require annual and quarterly reports); 17 C.F.R. § 249.310 (requiring annual registration using Form 10-K); 17 C.F.R. § 240.15d-13 (requiring quarterly reports using Form 10-Q); see also, e.g., Robert Joe Hull, Mark T. Hiraide, & Andrew G. Petillon, Representing Start-Up Companies §§ 12:6–7 (2019 ed.) (discussing registration and reporting requirements for issuers of securities).

\(^{39}\) See 16 C.F.R. § 436.7(e) (financial statements “need not be audited for quarterly revisions”).

\(^{40}\) NASAA Guidelines, supra note 7, at 20–21 (Form F).
honor an auditor’s expressed intent that its form of Auditor’s Consent remains valid despite updates to the FDD, and against treating NASAA’s instruction to “insert the Federal Trade Commission issuance date” too rigidly.41

B. Purpose of Requiring Issuance Date in Auditor’s Consent

The NASAA Guidelines do not disclose the purpose of the requirement that the Issuance Date be cited in the Auditor’s Consent.42 However, the purpose ought to be related to the function of the Issuance Date itself, which is to identify a version of the FDD. Specifically, the Issuance Date identifies a version as of its date of last amendment.43 Tying the consent to a single, identifiable version of the FDD cannot be the whole purpose of the requirement that the Issuance Date must be cited in the Auditor’s Consent, however, because the Auditor’s Consent on its face applies both to the version of the FDD with the specified Issuance Date, and also to later versions. The fact that the Auditor’s Consent is required only for an “initial or renewal filing Application” and never for the filing of amendments to an effective registration also suggests that the Auditor’s Consent is intended to apply to a range of versions of the FDD.44

The outer limit of the range of versions of the FDD to which the auditor can consent is fixed by law. The FTC Rule states that an audit report expires at the end of the first quarter following the end of the franchisor’s fiscal year.45 An FDD containing an expired audit report is not compliant with the FTC Rule. Thus, for example, assuming a fiscal year end of December 31, 2017, a “2018 FDD” is an FDD for use in 2018 and until the end of the first quarter of 2019, with an audit report covering 2017. If the audit report covers 2017, the auditor can consent to its use only with the 2018 FDD. Use with a later version of the FDD would be non-compliant.

These facts suggest that the purpose of the requirement that the Issuance Date must be cited in the Auditor’s Consent is to limit the scope of the consent to usage with the current year’s FDD. The words in the sample form “the Franchise Disclosure Document issued by (name of Franchisor) on (issuance date of Franchise Disclosure Document), as it may be amended” must mean “the FDD for use in the fiscal year following the fiscal year that is the subject of the audit report, and in the first quarter of the next fiscal year.” The clumsiness of referring specifically to the audit report’s expiration date may explain why NASAA instead used the FDD’s Issuance Date with the “as it may be amended” language to express the concept of “that year’s FDD.”

41. Id.
42. The author also could not find any reported case discussing the purpose of requiring the Issuance Date on the Auditor’s Consent.
43. See supra Part IV (explaining that the Issuance Date as used in the FDD always refers to the last-amended date of the FDD).
44. See NASAA Guidelines, supra note 7, at 20–21 (Form F).
45. See 16 C.F.R. § 436.7(b).
If NASAA used the Issuance Date to avoid this clumsy wording, it suggests why updated Auditor’s Consents are unnecessary. The NASAA Guidelines envision the Auditor’s Consent as remaining valid until a new audit report is required and do not envision its use as a cudgel to force or encourage franchisors to retain their auditors to review unaudited quarterly financials, as auditors do for public companies. Auditors of franchise offerings normally restrict the scope of the engagement to the audit report and disclaim any responsibility for ongoing oversight of the franchisor’s financial status. No state or federal law or regulation requires the auditor to exercise ongoing oversight of the franchisor’s finances after the audit report is completed, whereas both state and federal laws require franchisors to update parts of the FDD other than the audit report periodically.46

Accordingly, the Auditor’s Consent refers to a year’s worth of versions of the FDD, using the Issuance Date and “as it may be amended” language to include all versions of the FDD issued before a new audit report is required. The franchisor may not itself make changes to the audit report. When an auditor re-executes an Auditor’s Consent to cite a new Date of Issuance within the intended one-year period of the audit report’s validity, the auditor is saying something trivial, in effect “I now confirm that the form of audit report in the revised FDD is the same as the one in the previous FDD.” Because franchisors are by themselves never allowed to change the audit report, such a confirmation by the auditor is entirely unnecessary.

C. Purpose and Legal Significance of Auditor’s Consent

The NASAA Guidelines do not state the purpose of the Auditor’s Consent, and NASAA has not otherwise explained it. However, like most other NASAA forms, it is likely intended to assist state agencies and aggrieved franchisees in holding someone responsible for any violations of law committed during the franchise sales process. For example, the certification form provides evidence that the franchisor swore that the FDD was true and complete47 and is intended to help regulators and franchisees hold franchisors responsible for the content of the FDD. Similarly, the “consent to service” form helps effect valid service of process on an elusive franchisor through the state agency or registered agent.48 It follows that the Auditor’s Consent is likewise intended to become relevant only when the regulators or franchisees have a cause of action, in this instance not against the franchisor, but against the auditor for professional negligence based on a false or misleading audit report.49 The next consideration, then, is whether an auditor could be held liable to prospective franchisees arising from the audit report.

46. See supra notes 26 (updates required by FTC Rule), 33 (noting the procedures for updating FDDs in Registration States).
47. NASAA Guidelines, supra note 7, at 8–9 (Form A).
48. NASAA Guidelines, supra note 7, at 13–14 (Form C).
49. The audit report is part of the FDD and may itself be false or misleading. The audit report is produced by the auditor, but it rests on data provided by the franchisor to the auditor for purposes of the audit. If the audit report is false or misleading, the fault could lie with the...
For contract claims, because the franchisee is not a party to the contract between the auditor and the franchisor, the franchisee must first establish that it was an intended or permitted third-party beneficiary. The general rule is that only a party to a contract or an intended third-party beneficiary has standing to enforce its terms or obtain a remedy for breach. An express disclaimer of the intent to benefit any third parties creates a strong presumption that third parties do not have standing. In this context, the contract is between the franchisor and its auditor, and, like any other well-drafted professional services contract, it probably includes an express disclaimer of third-party beneficiaries. Although the Auditor’s Consent proves the auditor knew the audit report would be considered by prospective franchisees in connection with the franchise offering, the franchisee’s contract-based claim would almost certainly be defeated by an express disclaimer of third-party beneficiaries. In instances where the contract between the franchisor and auditor lacks an express disclaimer of third-party beneficiaries, the Auditor’s Consent would help the franchisee overcome the presumption that the contracting parties intended to benefit only themselves and each other.

If the franchisee cannot establish third-party beneficiary status, its only claims against the auditor will be in tort. Unless there was fraud, the franchisee’s claim will be for professional negligence. Just as the contract claims will depend on whether the franchisee was an intended third-party beneficiary, the tort claims will turn on the existence of a duty owed to the franchisee by the auditor.

In *Rhode Island Industrial-Recreational Building Authority v. Capco Endurance, LLC*, the Rhode Island Supreme Court explained whether and when an auditor owes a duty to third parties who claim to have relied on a misleading audit report. In 2010, the defendant, a contractor, took out a bank

**Notes:**

50. See, e.g., GECCMC 2005-C1 Plummer St. Office Ltd. P’ship v. JPMorgan Chase Bank, Nat. Ass’n, 671 F.3d 1027, 1033 (9th Cir. 2012) (applying federal common law and noting the “general principle” that “only a party to a contract or an intended third-party beneficiary may sue to enforce the terms of a contract or obtain an appropriate remedy for breach”).

51. Katz v. Pershing, LLC, 672 F.3d 64, 73 (1st Cir. 2012) (noting an express disclaimer of third-party beneficiaries is “decisive” under New York law).

52. See, e.g., Idaho Power Co. v. Hulet, 90 P.3d 335, 337–38 (Idaho 2004). To confer standing as a third-party beneficiary, “the contract itself must express an intent to benefit the third party. This intent must be gleaned from the contract itself unless that document is ambiguous, whereupon the circumstances surrounding its formation may be considered . . . a party must show that the contract was made for its direct benefit, and that it is not merely an indirect beneficiary.” *Id.* (internal citations and quotations omitted). Cf. *Restatement (Second) of Contracts* § 302 (defining “intended beneficiary” with reference to intent of parties).


loan secured by bonds, and the plaintiff state agency (IRBA) guaranteed the bonds, relying in part on an audit report for the contractor’s fiscal year 2009.\(^{55}\) In early 2011, still relying in part on the 2009 audit report, IRBA agreed to a credit increase for the contractor, tied to the same bonds.\(^{56}\) The contractor retained a different auditor for the 2010 fiscal year, and the new auditor determined that the 2009 audit report had materially misstated the financial strength of the contractor, who defaulted in 2012.\(^{57}\) The legal issue was whether the auditor that prepared the 2009 audit report owed a duty of care to IRBA. As noted by the court, there are three main approaches taken by the states to this question: the foreseeability rule, the Restatement (Second) of Torts rule, and the near-privity rule.\(^{58}\)

Of the three approaches, the foreseeability standard, famously articulated by Judge Cardozo in *Palsgraf v. Long Island Railroad Co.*, creates the most space for courts to find that an auditor owed a duty of care to prospective franchisees.\(^{59}\) To avoid this duty, the franchisor’s auditor must not have been reasonably able to foresee that prospective franchisees would rely on its audit report. A signed Auditor’s Consent would presumably be *prima facie* evidence that the auditor could have foreseen that prospective franchisees would rely on the audit report, because the auditor expressly consented to the franchisor’s use of it. It would be difficult for an auditor who signed an Auditor’s Consent to deny that harm to prospective franchisees from a negligently prepared audit report was foreseeable.

Section 552 of the *Restatement (Second) of Torts* provides a narrower but ample basis for courts to find that an auditor owed a duty of care to prospective franchisees.\(^{60}\) In *Capco Endurance*, the court adopted the rule, under which auditors owe a duty not just to known persons, but also to “the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it,” and not only for particular transactions, but for any “transaction that he intends the information to influence or knows that the recipient [intends to rely] or in a substantially similar transaction.”\(^{61}\) The *Capco Endurance* court held that there was no duty under the *Restatement (Second)* test because the

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\(^{55}\) Id. at 497.

\(^{56}\) Id. at 497–98.

\(^{57}\) Id. at 498.

\(^{58}\) Id. at 500.

\(^{59}\) *Palsgraf v. Long Island Railroad Co.*, 248 N.Y. 339, 162 N.E. 99 (1928). In *Palsgraf*, a railroad was not liable for its customer’s injuries because its employee was unaware that the parcel he knocked over would explode, so the railroad could not have foreseen the risk of injury to the plaintiff, standing at a distance. A rule of proximate causation is even more generous to plaintiffs than the foreseeability rule, but not available for purely economic injury.

\(^{60}\) See *Restatement (Second) of Torts* § 552(2) (1977).

\(^{61}\) *Capco Endurance, LLC*, 203 A.3d at 503–07 (adopting and quoting test of *Restatement (Second)* or Torts § 552(2) (1977) (emphasis added)). However, the court (applying the *Restatement (Second)* test) held ultimately that the auditor owed no duty because the auditor intended the 2009 audit report to be used only for the original loan/bond transaction, and not for the subsequent extensions of credit. Id.
auditor intended the 2009 audit report to be used only for the original loan/bond transaction, and not for the subsequent extensions of credit. 62

The near-privity rule provides the narrowest ground for a court to find that an auditor owed a duty of care to prospective franchisees. Under the near-privity doctrine, the duty will not arise unless the auditor knew the plaintiff's identity, knew the audit report would be presented to the plaintiff for a specific purpose, and had some direct dealings with or connection to the plaintiff. 63 In these jurisdictions, the Auditor's Consent would likely be insufficient by itself to overcome the near-privity hurdle, for two reasons. First, an Auditor's Consent does not show that the auditor knew the identities of the prospective franchisees. Second, an Auditor's Consent does not show that the auditor had any direct dealings with the prospective franchisees or any involvement with their franchise purchases beyond the initial preparation of the audit report.

In sum, the primary purpose of the Auditor's Consent is to help courts applying state law decide whether the franchisor's auditor had a duty of care to prospective franchisees in preparing the audit report. Thus, so long as the franchisor has deployed the audit report properly, the Auditor's Consent should in most cases establish the duty, satisfying both the foreseeability and the Restatement (Second) tests. 64

D. Mismatched Issuance Dates Do Not Negate Auditor's Consent

A state examiner might have a legitimate basis to reject an Auditor's Consent for a mismatch between the Issuance Date on the FDD's cover page and the one in the Auditor's Consent, if the mismatch harmed the ability of franchisees to prove that the auditor owed them a duty of care. But a mismatch will not interfere with a franchisee's ability to show a duty of care for two reasons.

First, the audit report almost always remains unchanged throughout the year. The auditor is not responsible for any part of the FDD other than the audit report. Because the audit report does not change, the Auditor's Consent establishes the existence (or not, depending on applicable law) of a duty to prospective franchisees at the time the Auditor's Consent is first executed. So long as the audit report is properly deployed by the franchisor and not altered, subsequent edits to the other parts of the FDD will not affect the legal effectiveness of the Auditor's Consent. An out-of-date Auditor's Consent shows the auditor's intent in exactly the same way as an

62. Id.

63. See, e.g., Credit Alliance Corp. v. Arthur Andersen & Co., 65 N.Y.2d 536, 553 (Ct. App. 1985) (applying near-privity rule to require "a particular purpose for the accountants' report, a known relying party, and some conduct on the part of the accountants linking them to that party").

64. The Auditor's Consent provides documentary evidence that the auditor intended the audit report to be supplied to a "limited group of persons" (prospective franchisees) while knowing that these same persons would likely rely on it for a "substantially similar transaction" (evaluating the franchise offering).
updated one, because the audit report to which the Auditor’s Consent applies has remained unchanged. The duty to franchisees, therefore, also remains unchanged. Thus, Registration States cannot help prospective franchisees with claims against auditors by requiring an updated Auditor’s Consent.

Second, prospective franchisees do not see the Auditor’s Consent, because it is not part of the FDD. An Auditor’s Consent bearing a mismatched Issuance Date has no potential to mislead or confuse prospective franchisees about whether they are still entitled to rely on the audit reports. Accordingly, the rejection of Auditor’s Consents with mismatched Issuance Dates does not help prevent prospective franchisees from being misled.

If an Auditor’s Consent still serves its primary legal purpose when there are mismatched Issuance Dates, then why does NASAA require the Issuance Date to appear on the Auditor’s Consent in the first place? As explained earlier, the purpose of requiring the Issuance Date on the Auditor’s Consent is to establish that the auditor agrees to the use of a particular audit report (specified by the audit report’s own date of issuance) in the FDD with the specified Issuance Date, and in all other compliant versions of the FDD issued up until the audit report expires. This reinforces the argument that requiring updates to the Auditor’s Consent is unnecessary, because the updated Auditor’s Consent will simply refer to the same audit report as the original. An updated form of Auditor’s Consent is truly necessary only in the rare case that the original audit report has been amended or disclaimed by the auditor.

E. Auditor’s Duty to Amend Audit Report

The American Institute of Certified Public Accountants (AICPA) publishes the Statement of Auditing Standards (SAS), a set of governing rules for audit reports. The auditor is required to modify or qualify an audit report only if the financial statements “as a whole are materially misstated” or the evidence is insufficient to deem them “as a whole free from material misstatement.” Nothing in the applicable SAS suggests the auditor has a duty to determine whether the audit report, although free from material misstatement at the time of issuance, becomes misleading because of subsequent events. Based on the SAS, the priority for the auditors and their professional organization is to limit the engagement to the subject matter of the audit report. The SAS does not envision auditors (other than auditors of publicly traded companies) assuming an open-ended, ongoing obligation to

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65. Some Registration States make the forms part of the public record and publish them online. The franchisee could, in such states, obtain the Auditor’s Consent and the other forms required for registration.
66. See supra Part V.A.
67. See supra Part I.V.D.
69. Id.
ensure that the financials for one fiscal year continue to fairly represent the financial strength of the franchisor throughout the subsequent fiscal year.

Updating the Auditor’s Consent more often than annually will not increase the quality or timeliness of financial disclosures, because auditors have no ongoing duty to monitor the financial status of a franchisor during the one-year period in which the audit report is effective. Some auditors respond to a request for an updated Auditor’s Consent by requesting a re-engagement to perform an updated evaluation of the franchisor’s financials (similar to a quarterly review for publicly traded companies). But even if a few franchisors re-engage the auditor, and it results in better oversight of their financial statements, regulators should not use the Auditor’s Consent to encourage franchisors to seek additional oversight by their auditors, because such ongoing evaluation is beyond the scope of what both franchisors and auditors are required to do by applicable law. The practice of forcing franchisors to go back to their auditors in the middle of the fiscal year for updated Auditor’s Consents has had an uneven and unintended effect: most auditors sign off without additional review, and most franchisors avoid auditors who insist on performing an updated evaluation.

Although there is a narrow path by which an audit report can be revised or disavowed by the auditor, requiring a precise match between the Issuance Date on the FDD’s cover page and the Issuance Date on the Auditor’s Consent is not an effective way to expand the scope of the auditor’s responsibility. If events subsequent to the audit report weaken the franchisor financially to the point that the prior year statements are misleading and can no longer be relied upon, the problem should be apparent from the supplemental unaudited financial statements that must be appended to the FDD each quarter.70 Moreover, because the FTC Rule prohibits false or misleading content in the FDD, the franchisor would, under these circumstances, have to stop using the prior year statements, or at least disclose that they are being revised.71

VII. The “Issued and Amended” Approach

Some practitioners have implemented an innovative approach to the problem of Auditor’s Consents with mismatched Issuance Dates: locking down the Issuance Date by using a formulation like “ Issued March 15, 2019; Amended June 15, 2019” on the FDD’s cover page and receipt.72 This language could be confusing to prospective franchisees and should not be used, especially when a better alternative exists.

70. 16 C.F.R. § 436.7(e) (allowing use of unaudited financial statements for required quarterly updates).
71. 16 C.F.R. § 436.9 (violations of the FTC Rule being violations of Section 5 of the FTC Act, 15 U.S.C. § 45).
72. As reported to the author.
The “Issued and Amended” formulation allows the franchisor to avoid asking its auditor to sign more than one Auditor’s Consent per year. Instead of changing the Issuance Date whenever the FDD is amended, the franchisor locks the Issuance Date on the federal cover page and on the receipt to the Issuance Date on the first or original Auditor’s Consent, the one issued together with the audit report. The franchisor can then submit the original Auditor’s Consent to the Registration States, because the Issuance Dates will always match, even if the FDD has undergone changes. Changes to the FDD would normally trigger a new Issuance Date. Instead, franchisors using this formulation signal that the FDD has been changed using the additional word “Amended” and the date of last amendment, as in “Issued March 15, 2019; Amended June 15, 2019.” In this formulation, the FDD’s Issuance Date and the FDD’s last amended date are not the same.

As noted in Part V, the FTC Rule defers to the states on their implementation of Issuance Dates and Effective Dates. Thus, this formulation is arguably consistent with the FTC Rule if the Registration State accepts it. However, this language would be preempted by the FTC Rule if it misleads prospective franchisees. The formulation clearly conveys the date of the last update to the FDD, but it alters and obfuscates the meaning of the term Issuance Date. In this formulation, the Issuance Date no longer conveys the currency of the FDD. Instead, it corresponds to the date on which the auditor first consented to the use of the audit report, but without telling the franchisee the reason for the use of the “issued and amended” formulation. The prospective franchisee has no direct way of knowing that the Issuance Date, which is expected to correspond to the last amended date, now refers to the date of the Auditor’s Consent, and not the date of the latest amendments. As noted in Part V, the FTC Rule and the Registration States both assume that the relation between the Effective Date and Issuance Date is self-explanatory to prospective franchisees. The published guidance available to prospective franchisees would lead them to believe that “issued” and “last amended” are synonymous, and an FDD treating them as different concepts could be confusing. Accordingly, franchisors should not use the “issued and amended” language because it is potentially misleading to prospective franchisees.

VIII. Conclusion: Honor Prospective Forms of Auditor’s Consent

Registration States ought to recognize that rejecting applications for franchise registration over mismatched Issuance Dates on the federal cover page and the Auditor’s Consent serves no legitimate public purpose and wastes resources. The prospective language in the Auditor’s Consent removes any ambiguity about whether the auditor knew the franchisor would update the document throughout the year, and whether the auditor intended the consent to remain valid despite such updates, in line with the primary policy
purpose of the Auditor’s Consent. If Auditor’s Consents with mismatched Dates of Issuance are equally effective to establish the auditor’s duty to prospective franchisees as updated ones, then Registration States’ rejection of Auditor’s Consents with mismatched dates is unjustified. NASAA should clarify that the words “as it may be amended” in reference to the FDD in its sample form of Auditor’s Consent mean that the Registration States may not require the Auditor’s Consent to be updated more often than annually.
ANTITRUST


In this case, the U.S. District Court for the Eastern District of Michigan held that a former Little Caesar’s manager failed to state an antitrust claim against the franchisor based on the “no poaching” provision in the Little Caesar franchise agreements.

Plaintiff Christopher Ogden alleged that Little Caesar franchisees “contracted, combined, and/or conspired to not solicit, poach, or hire each other’s management employees.” As evidence, he pointed to paragraph 15.2.3 of Little Caesar’s franchise agreements, which states that franchisees should not “[e]mploy or seek to employ, directly or indirectly, any person serving in a managerial position who is at the time or was at any time during the prior six (6) months employed by Little Caesar or its affiliates, or a franchisee of any restaurant concept franchised by Little Caesar or its affiliates, without the prior written consent of the then-current or prior employer.”

Ogden grew frustrated with his position as a General Manager of a Little Caesar restaurant and began to look for a different job. He claimed that, because of Little Caesar’s no-poaching provision, his only options were to either stay at his current job, or quit and start over at an entry-level job in another business. He chose to do the latter by taking a lower-paying job at Taco Bell.

Ogden alleged that defendants violated Section 1 of the Sherman Act by creating an agreement among

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Little Caesar franchisees to restrict competition, which unjustly suppressed management wages and unreasonably retrained trade. Ogden alleged the no-poaching provision restricted lateral hiring of current employees within the Little Caesar's system. The complaint broadly claimed that no-poaching and non-compete agreements have had a widespread negative impact on the mobility and wages of low-paid workers in the fast-food industry. Ogden argued that because he quit his job and took a lower-paying position, the no-poaching agreement suppressed his wages, limited his employment mobility, and narrowed his job opportunities.

The court started by reviewing the basic principles regarding Section 1 of the Sherman Act, which prohibits every contract, combination, or conspiracy that creates an unreasonable restraint on trade or commerce. Some restraints are *per se* unreasonable “because they always or almost always tend to restrict competition and decrease output.” Typically, only “horizontal” restraints qualify as unreasonable *per se*. Horizontal restraints are those imposed by agreement between competitors. Most restraints, though, are not *per se* unreasonable. These restraints are analyzed under the more lenient “rule of reason,” which “requires courts to conduct a factspecific assessment of market power and market structure to assess the restraint’s actual effect on competition.” The goal of this analysis is to distinguish between restraints with an anticompetitive effect that are harmful to the consumer versus those that stimulate competition in the consumer’s best interest. Vertical restraints—those imposed by agreement between companies at different levels of distribution—are rarely *per se* unreasonable and thus are analyzed under the rule of reason.

The Sixth Circuit has adopted a third approach for analyzing a Section 1 Sherman Act claim known as the “quick look,” which is an abbreviated form of the rule of reason analysis in which “the requirements for the definition of the relevant market are relaxed.” The Sixth Circuit typically applies the “quick look” analysis in situations where an observer with even a basic understanding of economics “could conclude that the arrangements in question would have an anticompetitive effect on customers and the market.”

The court began by analyzing whether the franchise agreements in question were vertical or horizontal. The court found that the agreements were at least partially horizontal because they restricted competition among franchisees in hiring fast-food employees.

Next, the court analyzed whether the claims should be evaluated under the *per se* approach. The court held that, although the agreements were partially horizontal, Ogden failed to establish that his claims should proceed under a *per se* analysis because he did not allege that the defendants engaged in any explicit agreement to fix wages or divide the labor market into exclusive territories. The court explained that, because the agreements had some vertical component, they were complex and not amenable to the simplified *per se* approach. The fact that the agreements prohibited only intrabrand
hiring, and even then did allow for crosshiring if the former employer consented, weighed in favor of applying the rule of reason analysis.

Even if a per se approach could be applied, the court found Ogden failed to sufficiently allege explicit, comprehensive wage-fixing that would sustain a per se antitrust violation. The court explained that the complaint merely alleged in a general fashion that no-poaching agreements had a broad effect in depressing fast-food employees’ wages on a macro scale. Ogden did not allege that franchisees in any market actually met to fix wages or establish uniform wages. Thus, the complaint failed to show that the no-poaching provisions were per se unreasonable.

The court next analyzed whether Ogden satisfied the “quick look” standard, finding that he fell short of that mark as well. The court noted that there were no allegations of an onerous non-compete that prevented Ogden from seeking alternate employment. Ogden did not allege that he was denied employment by another Little Caesar franchisee due to the no-poaching provision or that another employer would have hired him but for the no-poaching clause. As such, the court found the alleged antitrust violation was not obvious enough to warrant a “quick look” analysis.

Finally, the court reviewed Ogden’s claims under the rule of reason. The court applied the rule’s three-step, burden-shifting framework. Under this framework, the plaintiff has the initial burden of proving the challenged restraint has a substantial anticompetitive effect that harms consumers in the relevant market. If the plaintiff carries its burden, the burden then shifts to the defendant to show a procompetitive rationale for the restraint. If the defendant makes the showing, the burden shifts back to the plaintiff to demonstrate that the procompetitive effects could be reasonably achieved through less anticompetitive means. The court found that Ogden fell far short of satisfying the rule of reason because he failed to define any relevant market or show that any anticompetitive effects of the agreements could not be negated by the pro-competitive effects on interbrand competition.

Finally, the court found that Ogden also failed to demonstrate any antitrust injury. The court stated that Ogden’s allegations did not offer any facts showing that the no-poaching clause caused him any specific wage or opportunity loss. The court found this deficiency contrasted with the facts in other antitrust cases involving no-poaching clauses that appeared in franchise agreements. In these other cases, the plaintiffs pointed to specific instances where they were refused a higher-paying job at another franchisee’s business specifically due to a no-poaching provision. As a result, they were forced to take a lower-paying job with a different employer. Ogden made no such allegations. As such, the court found that he did not sustain an antitrust injury.

Thus, the court held Ogden failed to state a plausible claim for relief since he failed to plead facts establishing a prima facie violation of Section 1 of the Sherman Act, or any antitrust injury, and, accordingly, granted Little Caesar’s motion to dismiss.
Granting in part and denying in part defendants’ motions to dismiss, the U.S. District Court for the Northern District of Texas found that the franchisee plaintiffs had standing to bring a price discrimination claim against the manufacturer defendant because, although they were indirect purchasers, they had the functional equivalent of a cost-plus contract with the franchisor.

Plaintiff Security Data Supply, LLC (SDS) and its franchisees (SDS Franchisees, and together with SDS, Plaintiffs) are wholesale distributors of CCTVs, fire alarms, intrusion alarm systems, and home automation systems, operating in Texas and Louisiana. Plaintiffs alleged that Nortek Security and Control LLC (Nortek), Earnest Bernard (Bernard), and Wave Electronics Inc. (Wave) (collectively, Defendants) tortiously interfered with existing contracts, prospective business relationships, and existing business relationships, and violated anticorporate bribery laws. Plaintiffs further alleged that Nortek and Wave violated federal antitrust law.

Nortek manufactures home automation and personal security systems, and it is the sole manufacturer of a residential intrusion system called 2GIG. Nortek distributes its products, including 2GIG products, through wholesale distributors such as SDS. Wave, a competitor of Plaintiffs, also distributed security systems, including Nortek’s 2GIG product. Plaintiffs alleged that Wave and Nortek entered into a special pricing scheme (the Four Star Program), which allowed Wave to sell 2GIG systems for up to forty percent below the wholesale price that Nortek charged its other distributors. The Four Star Program allegedly involved special rebates to Wave’s customers and a kickback to Wave, increasing its profit on sales. Further, Nortek employees allegedly provided the discount, along with the names of Plaintiffs’ customers, to Wave, in exchange for payments and American Express gift cards.

Plaintiffs contacted Nortek seeking to enter into a similar pricing arrangement; however, Nortek denied the program’s existence. Bernard, a Nortek employee, allegedly told Plaintiffs that they were receiving the best price on purchased items. Soon thereafter, Bernard resigned, and other employees involved in the scheme were terminated when Nortek discovered its employees’ activities. Plaintiffs alleged that Wave nonetheless continued to receive preferential treatment allowing Wave to maintain its competitive advantage. For example, Nortek allowed Wave’s top thirty dealers to continue operating under the Four Star Program.

Although the Four Star Program ended and Wave eventually entered into a special pricing program with Quolsys, another manufacturer, Plaintiffs claimed that its customers began to purchase Quolsys products, rather than 2GIG products, causing Plaintiffs to lose a large number of customers and suffer an estimated $9,575,000 in annual losses.

Although Plaintiffs’ sales increased when Nortek began offering Plaintiffs the special pricing program, Nortek later pulled its products from Plaintiffs
without providing notice as required under the contract. In response to Nortek’s suit to collect past-due invoices, Plaintiffs counterclaimed, alleging that Nortek and Wave had violated the Robinson-Patman Act (RPA), 15 U.S.C. §§ 13(a) and 13(f). Plaintiffs further alleged that Defendants engaged in commercial bribery in violation of RPA and tortuously interfered with existing contracts, prospective business relationships, and existing business relationships.

Defendants argued that SDS Franchisees’ claims should be dismissed for lack of standing. The court disagreed, finding that SDS Franchisees were proper plaintiffs. The court analyzed whether SDS Franchisees met the standing requirements for a private antitrust action, specifically whether the plaintiffs adequately showed injury-in-fact, antitrust injury, and proper plaintiff status. The court found that plaintiffs adequately pleaded injury-in-fact and antitrust injury as the complaint alleged that the Four Star Program caused Plaintiffs to lose fifty-nine clients and $9,575,000 in annual revenue.

Next, the court analyzed whether SDS Franchisees were “proper plaintiffs.” Defendants argued that SDS Franchisees were not proper plaintiffs because they indirectly received their products from Nortek. The court disagreed. Although generally only direct purchasers have standing to pursue a claim for price discrimination, there is a “cost-plus” contract exception when a “purchaser commits to buy a fixed quantity regardless of price, such that the effect of the overcharge is essentially determined in advance without reference to the interaction of supply and demand.” Relying on a Fifth Circuit decision, the court noted that a “purchaser can plead the functional equivalent of cost-plus contracts by showing that the price was determined by strictly applying certain formulate to the wholesale price.” Although SDS Franchisees were indirect purchasers, the court found that Plaintiffs had adequately pleaded the functional equivalent of a cost-plus agreement because the complaint stated that the SDS Plaintiffs and SDS were parties to an agreement under which SDS franchisees were required to purchase all of their products from SDS for an amount based on a standard markup of the wholesale price SDS received from a manufacturer.

The court then considered the commercial bribery claim, finding that commercial bribery may be a violation of RPA § 2I. Turning to the sufficiency of Plaintiffs’ allegation for each Defendant separately, the court sets forth the requirements for a commercial bribery claim: “(1) the giving or offering of something of value; (2) to an agent or fiduciary; (3) without the consent to the principal; (4) with the intent to influence the conduct of the agent or the fiduciary.” Plaintiffs did not allege that Nortek offered or accepted any bribes and, as a result, the court dismissed Plaintiffs’ direct bribery claim. However, the court accepted Plaintiffs’ argument that Nortek could be held vicariously liable for commercial bribery and, therefore, denied Defendants’ motion as to vicariously liability.

Bernard and Wave also challenged the sufficiency of Plaintiffs’ commercial bribery pleading. Bernard contended that Plaintiffs failed to adequately
plead with specificity their commercial bribery claim. Wave argued that the allegations “ma[de] no sense” because there would be no reason to bribe Bernard if Nortek would freely give the discount. Wave also argued that Plaintiffs failed to plead that Nortek’s employees acted for Nortek. The court found Bernard’s and Wave’s arguments unpersuasive and denied each party’s motion as to the commercial bribery claim.

Next, the court addressed Defendants’ motion to dismiss the claims for tortious interference with existing contracts, prospective business relationships, and existing business relationships. The court granted Defendant’s motion to dismiss the tortious interference with contract claim on the ground that Plaintiffs failed to state facts showing that Defendants caused a party to breach an existing contract. However, the court permitted them to replead.

Denying Defendants’ motions to dismiss the tortious interference with prospective business relations claim, the court determined that Plaintiffs adequately pleaded tortious interference because the complaint stated that “Plaintiffs had a long, ongoing relationship with Nortek; that due to Bernard and Wave’s rebate program, Plaintiffs lost market share of Nortek’s products; and that Nortek pulled other related product lines from Plaintiffs.”

Last, the court denied Defendants’ motion to dismiss the civil conspiracy allegations, finding that the complaint adequately alleged facts that are “facially plausible and sufficient to show the Defendants conspired to commit one or more unlawful, overt acts, which harmed Plaintiffs.”

ARBITRATION


This case is discussed under the topic heading “Choice of Venue.”


Sky Zone Franchise Group was unable to compel arbitration of an action brought against it and the franchisee of one of its trampoline parks by a customer who was injured at the park. The New Jersey Appellate Division found the arbitration clause at issue was unenforceable under New Jersey law because it failed to clearly and unambiguously inform the customer that he was giving up his right to bring claims in a court of law and have a jury trial.

Plaintiff Alexander Defina (Defina) participated in a game of trampoline dodgeball at Sky Zone Indoor Trampoline Park (SZITP). Before plaintiff gained access to the facility, his father signed a document entitled “Participant Agreement, Release and Assumption of Risk” (the Agreement). The Agreement contained an arbitration clause, which stated:
If there are any disputes regarding this Agreement, I on behalf of myself and/or my child(ren) hereby waive any right I and/or my child(ren) may have to a trial and agree that such dispute shall be brought within one year of the date of this Agreement and will be determined by binding arbitration before one arbitrator to be administered by JAMS pursuant to its Comprehensive Arbitration Rules and Procedures. I further agree that the arbitration will take place solely in the state of Texas and that the substantive law of Texas shall apply. If, despite the representations made in this Agreement, I or anyone on behalf of myself and/or my child(ren) file or otherwise initiate a lawsuit against SZITP, in addition to my agreement to defend and indemnify SZITP, I agree to pay within 60 days liquidated damages in the amount of $5,000 to SZITP. Should I fail to pay this liquidated damages amount within the 60 day time period provided by this Agreement, I further agree to pay interest on the $5,000 amount calculated at 12% per annum.

The court found that the arbitration clause “did not clearly and unambiguously inform plaintiff that he was giving up his right to bring claims arising out of the participation in activities at SZITP in a court of law and have a jury decide the case.” The court focused on the fact that the arbitration clause did not contain the word “trial” or “jury.” The court also noted that the Agreement did not explain how arbitration differs from a proceeding in a court of law.

The court came to this decision despite the Supreme Court’s 2017 decision in *Kindred Nursing Centers Ltd. Partnership v. Clark*, which held that a Kentucky rule requiring that a power of attorney specifically state that the attorney-in-fact is authorized to enter into an arbitration agreement violated the Federal Arbitration Act’s (FAA) requirement that arbitration agreements be placed “on equal footing with all other contracts.”

In September 2017, the franchisor defendants filed a motion to compel arbitration and stay further trial court proceedings, arguing that the prior ruling by the New Jersey Appellate Court refusing to compel arbitration was no longer valid after *Kindred Nursing*. The trial court rejected this argument and denied the motion. Defendants appealed, but the appellate court affirmed the trial court’s order.


Ultimately, the New Jersey Appellate Division decided that the arbitration clause was not enforceable under *Atalese* and *Kernahan*. The court explained that, under *Atalese* and *Kernahan*, there must be mutual assent by the parties to submit their dispute to arbitration. Since arbitration involves the waiver of the right to pursue the claims in court, the arbitration clause must show that the party waiving the right did so clearly and unambiguously. Although no magic words are needed to render an arbitration clause enforceable, the contract “must explain that the plaintiff is giving up her right to bring her claims in court or have a jury resolve the dispute.”
In the present case, the arbitration clause referred to a waiver of any right to “a trial” but did not explain that the person signing the Agreement was giving up his right to bring claims in court or have a jury resolve the dispute. Furthermore, the arbitration clause did not explain arbitration or how it differs from a proceeding in court. On that basis, the court found the arbitration clause could not constitute a knowing waiver of the right to sue in court.

The franchisor argued that the arbitration clause should be enforced because it was not substantially different from the arbitration clause upheld in another New Jersey decision: Martindale v. Sandvik, Inc., 173 N.J. 76, 800 A.2d 872 (2002). However, the court found that the two clauses were distinguishable. The clause in Martindale stated that as a condition of employment, the plaintiff agreed to “waive” her “right to a jury trial” in any action or proceeding relating to her employment. The court found that this reference to a waiver of a jury trial sufficiently informed the plaintiff that she was giving up her right to bring her claims in court or have a jury resolve the dispute as required under Atalese.

The defendants also argued that the discussion in Kernahan of the Atalese standard demonstrated that Atalese violates the “equal-footing” principle in the FAA as interpreted in Kindred Nursing. They theorized that Atalese establishes a subjective standard for mutual assent that is not applied to other contracts. The court disagreed, finding that Atalese did not single out arbitration clauses “for more burdensome treatment than other waiver-of-rights clauses under state law.” The court held that Atalese did not establish a subjective test for mutual assent for arbitration agreements. Instead, Atalese requires courts to examine the relevant contractual language and, based on that language, determine whether mutual assent has been achieved. Therefore, the court determined that Atalese did not establish a standard for mutual assent that applies only to arbitration agreements and does not violate the FAA’s “equal-footing” principle as interpreted in Kindred Nursing. Accordingly, based on its interpretation of Atalese and Kernahan, the court held that the arbitration agreement signed by plaintiff’s father was unenforceable.


In this case, the Second Circuit Court of Appeals vacated a district court’s decision denying Doctor’s Associates, Inc.’s (DAI) claims to compel arbitration of a prospective franchisee’s claims.

Defendant-Appellee Girum Alemayehu (Alemayehu) sought to purchase an existing Subway franchise in Colorado. The application process included an online application, which contained a provision requiring the applicant to submit any claims arising out of the application process to binding arbitration in Bridgeport, Connecticut. Alemayehu checked a box confirming that he had read this provision. The application could not be submitted without the box being checked and typing a name into the signature box below it. DAI denied Alemayehu’s application.
Alemayehu filed a lawsuit in the U.S. District Court for the District of Colorado claiming, among other things, that DAI and its agent had discriminated against him on the basis of his race in violation of 42 U.S.C. § 1981. DAI responded by initiating an action in the U.S. District Court for the District of Connecticut (district court) and filing a motion to compel arbitration. Although Alemayehu had not raised the issue, the district court on its own requested briefing on the question of consideration. The district court found that the application “contain[ed] only unilateral promises made by [Alemayehu]” and did not require anything in exchange from DAI. Accordingly, the district court concluded there was no consideration and, therefore, the parties had not agreed to arbitrate. DAI appealed.

On appeal, DAI advanced two primary arguments. First, the issue of whether the agreement to arbitrate was supported by adequate consideration should have been decided by the arbitrator. Second, the arbitration agreement was supported by adequate consideration and, therefore, the agreement is enforceable.

The appellate court first addressed the question of whether the district court or the arbitrator should decide the consideration question. Under the FAA, the general rule is that threshold questions of arbitrability are for the court to decide. Although the parties can agree to arbitrate certain arbitrability questions, the parties may not delegate to an arbitrator “the fundamental question of whether they formed the agreement to arbitrate in the first place.” Thus, the question of contract formation, as distinct from questions regarding the enforceability or scope of an arbitration agreement, must be resolved by the district court. The court noted that this result is consistent with basic contract law principles. An agreement that was not properly formed is not just “unenforceable”; it “is not a contract at all” and, therefore, may not be the basis for compelling arbitration.

Analyzing both Connecticut and Colorado law, the court concluded that consideration is “a necessary element of contract formation” and, therefore, whether a promise was supported by adequate consideration must be decided by the court.

The court then turned to the question of whether the agreement to arbitrate was supported by consideration. The court found that the district court’s conclusion that DAI did not make a legally enforceable promise to consider Alemayehu’s application because the application did not include any language obligating DAI to consider the application, provide applicants with additional information, or respond to every party who submits an application was incorrect. The court concluded that under both Colorado and Connecticut law, consideration may consist of either performance or a return promise. The court then went on to examine the circumstances regarding DAI’s review of Alemayehu’s application, finding that this review constituted bargained-for performance. The court further found that, in reviewing the application, DAI provided Alemayehu with a “benefit” in exchange for his promises, one of which was his agreement to arbitrate any disputes arising out of the application process.
The court also addressed Alemayehu’s slightly different argument that DAI provided something that was somehow materially different from what Alemayehu bargained for and, therefore, there was no contract. The court rejected this argument, finding that DAI provided the “exact performance” that Alemayehu sought (i.e., to consider his application to own a Subway franchise).

Although the court vacated the district court’s decision, it remanded the matter to the district court to consider Alemayehu’s other arguments that had not been previously been addressed.

**CHOICE OF FORUM**


The U.S. District Court for the Eastern District of Kentucky found that CK Franchising, Inc. (CKFI), a national franchisor of inhome, nonmedical care services, was entitled to a declaration that the forum selection component of the alternative dispute resolution (ADR) provision in its franchise agreement was valid and enforceable.

Defendant SAS Services, Inc. (SAS) began operating a CKFI franchise in Kentucky in 2007. Before entering the franchise agreement, the owners of SAS, Mary Perkins (Perkins) and Sarah Short (Short), reviewed the contract and accompanying Offering Circular and consulted with an attorney about the documents and prospective business. Short and Perkins are both educated and have experience in the home-care industry.

The 2007 franchise agreement mandated certain ADR procedures that would occur “in Dayton, Ohio or if [CKFI] has moved its principal place of business, in the city where [CKFI]’s principal place of business is located.”

The agreement had a ten-year term and was subject to an optional renewal in 2017. In April 2017, Short and Perkins received a letter regarding renewing the franchise, which enclosed the new franchise agreement and directed SAS (if renewing) to return the executed new agreement to CKFI. The 2017 franchise renewal agreement (the Agreement) contained forum selection clauses within the ADR section that closely resembled the 2007 language. The Agreement provided that “mediation must take place in the city where CKFI’s principal place of business is then located.” SAS did not discuss the 2017 Agreement with an attorney. Nor did it seek to negotiate any provisions with CKFI.

In December 2017, after SAS entered the Agreement, CKFI announced that it was relocating its corporate headquarters from Dayton, Ohio, to Irvine, California. Thereafter, SAS initiated the ADR process to address an issue regarding an encroaching CKFI franchise, and CKFI sought to enforce the forum selection clause. The parties were unable to agree on the ADR location, and CKFI sought a declaratory judgment that the ADR forum selection clause was valid and enforceable.
First, the court determined that the Federal Arbitration Act (FAA) governed the Agreement’s ADR provisions, despite arguments by SAS that the Kentucky Uniform Arbitration Act controlled. The court explained that, absent an ADR provision’s clear intent otherwise, “the FAA generally preempts inconsistent state laws and governs all aspects of arbitrations concerning transaction[s] involving commerce.”

In the parties’ 2007 franchise agreement, the “Governing Law” provision expressly provided that Ohio law governed all parts of the contract except the ADR portion. In the 2017 version, however, the “Governing Law” provision made no exception for the ADR clause. Nevertheless, the court found that the 2017 Agreement’s general “Governing Law” section—which applied Ohio law to the Agreement as a whole—was insufficient to establish that the parties unambiguously intended to displace the FAA as applied to the ADR provisions. The court indicated that state law would only preempt the FAA in situations where the contract specifically provides that state law, rather than the FAA, applies to an arbitration clause.

SAS also argued that, even if the FAA applied, the forum selection clause was both procedurally and substantive unconscionable. The court first examined SAS’s procedural unconscionability argument. In finding that the provision was not procedurally unconscionable, the court looked at several relevant factors, including “the bargaining power of the parties, the conspicuousness and comprehensibility of the contract language, the oppressiveness of the terms, and the presence or absence of a meaningful choice.” The court found that SAS was a sophisticated entity rather than an unwitting consumer. Further, the court noted that SAS had unlimited opportunity to consult with legal counsel prior to signing the Agreement. The court was also persuaded by the fact that the Agreement’s ADR provision was not buried within the document. In addition, the court found the provision to be clear, direct, and without legalese.

SAS argued that the ADR provision contradicted language within the Franchise Disclosure Document (FDD) accompanying the franchise renewal contract. The court rejected this contention, pointing out that the FDD began by emphasizing the importance of reviewing the actual franchise agreement carefully, ideally with counsel. Despite one risk factor in the FDD stating that disputes would be resolved only in Ohio, the court found that in several other places, the FDD accurately alerted potential franchisees to the precise ADR requirements. Thus, the court found that nothing in the Agreement itself or in the contract review process (including SAS’s receipt of the FDD) supported a finding of procedural unconscionability.

The court also held that the ADR forum requirement was not substantively unconscionable, explaining that Kentucky law directs that a forum selection clause be enforced as *prima facie* valid unless its opponent presents evidence of “countervailing circumstances that would render the clause unreasonable.” In assessing reasonableness, the court considered: “the inconvenience created by holding the trial in the specified forum; the disparity of
bargaining power between the two parties; and whether the state in which the incident occurred has a minimal interest in the lawsuit.”

The court found that a balancing of the preceding factors weighed in favor of CKFI. First, the court explained that SAS’s concerns regarding the ability to effectively present witness proof to a mediator/arbitrator in California were unfounded because the FAA confers upon arbitrators the ability to compel witness attendance. Furthermore, the JAMS Arbitration Rules allow parties to depose and examine witnesses in any location and submit the deposition transcript for the arbitrator’s consideration.

The court also found that SAS failed to show any likelihood that it would incur exorbitant expenses if compelled to participate in the ADR process in California. SAS asserted, without evidence, that it would incur significant costs due to travel, lodging, and childcare costs. The court was not persuaded, though, by SAS’s conclusory assertions of increased costs because there was no itemization, supporting documentation, or calculations underlying SAS’s assertion that ADR in California would cost a significant sum of money.

Next, the court looked at the relationships of the parties and found that their relative bargaining power was not so unequal as to warrant invalidating the clause. The court explained that the parties were sophisticated corporate entities and dealt at arms’ length in executing the Agreement. Thus, the court found nothing in the record to support the notion that the parties’ unequal bargaining power rendered the ADR forum clause unreasonable.

Finally, the court considered Kentucky’s interest in the substance of the parties’ dispute. Although the court noted that the subject matter of the underlying franchise territory controversy took place entirely in Kentucky and that Kentucky had an interest in the issue, the court concluded that the contract dispute issue ultimately was between a national franchisor and a franchisee that just happened to be located in Kentucky. As such, the court found that this factor did not outweigh the other factors, all of which favored enforcement of the ADR forum selection clause.

**CONTRACT ISSUES**


This case is discussed under the topic heading “Termination.”


In this case, plaintiff Bassel Khorchid (Khorchid) alleges that defendant 7-Eleven, Inc. (7-Eleven) repeatedly violated their franchise agreement, which ultimately forced Khorchid to surrender his store. Khorchid’s amended complaint asserts that 7-Eleven breached the franchise agreement, breached the covenant of good faith and fair dealing under New Jersey law, and violated the
New Jersey Franchisee Protection Act (NJFPA) by attempting to constructively terminate Khorchid’s franchise. Khorchid also asserts claims for unjust enrichment and unconscionability. The U.S. District Court for the District of New Jersey granted in part and denied in part 7-Eleven’s motion to dismiss Khorchid’s claims and granted 7-Eleven’s motion to stay the claims that were arbitrable in accordance with the terms of the franchise agreement.

Khorchid alleged two separate breaches of the franchise agreement. First, that 7-Eleven failed to provide necessary maintenance after Khorchid’s store was damaged by Hurricane Sandy. Second, that 7-Eleven failed to treat Khorchid as an independent contractor as required by the franchise agreement, because it ordered merchandise that Khorchid did not authorize and forced Khorchid to writeoff unsold merchandise at a loss. Assuming all factual allegations Khorchid asserted as true, the court denied 7-Eleven’s motion with respect to the breach of contract claim, finding that Khorchid had pled sufficient facts to set forth a cause of action. Relying on the same reasoning, the court denied 7-Eleven’s motion to dismiss the breach of the covenant of good faith and fair dealing claim.

Khorchid’s third count alleged that 7-Eleven breached the NJFPA. The parties agreed that the NJFPA applied to their franchisee-franchisor relationship. However, because Khorchid’s pleading failed to identify which section(s) of the NJFPA 7-Eleven had allegedly violated, the court granted 7-Eleven’s motion to dismiss this claim.

Khorchid’s fourth claim alleged that 7-Eleven was unjustly enriched because Khorchid paid increased maintenance charges to 7-Eleven. To plead an unjust enrichment claim, a plaintiff must allege that the other party received a benefit from the plaintiff and that it would be inequitable for the defendant to retain the benefit. The court found that Khorchid had failed to plead the required facts and granted 7-Eleven’s motion to dismiss this count. The court also granted 7-Eleven’s motion to dismiss the unconscionability claim, finding that there is no such affirmative cause of action.

The court next addressed 7-Eleven’s argument that Khorchid’s claim that 7-Eleven did not make every effort to obtain the lowest cost products and service from its suppliers to maximize profits should be submitted to arbitration. The court agreed, finding that these claims were arbitrable and stayed them pending the completion of arbitration. Finally, having determined that there was overlap between the arbitrable and non-arbitrable claims, and that the resolution of the arbitrable claims may facilitate the “progression” of the non-arbitrable claims, the court exercised discretion to administratively terminate the action without prejudice pending the completion of the arbitration.

In this case, the U.S. District Court for the Southern District of Florida granted plaintiff and cross-defendant Tim Hortons USA, Inc.’s (Tim
Tim Hortons is the franchisor of Tim Hortons restaurants. Tims Milner is a collection of business entities, as well as their owners and guarantors. Tim Hortons and Tims Milner entered into franchise agreements and lease agreements pursuant to which Tims Milner was granted the right to operate seven Tim Hortons restaurants in Michigan. Pursuant to the lease agreements, Tims Milner was required to pay rent calculated as a percentage of monthly gross sales, as well as other charges, including taxes, utilities, and common area maintenance (CAM) charges. Tims Milner claims that the rent provision of the leases was amended by a verbal agreement, which, according to Tims Milner, required them to only pay rent based on a flat percentage of gross sales and not the other charges.

Throughout the course of the parties’ relationship, Tims Milner was concerned about the accuracy of Tim Hortons’ accounting and billing procedures. Allegedly due in part to this, Tims Milner attempted to sell their franchise locations. However, the franchise agreements gave Tim Hortons the right to approve any sale before it could be finalized. Tim Hortons conditioned its approval of the sale upon Tims Milner’s payment of all past due amounts, including the disputed rent. Tims Milner did not pay the disputed rent, and the prospective purchaser chose not to move forward with the sale.

The parties’ relationship deteriorated, and Tim Hortons ultimately terminated the franchise and lease agreements. Tim Hortons filed suit, and the parties each filed a motion seeking injunctive relief. Tim Hortons sought an order prohibiting Tims Milner from using the Tim Hortons trademarks and from representing its restaurants as genuine Tim Hortons franchises. Tims Milner sought an order allowing them to continue operating the restaurants as authorized Tim Hortons’ franchises, and requiring Tim Hortons to continue supplying the restaurants with approved products.

The court started by setting forth the common law test for granting injunctive relief, which requires the moving party show (1) a substantial likelihood of success on the merits of the case; (2) that irreparable injury will be suffered unless the injunction is issued; (3) that the threatened injury to the party seeking the order outweighs the damage the proposed injunction may cause the other party; and (4) if ordered, that the injunction would not be adverse to the public interest. The court found in favor of Tim Hortons on all four of these requirements. Most notably, the court stated that when a franchisor seeks a preliminary injunction against a former franchisee on a claim of trademark infringement, the franchisor must demonstrate that it properly terminated the contract, thus resulting in the unauthorized use of the trademarks by the franchisee.

Although it was disputed whether the monthly rental amount owed had been amended by the alleged oral agreement, Tims Milner argued that Tim Hortons had not established that the termination was proper because the past due rent was disputed, although Tims Milner did not contest that the
additional rent in dispute was in excess of $225,000. With respect to Tims Milner’s argument that the lease agreements had been verbally amended, the court held that Florida law prohibits evidence of prior agreements being used to vary the unambiguous language of a valid contract. Therefore, the court found in favor of Tim Hortons and granted its motion for a preliminary injunction, prohibiting Tims Milner from continuing to operate the restaurants and using the Tim Hortons’ marks. The court denied Tims Milner’s motion because it failed to show a likelihood of success on the merits of its claim that Tim Hortons breached the franchise agreements by terminating Tims Milner without good cause.

DAMAGES

Auto Driveaway Franchise System, LLC v. Corbett, Bus. Franchise Guide (CCH) ¶ 16,453, 928 F.3d 670 (7th Cir. 2019)

In this case, the Seventh Circuit affirmed in part a district court’s preliminary injunction against a former franchisee of Auto Driveaway Franchise System, LLC (Auto Driveaway). The injunction prevented the franchisee from operating a competitive business anywhere Auto Driveaway operates for a period of two years pursuant to the terms of a noncompetition provision in the franchise agreement. Although the court affirmed the injunction’s limits on competition, the court remanded the case to the district court to consider imposing a larger security bond to protect the franchisee’s interest if he were to ultimately prevail in the litigation.

Auto Driveaway is a franchisor of commercial vehicle transportation services. Jeff Corbett (Corbett) was one of its franchisees. Through his company, Auto Driveaway Richmond, LLC (AD Richmond), Corbett operated Auto Driveaway franchises in Richmond, Nashville, and Cleveland. The businesses were governed by separate, but substantively identical, franchise agreements. Each agreement contained a non-compete clause and a non-disclosure clause, and each agreement expired in 2016. The expiration dates came and went, but both parties continued dealing as though the contracts were still in place.

In late 2017, Auto Driveaway learned that Corbett was developing an app to compete against the app that Auto Driveaway had hired Corbett to build. Auto Driveaway suspected Corbett was using Auto Driveaway’s proprietary work product to assist in developing his own app. In addition, Corbett was set to launch his own app through a new company, InnovAuto, that also provided auto transportation services in direct competition with Auto Driveaway. Auto Driveaway filed a lawsuit in the U.S. District Court for the Northern District of Illinois seeking to stop Corbett and InnovAuto from selling or using the app. One month later, Auto Driveaway formally terminated its relationship with Corbett and AD Richmond.

Several months after filing its complaint, Auto Driveaway discovered that Corbett had another competitive auto transport business, Tactical Fleet.
Although Tactical Fleet was not named in the original complaint, Auto Driveaway asked the district court to enjoin Corbett from operating that company too. After a brief hearing, the district court granted Auto Driveaway’s motion for injunctive relief based on evidence that Corbett was harming consumer goodwill and taking Auto Driveaway’s customers through his competing businesses. The district’s court order prohibited Corbett from engaging in any conduct that might violate the non-compete clause in the franchise agreements and required Auto Driveaway to post a $10,000 bond as security for the injunction.

On appeal, the Seventh Circuit began by resolving procedural challenges to the claims. On the merits, the court noted that Auto Driveaway could not have been expected to know facts (specifically regarding Tactical Fleet) that Corbett was deliberately keeping from it.

Next, the court found that the district court failed to comply with Federal Rule of Civil Procedure 65(d), which requires that every order granting an injunction must (1) state the reasons why it was issued; (2) state its terms specifically; and (3) describe in reasonable detail the act or acts restrained or required. The court interpreted Rule 65(d) as requiring that an injunction be embodied in a stand-alone separate document, which must contain enough information to render its scope clear. Here, the lower court issued a single order styled as a “Preliminary Injunction Order.” Because it was not a stand-alone separate document that spelled out within its four corners exactly what the enjoined parties must or must not do, the court found it did not comply with Rule 65(d).

Despite this error, the court decided it still had proper appellate jurisdiction. The court stated it could review injunctions that contain enough content to permit effective enforcement and have the practical effect of an injunction. In fact, as the court noted, to decide otherwise would defeat the purpose of Rule 65(d), and appellate review, because Rule 65(d) is intended to protect the party against which an injunction is issued by requiring clear notice as to what the party must do or not do. Citing a recent Supreme Court decision, the court held that “[w]here a vague injunction does not comply with Rule 65(d), the aggrieved party has a particularly strong need for appellate review. It would be odd to hold that there can be no appeal in such a circumstance.” The court found that the practical effect of the injunction was that it prevented Corbett from operating his business and required Auto Driveaway to secure the order with a bond. The court stated this was “ample” for purposes of appellate jurisdiction and did not remand the case on this issue.

The court then turned to the question of whether the district court abused its discretion when it entered the preliminary injunction. The court stated that the district court found that Auto Driveaway was likely to succeed on the merits on several key points, including the enforceability of the restrictive covenants in the agreement, the existence of an implied-in-fact contract, and the breach of that contract. The lower court also found that
harm to consumer goodwill and loss of customer relationships are irreparable harms. The Seventh Circuit took no issue with these findings; however, the court found that the district court failed to satisfy two requirements to justify an injunction.

First, the lower court did not explain why a remedy at law, such as an award of damages, was inadequate. Second, the lower court imposed the modest amount of $10,000 for the security bond. When setting the amount of security, the Seventh Circuit has instructed district courts to “err on the high side.” The court found that $10,000 was too low given the sweeping nature of the injunction. The court noted that, because the injunction was broad both in geographic scope and its prohibitions against Corbett and AD Richmond, the security bond likely needed to be much higher. The Court remanded the issue of the security bond to the district court.


In this case, the U.S. District Court for the Western District of Virginia granted Choice Hotels International, Inc.’s (Choice Hotels) motion for summary judgment on its claims that defendants continued using Choice Hotels’ trademarks after the parties’ franchise agreement was terminated. The court also granted Choice Hotels’ motion for summary judgment on its claims that A Royal Touch Hospitality, LLC (VA), a related non-franchisee, used Choice Western’s trademarks without permission.

Choice Hotels, the owner of a family of trademarks that it uses in connection with its lodging franchise business, entered into a franchise agreement with defendant A Royal Touch Hospitality, LLC (NC), Ujas Patel, and Ketki Patel, for the operation of a QUALITY INN®, a Choice Hotels hotel in Virginia. One week after executing the franchise agreement, Ketki Patel created a new limited liability company in Virginia, A Royal Touch Hospitality, LLC (VA), and identified the franchise location as its registered office, even though this new company was not a party to the franchise agreement or the subsequently executed reinstatement agreement.

Choice Hotels terminated the franchise agreement. Shortly thereafter, and unbeknownst to Choice Western, A Royal Touch (NC) was administratively dissolved. Choice Hotel subsequently entered into a reinstatement agreement with the Patels and what it thought was A Royal Touch (NC).

Choice Hotels ultimately terminated the reinstatement agreement when defendants defaulted on their payment obligations. Choice Hotels then filed suit asserting claims for trademark infringement and unfair competition under the Lanham Act and common law, claiming that the defendants continued using Choice Hotel’s trademarks without authorization after the reinstatement agreement was terminated.

Choice Hotels moved for summary judgment, requesting (1) a permanent injunction prohibiting defendants from continuing to use the QUALITY®
to establish a claim for trademark infringement under the Lanham Act, the moving party must prove that (1) it owns a valid trademark; (2) the defendant used the mark “in commerce” and without the moving party’s authorization; (3) the defendant used the mark (or an imitation of it) in connection with the sale, offering for sale, distribution or advertising of goods or services; and (4) the defendant’s use of the mark is likely to confuse customers. The court concluded that Choice Hotels had presented evidence in support of each of these elements and, therefore, granted summary judgment on the federal trademark infringement claim. The court also found that Choice Hotels was entitled to judgment as a matter of law on its Lanham Act unfair competition claim because it and federal trademark infringement are “measured by identical standards.” The court, noting that the test for trademark infringement under the common law is effectively the same as federal trademark infringement under the Lanham Act, also granted summary judgment on Choice Hotel’s common law trademark infringement claim.

The court then turned to Choice Hotel’s requested relief. The court granted a permanent injunction, finding that Choice Hotels suffered an irreparable injury, the remedies available at law were inadequate, the balance of hardships favored Choice Hotels, and the public interest would not be disserved by the injunction. As to the requested damages of almost $2.5 million in infringer profit damages plus over $200,000 in actual damages (trebled to in excess of $600,000), the court requested supplemental briefing from Choice Hotels due to the large amounts being sought. Finally, with respect to the requested attorneys’ fees, the court found that because the defendants admitted Choice Hotels’ material allegations during discovery, litigated the case in an unreasonable manner, and essentially abandoned their defense, that this was an exceptional case justifying an award of attorneys’ fees and directed Choice Hotels to submit a lodestar petition.


The U.S. District Court for the Northern District of Illinois denied plaintiff franchisee H Guys LLC’s motion to enjoin the termination of its franchise agreement with The Halal Guys Franchise, Inc. (THG).

THG is in the business of selling franchises for the operation of restaurants that primarily serve chicken and gyro over rice. Plaintiff H Guys LLC (plaintiff) operated two Halal Guys restaurants in Chicago and was the first THG franchisee outside of New York. In addition to operating its two franchises, plaintiff owned the exclusive rights to operate Halal Guys restaurants in some of the “most valuable and desirable” areas in Chicago.

Shortly after opening in 2016 and 2017, THG became concerned about improperly handled food and sanitation issues at plaintiff’s restaurants. In
April 2018, THG’s then Director of Franchise Operations sent an email to several of THG’s executives detailing problems at plaintiff’s restaurants with food handling, cleanliness, food safety, and the temperature of food storage devices. Also in 2018, plaintiff’s restaurants failed two inspections by the Chicago Department of Public Health.

In March 2019, THG’s new Director of Franchise Operations sent an email to plaintiff expressing concerns about the sanitary conditions and safety of plaintiff’s restaurants. A detailed inspection report accompanied this email.

In May 2019, THG conducted an audit of plaintiff’s restaurants, which identified a number of problems, including improper cooler and food warmer temperatures, inadequate and undated labels on food containers, expired food, and overall cleanliness issues. THG sent a letter and pictures to plaintiff regarding the conditions. The letter also cited the contract provisions that THG alleged plaintiff had violated and advised that the conditions must be remedied or the franchise agreements would be terminated.

In July 2019, THG again audited plaintiff’s restaurants. The problems had not been remedied and in some instances had worsened. Photographs confirmed the conditions. On July 19, 2019, THG conducted a follow-up inspection, which revealed that the conditions identified in the prior audits had not been remedied. As a result, on July 19, THG sent a notice of termination to plaintiff based on repeated material defaults of the franchise agreement.

The day after the notice of termination was served, one of plaintiff’s executives (Chong) and THG’s former Director of Franchise Operations (Wilson) had a text conversation in which Wilson allegedly told Chong that THG’s CEO and Chief Development Officer disliked plaintiff’s principals, that the THG auditors should “go hard” on plaintiff’s restaurants to push plaintiff out of the system, and that THG treated plaintiff worse than other franchisees.

Several days after the notice of termination was served, THG stopped shipment of food and supplies to plaintiff.

Plaintiff filed suit against THG alleging claims for breach of contract, breach of the implied covenant of good faith and fair dealing, and violations of the Illinois Franchise Disclosure Act (the Act) by terminating the franchise agreement without good cause. Plaintiff asserted that the termination was “pretextual” because THG wanted to re-sell the rights to plaintiff’s territory and was further motivated by personal “animus.” THG argued the termination was based on repeated violations of the franchise agreement (principally food safety issues), as well plaintiff’s operation of a Tea Ninja stand in one of the restaurants.

The court first reviewed the two-step analysis applicable in the Seventh Circuit to determine whether a temporary restraining order (or preliminary injunction) is warranted: the moving party must first make a threshold showing that (1) it will suffer irreparable harm absent the requested
injunctive relief; (2) there is no adequate remedy at law; and (3) there is a reasonable likelihood of success on the merits (“more than a negligible chance of succeeding on the merits”). If the moving party makes this showing, the court then considers (4) the irreparable harm the moving party will suffer if the injunction is “wrongfully denied,” versus the harm to the nonmoving party if it is “wrongfully granted”; and (5) whether the grant or denial of the requested relief would have any effect on third parties. The court balances the potential harms on a sliding scale against the moving party’s likelihood of success. Thus, the greater its likelihood of success, the less strong a showing the moving party must make that the balance of harms is in its favor.

The court started its analysis with the likelihood of success on the merits factor, addressing each of plaintiff’s claims at length.

With respect to plaintiff’s claim under the Act, the court concluded that it was unlikely plaintiff could prove the termination was without good cause because there were multiple detailed inspection reports and photographs confirming serious “violations of sanitation and food safety standards.” The court found that this was “strong” evidence the termination was with good cause because it was likely the franchisee has repeatedly fail[ed] to comply with the lawful provisions of the franchise or other agreement.” The court rejected plaintiff’s argument discounting some of the food safety issues raised in the May 2019 letter because no evidence addressed the food safety issues raised in the July 2019 letter. The court was similarly unimpressed with plaintiff’s claim that the termination was pretextual, noting that the texts were not made under oath and were made by a former employee. Finally, the court found that it was possible THG did not “like” plaintiff, but still had good cause to terminate the parties’ agreement.

The court also found that it was unlikely plaintiff would prevail on its breach of the implied covenant of good faith and fair dealing claims. The court concluded that, although plaintiff may have a reasonable expectation, THG would not unilaterally terminate the franchise agreement; that would only be the case if plaintiffs were in compliance with the agreements. The court rejected plaintiff’s theory that the termination was defective because the notice of termination was sent to an address different than the one set forth in the franchise agreement, noting that the notice was sent to the address plaintiff had requested for correspondence and a courtesy copy had been sent to plaintiff’s counsel. The court similarly dismissed plaintiff’s claim that the notice of termination would not be effective for five days and was an invitation to discuss the letter, which was “subverted” when THG cut off plaintiff’s access to food and supplies before the five days had run, finding that the termination was immediate and the language relied on by plaintiff “did not walk back the entirety of the preceding six pages” of the termination notice.

The court next addressed whether plaintiff has an adequate remedy at law such that injunctive relief was not necessary. Although the court noted
that the termination may “inflict serious or even terminal harm” to plaintiff’s restaurant operations, the court found that this did not mean there was no adequate remedy at law. The court concluded that plaintiff’s investment in the restaurants (claimed to be approximately $1.4 million), the value of the business and the profit from the business were “measurable with a reasonable degree of precision” and, therefore, this factor tilted in THG’s favor.

The court then turned to the irreparable harm factor. Plaintiff’s argument focused on its financial harm and the harm to the continued operation of its restaurants. THG focused on potential harm to its customers and its goodwill, citing alleged negative customer experiences. Plaintiff responded by citing to positive customers reviews from an online platform. Although the court considered the customer issues, it gave them little weight because they were unsworn statements from parties whose identity the court could not confirm. In balancing the harm, the court concluded that this factor leaned slightly in plaintiff’s favor.

Finally, the court considered the effect on nonparties and the public interest factor. The court found that the public has an interest in parties “abiding by their contracts” and in franchisors and franchisees “treating each other fairly within the bounds of the agreement.” However, the court concluded that it did not have enough evidence to “referee” the dispute whether THG terminated plaintiff out of spite as plaintiff claimed or because of health and safety concerns regarding plaintiff’s restaurants as TDG claimed. Notwithstanding, the court found that the public interest balance tilted slightly in THG’s favor to the approximate same degree the balance of harms tilted in plaintiff’s favor.

Accordingly, the court denied plaintiff’s motion for a temporary restraining order and directed, among other things, plaintiff to advise if it wanted to pursue a preliminary injunction and, if so, whether any expedited discovery was necessary.


In this case, the U.S. District Court for the Southern District of New York granted in part plaintiffs’ motion for injunctive relief, holding that defendant Pawanmeet Sawhney’s (Sawhney) continued use of plaintiffs’ trademarks and service marks after the termination of their franchise agreement violated the agreement.

Plaintiffs Liberty Tax Service and Siemptretax+ LLC (collectively, Liberty) are franchisors of an income tax preparation service with locations throughout the United States. Sawhney entered into a franchise agreement with Liberty to operate a tax preparation service in New York City. The agreement included a noncompetition clause pursuant to which Sawhney agreed that upon termination of the agreement, Sawhney would not compete with Liberty within twenty-five miles of Sawhney's former franchise location and would immediately stop using any marks, associated fixtures,
and assets unique to Liberty. The agreement also included a Virginia choice of law provision.

After Sawhney's franchise agreement was terminated, Liberty alleged that Sawhney failed to comply with its post-termination obligations, namely that it would refrain from using Liberty's marks, not employ Liberty's former employees after the termination of the agreement, and stop operating as a Liberty branded franchise. As a result, Liberty filed suit and sought a temporary restraining order and preliminary injunction. At the time Liberty's motion was heard, Sawhney had not responded or otherwise appeared in the action.

The court started by conducting a choice of law analysis, ultimately determining that because Liberty's principal place of business was in Virginia and because New York courts will generally enforce a choice of law clause so long as the chosen law “bears a reasonable relationship” to the parties or to the transaction, Virginia law governed the breach of contract analysis.

In considering the merits of Liberty's motion, the counter analyzed each of the traditional preliminary injunction factors: (1) whether the moving party is likely to succeed on the merits; (2) whether the moving party is likely to suffer irreparable harm in the absence of preliminary relief; (3) whether the balance of equities tips in the moving party's favor; and (4) whether an injunction is in the public interest.

The court concluded that Liberty had made the requisite showing entitling it to injunctive relief. The court agreed that Sawhney's breach of his post-termination obligations, including the continued use of Liberty's marks, caused irreparable harm to Liberty's goodwill, reputation, and relationships with customers. However, the court found that Liberty had failed to demonstrate a likelihood of irreparable harm if Sawhney were to continue offering tax preparation services without using any of the marks or identifying features of Liberty's business, so long as Sawhney operated its business from a different location. Therefore, the court concluded there was no risk based upon the speculation that Sawhney may violate the franchise agreement's noncompetition provisions by operating from another business location without using the Liberty's marks or branding. Accordingly, the court granted the injunctive relief, in part, and ordered Sawhney to, among other things, return all confidential information to Liberty and cease holding himself out to the public as a current or former franchisee of Liberty.


The U.S. District Court for the Eastern District of Michigan denied a motion to stay enforcement of preliminary injunctions pending appeal to the Sixth Circuit. Plaintiffs Little Caesar Enterprises, Inc. and LC Trademarks, Inc. (collectively, Little Caesar) sought and obtained injunctions enjoining
former Little Caesar franchisees from continuing to operate their Little Caesar restaurants, infringing on the Little Caesar trademarks, and violating various post-termination provisions of the parties’ franchise agreement.

As an initial matter, the court reviewed the relevant legal standards. First, a preliminary injunction order is subject to an abuse-of-discretion standard and will only be overturned if “the court relied upon clearly erroneous findings of fact, improperly applied the governing law, or used an erroneous legal standard.” And, second, the factors to consider in addressing a motion to stay a preliminary injunction are essentially the same factors considered when deciding whether to grant the requested injunctive relief: “(1) the likelihood that the party seeking the stay will prevail on the merits of the appeal; (2) the likelihood that the moving party will be irreparably harmed absent a stay; (3) the prospect that others will be harmed if the court grants the stay; and (4) the public interest in granting the stay.”

The court first addressed the likelihood of success on appeal factor, holding that defendants failed to advance any new legal or factual arguments, but rather repeated the arguments they previously made in opposition to the Little Caesar’s motion for injunctive relief, including that the termination of the franchise agreement was retaliatory and “motivated by national-origin discrimination.” The court found that the evidence in support these allegations was “not strong,” and defendants failed to rebut “compelling evidence” that they breached the franchise agreement, warranting the termination.

With respect to the irreparable harm factor, the court found that although defendants “may experience financial hardship” as a result of being prohibited from operating their Little Caesar restaurants pending a trial, the harm was not irreparable because it was “readily compensable by monetary damages.”

The court next addressed the harm to other factors, noting that it previously found that Little Caesar would suffer irreparable harm if injunctive relief was not granted. The court held that, in the Sixth Circuit, the likelihood of confusion or potential reputational damages flowing from trademark infringement constitutes irreparable injury. The court also noted that, because defendants were no longer making payments to Little Caesar and were failing to comply with other unspecified post-termination requirements, staying the preliminary injunction would harm Little Caesar.

Finally, the court found that staying the preliminary injunction would not benefit the public interest because the public interest is served in protecting a trademark owner’s “property interests in marks” and preventing the customer confusion that could occur where a former franchisee continues to hold itself out as an authorized franchisee.

This case is discussed under the topic heading “Breach of Contract.”
JURISDICTION


In this case, the U.S. District Court for the District of Arizona denied defendants’ motion to dismiss Best Western International Inc.’s (Best Western) complaint asserting multiple causes of action related to the termination of a Best Western membership agreement (Membership Agreement).

Best Western is a non-profit corporation that serves its members, who own and operate Best Western branded hotels. Defendants Twin City Lodging, LLC and Percy Pooniwalala entered into a Membership Agreement to operate a Best Western Hotel in Minnesota. The following year, defendant Santha Kondatha signed an application agreeing to be bound by the Membership Agreement in exchange for becoming a voting member of the Best Western organization. Best Western terminated the Membership Agreement in 2018 due to defendants’ alleged failure to comply with unspecified regulatory documents.

Best Western subsequently filed suit against defendants, alleging that defendants continued to use Best Western signage, Internet advertising, and other branded items after the termination. Defendants responded by filing a motion to dismiss on the grounds that Best Western's complaint failed to state plausible claims (Federal Rule of Civil Procedure 12(b)(6)) and the court lacked personal jurisdiction (Federal Rule of Civil Procedure 12(b)(2)).

Defendants argued that the complaint failed to state a viable claim against defendant Kondatha because there was no allegation that he received “any consideration for agreeing to the Membership Agreement” and, therefore, Best Western's breach of contract claim against Kondatha was not plausible. In response, Best Western argued the complaint alleged that Kondatha received consideration as a result of becoming a voting member after signing the Membership Agreement.

The court began its analysis by noting that, under Arizona law, “every contract in writing imports consideration” and that consideration need not be specifically pleaded when a claim is based upon an “instrument which as a matter of law imports a consideration.” Because it was undisputed that the Membership Agreement and the Kondatha’s application to be bound by the Membership Agreement were contracts made in writing, the court held that consideration was imported and therefore did not need to be specifically alleged. Accordingly defendants’ motion on this ground was denied.

Defendants also argued that the complaint should be dismissed because Best Western had failed to comply with disclosure requirements set forth in the Minnesota Franchise Act (the Act) when “selling the franchise” and, therefore, the Membership Agreement was unenforceable. Best Western argued that it was not a franchisor and, therefore, was not subject to the Act’s disclosure requirements. The court, in analyzing the relevant facts in the light most favorable to Best Western for purposes of the motion, found that
Best Western was not a franchisor as the complaint alleged that Best Western is a nonprofit corporation and does not identify itself as a franchisor or defendants as franchisees. Further, the Membership Agreement describes Best Western as a “membership organization.” Accordingly, after holding that the Act only applies to franchisors and franchisees, the court rejected defendants’ argument.

The court then turned to defendants’ argument that the court lacked personal jurisdiction because Best Western could not establish the defendants (1) “maintained 'continuous corporate operations’” in Arizona, and (2) “had any business in Arizona or had any purposeful activities” in the state. Best Western argued that the Membership Agreement included provisions requiring that any disputes arising under the Membership Agreement were to be resolved in Arizona under Arizona law. The court noted that an agreed-to forum selection clause may result in a waiver of any objections to personal jurisdiction and that defendants did not contend that the forum selection clause in the Membership Agreement was invalid. For these reasons, and because it was required to view the facts in the light most favorable to Best Western, the court found that defendants had submitted to personal jurisdiction in Arizona.

LABOR AND EMPLOYMENT


The U.S. District Court for the Northern District of Illinois granted in part and denied in part McDonald’s USA, LLC and McDonald’s Corporation’s (collectively, McDonald’s) motion for a protective order with respect to employee data and denied McDonald’s motion to compel plaintiffs to produce documents withheld on the basis of attorney-client privilege.

Leinani Deslandes (Deslandes), a then employee of a McDonald’s franchise in Florida, sought a higher paying position at a corporate-owned McDonald’s restaurant, but was unable to secure the position because her current employer refused to “release her” based on the non-solicitation provision in the franchise agreement.

The lawsuit challenged the non-solicitation provision in the McDonald’s franchise agreement that prohibited the franchisee-owned restaurant and the corporate-owned restaurant Deslandes was seeking to work at from hiring each other’s employees. Deslandes brought an action on behalf of herself and a purported nationwide class.

Deslandes sought discovery of (1) employee data from McDonald’s Lawson database (Lawson Data), (2) documents from McDonald’s custodians across the country and all divisions of the company (Custodian Data), and (3) employment data from five payroll companies that McDonald’s franchisees used (Third Party Subpoena Data). McDonald’s challenged the scope of these discovery requests.
With respect to the Lawson data, Deslandes sought to discover nationwide data regarding millions of employees. The court held that the discovery should be limited, and the extent of the Lawson Data to be released was to be determined after consultations with experts regarding a geographically diverse sampling. With respect to the Custodian Data, the court found that, although Deslandes was entitled to this data, the scope of what was to be produced must be narrowed, and the parties’ experts were in a better position than the court to determine the appropriate sampling methodology. McDonald’s motion to quash the Third Party Subpoena was denied. The court noted that parties generally do not have standing to quash a subpoena to a non-party and found that McDonald’s had not sufficiently established a potential interference with business relationships with respect to this data sufficient to except itself from the general rule.

The court denied McDonald’s motion to compel the production of two documents that Deslandes withheld on the basis of the attorney-client privilege. The documents in issue were questionnaire responses that Deslandes submitted online in response to an advertisement from a law firm. After submitting her responses to the questionnaires, Deslandes met with the law firm. The questionnaire responses were reviewed by attorneys and support staff at the law firm, as well as the marketing company that helped the law firm create the online questionnaires. McDonald’s argued that because a third party (the marketing company) saw the questionnaire responses, the attorney-client privilege was not applicable. Although statements made to lawyers in the presence of third parties are generally not privileged, there is an exception where a third party is present to assist the attorney in rendering legal services. The court found that other courts in the district have generally found that the privilege was applicable if the person completing the questionnaire was seeking legal device. The court agreed and, therefore, denied McDonald’s motion to compel.


In this case, the U.S. District Court for the Southern District of New York granted Bimbo Goods Bakeries Distribution, LLC’s (BGBD) motion for summary judgment after determining that plaintiffs, former delivery drivers for BGBD, were properly classified as independent contractors and not employees under the Fair Labor Standards Act (FLSA) and New York Labor Law.

Nicholas Franze and George Schrufer (Plaintiffs) worked for BGBD, delivering baked goods. Both Plaintiffs signed distribution agreements, which stated that they were independent contractors. During his nearly twenty-one years as a driver, Schrufer was deemed an “independent operator.” In his capacity as an independent operator, Schrufer bought distribution rights from independent operators and sold distribution rights to others, which resulted in changes to the scope of his territory. Franze, also designated as an “independent operator,” purchased his distribution rights
from another independent operator. Neither Plaintiff received any benefits from BGBD or W2s or 1099s, and both paid for various items and expenses associated with their distributorships. Plaintiffs also had no fixed hours, except for a set time when they could access BGBD’s depot to purchase and pick up products, had no control over product quantities or prices with institutional customers, and received no mandatory training or policies regarding how to meet their contractual obligations.

The court first analyzed whether Plaintiffs were properly characterized as “employees” or “independent contractors” under FLSA. In undertaking this analysis, the court considered various factors derived from case law, including (1) the degree of control BGBD exerted over Plaintiffs; (2) Plaintiffs’ opportunity for profit or loss; (3) the degree of skill and independent initiative required to perform the work; (4) the performance or the duration of the working relationship with regards to which party controlled the term and permanency of the relationship; and (5) the extent to which the work was an integral part of BGBD’s business. The court found in BGBD’s favor with respect to each of these factors.

With respect to the first factor, the court found that BGBD did not control the Plaintiffs “closely and directly” enough to render the relationship an employee-employer relationship because Plaintiffs controlled the size and scope of their territories and the distribution agreements did not provide BGBD with control over the manner or means by which Plaintiffs were to achieve their distribution targets. As to the fifth factor, the court found that, although Plaintiffs’ work as delivery drivers of baked goods was important, it was only a small piece of the BGBD’s business, which was more about product manufacturing than the delivery of the product.

The court did not conduct a separate analysis under New York Labor Law to determine whether Plaintiffs were independent contractors or employees, holding that the relevant factors are similar to the factors under FLSA.

Accordingly, the court granted the BGBD’s motion for summary judgment and dismissed Plaintiffs’ claims.

The U.S. District Court for the Northern District of Illinois found that a 7-Eleven franchisee in Illinois was unable to state a valid claim against 7-Eleven for violations of the Illinois Wage Payment and Collection Act (IWPCA) for allegedly taking improper deductions from his “wages.”

Plaintiff Nira Patel owned and operated a franchised 7-Eleven store through a corporation, Shanti 11, of which he was the sole owner. Despite the franchise agreement between 7-Eleven and Shanti 11, Patel argued that he was nothing more than a glorified manager for 7-Eleven and should thus be afforded the protections of the IWPCA.

Patel argued that 7-Eleven controlled his working hours, store workers’ uniforms, the types of payment that his store could accept from customers,
the payroll system, the issuance of paychecks to store employees, and even the temperature of the store. In addition, Patel argued that he was required to deposit daily revenues into a bank account controlled by 7-Eleven, from which 7-Eleven would in turn deduct amounts owed to it for franchise fees, advertising fees, store maintenance, and payroll taxes for the store’s employees, before allowing Patel to withdraw his share of the store’s profits.

Patel alleged that the profits he received from the store account through his withdrawals constituted wages paid from 7-Eleven. According to Patel, the proof of this was the fact that 7-Eleven controlled the account.

In response, 7-Eleven asserted that Patel failed to adequately plead a claim under the IWCPA because he did not assert the existence of an agreement by 7-Eleven to pay wages to Patel. 7-Eleven made two arguments in this regard. First, there was no agreement to pay Patel if his store was not generating any revenue and, second, the franchise agreement was between 7-Eleven and Patel’s corporation, Shanti 11, but the IWCPA only provides remedies to individuals.

The court recognized that to plead a claim under the IWCPA, a plaintiff must allege that compensation is due to an employee from an employer under an employment contract or agreement. The IWCPA does not create any new rights or obligations; it merely provides a means for enforcing an existing employment contract or agreement, the court explained.

In analyzing whether 7-Eleven had agreed to pay Patel wages, the court cited the Seventh Circuit’s decision in *Enger v. Chicago Carriage Cab Corp.*, 812 F.3d 565 (7th Cir. 2016). In *Enger*, plaintiff taxi drivers argued that because the taxi company collected fares from passengers through its fare processing system, and then used those fares to in turn pay drivers, the drivers were in fact being paid wages as employees of the taxi company. The Seventh Circuit disagreed, concluding that the obligation to pay the drivers arose in the first instance from the passengers and not the taxi company. In other words, if no passengers hired the taxi drivers’ services, there would be no payments to the taxi company and, consequently, no payments from the taxi company to the drivers.

In this case, the court determined that the same reasoning should apply. If no customers made purchases from Patel’s 7-Eleven store, there would be nothing for Patel to withdraw from the store’s account. In fact, Patel’s franchise agreement with 7-Eleven contained a default weekly draw amount of $0.00, which the court found to be supportive of its reliance on *Enger*.

Patel further argued that 7–Eleven controlled his entire payroll system, that employees of the store entered hours on 7–Eleven’s system, and that 7–Eleven calculated payroll and issued checks directly to the store’s employees. But Patel failed to allege a connection between this system and his own compensation, so the court again cited *Enger* in concluding that these payments do not constitute an agreement by 7–Eleven to pay wages to Patel.

The court acknowledged that it was not aware of any law creating a hard-and-fast rule that prohibits a franchisee corporation’s sole owner from qualifying as
an employee of the franchisor under the IWPCA. It therefore invited Patel to
amend his complaint to plead either that his corporation is a sham, and should
thus be disregarded, or that he has an employment agreement with 7-Eleven
that is distinct from Shanti 11’s franchise agreement with 7-Eleven.

Co-author Matthew Gruenberg’s law firm DLA Piper LLP represented
7-Eleven in this case.

STATE DISCLOSURE/REGISTRATION LAWS

Best Western International Inc. v. Twin City Lodging, LLC, Bus. Franchise
The U.S. District Court for the District of Arizona granted in part and
denied in part a motion to dismiss counterclaims by a franchisee alleging
violations of the Minnesota Franchise Act (MFA), breach of the covenant of
good faith and fair dealing, and breach of contract.

Defendant Twin City Lodging, LLC (Twin City) entered into a mem-
bership agreement with plaintiff Best Western Hotel International Inc.
(Best Western) pursuant to which it acquired a license to operate a hotel in
Minnesota under the Best Western brand. Best Western subsequently ter-
minated the agreement and filed a complaint in the U.S. District Court for
the District of Arizona against Twin City, asserting various claims, including
breach of contract and trademark infringement. Twin City filed counter-
claims against Best Western, alleging violations of the Minnesota Franchise
Act (MFA), breach of the covenant of good faith and fair dealing, and breach
of contract. In response, Best Western filed a motion to dismiss Twin City’s
counterclaims.

The court granted in part and denied in part Best Western’s motion. Twin
City alleged that Best Western violated the MFA by (1) failing to register
the franchise under the MFA; (2) terminating the membership agreement
without providing Twin City with their reasons for termination ninety days
in advance and without good cause, and (3) for discriminating against Twin
City’s franchise. Based on the facts before it, the court denied the motion as
to the failure to register and termination claims, noting that the complaint
alleged facts plausibly establishing each of the elements of a franchise under
the MFA and, further, that Best Western had failed to register and had indis-
putably terminated the relationship with less than the statutorily required
advance written notice. The court granted the motion to dismiss for violat-
ing the MFA as to the discrimination claim, noting that the complaint was
devoid of any allegations that the franchisor arbitrarily treated the franchi-
see differently from other franchisees. Instead, the complaint only noted, in
conclusory fashion, that plaintiff was treated differently from other franchi-
sees. With respect to Twin City’s claims for breach of the covenant of good
faith and fair dealing and breach of contract, the court denied Best Western’s
motion, finding Twin City had alleged facts sufficient to state a claim under
these causes of action.
This case is discussed under the topic heading “Breach of Contract.”

This case is discussed under the topic heading “Transfer.”

TERMINATION AND NONRENEWAL

This case is discussed under the topic heading “Remedies, Damages, and Injunctive Relief.”

The U.S. District Court for the District of New Jersey granted plaintiff Howard Johnson International, Inc’s (HJII) motion for summary judgment on its claims against the defendant franchisee and the franchisee’s principals.

HJII entered into a franchise agreement with defendant Manomay, LLC (Manomay), granting Manomay the right to operate a Howard Johnson facility in Florida. At the same time, the individual defendants (collectively, the Patels) executed a guaranty of Manomay’s obligations under the franchise agreement. Pursuant to the parties’ agreement, Manomay was required to make various recurring payments (Recurring Fees), and HJII had the right to terminate the agreement in the event Manomay failed to perform its contractual obligations, as well as seek liquidated damages, attorneys’ fees, and costs in such event. Section 18.4 of the agreement also provided that either party had the right to terminate, so long as the party seeking to terminate the agreement was current on its financial obligations as of the date of the notice of termination and the effective date of the termination.

In late 2014, Manomay sent a letter of termination to HJII pursuant to Section 18.4 of the agreement. However, at the time of this letter, Manomay was in arrears on its Recurring Fees. HJII advised Manomay of this undisputed fact, that the failure to pay Recurring Fees was a breach of the parties’ agreement, and that the agreement could be terminated in the event Manomay did not pay the amounts owed.

Over the next eighteen months, Manomay repeatedly failed to pay the amounts owed, and HJII sent numerous letters regarding the defaults, warning that the franchise agreement could be terminated in the event that the outstanding Recurring Fees were not paid. HJII ultimately terminated the agreement and demanded that Manomay perform its post-termination obligations, cease using the HJIII trademarks, and pay the Recurring Fees owed through the date of termination and liquidated damages.
Manomay failed to make the demanded payments and continued to use exterior signage bearing HJII’s registered trademarks. As a result, HJII filed suit asserting claims for breach of the franchise agreement and guaranty, as well as for violations of the Lanham Act. HJII sought to recover the unpaid Recurring Fees, liquidated damages, interest, attorneys’ fees, and costs.

The court first addressed defendants’ argument that Manomay had terminated the franchise agreement pursuant to the letter it sent in late 2014 purporting to exercise its termination rights under Section 18.4 of the agreement. The court found that Section 18.4 was unambiguous and that Manomay’s attempted termination of the agreement failed because it was not current on its Recurring Fees as of the date that Manomay sent the letter of termination. Accordingly, the court held that the franchise agreement remained in effect until it was terminated by HJII.

The court also found that Manomay’s financial obligations under the franchise agreement were clear. And, because it was undisputed that Manomay had failed to make the payments required by the franchise agreement, the court held there was not triable issues as to Manomay’s breach of the agreement and, therefore, granted summary judgment on various of HJII’s claims.

The court then turned to the question of whether HJII was entitled to summary judgment on its claims for Recurring Fees, liquidated damages, attorneys’ fees, and costs, plus interest as applicable. HJII’s claim sought to recover almost $90,000 in liquidated damages and approximately $41,000 in interest. The court found that the formula for calculating liquidated damages set forth in the franchise agreement reasonably forecast the harm HJII would suffer as a result of the early termination of the agreement and, therefore, awarded HJII the amount requested. The court also awarded the requested prejudgment interest, which was calculated at the contractually agreed-upon rate of 1.5% per month. The court further awarded HJII almost $400,000 in Recurring Fees after deducting a small amount of “de-identification” charges and other amounts that were incurred after the franchise agreement was terminated and, therefore, were not recoverable. Finally, the court also awarded HJII attorneys’ fees and costs in the amount of $10,681.

The court next addressed HJII’s claim for breach of the guaranty, finding that the guaranty was unambiguous and that it was undisputed that the Patels had not paid the amounts owed by its terms. Accordingly, the court also granted summary judgment on this claim.

**TORTIOUS INTERFERENCE**


This case is discussed under the topic heading “Antitrust and Pricing.”
TRANSFERS


On interlocutory appeal, the Supreme Court of Mississippi found that a manufacturer violated the Mississippi Beer Industry Fair Dealing Act (BIFDA) by “interfering” with a transfer of a wholesaler’s business when it exercised its contractual right to redirect the sale and that the Act rendered the underlying contractual provision void.

Rex Distributing Company (Rex) was the exclusive, long-standing wholesale distributor for Anheuser-Busch, LLC (Anheuser-Busch) along a stretch of the Mississippi Gulf Coast. Rex and Anheuser-Busch were parties to a distribution agreement that granted Anheuser-Busch (1) a right of first refusal “at the price and on the terms and conditions applicable” if Rex were to sell or transfer its business, and (2) the right to assign that right to a third party (Match and Redirect).

Rex attempted to sell its business to another distributor. Under that sales contract, the “price would be determined by each individual distribution contract Rex successfully transferred.” Two days before this sale was set to close, Anheuser-Busch stepped in and elected to exercise its right to Match and Redirect. Anheuser-Busch then assigned its right to Mitchell Distributing Company, Inc. (Mitchell), which Rex contended was a “reward” for Mitchell and meant to “punish” Rex because, if any manufacturers with which Rex had a distribution agreement refused to allow a transfer of Rex’s distribution rights, Rex would receive a lower sale price.

Anheuser-Busch had recently tried to convince its distributors to refuse to sell beer for its competitor (Yuengling). Mitchell was the only distributor that agreed to not distribute products for Yuengling. Rex, on the other hand, had a distribution contract with Yuengling. Therefore, upon learning that Mitchell was purchasing Rex’s business, Yuengling refused to transfer its distribution rights to Mitchell, which cost Rex $3.1 million.

The lower court dismissed Rex’s claims against Anheuser-Busch and Mitchell for common-law tortious interference and civil conspiracy. It also dismissed Rex’s claim against Anheuser-Busch for violating the BIFDA and for breach of contract. The Mississippi Supreme Court granted Rex’s petition for interlocutory appeal from the lower court’s dismissal of these claims.

On appeal, the court first addressed Rex’s BIFDA claims. BIFDA states that a supplier “shall not interfere with, prevent or unreasonably delay the transfer of the wholesaler’s business.” BIFDA also states that “[a] wholesaler may not waive any of the rights granted in any provision of this chapter and the provisions of any agreement which would have such an effect shall be null and void.”

Based on these provisions, Rex alleged that the Match and Redirect right was void and that Anheuser-Busch “prevented” or “interfered with” the sale of Rex’s business. Anheuser-Busch argued that there was no violation of
BIFDA because, despite that fact that the sale was completed with a different party, the transfer did in fact occur. Siding with Rex, the court found that by exercising its Match and Redirect right, Anheuser-Busch “‘interfered’ with the proposed transfer.” Given that the purpose of BIFDA is to “maintain stability and healthy competition in the . . . beer industry,” the court concluded that “[a]llowing a manufacturer to choose the owners of its wholesalers in perpetuity would undermine the statutory separation of the beer industry into three tiers”: manufacturers, distributors, and retailers. Therefore, the court reversed the lower court’s dismissal of Rex’s BIFDA claim.

Next, the court addressed Rex’s breach of contract claim. Rex contended that, under the terms of his distribution agreement, Anheuser-Busch was required to ensure Rex received the same amount Rex would have received from the sale with the disapproved purchaser. Noting that it was unclear whether BIFDA voids Anheuser-Busch’s obligation to pay for the transfer of rights, the court affirmed the lower court’s dismissal of Rex’s breach of contract claim. However, the court indicated that the same price provision only applies to disapproved transfers and pointed out that a separate price formula relates to the Match and Redirect provision.

The court next considered Rex’s claims against Mitchell. In a line of unsuccessful arguments, Mitchell contended that it could not be liable to Rex for tortious interference because Rex did not allege that any act by Mitchell constituted interference. The court disagreed because the complaint alleged that both Mitchell and Anheuser-Busch interfered, and, while the specific acts may be attributed to Anheuser-Busch, Rex argued Mitchell was a joint tortfeasor and, therefore, liable for Anheuser-Busch’s actions. After rejecting the remainder of Mitchell’s arguments, the court concluded that the lower court erred in dismissing Rex’s tortious interference claim against Mitchell. Last, rejecting Mitchell’s arguments that there was no underlying tort, and that civil conspiracy required an overt act, the court reversed the dismissal of Rex’s civil conspiracy claim against Mitchell.


This case arises out of a dispute between Tavarua Restaurants, Inc., Scarab, Inc., and Carole Casale (collectively, Plaintiffs) and McDonald’s USA, LLC (McDonald’s) regarding a proposed sale of eight McDonald’s franchises in San Diego. The U.S. District Court for the Southern District of California granted McDonald’s motion for judgment on the pleadings as to its claim for a declaratory judgment that it validly invoked and exercised its right to purchase the restaurants for the price set forth in the purchase and sale agreement (PSA).

The proposed transaction was structured as a purchase and sale of stock in two privately held corporations that owned the McDonald’s restaurants. The corporations were owned by a trust established by Robin Sedar (Sedar). Sedar selected a friend, John Cook (Cook), to be the next owner of the
restaurants. Upon Sedar’s death, the trustee, Carole Casale (Casale), negotiated the PSA with Cook to purchase the stock, assume ownership of the restaurants, and purchase an office and storage facility that was unrelated to the restaurants.

The franchise agreements required that Casale obtain McDonald’s written consent prior to completing the purchase and sale. The agreements also provided McDonald’s with a right of first refusal, which McDonald’s chose to exercise. However, because McDonald’s refused to purchase any assets of the corporations unrelated to the restaurant franchises (including the office and storage facility), Casale rejected McDonald’s attempt to acquire the restaurants.

Plaintiffs filed suit seeking a declaratory judgment that McDonald’s failed to validly exercise its right of first refusal under the franchise agreements. McDonald’s counterclaimed, seeking a declaratory judgment that it validly invoked and exercised its right to purchase the restaurants for the purchase price set forth in the PSA. McDonald’s argued that the language of the provision that governs its right of first refusal did not encompass and was not contingent upon the purchase, sale, or transfer of any assets unrelated to the restaurant franchises. The court agreed, holding that McDonald’s validly exercised its option to purchase the restaurant franchises at the purchase price set forth in the PSA and was not required to purchase assets unrelated to the restaurants.