American Bar Association
35th Annual Forum on Franchising

THERE IS NO SUCH THING AS BOILERPLATE!

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October 3 – 5, 2012
Los Angeles, CA

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There Is No Such Thing As Boilerplate!

The standard-form provisions of a franchise agreement are often overlooked, unless and until they become the subject of dispute. This session will identify standard contract provisions that are most frequently disputed and discuss the lessons learned from the case law where such provisions have been at issue. These include provisions relating to contract modifications, class action waivers, disclaimers, integration, forum selection, contractual statutes of limitation, governing law, and clauses attempting to require neutral interpretation of the franchise agreement. They will explain how use of "boilerplate" can sometimes result in unintended consequences.[1]

I. INTRODUCTION

The Supreme Court recently remarked that the "times in which consumer contracts were anything other than adhesive are long past."[2] The prevalence of standard form contracts and their boilerplate filler is something that has been encountered by every modern consumer, whether in regard to a cell phone contract, car insurance contract, or any other multitude of commercial agreements.

The origins of the term "boilerplate" are similar to the origins of the provisions themselves;[3] once an industry (or manufacturer within an industry) began to use certain provisions to create standard contracts, other related industries and manufacturers rapidly mimic the "boilerplate" in their standard contracts.[4] The meteoric rise of contracts of every variety containing pages of boilerplate is well documented in court opinions – as they became more prominent, courts refused to enforce them in new areas. As early as 1910, courts were coming to grips with the unfairness of enforcing insurance policies with pages of boilerplate terms, as it was commonly understood that they were read only by a "very small percentage of policyholders[,]" and they could easily be "veritable traps for the unwary."[5] From there, courts

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[1] The authors thank Eric D. Stolze (Paul Hastings LLP) and Bryan Huntington (Dady & Gardner, P.A.) for their contributions in the preparation of this paper.

[2] *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1750 (2011).

[3] *See,* Carol Bast, *A Short History of Boilerplate*, 5 SCRIBES J. LEGAL WRITING 155 (1996). Late in the 1700's, steam-engines began to be made with iron rather than copper, and these iron plates were called boiler plates; nearly a century later the term boilerplate was used by small-town newspapers to describe news sheet plates sent out by news syndicates, and eventually the term was used to describe the news itself rather than refer to the plates. The term first appeared in a Supreme Court opinion in 1964. *Id.*

[4] For example, the "big three" auto manufacturers in the 1960s used a similar boilerplate provision that disclaimed any warranties were made by the dealer or manufacturer except as provided in the contract. *See Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69, 86-87, 32 N.J. 358, 390 (1960) (internal citations omitted). *Henningsen* explains how it came to be that an auto consumer in the 1960's could not buy a new car without having this provision in his/her contract:

> The form warranty is not only standard with Chrysler but, as mentioned above, it is the uniform warranty of the Automobile Manufacturers Association. Members of the Association are: General Motors, Inc., Ford, Chrysler, Studebaker-Packard, American Motors, (Rambler), Willys Motors, Checker Motors Corp., and International Harvester Company. Of these companies, the "Big Three" (General Motors, Ford, and Chrysler) represented 93.5% of the passenger-car production for 1958.

Id.

[5] *Raulet v. Nw. Nat'l Ins. Co.*, 157 Cal. 213, 107 P. 292 (1910).

wrestled with the negative effects of boilerplate in documents such as bank passbooks,[6] delivery sheets,[7] warehouse receipts,[8] freight bills,[9] an invoice for defective paint,[10] a disclaimer of the implied warranty of merchantability by a car dealer,[11] etc.

Boilerplate language commonly is incorporated in standard form contracts (also known as "contracts of adhesion"), defined by one court as follows:

> The term refers to a standardized contract prepared entirely by one party to the transaction for the acceptance of the other; such a contract, due to the disparity in bargaining power between the draftsman and the second party, must be accepted or rejected by the second party on a 'take it or leave it' basis, without opportunity for bargaining and under such conditions that the 'adherer' cannot obtain the desired product or service save by acquiescing in the form agreement.[12]

Generally boilerplate is used by entities that have strong bargaining power and positions. Frequently, drafters of such contracts have either significant market power, or all of the company's competitors use similar boilerplate provisions.[13] While there are many explanations for the use of boilerplate, perhaps one of the best is that it allows the drafter to have a pre-determined position that it can fall back on in negotiations. The other party may feel that each alteration to the boilerplate is actually a significant concession from the drafter; as phrased by Robert Ahdieh, it "may serve as a focal point from which a counterparty ultimately seeking agreement may be less likely to expect further movement."[14]

To better understand the operation of boilerplate in standard franchise agreements, this article will discuss the most heavily litigated boilerplate provisions, explaining how franchisors use these clauses to their advantage and the methods franchisees have used to resist them.

II. FORUM SELECTION CLAUSES

Over time, parties seeking to contract their way around the cumbersome personal jurisdiction analysis began to incorporate forum selection clauses demonstrating their mutual consent to subject themselves to a particular jurisdiction. The case of *Burger King Corp. v.*

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[6] *Los Angeles Inv. Co. v. Home Sav. Bank*, 180 Cal. 601, 182 P. 392 (1919).

[7] *See Steven v. Fidelity & Cas. Co.*, 27 Cal. Rptr. 172, 377 P.2d 284 (Cal. 1962). This court compiled the list of decisions listed in notes 4-6 and 8-10.

[8] *Wilson v. Crown Transfer & Storage Co.*, 201 Cal. 701, 714, 258 P. 596, 602 (1927).

[9] *McQueen v. Tyler*, 61 Cal. App. 2d 263, 142 P.2d 466 (1943).

[10] *India Paint & Lacquer Co. v. United Steel Prod. Corp.*, 123 Cal. App. 2d 597, 610, 267 P.2d 408, 417 (1954).

[11] *Henningsen*, 32 N.J. 358, 161 A.2d 69.

[12] *Steven*, 27 Cal. Rptr. at 185, 377 P.2d at 296 (citations omitted).

[13] *Henningsen* 32 N.J. 358, 161 A.2d 69 (quoting Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 632 (1943)).

[14] Robert B. Ahdieh, *The Strategy of Boilerplate*, 104 MICH. L. REV. 1062 (2006).

Rudzewicz was the first major decision in a line of franchise cases that recognized such clauses.[15] The Supreme Court upheld a lower court's decision that there was jurisdiction in Florida over a franchisee where Burger King, a Florida corporation with its principal place of business in Miami, entered into a twenty-year franchise agreement with a Michigan resident to operate a franchise in Michigan. The franchisee breached the contract and jurisdiction was established over the franchisee in Florida under Florida's long-arm statute. In its due process analysis, the Court also gave weight to the choice-of-law provisions in the franchise agreement as relevant in questions of personal jurisdiction.[16] The doctrine of *Burger King* was extended in *Bremen v. Zapata Off-Shore Co*.,[17] (forum selection clauses are prima-facie valid),[18] and *Carnival Cruise Lines Inc. v. Shute*, to the point the Court required a "heavy burden" of proof to strike down a forum selection clause.[19]

The principle that forum selection clauses are *prima facie* valid is frequently applied in franchise litigation. Because forum selection clauses establish strong presumptions that the parties have agreed that litigation in the chosen forum is not unfair for either party and that minimum contacts exist in that forum, such clauses facilitate franchisors' ability to force disputes to be litigated (or arbitrated) in their home states. Forum selection clauses also bolster franchisors' ability to avoid franchisee-favorable venues "where [the franchisee] can beguile hometown juries with sympathetic histories of the franchisor's supposedly abusive practices."[20]

A. <u>Permissive Versus Mandatory Language Matters</u>

When drafting forum selection clauses, franchise lawyers should consider carefully the ultimate goal of these provisions. Is the clause meant to secure a designated jurisdiction as the *only* place litigation may be filed? Or, is the clause simply meant to designate a particular locale as an appropriate forum, but not the exclusive forum, where litigation may be filed? Failure to tailor the words of forum selection clauses toward a particular goal can lead to litigation over an issue the franchisor specifically intended to avoid. Whether a clause will be characterized by the courts as a mere consent to jurisdiction (permissive jurisdiction) or a mandatory requirement (mandatory jurisdiction) is key.

[15] 471 U.S. 462, 479-80 (1985) (Noting that forum selection clauses are enforceable as a waiveable right and satisfy the "fair warning" requirement in a jurisdictional due process analysis).

[16] The clause in this case read:

> This Agreement shall become valid when executed and accepted by BKC at Miami, Florida; it shall be deemed made and entered into in the State of Florida and shall be governed and construed under and in accordance with the laws of the State of Florida. The choice of law designation does not require that all suits concerning this Agreement be filed in Florida.

The Court explained that "such a provision standing alone would be insufficient to confer jurisdiction." *Id.* at 482.

[17] 407 U.S. 1 (1972).

[18] *Id.* at 10.

[19] 499 U.S. 585, 594-95 (1991). In the context of this case, the forum selection clause was in a passenger's cruise line ticket. The Court rejected the passenger's claim of inconvenience over litigating in Florida rather than in Washington when there were no factual findings to that effect from the district court.

[20] Edward Wood Dunham et al., *Franchisor Attempts to Control the Dispute Resolution Forum: Why the Federal Arbitration Act Trumps the New Jersey Supreme Court's Decision in Kubis*, 29 RUTGERS L.J. 237, 239–40 (1998).

Agreements often include forum selection clauses such as:

> 1. Any and all causes of action for equitable relief relating to the enforcement of this Agreement may be brought in the [Franchisor's Home Federal and State Courts]; or
>
> 2. The Parties to this Agreement submit to the jurisdiction of the courts located in __________ County, [Franchisor's State], and each agrees not to raise and waives any objection to or defense based on the venue of any such court or *forum non conveniens*.

The drafter of clause number 1, above, might have intended that all potential disputes regarding the Agreement be adjudicated in the [Franchisor's Home Federal and State Courts.] But, because the clause contains permissive language with the term "may," it will not be construed by courts as dictating that a dispute between the parties only can be maintained in the identified forum. Similarly, with clause number 2, by agreeing to "submit to the jurisdiction of the courts located in _________ County, [Franchisor's Home State]" and "waiving any objection to or defense based on the venue of any such court," the drafter has made clear the parties' consent to the jurisdiction of those courts. The drafter has not, however, demonstrated a clear intent to make __________ County the only forum for settling the parties' dispute.

Federal and state courts use a "mandatory/permissive" test, enforcing to the exclusion of otherwise proper jurisdictions only those provisions that unambiguously designate the forum in which the parties must enforce their rights under the contract.[21] To be termed "mandatory," a clause must contain very specific language such that it dictates an exclusive and compulsory forum for litigation under the contract, requiring that all litigation between the parties be conducted in the designated forum and nowhere else. Permissive clauses, such as the two set forth above, contain language which authorizes jurisdiction in a designated forum but does not expressly prohibit litigation elsewhere. As a result, courts generally will not dismiss a suit or transfer an action because of a forum selection clause when the clause is deemed permissive.[22]

Courts have a long history of distinguishing between permissive and mandatory jurisdiction clauses in franchise agreements.[23] The West Virginia Supreme Court discussed this distinction in a matter involving a forum selection clause that contained the language, "[a]ll actions brought in connection with this Agreement *shall* be filed in and decided by the Circuit

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[21] *Citro Florida, Inc. v. Citrovale*, S.A., 760 F.2d 1231, 1232 (11th Cir. 1985); *AmerMed Corp. v. Disetronic Holding Ag*, 6 F. Supp. 2d 1371, 1374 (N.D. Ga. 1998).

[22] *Snapper, Inc. v. Redan*, 171 F.3d 1249, 1262 n.24 (11th Cir. 1999); *see also MAK Mktg., Inc. v. Kalapos*, 620 F. Supp. 2d 295, 303 (D. Conn. 2009); *Travelodge Hotels, Inc. v. Mangat Houston Race Track, LLC*, No. 06-3543, 2007 U.S. Dist. LEXIS 53655 (D.N.J. July 25, 2007) (unpublished) (finding that the forum selection clause is permissive because the franchisee consented to the "non-exclusive" jurisdiction of the New Jersey courts).

[23] *Caperton v. A.T. Massey Coal Co.,* 225 W. Va. 128, 133, 690 S.E.2d 322, 327 (2009) ("The second step requires classification of the clause as mandatory or permissive, i.e., whether the parties are *required* to bring any dispute to the designated forum or are simply *permitted* to do so."); *Eisaman v. Cinema Grill Sys., Inc.*, 87 F. Supp. 2d 446, 449 (D. Md. 1999) ("Prior to conducting the *Bremen* analysis, the court must determine whether the forum-selection clause at issue is mandatory or permissive."); *CQL Original Prods., Inc. v. Nat'l Hockey League Players' Ass'n*, 39 Cal. App. 4th 1347, 1358, 46 Cal. Rptr. 2d 412, 419 (1995) ("Although that case involved an election between either county, that election did not render the forum provision permissive. The forum selection clause here is not ambiguous.").

Court of Buchanan County, Virginia."[24] The court determined that Virginia did have personal jurisdiction based on this provision because the term "shall" designated an exclusive forum for bringing suit.[25] The court explained the state's approach to forum selection clauses:

> [T]he determination of whether a forum-selection clause is mandatory or permissive requires an examination of the particular language contained therein. If jurisdiction is specified with mandatory terms such as "shall,"[28] or exclusive terms such as "sole," "only," or "exclusive," the clause will be enforced as a mandatory forum-selection clause. However, if jurisdiction is not modified by mandatory or exclusive language, the clause will be deemed permissive only.[26]

The following are examples of forum selection clauses that fit the description of mandatory clauses, those that express unambiguously the parties' intention that the designated forum be the only place the action can be maintained regardless of who initiates suit:

> 1. *Governing Law and Forum.* This Agreement and performance hereunder shall be governed by and construed in accordance with the laws of the state of Indiana. Any and all proceedings relating to the subject matter hereof shall be maintained in the courts of the State of Indiana or the Federal District Courts sitting in Indianapolis, Indiana, which courts shall have exclusive jurisdiction for such purposes.[27]
>
> 2. This Agreement, and all modifications or extensions thereof, shall be governed in all respects by the law of the State of New York applicable to contracts to be fully executed and performed in New York State, without reference to conflict of laws. Any disputes arising under this agreement shall be subject exclusively to the jurisdiction of the state and/or federal courts having jurisdiction over New York County.[28]

B. Franchisors' Objectives

Forum selection clauses purport to allow franchisors to require all litigation with the franchisee to take place in a particular forum. Together with choice-of-law provisions, these clauses potentially offer franchisors the strategic advantage of litigating in a geographically convenient forum, where uniformity and predictability in court rulings are more likely.

Successful franchise systems generally focus significant attention on expanding geographically. Along with that expansion, however, litigation with out-of-state franchisees inevitably develops. Franchisors confront additional expensive and time-consuming concerns when they must adhere to and understand multiple states' diverse statutes and court rulings.

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[24] *Caperton,* 225 W. Va. at 135, 690 S.E.2d at 339 (emphasis added).

[25] *Id*.

[26] *Id*. *See also, Murray v. Education Res. Inst., Inc.*, 272 Ga. App. 171, 171, 612 S.E.2d 23, 24 (2005) (citing *Carbo v. Colonial Pacific Leasing Corp.,* 264 Ga. App. 785, 786, 592 SE2d 445, 446 (2003)).

[27] *In re Zotec Partners, LLC*, 353 S.W.3d 533, 535 (Tex. App. 2011).

[28] *Food Mktg. Consultants, Inc. v. Sesame Workshop*, No. 09-61776-CIV, 2010 WL 1571206 (S.D. Fla. Mar. 26, 2010) (unpublished).

Such inconsistency of results between jurisdictions undermines the efficiency for which franchisors strive, as litigation in multiple jurisdictions generates the additional tasks of sending counsel and witnesses to court hearings and depositions in other jurisdictions, obtaining counsel in each franchisee's jurisdiction, educating those attorneys about the company, and keeping track of the case law in each of those jurisdictions. These concerns reflect the desire on the part of the franchisor to have the freedom to choose to litigate franchisee claims in a single jurisdiction – typically, the franchisor's home state.

Despite the general desire for mandatory clauses, there are strategic reasons why a franchisor might prefer a permissive clause. The franchisor might want to retain the right to bring an action in its principal place of business, as well as have the flexibility to file suit elsewhere, where the law of a particular forum is more favorable to the specific dispute giving rise to the litigation. For example, at issue might be the breach of non-competition covenants. Because some states are more favorable than others with regard to the scope and duration of restricted activity, the franchisor might want the flexibility to file suit in the jurisdiction where a breaching franchisee resides if the law in that jurisdiction is believed to be more supportive of the franchisor's position. But, franchisors must be careful. Use of a permissive forum selection clause may invite a race to the courthouse in the event a dispute arises between the franchisor and franchisee. The franchisee who senses that the filing of an adverse action is imminent in the agreement's chosen forum might initiate an action in its home state seeking a declaratory judgment that the non-competition covenants are unenforceable. Because the clause is "permissive," the franchisee is able to initiate and maintain an action in an otherwise proper forum other than the one designated in the contract.

Another reason to use a permissive clause is to try to limit the restrictions caused by state franchise statutes. Some franchise relationship statutes seek to invalidate forum selection clauses that "require" litigation in the designated state or "restrict" litigation to the designated state.[29] One could make the argument that a forum selection clause that is permissive in nature, rather than mandatory, is outside the scope of these franchise relationship statutes because it simply requires the franchisee to consent to the nonexclusive jurisdiction of the courts located in the franchisor's chosen jurisdiction. It does not prevent the franchisee from suing the franchisor in the franchisee's home state or any other otherwise proper jurisdiction.

By and large, franchisors tend to prefer litigating cases in federal court. This preference surely is grounded, in part, on the perception that federal judges are not as prone to local bias in favor of individual franchisees as their often elected state court counterparts.[30] The concern about local bias is particularly significant where a judge must effectively close a local business to enforce a non-competition agreement.[31]

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[29] *See, e.g.,* CAL. BUS. & PROF. CODE § 20040.5; 815 ILL. COMP. STAT. 705/4, §§ 4, 14; IOWA CODE § 523H.3; MICH. COMP. LAWS § 445.1527; R. I. GEN. LAWS § 19-28.1-14.

[30] *See, e.g.,* Jean R. Sternlight, *Forum Shopping For Arbitration Decisions*: *Federal Courts' Use of Antisuit Injunctions Against State Court*, 147 U. PA. L. REV. 91, 95-96 (1998) (stating that "certain kinds of parties are more likely to prefer to litigate in federal court, and others are more likely to prefer state court . . . [I]t is virtually always a "little guy," that is a consumer, employee, franchisee, or dealer, who has filed in state court, whereas it is usually a "big guy," such as a manufacturer or franchisor, who has sought the protection of the federal courts").

[31] *Murray,* 272 Ga. App. at 172, 612 S.E.2d at 24.

Federal courts give forum selection clauses "controlling weight in all but the most exceptional cases."[32] In order to set aside a forum selection clause, a franchisee must demonstrate that: (1) enforcement would be unreasonable or unjust; (2) the clause is invalid due to fraud or overreaching; or (3) enforcement would contravene a strong public policy in the forum state.[33]

When drafting forum selection clauses, franchisors should be mindful of the growing trend in franchising involving system acquisitions and consolidations, and the possibility that someday the franchisor might be acquired by another franchise system and move operations to another state. Consequently, franchisors are wise to consider "floating" forum selection clauses. An example of such a clause is:

> All legal actions between the parties shall be venued exclusively in a state or federal court in the judicial district in which franchisor's principal offices are located at the time suit is filed, even if that location varies as the result of franchisor's relocation of its principal place of business following execution of this agreement. If franchisor assigns or otherwise transfers this agreement, all legal actions between the parties shall be venued exclusively in a state or federal court in the judicial district in which the assignee's or transferee's principal offices are located at the time suit is filed.

Without a similar floating clause, the franchisor whose principal place of business changes might have to commence litigation in its prior forum or be subject to having any case that it commences in the old forum transferred to the franchisee's home district.

C. Franchise Statutes – Implications

While forum selection clauses are presumptively valid under federal law and in many states, several jurisdictions have enacted anti-waiver statutes that limit the franchisor's ability to compel litigation outside of the state where the franchisee conducts business.[34] These statutes and regulations generally are premised on a concern over the perceived disparate bargaining power between franchisees and franchisors.[35]

These statutes and their application are far from uniform, however, and many franchise relationship statutes either invalidate all forum selection clauses or attach heightened scrutiny to

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[32] *Stewart Org., Inc. v. Ricoh Corp.*, 487 U.S. 22, 33 (1988); *see also Certified Restoration Dry Cleaning Network, L.L.C. v. Tenke Corp.*, 511 F.3d 535 (6th Cir. 2007).

[33] *Shute*, 499 U.S. at 594-595; *M/S Bremen v. Zapata Offshore Co.*, 407 U.S. 1, 12-18, 92 S. Ct. 1907, 1914-1918 (1972).

[34] *See, e.g.*, CAL. BUS. & PROF. CODE § 20040.5 ("A provision in a franchise agreement restricting venue to a forum outside this state is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state"); IDAHO CODE § 29-110; IOWA CODE § 523H.3; 815 III. COMP. STAT. 705/4; IND. CODE ANN. §23-2-2.7-1; MICH. COMP. LAWS SERV. § 445.1527(f); MINN. R. 2860.4400(J); N.J. STAT. ANN. § 56-10-7.3; WIS. STAT. § 553.76.

[35] To overcome this presumption, franchisors should document all evidence of negotiations between the parties, if any, to prove that the forum selection clause was not imposed upon the franchisee against its will as part of a "take it or leave it" franchise agreement. *Kubis & Perszyk Assocs., Inc. v. Sun Microsystems, Inc.*, 146 N.J. 176, 193-195, 680 A.2d 618, 627-28 (1996).

their review.[36] This impedes a franchisor's ability to depend on a forum selection clause as a means of preventing litigation in a franchisee's home venue. Courts seldom allow the waiver of personal jurisdiction defenses or agreements on venue expressed in enforceable forum selection clauses, so it is critical that a franchisor remain aware of the current state relationship statutes, agency regulations, and case law interpretations of these statutes in states where its franchisees are located.

Relationship statutes generally invalidate provisions fixing venue or jurisdiction in a location other than franchisee's state of residence,[37] often voiding forum selection clauses as a whole.[38] In *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*,[39] for example, the Supreme Court of New Jersey invalidated a franchise agreement's forum selection clause specifying that the law of California, the franchisor's state, would govern any litigation with the New Jersey franchisee. The court reasoned that "enforcement of forum-selection clauses in contracts subject to the Franchise Act would substantially undermine the protections that the Legislature intended to afford to all New Jersey franchisees."[40] The court determined that forum selection clauses "fundamentally conflict with the basic legislative objectives of protecting franchisees from the superior bargaining power of franchisors and providing swift and effective judicial relief against franchisors that violate the Act" and are thus generally invalid.[41]

Similarly, both Rhode Island and California automatically void franchise agreement provisions that require the parties to litigate outside of those states.[42] However, it remains unclear whether a franchisee being sued in a franchisor's home state other than California or Rhode Island could use the California statute to have a court outside of California invalidate a forum selection clause.[43] Even when a statute does not expressly prohibit forum selection

[36] *See,* James Zimmerman, *Restrictions on Forum-Selection Clauses in Franchise Agreements and the Federal Arbitration Act: Is State Law Preempted?*, 51 VAND. L. REV. 759, 774-75 (1998) ("Several states have case law upholding forum-selection clauses only if the clauses are demonstrated to be reasonable and not the product of unfair bargaining power. Many of these states apply rules that arguably are stricter than both the federal law of forum-selection and the general state law of unconscionability."). It is important to note that "[t]hese franchising-specific prohibitions of judicial forum selection clauses are, of course, in addition to whatever restrictions already exist by general statute or at common law. . . . For example, Alabama needs no legislation directed at franchising, since no judicial forum selection clause is enforceable there [under Ala. Code § 7-2A-106]." Dunham, *supra* note 20.

[37] *See, e.g.,* CAL. BUS. & PROF. CODE § 20040.5; 815 ILL. COMP. STAT. 705/4, §§ 4, 14 ("Any provision in a franchise agreement that designates jurisdiction or venue in a forum outside of this State is void."); IOWA CODE § 523H.3; MICH. COMP. LAWS § 445.1527; R.I. GEN. LAWS § 19-28.1-14.

[38] Only Rhode Island specifically penalizes the franchisor for inclusion of clauses limiting jurisdiction and venue. In Rhode Island, the director of the Department of Business Regulation may deny a franchise application where a clause limiting jurisdiction, venue, or choice of law is included in the franchise agreement. R.I. GEN. LAWS § 19-28.1-18(a).

[39] 146 N.J. 176, 680 A.2d 618 (1996).

[40] *Id*. at 192-93, 680 A.2d at 626-27.

[41] *Id*. at 193, 680 A.2d at 626-27.

[42] R.I. GEN. LAWS § 19-28.1-14; CAL. BUS. & PROF. CODE § 20040.5.

[43] In *Best W. Int'l, Inc. v. Govan*, No. 05-3247, 2006 WL 2523460 (D. Ariz. Aug. 29, 2006) (unpublished), the franchisor sued the franchisee in Arizona state court. The franchisee removed the case to federal court and moved to dismiss for lack of venue, alleging that the forum selection clause of the franchise agreement was void because it violated the California franchise relationship statute prohibition against restricting venue to a forum outside of (continued...)

clauses, some state courts may, nonetheless, invalidate a forum selection clause based on state public policy concerns.[44] Indiana courts, for example, invalidate forum selection clauses found to curtail the franchisee's rights under the Indiana statute.[45] Minnesota courts may also invalidate such clauses.[46]

A savvy franchisor may be able to navigate around the prohibitions in such statutes. For example, although substantive contract disputes are appropriately resolved under applicable state law,[47] in federal court the effect and weight accorded to a contractual forum selection clause is governed exclusively by federal law.[48] Because a forum selection clause is *prima facie* valid under federal law, a state policy to the contrary may be inapplicable in federal court, regardless of whether the court is exercising diversity or federal question jurisdiction.[49] Accordingly, a franchisor's initiation of litigation in federal court may afford the franchisor an opportunity to sidestep the application of state franchise relationship statutes that may, otherwise, invalidate the forum selection clause.

(...continued)
California. *Id.* The Arizona district court refused to apply the California statute because the venue transfer analysis was governed by federal law. *Id. See also Wimsatt v. Beverly Hills Weight Loss Clinics*, 32 Cal. App. 4th 1511, 1514 (1995).

[44] S*ee, Electrical & Magneto Serv. Co. v. AMBAC Int'l Corp.*, 941 F.2d 660, 664 (8th Cir. 1991) (voiding forum selection clause as violative of Missouri public policy); *see also Weidner Commc'ns, Inc. v. H.R.H. Prince Bandar Al Faisal*, 859 F.2d 1302, 1310 (7th Cir. 1988) (concluding that the forum selection clause was unenforceable and void on the grounds of duress and unequal bargaining power); *Davis v. Great Am. Cleaners, Inc.*, No. 952363B, 1996 WL 1185042 (Mass. Sup. Ct. July 23, 1996) (unpublished) (voiding the forum selection clause because it found an imbalance of bargaining power and that its enforcement would seriously inconvenience the franchisee); *Barter Exch., Inc. v. Barter Exch., Inc.*, 606 N.E.2d 186, 192 (Ill. App. Ct. 1992) (finding that franchisors should not be able to break the law in one state and then avoid that state's consideration of the claims under its franchise statutes by providing for the dispute to be heard in its home state via a forum selection clause).

[45] *See, Sheldon v. Munford, Inc.*, 950 F.2d 403 (7th Cir. 1991) (choice-of-law provision violated Indiana Franchise Act because it stripped the franchisee of substantive rights under the statute). *C.f. Deans v. Tutor Time Child Care Sys., Inc.*, 982 F. Supp. 1330 (S.D. Ind. 1997) (forum selection clause upheld as reasonable where franchisees had traveled to Florida prior to executing the agreement and were represented by counsel during the review, negotiations, and execution of the agreement).

[46] *Van Dusen Airport Servs. Co., L.P. v. Allied Signal, Inc.*, No. C5–90–2389, 1991 WL 151377 (Minn. Ct. App. Aug. 13, 1991) (unpublished); MINN. R. 2860.4400.

[47] Many of the franchise relationship statutes also seek to invalidate choice-of-law clauses, thereby giving effect to the law of the franchisee state. This article does not address choice of law. However, choice of law may factor into whether a court of a franchisor's home state recognizes a franchise relationship statute of the franchisee's home state that seeks to invalidate a forum selection clause.

[48] *Stewart Org., Inc. v. Ricoh Corp.*, 487 U.S. 22, 30-32 (1988) (rejecting application of Alabama law invalidating forum selection clause because state law cannot be allowed to interfere, under the supremacy doctrine, with "the flexible and multifaceted analysis that Congress intended to govern motion to transfer within the federal system"); *Brock v. Entre Computer Ctrs., Inc.*, 933 F.2d 1253, 1258 (4th Cir. 1991) ("[Franchisee] argues that the Virginia District Court should transfer this case back to Texas because the forum-selection clause would be void under Texas state law. Even if this is true, under *Stewart*, the proper focus is on federal law, specifically § 1404(a), and its position which is supreme over state law in this instance.").

[49] *Stewart Org.,* 487 U.S. at 31.

III. GOVERNING LAW PROVISIONS

A. <u>General Overview – Reality Often Does Not Match Intentions</u>

Conceptually, general contract principles are furthered by allowing parties to stipulate to the applicable law to govern interpretation of the franchise agreements and any disputes, promoting certainty and predictability in contractual relations. Courts, however, have determined that such outcomes should not be achieved at the expense of the important public policies of a state, the laws of which would be applicable if the contractual choice-of-law provision were disregarded.

Franchisors view choice-of-law provisions as a necessary means to operate a national system, and to achieve fairness and predictability across the system, rather than expending the resources on and bearing the uncertainty of litigating issues such as breach, cure, notice, transfer, selective enforcement, termination, nonrenewal, and noncompetition obligations under a myriad of state common and statutory laws. As the *Restatement* observes:

> Rationale. Prime objectives of contract law are to protect the justified expectations of the parties and to make it possible for them to foretell with accuracy what will be their rights and liabilities under the contract. These objectives may best be attained in multistate transactions by letting the parties choose the law to govern the validity of the contract and the rights created thereby. In this way, certainty and predictability of result are most likely to be secured. Giving parties this power of choice is also consistent with the fact that, in contrast to other areas of the law, persons are free within broad limits to determine the nature of their contractual obligations. . . .[50]

For franchisees, however, the equation differs; various states have enacted statutes to ensure minimally fair standards, especially in the areas of breach and cure rights, transfers, and terminations, that are "designed to protect [the] weaker party against the unfair exercise of superior bargaining power by the [franchisor]."[51]

These efforts would be vitiated at the stroke of a pen if the franchise agreement could wipe out such protections by imposing another jurisdiction's law. The *Restatement* recognizes this danger, but balances it by according favorable treatment to the contractual choice, while declining to enforce clauses where, as recited above, there are strong countervailing circumstances:

> It may likewise be objected that, if given this power of choice, the parties will be enabled to escape prohibitions prevailing in the state which would otherwise be the state of the applicable law. Nevertheless, the demands of certainty,

[50] *Id.*

[51] *Bush v. Nat'l Sch. Studios, Inc.*, 139 Wis. 2d 635, 407 N.W. 2d 883 (1987), (citing *S. Int'l Sales v. Potter & Brumfield Div.*, 410 F. Supp. 1339, 1341 (S.D.N.Y. 1976) (holding that Puerto Rican Dealers' Contracts Act was fundamental policy that supersedes choice of law); *Business Incentives Co. v. Sony Corp. of Am.*, 397 F. Supp. 63, 67 (S.D.N.Y. 1975) (New Jersey Franchise Practices Act is strong public policy designed to protect small businesses from "more powerful commercial giants" and supersedes New York choice of law); *Cutler v. Scott & Fetzer Co.*, 510 F. Supp. 905, 909 (E.D. Wis. 1981).

predictability, and convenience dictate that subject to some limitations, the parties should have power to choose the applicable law.[52]

1. Limitations on Applying a Foreign Jurisdiction's Laws

In most states, there are two primary limitations on applying a foreign jurisdiction's laws.[53] First, the laws of the foreign jurisdiction cannot be contrary to public policy. Second, the foreign jurisdiction must have a substantial relationship to the parties or the performance of the contract. Only if both of these provisions are satisfied will most courts honor the choice-of-law provision.[54] Accordingly, drafters of such provisions should not designate a jurisdiction whose laws may be more favorable for a specific purpose but which bears no relationship to the parties or the performance of the contract.[55] Similarly, even if a foreign jurisdiction designated by the contracting parties bears a substantial relationship to the parties, the "more favorable" laws of that jurisdiction will not be enforced if the laws conflict with the forum state's public policy.[56]

2. How Much of the Foreign Jurisdiction's Laws Govern?

When a foreign jurisdiction's laws are applied, the chosen state's laws will not govern every aspect of any cause of action that arises.[57] Generally, a choice-of-law provision only allows the franchisor to select the laws of a foreign jurisdiction to govern substantive rights regarding contractual relationship.[58] The chosen state's laws will not govern procedural or remedial issues or causes of action that arise in tort.[59]

Franchisors that draft choice-of-law provisions calling for application of the law of the franchisor's home state must also consider whether the laws of the home state apply extraterritorially. For example, in *Red Lion Hotels Franchising Inc. v. MAK, LLC*, the franchisor (Red Lion) was incorporated in Washington and the franchisee (MAK) was both incorporated in and operating in California.[60] Included in the franchise agreement was a choice-of-law clause which provided for application of Washington law.[61] Following the franchisee's alleged failure to

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[52] Restat. 2d. Conf. of Laws § 187, cmt. e (1971).

[53] *Delaware Valley Home Evaluations, Inc. v. Housemaster of Am., Inc.*, 559 F. Supp. 2d 591, 597 (E.D. Pa. 2008).

[54] See, *1-800-Got Junk? LLC v. Superior Court*, 189 Cal. App. 4th 500, 513, 116 Cal. Rptr. 3d 923, 932 (2010); *Texas Taco Cabana, L.P. v. Taco Cabana*, 304 F. Supp. 2d 903, 908 (W.D. Tex. 2003).

[55] *Id.*

[56] *Cottman Transmission Sys., LLC v. Kershner*, 492 F. Supp. 2d 461, 467-70 (E.D. Pa. 2007).

[57] *Red Roof Inns, Inc. v. Murat Holdings, LLC*, 223 S.W.3d 676 (2007).

[58] *Midwest Med. Supply Co. v. Wingert*, 317 S.W.3d 530, 537 (Tex. App. 2010); *Cole v. Mileti*, 133 F.3d 433, 437-38 (6th Cir. 1998); *Lago & Sons Dairy, Inc. v. H.P. Hood, Inc.*, No. 92-200, 1994 WL 484306 (D.N.H. Sept. 6, 1994) (unpublished).

[59] *Melia v. Zenhire, Inc.*, 462 Mass. 164, 175-78, 967 N.E.2d 580, 590-94 (2012).

[60] *Red Lion Hotels Franchising Inc. v. MAK, LLC*, 663 F.3d 1080 (9th Cir. 2011).

[61] The choice-of-law provision stated:

> [T]his Agreement, all relations between us, and any and all disputes between us, whether sounding in contract, tort, or otherwise, are to be exclusively construed in accordance with and/or governed by (as

(continued...)

update its hotel in accordance with a property improvement plan ("PIP"), the franchisor sued in Washington.

The California-based franchisee counterclaimed, alleging a breach of the franchisee "Bill of Rights" provision in the Washington Franchise Act (FIPA), asserting that the franchisor had promised to make certain exceptions to its PIP requirements.[62] Red Lion was initially granted summary judgment on the FIPA claim with the district court holding that the "'overall statutory scheme evinces the legislature's intent to confine FIPA's reach to franchises operating 'in this state.'"[63] On appeal, however, the Ninth Circuit noting that, "[u]nder the choice-of-law provision in the franchise agreement, Washington law applies to this dispute 'without recourse to Washington (or any other) choice of law or conflicts of law principles.' We construe the provision to mean that we should apply Washington law only insofar as that law, according to its own terms, would be applicable."[64] The Ninth Circuit concluded that while "FIPA deals mainly with registration and disclosure requirements … FIPA's bill of rights does not contain – indeed, has never contained – language limiting its application to the relation between a franchisor and franchisee 'in this state.'"[65] Accordingly, the Ninth Circuit held that even a franchisee operating outside of Washington might claim the relationship protection established under the FIPA.

3. <u>Procedural/Remedial Versus Substantive Issues</u>

Under the rule of *lex fori*, procedural or remedial questions generally are governed by the laws of the state in which the action is brought.[66] Thus, if an action is brought in Georgia, Georgia laws will govern procedural and remedial questions, including the statute of limitations and rules of evidence, regardless of a contractual choice of another state's law.[67] The chosen state's laws will govern substantive questions regarding the parties' contractual rights and duties, including construction or interpretation of the franchise agreement.[68] In instances where it is unclear whether the issue is substantive or procedural, the forum's laws dictate the

(...continued)

> applicable) the laws of the State of Washington *without recourse to Washington (or any other) choice of law or conflicts of law principles*.... *Nothing in this section is intended to invoke the application of any franchise*, business opportunity, antitrust, "implied covenant," unfair competition, fiduciary *or any other doctrine of law of the State of Washington or any other state which would not otherwise apply absent this Paragraph* 16.b.

Id. at 1084 (emphasis added).

[62] *Red Lion*, 663 F.3d at 1084.

[63] *Id.* at 1086 (internal quotation marks omitted).

[64] *Id.* at 1087.

[65] *Id.*

[66] *Lloyd v. Prudential Sec., Inc.*, 211 Ga. App. 247, 248, 438 S.E.2d 703, 704 (1993).

[67] *Singletary v. Southeastern Freight Lines*, 832 F. Supp. 1552, 1555 (N.D. Ga. 1993) (internal quotations omitted); *Lago & Sons Dairy, Inc. v. H.P. Hood, Inc.*, No. 92-200, 1994 WL 484306 (D.N.H. Sept. 6, 1994).

[68] *Lago & Sons Dairy, Inc. v. H.P. Hood, Inc.*, No. 92-200-SD, 1994 WL 484306 (D.N.H. Sept. 6, 1994).

classification and, therefore, whether a dispute is procedural and governed by the forum's laws or substantive and governed by the chosen jurisdiction's laws.[69]

4. **Contract v. Tort**

Under the rule of *lex loci delicti*, regardless of a choice-of-law provision, tort cases generally are governed by the substantive laws of the state where the tort was committed.[70] To determine whether a cause of action arises in contract or tort, one must conduct a subject matter classification of the cause of action at issue. For an action stemming from a breach of a duty growing out of a contractual relationship to be classified as tortious, the breach must be shown to have been a breach of duty imposed by law and not merely a breach of a duty imposed by the contract itself.[71] A duty imposed by law means either a duty imposed by a statute or a duty imposed by a recognized common law principle such as fraud. An example of this analysis appears in *Maltz v. Union Carbide Chemicals and Plastics Co. Inc.*[72] Five individual franchise shareholders and five franchisees sued Union Carbide Marble Care, Inc. in Texas for fraudulent omissions, fraudulent misrepresentation, negligence, and tortious interference with contract and with prospective business relations.[73] The franchisees also brought several contract claims.[74] The parties' franchise agreement dictated that New York law would govern the agreement.[75] The franchisees argued that Texas law should apply to all claims, including both the contract claims and the tort claims; however, the franchisors asserted that only New York law was applicable.[76] To determine whether the tort claims fell within the scope of the parties' contract, the court looked to the specific language of the contract.[77] The court found that the choice-of-law provision did not extend to the tort claims, as that clause's language suggested a narrow scope that covered contract claims only, and not tort claims.[78] Thus, the tort claims were entirely independent of the contract. The court held that New York law applied only to the contract claims and that Texas, Ohio, and California law governed the respective tort claims.[79]

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[69] *Frankel v. Citicorp Ins. Servs., Inc.*, 80 A.D.3d 280, 285, 913 N.Y.S.2d 254, 258-59 (2010) (designating South Dakota in choice-of-law provision and using New York law to determine whether South Dakota law applied to this specific controversy).

[70] *Cooney v. Osgood Mach., Inc.*, 81 N.Y.2d 66, 71-72 (1993); *Sunbelt Veterinary Supply, Inc. v. Int'l Bus. Sys. U.S., Inc.*, 985 F. Supp. 1352, 1355 (M.D. Ala. 1997).

[71] *Maltz v. Union Carbide Chems. & Plastics Co.,* 992 F. Supp. 286 (S.D.N.Y. 1998).

[72] *Id*. at 297-98.

[73] *Id*. at 294, 311.

[74] *Id*.

[75] *Id*. at 298.

[76] *Id*. at 296.

[77] *Id*.

[78] *Id*. at 298.

[79] *Id*. at 295.

B. Franchise Statutes – Implications

Courts may also decline to enforce choice-of-law provisions if a state has enacted a franchise statute which incorporates an anti-waiver provision,[80] while others without anti-waiver provisions have addressed the conflict arising between "fundamental" state policies and contractual choice-of-law provisions. The language and purpose of the statute, the presence or absence of an anti-waiver provision, the examination of other, similar state statutes, and their judicial construction and legislative history all contribute to an assessment of whether a state franchise law will be deemed "fundamental."[81] If so, and assuming sufficient state material interest in the controversy, the statute will trump a choice-of-law provision.

Decisions based on anti-waiver provisions, and those that are grounded in public policy, contain themes aligned with the Restatement:

> When application of chosen law would be contrary to fundamental policy of state of otherwise applicable law. Fulfillment of the parties' expectations is not the only value in contract law; regard must also be had for state interests and for state regulation. . . .
>
> No detailed statement can be made of the situations where a "fundamental" policy of the state of the otherwise applicable law will be found to exist. An important consideration is the extent to which the significant contacts are grouped in this state. For the forum will be more inclined to defer to the policy of a state which is closely related to the contract and the parties than to the policy of a state where few contacts are grouped but which, because of the wide dispersion of contacts among several states, would be the state of the applicable law if effect were to be denied the choice-of-law provision. Another important consideration is the extent to which the significant contacts are grouped in the state of the chosen law. The more closely this state is related to the contract and to the parties, the more likely it is that the choice-of-law provision will be given effect. The more closely the state of the chosen law is related to the contract and the parties, the more fundamental must be the policy of the state of the otherwise applicable law to justify denying effect to the choice-of-law provision.
>
> To be "fundamental," a policy must in any event be a substantial one. . . . [A] fundamental policy may be embodied in a statute which makes one or more kinds of contracts illegal or which is designed to protect a person against the oppressive use of a superior bargaining power.[82]

Following this reasoning, it may be argued that nearly all state franchise statutes would be considered fundamental, and if the state also has a sufficient material interest in the

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[80] *See, e.g. Randall v. Lady of Am. Franchise Corp.*, 532 F. Supp. 2d 1071, 1087-89 (D. Minn. 2007) (citing MINN. STAT. § 80C.21); *Three M Enters., Inc. v. Texas D.A.R. Enters., Inc.*, 368 F. Supp. 2d 450, 458 (D. Md. 2005) (citing MD. CODE ANN. BUS. REG. § 14-226).

[81] *See, e.g. Three M*, 368 F. Supp. 2d at 458-59.

[82] Restat. 2d. Conf. of Laws § 187, cmt. g (1971) (emphasis added).

controversy, the statute likely will be deemed to trump the franchise agreement's choice-of-law clause.[83]

IV. WAIVER PROVISIONS

The Declaration of Independence refers to the rights to life, liberty and the pursuit of happiness as inalienable. We know, however, that many other rights are alienable, primarily by consent in contract. The Supreme Court has long recognized this reality:

> A man may not barter away his life or his freedom, or his substantial rights . . . In a civil case . . . any citizen may no doubt waive the rights to which he may be entitled. He cannot, however, bind himself in advance by an agreement, which may be specifically enforced, thus to forfeit his rights at all times and on all occasions, whenever the case may be presented.[84]

While consent in contract is a means of waiving rights in many areas of the law, these areas vary in their standards of consent. Below we explore two types of waivers consistently found in franchise agreements, jury-waivers and class action arbitration waivers.

A. Jury-Waivers

The Seventh Amendment of the United States Constitution guarantees a right to jury trial in suits at common law where the amount in controversy is over twenty dollars.[85] This right is often waived by consent in franchise agreements containing an arbitration clause – that is, a clause purporting to waive the right to have disputes resolved in court and to create the right to have them resolved by arbitration. Another way to waive the jury trial right is to consent to a contract containing a jury-waiver clause. Unlike arbitration clauses, jury-waiver clauses neither waive the right to have disputes resolved in court nor create rights to have disputes resolved by arbitration. Jury-waiver clauses only purport to waive the right to have disputes resolved by a jury, replacing a jury trial with a bench trial as the default process of dispute resolution. Franchisors, under most circumstances, desire to avoid jury trials, in part, because of the perceived delays and inconveniences involved, and, in part, because juries, consistent with human nature, favor the franchisee as the "little guy" against the "giant" franchisor. It is, however, becoming increasingly unclear how effective these waivers are.

1. Enforceability Overview

Parties seeking to avoid a jury trial if a dispute arises between them, but not wanting to stipulate to arbitration, often include in their contracts a provision such as: "The parties waive the right to a jury trial in any action related to this Agreement." While this or similarly drafted jury-waiver provisions are enforceable in some jurisdictions, many others do not recognize such pre-litigation contractual waivers of jury trials.[86] Those jurisdictions typically hold that a jury trial

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[83] *Id.*

[84] *Home Ins. Co. v. Morse*, 87 U.S. 445, 451 (1874).

[85] U.S. CONST. amend. VII.

[86] *See,* Jay M. Zitter, Annotation, *Contractual jury trial waivers in state civil cases*, 42 A.L.R. 5th 53 (1996) (annotating state by state enforceability of jury-waiver provisions). *Bank South v. Howard*, 264 Ga. 339, 444 S.E.2d 799 (1994). *See also* Bryan D. Bolton, *Important Terms for Inclusion in Confidential Settlement Agreements for Financial Service*
(continued...)

is guaranteed under the state constitution and can only be waived after an actual dispute has arisen.[87] A number of jurisdictions have rules, regulations, constitutional provisions, or legislative enactments directly bearing on the enforceability of these provisions. All should be given consideration when inserting boilerplate jury-waiver provisions into the franchise agreement.

2. **Franchisors' Ability to Obtain the Same Goal Via Arbitration**

While some states hold that a jury trial cannot be waived, sometimes as a matter of constitutional right, these rules do not exhaust the options, such as alternative dispute resolution, available to franchisors seeking to have claims resolved without the involvement of jurors.[88] Prohibitions on jury trial waivers only affect the agreements of parties that implicate a judicial forum, not agreements to avoid the courts altogether.[89] Rather than contractually modifying the rights available to a party in the courts, the same outcome may be achieved by an agreement to circumvent the judicial forum altogether.

Arbitration, which is discussed in greater detail below, allows for a more private resolution of claims without several of the potential drawbacks of a jury trial. When arbitration is mandatory and binding, it can significantly limit the ability of franchisees to invoke the assistance of courts. Use of other alternatives, such as mandatory mediation prior to filing suit, can help resolve differences before formal litigation commences.

3. **Franchisees' Resistance**

Franchisees have successfully persuaded courts to take precautionary measures against finding a jury-waiver to be knowing and voluntary. These measures include "indulg[ing] in every reasonable presumption against the waiver[,]"[90] and construing waiver agreements "strictly and narrowly[.]"[91] Generally, courts review four factors in deciding whether there has been a valid waiver: (1) whether the franchisor had more bargaining power than the franchisee;[92] (2) whether the franchisee fully understood the effect of the waiver; (3) whether

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Companies, 35 U. BALT. L. REV. 347, 361-62 (2006) (noting that prelitigation waivers of the right to a jury trial are upheld in Maryland and Pennsylvania).

[87] *Bank South v. Howard*, 264 Ga. 339, 444 S.E.2d 799 (1994).

[88] Cal. Code Civ. Proc. § 631 ("The right to a trial by jury as declared by Section 16 of Article I of the California Constitution shall be preserved to the parties inviolate."); *Cadle Co. v. World Wide Hospitality Furniture, Inc.*, 144 Cal. App. 4th 504, 510 (2006) ("Code of Civil Procedure section 631 . . . identifies six exclusive means by which a jury trial may be waived in a civil case. . . . [N]o statute specifically authorizes predispute jury waivers.").

[89] *Bowers v. Raymond J. Lucia Co.*, 206 Cal. App. 4th 724, 737 (2012) (citing *Grafton Partners L.P. v. Superior Court,* 36 Cal. 4th 944 (2005)) (describing California's restriction as one restricted to the "validity of a predispute jury trial waiver in a judicial forum").

[90] *MZ Ventures v. Mitsubishi Motor Sales of Am., Inc.*, No. 99-02395, 1999 U.S. Dist. LEXIS 14421 (C.D. Cal. Aug. 31, 1999) (unpublished) (quoting *United States v. California Mobile Home Park Management Co.*, 107 F.3d 1374, 1378 (9th Cir. 1997)).

[91] *Id*.

[92] At least one court has said there must be a "gross disparity" between the parties in bargaining power. *Too Tall Inc., v. Sara Lee Bakery Group, Inc.*, No. 08-191, Bus. Franchise Guide (CCH) ¶ 14,229 (D.N.M. Sept. 9, 2009).

there are facts showing the waiver was negotiated; and (4) whether the provision including the waiver was conspicuous.[93]

In applying these factors, courts have not been receptive to arguments that the mere presence of state and federal statutory protections for franchisees affords them equal bargaining power; nor will courts find the presence of bargaining power solely on the basis of the franchisee's ability to walk away from a transaction.[94] Further, franchisees can forcefully argue that a waiver's presence in a provision titled "Standard Provisions" or its equivalent demonstrates it was not a term that they had ability to negotiate.[95] Franchisees should be aware of whether the waiver was in a separate document, or even presented to them, at the time of entering into the franchise agreement.[96] Courts treat these factors as questions of fact that require discovery.[97] Even absent a provision in a state's franchise statute requiring jury trials, courts may be sympathetic to arguments that the availability of jury trial was implicitly intended by the legislature.[98]

The case of *Too Tall Inc. v. Sara Lee Bakery Group, Inc.* highlights a number of arguments a franchisee may be able to make on the question of jury-waiver.[99] Nathan Sanchez, the president of the plaintiff, Too Tall Inc., ("TTI") was a delivery driver for defendant Sara Lee for four years before Sara Lee contracted out its delivery work. Sara Lee gave its drivers the chance to purchase distribution rights on the condition they incorporate a delivery company. Plaintiff incorporated TTI and contracted for a delivery route. After two years, Sara Lee terminated the agreement and Sanchez brought suit. Plaintiff requested a jury trial, and Sara Lee opposed. The court accepted Sanchez's argument the waiver was not knowing and voluntary. Despite a conspicuous waiver provision, the court found a "gross disparity" in bargaining power; that Sanchez had no business experience he could rely upon to make the waiver knowing; and that the waiver was non-negotiable.[100] The court found it significant that Sanchez had no high school degree, no negotiating experience, and had not sought legal assistance. The court contrasted these facts with *Boyd v. U.S. Bank Nat'l Ass'n,* where the party opposing a jury-waiver had a business degree, specialized finance training, and had

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[93] *See, Samica Enters., LLC v. Mail Boxes, etc. USA, Inc.*, 637 F. Supp. 2d 712 (C.D. Cal. July 17, 2008) (refusing to enforce a jury trial waiver in a franchise agreement because the franchisor had more bargaining power, the franchisee did not understand the waiver's effect, the waiver was not negotiated, and the waiver's conspicuousness did not outweigh the other three factors), aff'd, 460 F. App'x 664 (9th Cir. 2010).

[94] *See, MZ Ventures, LLC v. Mitsubishi Motor Sales of Am., Inc.*, No., 99-02395, 1999 U.S. Dist. LEXIS 14421 (C.D. Cal. Aug. 30, 1999).

[95] *Id.*

[96] The *MZ Ventures* court found it inappropriate, and impossible (because the waiver was in a separate document, and the court was unaware of where the documents were located at the time of the signing) to determine the matter based merely on the fact the waiver was conspicuous. *Id*.

[97] *Id.*

[98] *See, Goodyear Tire & Rubber Co. v. Tualatin Tire & Auto, Inc.*, 322 Or. 406, 908 P.2d 300 (1995) (holding that right to a jury trial exists under the Oregon Franchise Act after reviewing legislative intent and finding that--despite the absence of an express grant of the right--legislative history revealed the Act was intended to extend similar protections as were available under Oregon securities regulations, which included right to trial by jury).

[99] Bus. Franchise Guide (CCH) ¶ 14,229 (D.N.M. Sept. 9, 2009).

[100] *Id.*

approached a bank seeking financing.[101] On the negotiability factor, the court looked at meetings Sanchez attended with Sara Lee and found that other competitors for the delivery routes were present. The court recognized that this fact likely made Sanchez less able to negotiate the contract's terms.

Another recent case that thoroughly addresses the validity of jury waivers is *ERA Franchise Systems LLC v. Bowers Realty and Associates, Inc*.[102] In *ERA Franchise Systems*, defendants were real estate franchisees who sought to invalidate a jury waiver in their franchise agreement. Citing *K.M.C. Co. v. Irving Trust Co.*,[103] the court recognized that, under Sixth Circuit law, waivers must be knowing and voluntary, but also that the standards to invalidate on such grounds are high. Citing to the defendants' experience in the real estate business, the court found that they had not met their burden and that the waiver was knowing and voluntary and, accordingly, enforceable.

In reaching this conclusion, the court distinguished a number of cases on their facts. The court rejected defendants' attempt to analogize to *Dreiling v. Peugeot Motors of Am., Inc*.[104] The *Dreiling* court held the defendants in that case had not met their burden of proof on whether the waiver was knowing and voluntary, relying on the facts that the waiver was on the twentieth page of a twenty-two page document, hadn't been discussed by the parties, and the plaintiff had little choice but to accept the contract and had no negotiating power.[105] The *ERA Franchise Systems* court concluded that case inapposite; after all, under *K.M.C.* the burden of proof was on the party resisting the waiver. The court also decided that the defendants' reliance on the case of *Whirlpool Fin. Corp. v. Sevaux* was misplaced.[106] There, the court held the waiver was not entered knowingly and voluntarily where the plaintiff: (1) was not specifically informed about the jury-waiver; (2) was unfamiliar with the American civil jury system; (3) did not have counsel at the time of the waiver; and (4) had exigent financial circumstances.[107] Because defendants in *ERA Franchise Systems* had been working in the real estate business for over four decades, and had not alleged they were forced to accept the agreement, *Sevaux* did not support their claim.

A comparison of *Too Tall* and *ERA Franchise Systems* suggests that the allocation of the burden of proof as to the existence of a knowing and voluntary waiver may be dispositive. If a franchisee can point to facts that reveal he/she has little business experience and has not received legal advice, a franchisor may have a more difficult time rebutting such a claim, regardless of how conspicuous the contractual language may be. Similarly, a franchisee that can demonstrate there was an exigency driving them to enter into the contract – such as the *Sevaux* plaintiff's need for funds – may be able to invalidate the waiver. Franchisees also may pursue an estoppel argument (e.g., based on representations made about non-enforcement of

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[101] *Boyd v. U.S. Bank Nat'l Ass'n,* No. 06-2115, 2007 WL 2822518, at *18 (D. Kan. Sept. 26, 2007) (unpublished.).

[102] No. 10-13279, 2011 WL 653574 (E.D. Mich. Feb. 14, 2011).

[103] 757 F.2d 752, 656 (6th Cir. 1985).

[104] 539 F. Supp. 402 (D. Colo. 1982).

[105] *Id.* at 403.

[106] 866 F. Supp. 1102, 1106 (N.D. Ill. 1994).

[107] *See, Id.* at 1106.

the term) or that execution of the jury trial waiver was fraudulently induced.[108] While some jurisdictions may require there to be a specific fraud related to the waiver provision,[109] such specificity is not always required.[110]

Finally, one argument that has garnered some support in the case law recently is that a jury waiver does not apply to a particular claim by a franchisee because it was outside the contemplation of the franchise agreement at the time of its drafting. In *Riverside Portable Storage, Inc. v. PODS, Inc.*,[111] the franchisee posited the franchisor had made an oral contract with him allowing him to purchase a new franchise. The court found the claim was not covered by a waiver provision in the franchisee's contract which stated that legal action "in connection with" the agreement would be heard by the court."[112] Of significance to the court was the possibility that the claim could have existed regardless of whether or not the parties had entered into the initial franchise agreement.[113]

B. Arbitration Clauses and Class Action Waivers

With the aid of the Federal Arbitration Act, provisions in franchise agreements requiring arbitration of disputes frequently are deemed to be enforceable,[114] and franchisors often succeed in opposing franchisees' challenges to their earlier, contractual commitment to arbitrate all disputes outside of court. When a contract contains an arbitration clause, courts have found that all "doubts should be resolved in favor of coverage," such that disagreements are resolved outside the courts.[115] A sample boilerplate provision requiring arbitration reads:

> *Disputes-Arbitration.* (a) Subject to the following provisions of this section, GM and Dealer agree to submit to final and binding arbitration, upon either party's written notice, any and all claims, disputes, and controversies between them arising under or relating to this Agreement and its negotiation, execution,

[108] *C.f. Telum, Inc. v. E.F. Hutton Credit Corp.*, 859 F.2d 835, 837-38 (10th Cir. 1988) (holding that fraud in the inducement does not affect a jury-waiver provision unless there is a claim the fraud related particularly to that provision).

[109] *Id.*

[110] *MZ Ventures*, 1999 U.S. Dist. LEXIS 14421.

[111] No. 808-CV-1771-T-24TGW, 2009 WL 804666 (M.D. Fla. Mar. 27, 2009) (unpublished).

[112] *Id.*, 2009 WL 804666 at *3; *but see Coyote Portable Storage, LLC v. PODS Enters., Inc.*, 1:09-CV-1152-AT, at *17-*18 (N.D. Ga. Mar. 29, 2012) (unpublished). In *Coyote*, a dispute arose between a franchisee and franchisor over whether a contractual jury-waiver would apply to tort-based (including conversion) and statutory (violation of MFA) claims brought in connection with contract claims. The court distinguished *Riverside Portable Storage* and recognized "all of [p]laintiffs' claims are grounded in their business dealings with PODS surrounding the Franchise Agreements, and none of these claims for conversion and violation of the Florida Franchise Act are unquestionably connected with and depend on the parties' rights and duties established by the Franchise Agreements." *Id.* at *18. Therefore, the court applied the jury-waiver to the tort and statutory claims as well as the contract claims.

[113] *Id.*

[114] The Federal Arbitration Act states that arbitration clauses "shall be valid, irrevocable, and enforceable." 9 U.S.C. § 2.

[115] *Municipality of San Juan v. Corporación para el Fomento Económico de la Ciudad Capital*, 415 F.3d 145, 149 (1st Cir. 2005).

administration, modification, extension or enforcement (collectively, *"Claims"*)[;] (b) GM and Dealer agree that the dispute resolution process outlined in this section shall be the exclusive mechanism for resolving any Claims.[116]

Franchisors frequently include class action waiver provisions in their arbitration agreements. The enforceability of those provisions has been in flux, with different courts reaching different and inconsistent conclusions on the same franchise agreements.[117] Corporations once primarily used the class action waiver to insulate themselves from class actions in judicial proceedings, as class wide arbitration procedures are a relatively recent development.[118] After the 2003 Supreme Court decision in *Green Tree v. Bazzle*, which was read as "sanctioning class wide arbitration procedures, the American Arbitration Association (AAA) began to administer demands for class arbitration pursuant to its Supplementary Rules for Class Arbitrations if (1) the underlying agreement specifies that disputes arising out of the parties' agreement shall be resolved by arbitration in accordance with any of the Association's rules, and (2) the agreement is silent with respect to class claims, consolidation or joinder of claims."[119] Yet in the 2010 *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.* decision, the Supreme Court revisited the issue of class wide arbitration, and held that class wide arbitration could only proceed if the contract clearly indicated an agreement between the parties to allow it.[120]

Once it became clear that it was possible to have a class action in arbitration, many corporations began adding separate clauses[121] within the arbitration agreement expressly

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[116] *Brown Pontiac-Olds, Inc. v. Gen. Motors Corp.*, No. 05-204-P-H, 2006 WL 318827 (D. Me. Feb. 9, 2006) (unpublished).

[117] *See,* Mark M. Leitner & Joseph S. Goode, *Class Action Prohibitions and the Effect of Contract Rules on the Collective Pursuit of Common Claims*, 30 FRANCHISE L.J. 166, at 166 (2011).

[118] *See,* Edna Sussman, *Comments to the Consumer Financial Protection Bureau in Connection with Its Review of Arbitration for Consumer Financial Products or Services*, 12 CARDOZO J. CONFLICT RESOL. 491, 501 (2011).

[119] *See, id.* (noting that the AAA put these rules into place following the decision in *Green Tree Fin. Corp. v. Bazzle*); Am. Arbitration Ass'n, Supplementary Rules for Class Arbitrations (2003).

[120] *See, Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1776 (2010) ("We think that the differences between bilateral and class-action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings."). *But see Medicine Shoppe Int'l, Inc. v. Edlucy, Inc.*, Bus. Franchise Guide (CCH) ¶ 14,822 (E.D. Mo. May 14, 2012). Medicine Shoppe filed a motion to stay pending collective arbitration and a motion to compel individual arbitration, claiming that bilateral arbitrations were required by the terms of the parties' franchise agreements. The specific provision provided: "We both hereby agree that arbitration shall be conducted on an individual, not a class-wide basis." The court first had to decide whether it, or the arbitrator, was the appropriate decision-maker of whether an agreement permits class arbitration. The court examined the arbitration clause involved: "[A]ll controversies, disputes, or claims . . . shall be heard by one arbitrator in accordance with the then current Commercial Arbitration Rules of the AAA." This clause was significant because Rule 7(a) of the AAA Commercial Rules vests arbitrators with the authority to decide their own jurisdiction. Medicine Shoppe sought to persuade the court that Rule 7(a) was not meant to be a part of the agreement. It presented another clause in the arbitration agreement that stipulated the AAA Rules would apply "'except as otherwise provided in this Agreement[.]'" Medicine Shoppe urged that this provision, when considered alongside the individual arbitration clause mentioned above, meant the arbitrator did not have the authority to determine whether the franchisees would have to litigate individually. The court disagreed, finding that it was for the arbitrator to determine whether class arbitration was allowed under the franchise agreement as a matter of contract interpretation.

[121] *See, Kaltwasser v. AT&T Mobility LLC*, No. C 07-00411, 2011 U.S. Dist. LEXIS 106783 (D. Cal. Sept. 20, 2011) (providing an example of a class action waiver clause: "YOU AND CINGULAR AGREE THAT EACH MAY BRING (continued...)

prohibiting the aggregation of claims in a class action.[122] Therefore, "when an arbitration clause and a class arbitration waiver are present together in an arbitration agreement, class relief may be altogether unavailable."[123]

1. <u>How and Why Franchisors Use Arbitration Clauses</u>

As in many business settings, arbitration, as a method of dispute resolution, makes a lot of sense in franchising.[124] In general, the "theory" is that arbitration is designed to reduce the costs and length of judicial proceedings for all.[125] For example, arbitration typically has less discovery than litigation, which reduces the time and cost of proceedings.[126] In addition to the lower costs and relative speed of arbitration procedures, arbitration also can provide parties with customized procedural rules and expertise in the decision making process.[127] It is argued then that businesses' reduction in dispute resolution costs results in savings for their customers that are realized in the form of lower prices.[128] Defenders of mandatory arbitration thereby contend that overregulation of mandatory arbitration could lead to higher prices for certain products and services.[129] These same concerns apply in the franchise contract as franchisors seek to reduce costs that ultimately impact the entire franchise system.

Courts have found that a motion to compel arbitration should not be denied "unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute."[130] This is particularly true for a franchise

(...continued)
CLAIMS AGAINST THE OTHER ONLY IN YOUR OR ITS INDIVIDUAL CAPACITY, AND NOT AS A PLAINTIFF OR CLASS MEMBER IN ANY PURPORTED CLASS OR REPRESENTATIVE PROCEEDING.").

[122] Benjamin Sachs-Michaels, *The Demise of Class Actions Will Not Be Televised, 12 Cardozo J. Conflict Resol. 665, 665 (2011)*.

[123] Christopher R. Drahozal & Peter B. Rutledge, Arbitration and Consumer Credit 8 (Univ. of Kan. Sch. Of Law, Working Paper No. 2011-3, 2011) (hereinafter Drahozal & Rutledge, Arbitration & Consumer), available at <u>http://ssrn.com/abstract=1880154</u>.

[124] *See,* Michael A. Satz, *Mandatory Binding Arbitration: Our Legal History Demands Balanced Reform*, 44 IDAHO L. REV. 19, 25-26 (2007) ("Business actors are seen as being more sophisticated, repeat players in the conduct of their affairs, or at the very least, they are seen as having access to more sophisticated resources in the form of lawyers and advisors. This sophisticated, business-to-business, repeat player model is a critical component for the theoretical argument in favor of arbitration in general: the actors in a typical business transaction will know the business and industry norms; they will likely have an institutional knowledge of the transaction and transaction-type at issue; they will have the resources to effectively advocate their position in an arbitration; and they will be more likely to 'self-police' when, where, and how they press their claims because they deal with far fewer business actors than consumer actors.").

[125] Meredith Goldich, *Throwing Out the Threshold: Analyzing the Severability Conundrum Under Rent-A-Center, West, Inc. v. Jackson*, 60 AM. U.L. REV. 1673, 1679 (2011).

[126] *See, Drahozal*, *supra* note 123, at 28 (citing David B. Lipinsky & Ronald L. Seeber, *The Appropriate Resolution of Corporate Disputes: A Report on the Growing Use of ADR by U.S. Corporations,* 17, 26 (1998)).

[127] *Goldich*, *supra* note 125, at 1679.

[128] *See,EDWARD BRUNET ET AL., ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT, 149 (2006)*.

[129] *See, id.*

[130] *Brown Pontiac-Olds, Inc.*, No. 05-204-P-H, 2006 WL 318827, at *3 (D. Me. Feb. 9, 2006) (unpublished).

agreement, in which the arbitration clause is "quite broad."[131] An arbitration clause that defines its scope to include "[a]ll claims, disputes and other matters in question arising out of, or relating to, this Agreement or the breach thereof" is an example of such a broad arbitration clause.[132] An arbitration agreement with this scope creates a presumption that arbitration will govern all claims that a franchisee brings against a franchisor, and only those claims that in no way fall under the franchise agreement's terms avoid being subject to arbitration.[133] In *Arciniaga v. General Motors Corp.*, the court reasoned that "[h]aving made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue."[134]

While long ago, courts showed "hostility" toward arbitration agreements,[135] enactment of the Federal Arbitration Act in 1925 reversed that viewpoint.[136] Today, federal policy strongly favors arbitration, and such clauses are "often and emphatically applied."[137] To reduce the likelihood of a franchisee challenging, or succeeding in a challenge, to an arbitration provision, franchisors should follow all substantive and procedural requirements for execution of enforceable arbitration agreements, and then remind discontented franchisees – at the beginning of any dispute – that the parties clearly intended that all disputes proceed through arbitration, the parties' only available remedy against the other.[138] The franchise agreement must clearly indicate a mutual assent to be bound for an arbitration agreement to bind the franchisee.[139]

The reach of arbitration agreements is not limitless, and franchise agreements that cross the line may trigger challenges by franchisees and result in litigation, the very event arbitration was intended to avoid. In *Chin v. Advanced Fresh Concepts Franchise*, the parties disputed whether the court or the arbitrator should determine whether the arbitration provision was unconscionable. The arbitration provision included a delegation clause, which said:

> Any dispute that rises out of or relates directly or indirectly to this Agreement or the relationship of the parties hereto, including without limitation, any claimed breach of this Agreement or any claim that any part of this Agreement (including this Section 16.8 or any part thereof) is invalid, illegal, voidable, or void, shall be resolved by arbitration . . . .[140]

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[131] *Id.* at *3.

[132] *Id.*

[133] *Id.*

[134] *Arciniaga v. Gen. Motors Corp.*, 460 F.3d 231, 235 (2d Cir. 2006) (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

[135] *Id.* (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991)).

[136] *Id. at* 235.

[137] *Id.*

[138] *Awuah v. Coverall N. Am., Inc.*, 843 F. Supp. 2d 172, 178-79 (D. Mass. 2012) (unpublished).

[139] *Id.* at 178.

[140] *Chin v. Advanced Fresh Concepts Franchise Corp.*, 194 Cal. App. 4th 704 (2011).

Under its terms, this clause would delegate the responsibility of determining whether the arbitration was unconscionable to an arbitrator, where that question would otherwise be decided by a court. The court noted that delegation clauses have been held unconscionable in adhesion contracts, and also considered the conflicts of interest that arise from placing the power to decide if arbitration continues in the hands of a paid arbitrator. Ultimately, the court held that declaring the delegation clause unenforceable would have no effect unless the arbitration provision was unconscionable and, in this case, it was not.[141]

Even non-signatories to an original arbitration agreement also can be required to arbitrate in certain circumstances.[142] The First Circuit applies contract and agency principles to bind non-signatory franchisees, while the Second Circuit uses incorporation by reference, agency, assumption, estoppel, and veil-piercing and alter ego concepts.[143] In the Fifth Circuit, courts apply the doctrine of direct benefits estoppel, whereby non-signatories are bound by the agreement's arbitration provisions because they "knowingly exploited" the contract during its life.[144] A Texas court held that a franchisor could compel a franchisee to arbitrate claims against non-signatory agents of the franchisor under these same theories, as long as the subject matter would be covered by the franchise agreement.[145] Because contract law permits incorporation by reference, courts permit arbitration agreements to be incorporated by reference, as well.[146] A franchisor may force a non-signatory to arbitrate any disputes against that franchisor, who was a party to the arbitration agreement, if the franchisor and that non-signatory have a contractual relationship that incorporates an arbitration clause from another agreement.[147]

The case of *Awuah v. Coverall North America, Inc.* illustrates the nuances involved with determining whether a non-signatory is bound to arbitrate in the context of franchisees that obtained their franchises from prior franchisees.[148] To facilitate those transfers, consent to transfer agreements were executed, which did not contain an arbitration clause but did, however, state that the transferee franchisees would "succeed to all of [the] Franchisee's rights and obligations" under the franchise agreement.[149] If the arbitration provision was binding on the transferees, the result was exclusion from the pending class action; if not binding, then transferees were part of the class certified. Although the franchisor must provide "some minimal level of notice" to the franchisee that claims must proceed through arbitration,[150] "the sufficiency

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141 *Id.*

142 *Awuah*, 843 F. Supp. 2d at 176.

143 *McCarthy v. Azure*, 22 F.3d 351, 356 (1st Cir.1994); *Thomson–CSF, S.A. v. Am. Arbitration Ass'n*, 64 F.3d 773, 776 (2d Cir.1995).

144 *Noble v. Certex*, 620 F.3d 469, 473 (5th Cir. 2010).

145 *Salad Bowl Franchise Corp. v. Crane*, No. 3:11–CV–0043, 2011 WL 942239, at *4 (N.D. Tex. Mar. 17, 2011) (unpublished).

146 *Awuah*, 843 F. Supp. 2d at 178-79.

147 *Id.*

148 *Id.*

149 *Id.*

150 *Id.* at 179.

of the notice turns on whether, under the totality of the circumstances, the . . . communication would have provided a reasonably prudent [franchisee] notice of the waiver of the right to proceed in a judicial forum."[151] Ultimately, the court decided that the transferee franchisees must be treated differently, as two groups, based on the documents actually provided to the transferee franchisees. Transferees receiving the franchise offering circular, which included a conspicuous, capitalized reference to the franchisee agreement containing the arbitration agreement were held to have adequate notice of the arbitration clause and, accordingly, bound by it.[152] However, other transferees whose consent to transfer agreement contained no mention of arbitration and did not receive the franchise offering circular were not bound to arbitration because "[t]he mere expression 'shall succeed in all rights and obligations' without minimum notice of the arbitration clause, is insufficient to bind the Transferees to the arbitration clause."[153]

Rather than adopting a blanket alternative dispute resolution requiring arbitration for all claims, franchisors may wish to specify which, if any, types of claims may go to court. For example, franchisors may seek to advance claims, outside of arbitration, against the franchisee for injunctive relief, or Lanham Act claims related to infringing trademarks or trade dress. In addition, franchisors have succeeded in having claims dismissed when the franchisee's complaint did not completely adhere to the franchise agreement's specific requirements for asserting claims in court rather than arbitration.[154] In *Guirguis v. Dunkin' Donuts Inc.*, the franchisor included a detailed arbitration clause in the franchise agreement that permitted the franchisee to make claims in court only if the franchisee waived the right to jury trial and all claims for punitive damages.[155] The court held that the franchisee's complaint failed to make the necessary waivers by including both a jury demand and claim for punitive damages, so the franchisee was forced to pursue claims in arbitration.[156]

2. <u>Post *Concepcion* Implications</u>

The U.S. Supreme Court decision of *AT&T Mobility LLC v. Concepcion*,[157] is critical to the determination of the enforceability of class action waiver provisions in arbitration agreements, including those embedded in many franchise agreements. The Court held in *Concepcion* that the Federal Arbitration Act (FAA) preempts California's law rendering class arbitration waivers unconscionable and unenforceable.[158] This decision, and the state and federal court decisions that have followed it, dictate that, regardless of state law, class action waivers in franchise agreements likely will be upheld.

[151] *Id.* at 179-80.

[152] *Id.* at 180-81.

[153] *Id.* at 181.

[154] *Guirguis v. Dunkin' Donuts Inc.*, No. 09-5118, 2010 WL 715514, at *3 (D.N.J. Mar. 1, 2010) (unpublished).

[155] *Id.*

[156] *Id.*

[157] *Concepcion*, 131 S. Ct. 1740.

[158] *Id.* at 1752.

Vincent and Liza Concepcion sued AT&T Mobility, an AT&T subsidiary, for false advertising and fraud after they were charged approximately $30 in sales tax for a phone that they were promised for free. Their cell phone service contract not only provided for arbitration of all disputes, it also required the parties to arbitrate only in the "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding." It also prohibited the arbitrator from consolidating the claims of more than one person, or from presiding over any form of representative or class proceeding.[159]

A trial court denied AT&T Mobility's motion to compel the Concepcions to arbitrate and the Ninth Circuit affirmed, both courts concluding that the class arbitration waiver was unlawful under a California case, *Discover Bank v. Superior Court*.[160] The California Supreme Court had held in *Discover Bank* that waivers of the ability to bring a class action in an arbitration agreement – where the waiver was in an adhesion contract and involved small damages, and when one party possessed superior bargaining power and used it to "carr[y] out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money . . . . are unconscionable under California law and should not be enforced."[161] A majority of the United States Supreme Court reversed and ordered the Concepcions to arbitrate individually their claims against the company. The opinion stated that the principal advantage of arbitration, its informality, would be sacrificed by classwide arbitration and that the time-consuming nature of such proceedings and numerous procedural issues make arbitration "poorly suited" to the higher stakes of class litigation.[162] Accordingly, the majority concluded that a collective or representative action, convenient as it may be as a method to try to "pressure defendants into settling questionable claims," is not available in this context absent the post-dispute consent of both parties.

The United States Supreme Court's earlier protection of arbitration in *Stolt-Nielsen*, which required express consent of the parties for class arbitration to take place,[163] was expanded by the *Concepcion* holding. The *Concepcion* majority held that since the FAA's overarching purpose is to "ensure the enforcement of arbitration agreements according to their terms," requiring class arbitration on a non-consensual basis would interfere with Congressional intent.[164] Calling *Stolt-Nielsen* "instructive," the *Concepcion* majority also noted that class-wide arbitration is a "structural matter" that includes absent parties, necessitating additional and different procedures and concerns about confidentiality that are not present in the traditional arbitration setting.[165]

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[159] *Id.* at 1744, n.2.

[160] 36 Cal. 4th 148 (2005).

[161] *Id.* (quoting Cal. Civ. Code Ann § 1668).

[162] *Concepcion,* 131 S. Ct. at 1751-52.

[163] *Id.* at 1775-76.

[164] *Id.* at 1748 (citing *Volt Info. Sci., Inc. v. Board of Trustees of Leland Stanford Jr. Univ.,* 489 U.S. 468, 479 (1989)).

[165] *Id.* at 1750-51.

Through *Stolt-Nielsen* and *Concepcion*, the United States Supreme Court has made it clear class arbitration proceedings cannot be forced upon parties without explicit agreement to arbitrate on a classwide or representative basis.

This logic has been applied in the franchise context. In *Green v. SuperShuttle Int'l, Inc.*,[166] the Eighth Circuit applied *Concepcion* to affirm an order compelling arbitration and enforcing a class waiver. The court said:

> *Green* . . . contends the class action waivers in the UFAs [franchise agreements] are unenforceable under Minnesota law. . . . Like the phone customers in *Concepcion* who based their challenge to the enforceability of a class action waiver provision upon California law, *Green* and the other drivers make a Minnesota-state-law based challenge to the enforceability of the class action waivers in the UFAs. Our reading of *Concepcion* convinces us the state-law-based challenge involved here suffers from the same flaw as the state-law-based challenge in *Concepcion* – it is preempted by the FAA.[167]

3. <u>Potential Franchisee Arguments Challenging Arbitration and Class Arbitration Waiver</u>

Franchisees still have arguments at their disposal to defeat an arbitration clause. For example, the Ninth Circuit has held that franchisees cannot be forced to forfeit their statutory rights[168] under the federal Petroleum Marketing Practices Act ("PMPA").[169] In *Graham Oil*, the Ninth Circuit severed the arbitration clause from the underlying agreement, reasoning that the clause operated to strip the franchisee of its "statutorily mandated" rights under the PMPA (e.g., to recover damages and attorneys' fees, and, otherwise, limiting the timeframe in which the franchisee was entitled to file a claim under the PMPA). Though the decision arose in the context of an analysis of the PMPA, the logic of the decision conceivably could apply to other statutory claims to the extent that the underlying arbitration clause substantively limits a franchisee's rights to assert other statutory claims.[170] Thus, depending on the circuit (and on how courts apply *Concepcion*), the door may remain open for franchisees to assert they would be losing important statutory benefits if forced to arbitrate.

Other potentially effective arguments include the franchisee asserting that: (1) the franchisee's statutory claims are not covered by the agreement at all, and are thus not covered

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[166] *Green v. SuperShuttle Int'l, Inc.,* 653 F.3d 766 (8th Cir. 2011).

[167] *Id.* at 769.

[168] Specifically, the distributor would lose the ability to collect exemplary damages, 15 U.S.C. § 2805(d)(1)(B), and attorneys' fees, 15 U.S.C. § 2805(d)(1)(C) if it was victorious, and it also would forego the one-year statute of limitations under the Act, 15 U.S.C. § 2805(a).

[169] *Graham Oil Co. v. ARCO Prods. Co.,* 43 F.3d 1244, 1247 (9th Cir. 1994) ("the fact that franchisees may agree to an arbitral forum for the resolution of statutory disputes in no way suggests that they may be forced by those with dominant economic power to surrender the statutorily-mandated rights and benefits that Congress intended them to possess.").

[170] *See id.*

by the arbitration clause;[171] (2) the franchisee's tort claims are not governed by an arbitration clause;[172] (3) the conduct in question took place following the conclusion of the contract, and thus was not covered by the arbitration clause;[173] and (4) the clause is unconscionable.[174]

Unclear following *Concepcion* is the extent to which prior case law limiting enforcement of class arbitration waivers remains intact. For example, franchisees fighting a class arbitration waiver might point to earlier cases recognizing that mandatory arbitration could deprive a plaintiff of the ability to "effectively […] vindicate its statutory cause of action in the arbitral forum."[175] The Second Circuit Court of Appeals recently followed this line of reasoning and refused to enforce a class action waiver where the "practical effect" would be to deprive the plaintiffs of their statutory rights under the Sherman and Clayton Acts.[176] The court referenced two pre-*Concepcion* cases, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.* and *Green Tree Financial Corp.-Alabama v. Randolph*, that laid the foundation for a federal recognition of a case's "arbitrability."[177] The court relied on an affidavit indicating it would be irrational to bring an individual antitrust claim because the expert witness fees alone could be between $300,000 and $2 million dollars. Although *Concepcion* casts considerable doubt on whether state statutory claims merit arbitrability analysis, before it was decided the Court of Appeals for the District of Columbia, in an opinion written by now Chief Justice John Roberts Jr., presumed that state claims' vindication would require a forum outside of arbitration.[178]

Because some courts have interpreted *Concepcion* to preempt only state law, franchisees that have federal statutory claims may still have a credible basis for challenging the class arbitration waiver. Those franchisees without such additional claims may have to be somewhat creative. Although the franchisee does not have a private right of action under the FTC Act, they may if the state has a "little FTC Act."[179] It remains to be seen whether

[171] *Campbell v. TES Franchising, LLC*, 2005 Ohio 2271, Bus. Franchise Guide (CCH) ¶ 13,071 (Ohio Ct. App. 2005) (reasoning that statutory claims were not covered by an arbitration agreement because a violation did not involve a violation, by either party, of the terms of the agreement).

[172] *Old Republic Ins. Co. v. Lanier*, 644 So. 2d 1258 (Ala. 1994) (holding that an arbitration clause that covered "any dispute arising out of this franchises agreement" would extend only to claims that concern direct contract or contract performance disputes, excluding controversies such as interference with business relationships and conversion of client information).

[173] *Basketball Mktg. Co. v. Urbanworks Entm't*, Bus. Franchise Guide (CCH) ¶ 12, 953 (E.D. Pa. 2004) (holding that an arbitration clause did not apply to post-termination disputes).

[174] *Independent Ass'n of Mailbox Ctr. Owners v. Superior Court*, 133 Cal. App. 4th 396 (2005) (holding a franchise agreement's arbitration provisions were unconscionable because plaintiff would be precluded from receiving punitive, consequential, and other forms of damages such as attorneys' fees).

[175] *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637, 105 S. Ct. 3346, 3359-60 (1985).

[176] *In re American Express Merchants' Litig.*, 667 F.3d 204 (2d Cir. 2012). *See also Coiro v. Wachovia Bank*, *N.A.*, No. 11–3597, 2012 WL 628514, at *4 (D.N.J. Feb. 27, 2012) (interpreting *Concepcion* to apply only to categorical rules and applying unconscionability doctrine to a class action waiver).

[177] *Mitsubishi Motors Corp.,* 473 U.S. at 632; *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000).

[178] *Booker v. Robert Half Int'l Inc.*, 413 F.3d 77, 79 (D.C. Cir. 2005); *but see In re American Exp. Merchants' Litigation*, 667 F.3d 204, 213 (2012) ("*Concepcion* plainly offers a path for analyzing whether a state contract law is preempted by the FAA.").

[179] *See, e.g.,* CAL. BUS. & PROF. CODE § 17001; MASS. GEN. LAW ch. 93A § 9; N.H. REV. STAT. § 358-A:10; OHIO REV. CODE § 1345.09; TEX. BUS. & COM. CODE § 17.50.

franchisees will be able to successfully assert that their statutory rights may only be vindicated by presenting their claims on a classwide basis.

4. How and Why Franchisees Oppose Class Action Waivers

Franchisees have successfully opposed a class action waiver in court proceedings by suggesting that such a waiver frustrates the purpose of Rules 23 and 42 of the Federal Rules of Civil Procedure. For example, in *Martrano v. Quizno's Franchise Co.*, a Western District of Pennsylvania court explained that federal courts, while sitting in diversity, will apply state substantive law to interpret a contract, but that procedural issues are governed by federal law.[180] The court further held that "[c]onsolidated and class-wide adjudication are clearly *procedural* devices governed by specific Federal Rules."[181] The court went on to examine whether enforcement of the contractual class action waiver would comport with the language and purpose of Rules 23 and 42.[182] The court concluded that Rules 23 and 42 were designed to further efficient judicial administration and that the contractual class action waiver operated to frustrate the purpose of these Rules.[183] The court reasoned that enforcement of the class action waiver would too greatly expand the number of cases that might conceivably be tried separately.[184] Accordingly, the court opined that, under the Federal Rules, "the ultimate governing standard is furtherance of efficient judicial administration, which leaves no room for enforceability of private agreements among litigants to forego the efficiencies potentially afforded by consolidated or class action."[185]

Real incentives exist for franchisees to oppose class action waivers. Perhaps the most significant benefit for franchisees who can avoid them is the ability to claim *res judicata* and issue preclusion once a class has been certified. A group of franchisees might also allow one franchisee to bring a suit in the hopes of a favorable outcome, and then, later, seek to have that outcome apply to all of them against the franchisor. An example of this is provided by *Bayshore Ford Truck v. Ford Motor Co*.[186] That case centered on Ford Motor's termination of its heavy truck division in 2007. Ford stopped supplying heavy trucks to its dealers, and certain named plaintiffs sued for breach of contract. The court accepted plaintiffs' claim, and granted summary judgment. Subsequently, a class of plaintiffs was certified, and that class sought to have the prior summary judgment ruling applied to the whole class. Ford resisted the motion, seeking to re-litigate issues that had been decided by the court almost four years before. The court rejected Ford's efforts as untimely, and held that the earlier summary judgment ruling may appropriately be applied to all class members.[187]

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[180] *Martrano v. Quizno's Franchise Co.*, L.L.C., No. 08-0932, 2009 WL 1704469, at *20 (W.D. Pa. June 15, 2009).

[181] *Id.* at *20 (italics added).

[182] *Id.*

[183] *Id.* at *21.

[184] *Id.*

[185] *Id.*

[186] *Bayshore Ford Truck v. Ford Motor Co.,* Bus. Franchise Guide (CCH) ¶ 14,274 (D.N.J. Nov. 16, 2009).

[187] *Id.*

Class actions may allow franchisees to pool resources and leverage their collective strength against the franchisor: "A large group of franchisees acting in concert can accomplish missions that are simply inaccessible to the single franchisee acting alone."[188] A recent example of franchisees grouping together to allege common franchisor misconduct was *Moua v. Jani-King of Minnesota, Inc.*[189] Plaintiffs alleged breach of contract, violation of the covenant of good faith and fair dealing, and numerous other claims, alleging they were promised that after they paid the franchise fees, completed training, and obtained supplies and equipment, they would receive a certain amount of business monthly. Plaintiffs argued that defendant knew it had insufficient cleaning and janitorial accounts to provide the promised amount of business. Plaintiffs sought class certification under Federal Rule of Civil Procedure 23(b).[190] Each class member received a nearly identical franchise agreement, and each asserted a violation of the same provisions of that franchise agreement. Nonetheless, the court refused to certify the class, holding that because individual testimony from each class member would be required to prove that individual members received the same treatment, and because each class member would have to prove how those tactics prevented that class member from realizing the minimum amount of monthly business that had been promised, plaintiffs failed to show predominance.[191] Similarly, because plaintiffs' good faith claims (alleging that Jani-King (1) intentionally offered accounts to class members when they could not be performed because the work had to be completed at a certain time of day, and (2) offered accounts to multiple franchisees and then counted that account against each franchisee who received the offer) required independent evidence, they could not meet the test of predominance.[192] This case highlights the difficulties that franchisees may expect to face upon initiating a class action. These barriers are hardly insurmountable, and recent experience has shown certain types of claims are more likely to survive class certification than others.[193]

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[188] Fundamentals of Franchising 304 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed. 2008).

[189] *Moua v. Jani-King of Minnesota, Inc.*, No. 08-4942, 2010 U.S. Dist. LEXIS 23462 (D. Minn. Mar. 12, 2010) (unpublished).

[190] Fed. R. Civ. P. 23(b)(3) (requiring common questions of law or fact that "predominate" over questions affecting individual members and class resolution is "superior" to other methods for resolving the controversy).

[191] *Moua*, 2010 U.S. Dist. LEXIS 23462, at *8-*10.

[192] *Id.*, 2010 U.S. Dist. LEXIS 23462, at *10-*13.

[193] Franchisees have survived class certification at least two times in the last five years where they claimed the franchisor was wrongfully classifying them as independent contractors when they are actually employees. *Awuah,* 843 F. Supp. 2d 172; *De Giovanni v. Jani-King Int'l, Inc.*, 262 F.R.D. 71, 84-88 (D. Mass. 2009). The primary battle between the parties in *Giovanni* was predominance, Fed. R. Civ. P. 23(b)(3). Resolving the issue of whether common questions of law and fact predominated, the court first stated the necessary elements that must be satisfied in order to be an "independent contractor". The services "at issue are performed[:]"

(a) free from control or direction of the employing enterprise;

(b) outside of the usual course of business, or outside of all the places of business, of the enterprise; and

(c) as part of an independently established trade, occupation, profession, or business of the worker.

De Giovanni, 262 F.R.D. 71, 84 (quoting *Athol Daily News v. Bd. of Review of the Div. of Employment & Training*, 439 Mass.171, 175, 786 N.E.2d 365, 369 (2003)).

(continued...)

V. NEUTRAL INTERPRETATION OF FRANCHISE AGREEMENT

Another basic concept of contract law is the doctrine of *contra proferentem*, which translates from Latin to mean "against the offeror."[194] This principle is a secondary method of construction that applies when there is some ambiguity in the document, and is applied most frequently to contracts of adhesion.[195] Parties seeking a favorable interpretation of an ambiguous term in a contract argue that this doctrine applies, hoping to persuade the court to adopt a construction favorable to the non-drafting party.[196] Courts and attorneys representing the parties to franchise disputes are familiar with the typical method of forming a franchise agreement, which usually begins with presentment of the franchisor's standard or form agreement to the prospective franchisee for review and execution.

This practice capitalizes on two central components of the franchise model, efficiency and economies of scale, but it also has significant drawbacks. In addition to promoting the incorporation of boilerplate language into agreements, it also has implications for how the franchise agreement is interpreted in most jurisdictions. Because the franchisor is typically the primary (or only) drafter of the franchise agreement, franchisees argue that the agreement should be interpreted against the franchisor,[197] and present challenges to franchisors hoping to proactively counteract or nullify those arguments in litigation.

Franchisees typically argue that they play no meaningful part in the actual drafting of commonly litigated sections of the franchise document and, therefore, that the *contra proferentem* principle should apply; one of the main reasons to apply the doctrine is that "the language is presumptively within the control of the party drafting the agreement[.]"[198] Franchisees should assert that their lack of bargaining power and inability to modify the contract language ought to mean that any ambiguities in the meaning of the contract must be resolved in their favor. In order to advocate effectively for application of the *contra proferentem* principle, franchisees should proffer reasonable interpretations of ambiguous contractual terms because a

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(...continued)
The court recognized that the defendants had not presented any issues that would complicate the inquiry of what type of business the purported class, or defendants' business itself, had. The court also concluded predominance would not be an issue on prong (c); common issues would be presented in determining whether plaintiffs relied on a single employer to provide much of their income or whether the franchisees could work for anyone who wished to hire them. *Id.* at *31. Element (a) proved to be the closest issue; the variety of different ways the franchisees operated ("including whether they chose to incorporate their franchises, to hire employees, or to sell their franchises") arguably made the franchisees claims not predominate. The court was persuaded that the similarities between the areas of control of the franchisees over their own business, and the control the franchisor imposed over the franchisees, could be discovered by considering the same facts and therefore certified the class. *See id.* at *32.

[194] BLACK'S LAW DICTIONARY 377 (9th ed. 2009).

[195] *Id.*

[196] 5-24 Corbin on Contracts § 24.27 ("When the terms of a written contract have been authored by one of the parties and merely assented to by the other, this fact will in some cases influence the interpretation that the court will give to these terms. . . . If, however, it is clear that the parties did attempt to make a valid contract and the only remaining question is which of two possible and reasonable meanings should be adopted, the court will often adopt the meaning that is less favorable in its legal effect to the party who chose the words.").

[197] *Thompson v. Amoco Oil Co.*, 903 F.2d 1118, 1121 (7th Cir. 1990) (noting that franchisee argued that the franchise agreement, as a contract of adhesion, should be construed against the interests of the drafter: the franchisor).

[198] 11 Williston on Contracts § 32:12 (4th ed.).

material difference between the express language and the suggested interpretation arguably will kill a franchisee's claim.

Not surprisingly, franchisors have responded by seeking to contract around the doctrine of *contra proferentem* by the use of contractual language calling for neutral interpretation of the franchise agreement. These clauses[199] posit that the franchise agreement was jointly drafted and, therefore, should not be construed against either party. A sample "neutral interpretation" clause may read:

> This Agreement shall be construed according to its plain meaning and neither for nor against either party hereof regardless of which party's counsel drafted the provision. Neither this Agreement nor any uncertainty or ambiguity herein shall be construed or resolved against the drafter hereof, whether under any rule of construction or otherwise. On the contrary, this Agreement has been reviewed by all parties and shall be construed and interpreted according to the ordinary meaning of the words used so as to fairly accomplish the purposes and intentions of all parties hereto.[200]

Beyond the contractual text, courts will look at the actual process of the negotiation and examine how the parties entered into the franchise relationship. Presenting evidence that the parties did, in fact, exchange proposals (i.e., regarding the would-be terms of the franchise agreement) may also assist the primary drafter of the agreement in avoiding application of the *contra proferentum* principle. This only works, however, if there actually has been some negotiation. When a track record of negotiations is both presented to and accepted by the court, the application of *contra proferentem* can be avoided. As one court reasoned:

> [T]he parties were free to negotiate the terms of the franchise agreement, and did so. Despite fairly extensive negotiations regarding the terms of the agreement between [franchisor and franchisee], the terms of the arbitration clause in the agreement were never modified or at issue, and the terms of the arbitration clause never changed throughout the various drafts of the agreement. Further, the arbitration clause was in the same font size as the rest of the agreement and was also in bold face in all copies of the agreement.[201]

Prior to executing an agreement with franchisees, and well before litigation commences, franchisors can take steps in drafting their standard franchise agreements to reduce ambiguities that may become the subject of future debate.[202] In many jurisdictions, construction of an

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[199] Cincinnati Bell, Inc., Annual Report (Form 10-K) (Feb. 26, 2009) (including an agreement with the following clause: "<u>Neutral Interpretation</u>. This Agreement constitutes the product of the negotiation of the parties hereto and the enforcement hereof shall be interpreted in a neutral manner, and not more strongly for or against any party based upon the source of the draftsmanship hereof.").

[200] http://www.maslynlaw.com/wp-content/uploads/2011/11/IFA-Franchise-Agreement-Drafting-Paper-2005.pdf.

[201] *Vishal Hospitality, LLC v. Choice Hotels Int'l, Inc.*, 939 So.2d 414, 417 (La. Ct. App. 2006).

[202] *Cranpark, Inc. v. Rogers Grp. Inc.*, 721 F. Supp. 2d 613, 621 (N.D. Ohio 2010) ("*If the language in the contract is ambiguous*, the court should generally construe it against the drafter" (emphasis added)."); *DVD Copy Control Ass'n, Inc. v. Kaleidescape, Inc.*, 176 Cal. App. 4th 697, 716 (2009) ("Since we find the extrinsic evidence resolves any ambiguity in the contract language, application of that rule is beside the point.").

agreement against the drafter is a tool of "last resort,"[203] and can become unnecessary where the court determines that no ambiguity requires the use of the doctrine of *contra proferentem*. In *KFC Corp. v. Wagstaff Minn., Inc.*, a debtor in bankruptcy owned and operated 77 Kentucky Fried Chicken restaurants and entered into agreements to sell the franchises to a subsequent purchaser.[204] The court declined to construe the agreement against the drafter, the franchisor, stating:

> [W]here the parties' intent is clear from the documents. There are no allegations that Debtors were not sophisticated, and the record states that the parties engaged in "extended negotiations" to arrive at the Reinstatement Agreement and New Franchise Agreement. The parties entered into the agreement knowingly and with the same mutually beneficial intent . . . . *There is no need to resort to contra proferentem.*[205]

Additionally, the franchisor should be aware that other sources of law may specify how an ambiguity is to be construed. For instance, the ambiguities regarding arbitration under the Federal Arbitration Act are construed neither for nor against a party, but "in favor of arbitration, notwithstanding the rule that a contract is construed most strongly against the drafter."[206]

VI. CONTRACT MODIFICATION PROVISIONS

Franchise agreements, even when carefully prepared by franchisors, cannot and often do not adequately account for changing conditions in the marketplace, the law, or the franchise business model. Like any contract, the parties must be able to modify the agreement to remain competitive and react to recent events. The black letter law of contracts obviously allows for changing an agreement after it is executed: "A 'modification of a contract' is a change in one or more respects, which introduces new elements into the details of the contract and cancels others but leaves the general purpose and effect undisturbed."[207]

The franchise model presents unique challenges, because franchisees may not always see the franchisor's proposed system modifications to be in the franchisees' best interests (or, instead, view the proposed modifications as a chance to extract larger concessions in exchange for consent). Franchisors have developed common provisions and mechanism to address these problems, which coexist within a framework of statutes that may limit the effectiveness of franchisors' attempt to harmonize franchise agreements across many different franchisees.[208]

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[203] *Elliott v. Pikeville Nat'l Bank & Trust Co.*, 128 S.W.2d 756, 760 (Ky. 1939).

[204] *KFC Corp. v. Wagstaff Minn., Inc.*, No. 11-2450, 2012 U.S. Dist. LEXIS 372 (D. Minn. Jan. 3, 2012).

[205] *Id.* at *40.

[206] *Chan v. Drexel Burnham Lambert, Inc.*, 178 Cal. App. 3d 632 (1986).

[207] 7A Am. Jur. 2d Contracts § 507 (2012).

[208] *Bray v. Tejas Toyota, Inc.*, 363 S.W.3d 777, 781-82 (Tex. Ct. App. 2012) (applying Texas statute and concluding that "notice of a right to protest be given to a franchisee, nor good cause established, unless a modification to a franchise agreement or a replacement agreement would adversely affect to a substantial degree the dealer's sales, investment, or obligations to provide service to the public. We conclude that if there is no substantive difference between the replacement contract and the replaced contract, there is no substantial adverse effect as a matter of law.
(continued...)

A. Trend Toward Unilateral Modification by Franchisors

A franchisor may be in a position to unilaterally modify a franchise agreement, without giving notice to the franchisee, if the franchise agreement allows the franchisor to take such action.[209] One such provision, later challenged in litigation, stated:

> [Franchisor] will have the right to amend this Agreement to the extent that [Franchisor] deems advisable, provided that [Franchisor] makes the same amendment in [Franchisor's] Sales and Service Agreements generally.[210]

Today, courts increasingly permit franchisors to modify their franchise agreements without providing notice to the franchisees as an extension of the common law of contracts.[211] Some states, including Illinois and Texas, limit the extent to which a franchisor may unilaterally modify a franchise agreement,[212] applying the contract principle that a modification requires a meeting of the minds and, therefore, unilateral modification is only appropriate if the franchise agreement allows it explicitly. Other states will not enforce unilateral modification provisions that permit substantial modification of the franchise agreement without the franchisor's written consent.[213] In those states, a court will not enforce the parties' mutual agreement to allow a franchisor to make substantial changes to the franchise agreement without consent of the franchisee.[214] Not surprisingly, differences arise when a franchisor seeks to characterize its proposed, unilateral changes as being insubstantial because a franchisee may not share the franchisor's perspective.[215] Unilateral modification provisions are particularly relevant for choice-of-law provisions, arbitration provisions, and class arbitration waivers.[216] Still other

(...continued)
It is undisputed that the contested provisions are either identical or substantively identical to the provisions in the previous franchise agreement").

[209] 17A C.J.S. Contracts § 560 (2012).

[210] *Kahlo Jeep Chrysler Dodge of Knightstown, Inc. v. DaimlerChrysler Motors Co., LLC*, 835 N.E.2d 526, 526-28 (Ind. Ct. App. 2005) (interpreting this language as permitting the franchisor "to make any modification to the agreement that it determined was necessary, provided it did so uniformly to all franchises").

[211] *Id.* at 530 ("Under the common law, for instance, it is "[f]undamental contract law that original contracts may provide for modification."), *appeal dismissed per stipulation Kahlo Jeep Chrysler Dodge v. DaimlerChrysler Motors Co., LLC*, No. 49S02-0602-CV-65, 2006 Ind. LEXIS 225 (Mar. 13, 2006).

[212] *See, e.g. Smith v. ERJ Dining, LLC*, 2012 U.S. Dist. LEXIS 22408, at *6-*7, no. 3 (N.D. Ill. Feb. 10, 2012)("In Texas, as in Illinois, a modification must satisfy the elements of a contract: a meeting of the minds supported by consideration. *Hathaway v. General Mills, Inc.,* 711 S.W.2d 227, 228 (Tex. 1986). (Because Plaintiff has not accepted Defendants' offer to modify the terms of the agreement, there was no valid modification.").

[213] *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128, 140 (7th Cir. 1990).

[214] *See, Wright-Moore Corp.*, 908 F.2d at 140 (stating that Indiana franchise law prohibits contract provisions that permit substantial unilateral modification of a franchise agreement by the franchisor).

[215] *See, e.g., id.* at 140.

[216] David Horton, *The Shadow Terms: Contract Procedure and Unilateral Amendments*, 57 UCLA L. Rev. 605, 623-40 (2010).

states require a franchisor to show good cause for unilaterally modifying a franchise agreement.[217] Finally, some states prohibit unilateral modification altogether.[218]

In states that restrict unilateral modification without prior notice to changes that do not substantially alter the parties' agreement, courts often broadly construe the meaning of "insubstantial changes" to permit franchisors to modify their franchise agreements. For example, in *Coady Corp. v. Toyota Motor Distributors, Inc.*, the court found that changing the length of the parties' franchise agreement from six years to two years did not constitute a substantial change.[219] Some courts have reacted favorably to provisions that expressly allow for future unilateral modification.[220] In *Clark v. BP Oil Co.*,[221] the court upheld a provision in an agreement between a dealer and a distributor that stated that "prices for all products [would] . . . be subject to change without notice to [the] [d]ealer."[222] Similarly, in *Duncan Services, Inc. v. ExxonMobil Oil Corp.*,[223] a Maryland district court upheld a provision that permitted a franchisor to have the privilege of freely assigning its franchisees to another company without any restrictions.[224] In addition, that court upheld a franchise agreement provision that provided that the prices at which ExxonMobil sold fuel to its franchisees were subject to change at any time without notice to the franchisees.[225] One court explained its reasoning as follows:

> We have not been directed to any other state that has a statute flatly prohibiting a franchise agreement from containing a provision that allows unilateral modification by the franchisor. In fact, such provisions seem to be generally acceptable. The editors of American Jurisprudence specifically advise: "A franchisor may wish to change the contracts with its franchisees in order to keep up with the competition . . . . [I]t is important that the franchise agreement be

[217] *Racine Harley-Davidson, Inc. v. State, Div. of Hearings & Appeals*, 278 Wis. 2d 508, 523-24, 692 N.W.2d 670, 678 (Wis. Ct. App. 2004) *rev'd*, *Racine Harley-Davidson v. State Div. of Hearings & Appeals*, 292 Wis. 2d 549, 600-601, 717 N.W.2d 184, 209 (Wis. 2006) (stating that Wisconsin prohibits unilateral modification unless franchisor shows good cause); *see Lois Latour, Inc. v. Va. Alcoholic Beverage Control Bd.*, 49 Va. App. 758, 767-68, 645 S.E.2d 318, 323 (2007).

[218] *Kahlo Jeep Chrysler Dodge of Knightstown, Inc.,* 835 N.E.2d 526 at 526; *LaGuardia Assocs. v. Holiday Hospitality Franchising, Inc.*, 92 F. Supp. 2d 119, 129 (E.D.N.Y. 2000).

[219] *Coady Corp. v. Toyota Motor Distrib., Inc.*, 346 F. Supp. 2d 225, 245 (D. Mass. 2003).

[220] *See, In re ConocoPhillips Co. Serv. Station Rent Contract Litig.*, No. M:09-CV-2040, 2011 WL 1399783 (N.D. Cal. Apr. 13, 2011) ("The fatal flaw in plaintiffs' allegation is that plaintiffs agreed in the 'RENTAL' section of their Dealer Station Leases that plaintiffs would pay to Conoco rent, as determined in accordance with Conoco's Rent Policy adopted by Conoco, 'in good faith and in the ordinary course of business.' ")

[221] 930 F. Supp. 1196 (E.D. Tenn. 1996).

[222] *Id.* at 1206-09.

[223] 722 F. Supp. 2d 640, 647 (S.D. Md. 2010).

[224] *Id.*

[225] *Id.*; *see also Metroil, Inc. v. ExxonMobil Oil Corp.*, 724 F. Supp. 2d 70, 81 (D.D.C. 2010) (enforcing a franchise agreement provision permitting franchisor to change prices at any time without notice).

drafted in such a manner as to make it clear that future system changes may be required.[226]

However, not all states share this view and some are less accommodating to franchisors who attempt to modify their franchise agreements.[227] In *Moore Corp. v. Ricoh Corp.*[228] for example, the court found that changes of credit and pricing terms were substantial modifications and, therefore, disallowed for lack of notice.[229] Under the requirements of Texas's specialized franchise statute,[230] a franchisor is allowed to modify unilaterally a franchise agreement, and, as long as the modification does not create any substantive difference between the original and modified documents, a franchisor does not have an obligation either to provide notice of the right to protest to the franchisee or to show good cause for the modification.[231] If, however, the franchisor's modification "would adversely affect to a substantial degree the dealer's sales, investment, or obligations to provide service to the public," the franchisor must provide adequate notice to the franchisee, and a court must resolve any resulting protests in favor of the modification.[232]

Indiana courts further demonstrate the need to investigate a jurisdiction's laws before a franchisor pursues unilateral modification.[233] The less accommodating Indiana statute[234] departs from the general trend toward permitting a franchisor to modify its franchise agreement with a franchisee[235] and, instead, applies a reasonableness test and a test of whether the modification "would not be justified by current economic conditions or reasonable business considerations" to determine whether a franchisee may challenge a franchisor's insubstantial unilateral changes to a franchise agreement.[236]

Franchisors should also carefully draft provisions allowing for modifications of operations manuals. Franchise agreements generally include an agreement by the franchisee to abide by

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[226] *Kahlo Jeep Chrysler Dodge of Knightstown, Inc,* 835 N.E.2d 526 at 531 (quoting 62B Am.Jur.2d 294, *Private Franchise Contracts* § 345 (1990)).

[227] TEX. OCC. CODE § 2301.454.

[228] 794 F. Supp. 844 (N.D. Ind. 1991).

[229] *Moore Corp. v. Ricoh Corp.*, 908 F.2d 128 (7th Cir. 1990) (finding a change of credit terms to be a substantial modification).

[230] TEX. OCC. CODE § 2301.454.

[231] *Bray,* 363 S.W.3d 777.

[232] *Id.* at 780; *Kahlo Jeep Chrysler Dodge of Knightstown, Inc.,* 835 N.E.2d at 531-32 (noting that "[i]n Texas, for example, a motor vehicle manufacturer-franchisor is prohibited from modifying a franchise agreement, "[n]otwithstanding the terms of any franchise," unless the manufacturer gives written notice to the dealer-franchisee and the Texas Motor Vehicle Board approves of the modification if the dealer objects to the proposed modification. Tex. Occ. Code § 2301.454. Thus, in Texas . . . there is an administrative limitation on actual attempts at modification").

[233] *See, Dersch Energies, Inc. v. Shell Oil Co.*, 314 F.3d 846, 852 (7th Cir. 2002).

[234] BURNS IND. CODE ANN. § 23-2-2.7-1.

[235] *Kahlo Jeep Chrysler Dodge of Knightstown, Inc.,* 835 N.E.2d 526 at 531.

[236] *Id.*

the provisions of a franchise system or operations manual, which states the rules and quality standards that franchisees must comply with in operating their franchises. Franchise agreements may also contain language allowing the franchisor to amend these manuals periodically. In certain cases, however, the language allowing modification of manuals has been interpreted narrowly, only encompassing those elements discussed in the franchise agreement. An example of such a case is *Stuller v. Steak N Shake*, where an Illinois court considered whether the franchisor could dictate new pricing requirements to franchisees.[237] The court agreed with the defendant franchisor that the franchisee had agreed to "comply with the entire System as revised from time to time by Defendants."[238] However, the court disagreed with the franchisor that the language of the franchise agreements was broad enough to allow the franchisor to alter prices, holding that "[t]he Agreements herein identify the specific items in the Operating Standards Manual that Defendants had the right to modify – products, services, standards of product quality – and do not specifically mention "'price.'"[239]

B. Franchisees Resist, Pointing to Mutual Modification Clause

Franchisors must consider a specific state's law before drafting provisions on operations manual revisions in order to avoid overly limiting their powers or allowing unchanged, default rules to control the franchise relationship. For example, nearly every contract includes an implied duty of good faith. A Florida court applied this principle to Burger King, allowing it to make changes to its franchise system, including imposing maximum prices for certain items, but placed restrictions on Burger King because it was bound to make those decisions in good faith, both by the language of its own franchise agreement and by the implied covenant of good faith under state law.[240]

In addition to challenges based on good faith obligations, franchisees have also successfully argued that, even where the franchise agreement contains a provision giving the franchisor discretion to unilaterally alter the terms of the parties' relationship, the franchisor must not exercise such discretion in a manner that conflicts with other commitments made by the franchisor under the agreement. For example, in *Bird Hotel Corp. v. Super 8 Motels, Inc.*, plaintiffs claimed that Super 8 breached its franchise agreement by imposing an additional 5% fee that was invoiced to all Super 8 franchisees as part of a customer reward program instituted by the franchisor.[241] The franchise agreement provided for four specific franchise fees and the 5% fee was not among them.[242] The franchisor filed a motion to dismiss on the ground that its action was protected by a provision which allowed it "[…] from time to time [to] make revisions in or amendments to such rules of operation which Franchisor shall apply uniformly to all Super 8 Motels[.]"[243] The court reasoned that "[t]he fact that Super 8 can revise the system and the

[237] No. 10-CV-3303, 2011 WL 2473330 (C.D. Ill. June 22, 2011).

[238] *Id.* at *6.

[239] *Id.* at *8.

[240] *National Franchise Ass'n v. Burger King Corp.*, 715 F. Supp. 2d 1232, 1240 (S.D. Fla. 2010), (citing *Burger King Corp. v. Ashland Equities, Inc.*, 217 F. Supp. 2d 1266, 1278 (S.D. Fla. 2002)).

[241] 245 F.R.D. 664, 644-45 (2007).

[242] *Id*. at 645.

[243] *Id*.

operating rules, […] does not necessarily mean it can unilaterally impose an additional new fee without breaching the franchise agreement."[244] Consequently, the court denied the motion to dismiss on the grounds that it was unclear whether the 5% charge was an additional franchise fee.[245]

Alternatively, franchisees may contend that allocating unlimited discretion to the franchisor invalidates portions of the agreement as illusory and unenforceable. In *Carey v. 24 Hour Fitness, USA, Inc.,* the Fifth Circuit held that an arbitration clause in an agreement was illusory because the defendant retained the unilateral right to modify or terminate the arbitration provision at any time, such that 24 Hour Fitness could have unilaterally avoided arbitration by simply modifying its Handbook.[246] Because the agreement to arbitrate was illusory, the Fifth Circuit affirmed the district court's denial of 24 Hour Fitness' motion to compel arbitration.

Franchisees also may rely on a mutual modification clause to defeat a claim for breach by the franchisor. In *The Tinder Box Int'l, LTD v. Patterson*,[247] the parties entered into an agreement to last for ten years which allowed the franchisees to renew for five more years upon meeting certain conditions. Once the agreement expired, the franchisees were prohibited from using the franchisor's marks and other "confidential methods and procedures, had to promptly pay all sums owed, and had to observe a one-year noncompete agreement."[248] The agreement expired on October 10, 2006, but the franchisor did not recognize the expiration for three months. The franchisor asserted that the parties' post-expiration conduct must be governed by the same terms as applied to the parties' relationship during the existence of the contract. The court disagreed, concluding that the franchisees' continued operation on a post-expiration basis "did not renew, extend, or alter" the franchise agreement's terms.[249] The court supported this conclusion by referencing a provision in the agreement that required a written agreement, signed by both parties, to alter the terms of the contract.

VII. MERGER AND INTEGRATION CLAUSES

Merger and integration clauses are among the most prevalent boilerplate in franchise agreements.[250] While the basic concepts behind these nearly ubiquitous provisions have remained constant over several decades, recent decisions in the franchising context demonstrate the nuances that still arise in litigation. Even these foundations of contract law can

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[244] *Id*. at 646.

[245] *Id*.

[246] *Carey v. 24 Hour Fitness, USA, Inc.*, 669 F.3d 202, 205 (5th Cir. 2012). ("[A]n arbitration clause is illusory if one party can 'avoid its promise to arbitrate by amending the provision or terminating it altogether' ") (quoting *In re 24R, Inc.*, 324 S.W.3d 565, 567 (Tex. 2010)).

[247] *Tinder Box Int'l, LTD. V. Patterson*, No. 07-cv-05014-JF, 2010 WL 2302298 (E.D. Pa. June 7, 2010) (unpublished).

[248] *Id.* at *1.

[249] *Id*. For this reason, the court dismissed all of the franchisor plaintiff's claims for breach. The court did, however, find the franchisee defendants to have committed a Lanham Act violation as a result of the defendants' continued post-expiration use of the franchisor's marks. *Id.* at *3.

[250] *See,* 6-25 Corbin on Contracts § 25.8 ("[A] large percentage of contemporary contracts contain a merger (or integration) clauses . . . .").

lead to unexpected consequences[251] and litigation on claims that the franchisor may have intended to bar.

A. **What's the Deal**

An off-the-shelf merger or integration clause typically recites that the written contract is the complete and entire agreement between the parties, and is designed to supersede any prior agreement between the parties, whether oral or written.[252] Several goals and policies lead to the inclusion of this standard provision in nearly all standard franchise agreements, notwithstanding significant issues that may jeopardize a party from realizing in litigation the benefits it believed had been part of the bargain. Before turning to the substantially different protection that an identical merger and integration can garner across all fifty states – and how these clauses can be modified to maximize their scope of protection – some of the bases of these important tools of contract law are discussed below.

Merger and integration clauses are used in franchise agreements and contracts generally to give finality and completeness to negotiations that are consummated in the form of a written agreement and to express that the parties intended the agreement to be "completely integrated." An agreement that is completely integrated increases certainty about the terms of the agreement by memorializing it in a writing that both parties declare to be a complete and final expression of their agreement.[253] Additionally, merger and integration clauses have historically been one method of combating allegations that there are other terms or agreements outside the written document, and to defeat claims based on fraud or misrepresentation.[254]

These basic concepts underlying merger and integration clauses are in tension with doctrines in contract and other areas of law.[255] For example, the parol evidence rule, when it applies as a result of a determination that an agreement is integrated, bars evidence of prior or contemporaneous statements that may otherwise be used to vary or contradict the parties' written agreement.[256] Under a strict application of the parol evidence rule, an adequate merger

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[251] *Duval Motors Co. v. Rogers*, 73 So. 3d 261, 269 (Fla. Dist. Ct. App. 2011) (ruling that a car dealership could not compel arbitration under a Retail Buyer's Order containing an arbitration provision where the Retail Installment Sales Contract contained an integration clause but no agreement to arbitrate).

[252] *See, e.g.,* 6-25 Corbin on Contracts § 25.8 ("[T]his Agreement constitutes the entire Agreement between the parties pertaining to the subject matter contained herein, and supersedes all prior agreements, representations and understandings of the parties.").

[253] Peter C. Lagarias, *The Misuse of Integration, No Representation, and No Reliance Clauses in the Name of Contract Certainty*, 18 FRANCHISE L.J. 3, at 3 (1998).

[254] M. Shapiro, *Protection Against Alleged Franchisor Misrepresentation*, L.A. Daily J. (May 2, 1994) (claiming that "the well-drafted integration clause will exclude almost every conceivable representation that the franchisee, with the benefit of hindsight, could claim was a misrepresentation").

[255] Daniel P. Elms, *Using Contractual Merger Clauses in Defense of Fraud Claims*, ABA Business Torts Litigation Spring 2012 at 4 (Jan. 27, 2011) ("In theory, a merger clause works in tandem with the parol evidence rule to ensure that the parties and courts are dealing with a fully integrated and final agreement.").

[256] Restat. 2d Contracts § 215 ("[W]here there is a binding agreement, either completely or partially integrated, evidence of prior or contemporaneous agreements or negotiations is not admissible in evidence to contradict a term of the writing.").

and integration clause would result in the exclusion of all other discussions and agreements other than the written contract.

However, the parol evidence rule is not without several important exceptions that have been successfully used against completely integrated franchise agreements in recent court opinions. Inconsistent application of rules surrounding merger and integration clauses, recent amendment to FTC rules, and varying state laws both lower the level of certainty that a rigid application of these clauses would bring to franchising law while lessening their effectiveness as a defense in litigation.

B. Franchisor Strategies

Franchisors typically view merger and integration clauses as a tool for minimizing litigation risks. Aimed at triggering the parol evidence rule to exclude prospective claims by franchisees, merger and integration clauses can be used in some jurisdictions to defeat a franchisees' claim that they were promised more than the terms of the written franchise agreements. However, courts take varying approaches to merger and integration clauses, the application of the parol evidence rule, and construing exceptions in the face of claims of foul play made by franchisees, sometimes years after a franchise agreement is executed.

The rationale behind the merger and integration clauses is that, by specifying the written agreement as the entire agreement between the parties, the universe of claims that a franchisee can later assert is narrowed. Whether the franchisee brings a claim as a plaintiff or uses those arguments in defense to a breach of contract claim, franchisors typically point to merger clauses and argue that the franchise agreement is completely integrated, thereby barring evidence of any other agreements not expressed in the written document between the parties. These clauses also provide a basis for an attack to an essential element of any claim based on fraud by undermining allegations of reliance by the franchisee:

> The logic of the argument is that a party cannot be said to have reasonably relied on an extracontractual representation when the contract itself says that all promises and representations between the parties are expressly recited in the contract.[257]

When merger and integration clauses are coupled with other provisions, franchisors are often able to realize the full benefit of the protections built-in to franchise agreements. Merger and integration clauses may be coupled with "no representation" or "no reliance" clauses, which typically state that no additional representations were either made to or relied upon by the franchisee, with the caveat that the Federal Trade Commission's Amended Rule prohibits franchisors from forcing a franchisee to waive its reliance on the Franchise Disclosure Document.[258]

When courts are receptive to a franchisor strategy that defines the agreement as narrowly as permitted by FTC rules, the outcome of litigation can be favorable to the franchisor,

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[257] Elms, *supra* note 255, at 4.

[258] 16 C.F.R. § 436.9(h) (defining unfair or deceptive acts or practices in violation of Section 5 of the Federal Trade Commission Act to include a requirement that a franchisee "disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments").

even including dismissal of franchisee claims for breach and/or fraudulent inducement. For example, Quizno's successfully defended part of a lawsuit by six franchisees, who signed franchise agreements containing both an integration clause and other provisions stating that "they could not rely on representations *made outside the UFOC and the agreement.*"[259] Nonetheless, the franchisees contended that Quizno's "fraudulently induced" them "to enter the Franchise Agreement through their misrepresentations and omissions."[260] The District Court was not receptive, finding that no fraud claim had been adequately pleaded because:

> [T]he UFOC and Franchise Agreement each contain disclaimers and non-reliance clauses that are repetitive and easily seen by any party who takes the time to read them. Faced with these "unambiguous" clauses, plaintiffs cannot have reasonably relied upon any oral statements concerning likely profits and expenses in deciding whether to invest in a Quizno's franchise. . . . Plaintiffs reviewed and even signed representations affirming that they would not rely on any statements outside the corners of the contractual documents. In fact, the UFOC explicitly warned Plaintiffs not to rely on any representations not contained in the document itself. In the Franchise Agreement, each Plaintiff signed an integration clause agreeing not to rely on any statements not contained in the UFOC or Franchise Agreement. The Franchise Agreement also contained an Acknowledgment Clause, in which Plaintiffs acknowledged that no statement, representation, act, event, or communication not contained in the document is binding on Quizno's. [I]t is unreasonable for Plaintiffs to claim reliance on extra-contractual representations despite having stated in writing that they would not rely on representations outside the UFOC and Franchise Agreement.
>
> . . .
>
> Plaintiffs had a clear choice, to affirm that they were not relying on representations beyond those contained in the Franchise Agreement and UFOC or walk away and pursue another business opportunity.[261]

Another recent case demonstrates the effectiveness of a franchise agreement that includes merger and integration clauses, coupled with non-reliance provisions. The franchisor, Ramada, terminated the franchise agreement and filed an action against the franchisee for nearly $100,000 in unpaid fees.[262] As a defense, the former franchisee claimed, among other arguments, that Ramada fraudulently induced the former franchisee to enter the franchise agreement by making representations Ramada never honored. While New Jersey law appeared receptive by allowing an exception to the parol evidence rule for oral communications constituting proof of fraud in the inducement, where "the alleged representations relate to *matters expressly addressed in the integrated writing*[,]" the exception was held not applicable.[263] Faced with a franchise agreement that was "wholly-integrated" and which

[259] *Seimer v. Quizno's Franchise Co.*, No. 07 C 2170, 2008 WL 904874, at *3 (N.D. Ill. Mar. 31, 2008) (unpublished).

[260] *Id.* at *8

[261] *Id.* at *9 (internal citations and quotations omitted).

[262] *Ramada Worldwide, Inc. v. Hotel of Grayling, Inc.*, No. 08-3845, 2010 U.S. Dist LEXIS 65186 (D.N.J. June 30, 2010) (unpublished).

[263] *Id.* at *20.

“disclaim[ed] any oral or written promise or representation not included in the contract,”[264] the court granted summary judgment against the franchisee because franchise agreement imposed no such obligations on Ramada.[265]

This strategy of relying on merger and integration clauses, whether used as a sword or shield, is neither universally effective, nor guaranteed to result in a similar outcome. In a different jurisdiction or under varying governing law, the outcome of a franchise dispute could be just the opposite. Even where an agreement is both totally integrated and disclaims reliance on representations, the impact and effectiveness of boilerplate language in litigation is wholly dependent on rules and laws outside the contract.[266] While several states continue to rigidly honor these clauses,[267] franchisees are becoming increasingly inventive – and successful – with strategies and legal arguments in spite of clauses that would, at first glance, seem to foreclose any recovery.

C. Franchisee Strategies for Avoiding Application of Merger Clauses

Franchisors have not experienced uniform success in using merger and integration clauses to frustrate franchisees’ claims. As an initial matter, franchisees have been able to successfully avoid strict application of merger clauses by asserting that a franchisor is estopped from using a generalized integration clause to defeat a claim regarding specific, pre-sale claims made by the franchisor in order to induce execution of the franchise agreement.[268] This argument was successfully made in *Progressive Foods LLC v. Dunkin Donuts, Inc.*[269] The parties entered into a multiple unit store development agreement where plaintiff agreed to develop a number of franchised restaurants around Cleveland. The franchise agreement

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[264] *Id.* at *20.

[265] Id. at *36.

[266] For example, Georgia courts strictly apply merger and integration clauses, in contrast to the governing law of other jurisdictions discussed in the subsection that follows. *See American Casual Dining, L.P. v. Moe's Southwest Grill, LLC*, 426 F. Supp. 2d 1356, 1367-68 (N.D. Ga. 2006) (concluding that plaintiff “expressly acknowledged that it did not rely upon representations that were not set forth in the UFOC or Franchise Agreement, and it cannot claim to have done so now” under Georgia law that “prior or contemporaneous representations that contradict the written contract cannot be used to vary the terms of a valid written agreement purporting to contain the entire agreement of the parties, *nor would the violation of any such alleged oral agreement amount to actionable fraud.*”).

[267] *See, e.g., Importers Serv. Corp. v. GP Chems. Equity, LLC,* 652 F. Supp. 2d 1292, 1305 (N.D. Ga. 2009) (“Georgia law provides as ‘a matter of law, a valid merger clause executed by two or more parties in an arm's length transaction precludes any subsequent claim of deceit based upon pre-contractual representations.’” (citing *First Data POS, Inc. v. Willi*s, 273 Ga. 792, 796 (2001)); *Cal. Bagel Co., LLC v. Am. Bagel Co.*, 2000 U.S. Dist. LEXIS 22898, at *44 (C.D. Cal. June 2, 2000) (unpublished) (applying, in a franchise dispute, the rule that “[f]or parol evidence of fraud or misrepresentation to be admissible under California law, it must tend to establish some independent fact or representation, some fraud in the procurement of the instrument or some breach of confidence concerning its use, and not a promise directly at variance with the promise of the writing” (quoting *Brinderson-Newberg Joint Venture v. Pac. Erectors, Inc.*, 971 F.2d 272, 281 (9th Cir. 1992)).

[268] *See, e.g. Commercial Property Inv., Inc. v. Quality Inns Int’l, Inc.*, 938 F.2d 870 (8th Cir. 1991) (rejecting the franchisor’s contention that the integration clause in the franchise contract barred the franchisee’s fraud claim concerning pre-sale misrepresentations about average occupancy and success of other franchisees, and holding that disclaimer or integration clauses would negate a fraud claim only when the provision explicitly states facts contradicting the specific misrepresentations involved).

[269] *Progressive Foods LLC v. Dunkin’ Donuts, Inc.*, No. 1:07 CV 3424, 2011 WL 672540 (N.D. Ohio Feb. 15, 2011) (unpublished), *rev’d on other grounds*, No. 11-11-3296, 11-3335, 2012 WL 3241696 (6th Cir. Aug. 9, 2012).

covered numerous locations that had been developed, opened, and operated by the franchisor, though the locations were not kept up to system standards. Not only had the plaintiff agreed in the franchise agreement that “Franchisor’s development and leasing of the site shall not impose any liability or obligation on Franchisor […] with respect to sales or profits of the unit[,]” but the agreement also contained an independent investigation clause that disclaimed any representations as to future success.[270] When the plaintiff’s business failed and defaulted, defendants terminated.

The court found it was reasonable for the plaintiff to have relied on a statement in defendants’ disclosure document that they had “‘acquired experience and skill in developing and operating stores[,]’” notwithstanding the disclaimer.[271] The court reasoned that, as the defendants had identified and operated multiple locations through opening, they still had to follow their own criteria in site selection. The court relied on these facts to show site selection was part of the parties’ agreement: (1) the defendants’ initial identification of a potential franchise location; (2) the defendants’ selection of another site for plaintiff’s use before the SDA was entered into; and (3) the defendants’ selection of two more sites following the execution of the SDA.[272]

Franchisees also may have meritorious arguments that their claim is a statutory claim, such that no basis exists for a finding that a merger clause would bar the claim. The court in *Randall* v. *Lady of America Franchise Corp.* indicated it may well be persuaded to accept such an argument.[273]

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[270] *Id*.

[271] *Id.* at *15. The court in *Next Generation Grp. LLC v. Sylvan Learning Ctrs. LLC*, discussed whether reliance on oral representations could be reasonable when an integration clause was present in a license agreement. No. CCB-11-0996, 2012 U.S. Dist. LEXIS 1519 (D. Md. Jan. 6, 2012) (unpublished). The court reviewed other case law and found, not only was this question of fact inappropriate to be resolved at the stage of litigation where plaintiff franchisee sought to amend its complaint, but it could even be inappropriate at the summary judgment stage. *See id.* at *7-8 (discussing *Greenfield v. Heckenbach*, 144 Md. App. 108, 130, 797 A.2d 63, 76 (2002)) (holding reasonableness of the plaintiffs’ reliance was a question “for the jury to consider”). The *Next Generation Grp.* court relied on the following facts to show reliance was not obviously unreasonable: (1) the negotiations leading to the license agreement “were not notably lengthy[;]” (2) the franchisee was not “particularly sophisticated or experienced “*in these type of sales*[;]” and (3) there was evidence of misrepresentation over a continued period of time. *Id.* at *8 (italics added). The second fact relied upon is particularly noteworthy; it can be inferred that it will be more likely reliance was reasonable for a franchisee when the individual(s) involved in entering into the agreement had no prior franchising experience.

[272] *Progressive Foods LLC,* 2011 WL 672540, at *15.

[273] *Randall v. Lady of America Franchise Corp.*, 532 F. Supp. 2d 1071 (D. Minn. 2007). The court, discussing whether it would apply the parol evidence rule to the franchisee’s claim, called into doubt “whether the parol-evidence [rule] applies to claims made under the Minnesota Franchise Act. . . . [T]he Minnesota Franchise Act creates a statutory cause of action, not a contract claim.” *Randall*, 532 F. Supp. 2d at 1082. Mr. Holland and his firm acted as Plaintiffs’ counsel in the *Lady of America* matter. *C.f. Next Generation Grp.*, 2012 U.S. Dist. LEXIS 1519, at *6. (“‘[T]he law in Maryland . . . is that a plaintiff can successfully bring a tort action for fraud that is based on false pre-contract promises by the defendant even if (1) the written contract contains an integration clause and even if (2) the pre-contractual promises that constitute the fraud are not mentioned in the written contract.’”).

An additional avenue for franchisees to attack agreements that include a merger clause is that such clauses, if enforced, would have the effect of excusing blatant violations of the state franchise law[274] in contravention of anti-waiver provisions found in many state franchise Acts.[275]

Franchisees also may assert the existence of a separate and distinct agreement other than that incorporating the merger clause. For example, in *Brennan v. Carvel Corp.*, defendants made a claim for breach of contract on the basis of a written contract that predated the parties' franchise agreement that required the franchisor to select, evaluate, and approve a location.[276] The franchise agreement made no mention of site selection assistance. The plaintiff franchisor argued that the merger clause in the franchise agreement extinguished any prior agreements. The court reasoned that the integrated franchise agreement had no bearing on a separate and distinct agreement, and, furthermore, that integration is ultimately a question of the parties' intent. Considering extrinsic evidence was necessary to "elucidate" the terms of the franchise agreement insofar as the evidence was not directly contrary to the terms of the final writing.[277]

VIII. DISCLAIMERS

A. Franchisees Circumvent the Disclaimer

As discussed above, franchisors have had some success employing disclaimers to defeat franchisees' claims. That said, franchisees have likewise had some success avoiding application of such disclaimers by challenging the breadth of the disclaimer. A variation on this argument is that a general disclaimer does not have an impact upon a specific misrepresentation.[278] This argument may even be advanced where reliance would be unreasonable in the face of the disclaimer.[279] Beyond these arguments, franchisees can argue that a particular disclaimer was not part of the basis of the bargain of the parties.

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[274] *C.f. A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc.*, Bus. Franchise Guide ¶ 10,523 (N.Y. Sup. Ct. Aug. 23, 1994) (holding, after considering the underlying policy of limiting fraud in the franchise sale context, a merger and waiver clause does not allow a franchisor to bypass the anti-fraud provisions in the New York Franchise Act).

[275] *See, e.g.,* ARK. CODE ANN § 4-72-206(1); CAL. BUS. & PROF. CODE § 20010; CONN. GEN. STAT. § 42-133f; HAW. REV. STAT. § 482E-6(2)(F); MINN. STAT. § 80C.21.

[276] 929 F.2d 801 (1st Cir. 1991).

[277] *Id.*

[278] *See, e.g. Randall*, 532 F. Supp. 2d at 1086.

[279] *See, id.* Note that since *Randall*, two Minnesota courts have cast doubt on this case's holding that unreasonable reliance might be enough under the Minnesota Franchise Act to maintain an action for fraud. In *Teng Moua v. Jani-King of Minnesota, Inc.*, 810 F. Supp. 2d 882 (D. Minn. 2011) the court exclaimed that it was "convinced that reasonable reliance is an element of a claim under the MFA." *Id.* at 891. If plaintiff asserted a claim where the representation he received was "completely contradicted by a governing written instrument" his claim would fail as a matter of law. The *Ellering v. Sellsate Realty Systems Network, Inc.* court discussed *Randall* without commenting on its uncertainty of whether reliance cannot be unreasonable; instead, the court simply stated reasonable reliance was required. 801 F. Supp. 2d 834, 845 (2011). The court went so far as to posit that a "general disclaimer" as discussed in *Randall* would "have planted seeds of doubt" in the minds of the plaintiffs, and the agreement contained an express acknowledgment that the plaintiffs had "'not relied upon any guarantee, warranty, projection, forecast or earnings claim, whether express, implied, purported, or alleged, in entering into'" the agreement. *Id.* at 845.

Such an argument was advanced by the franchisee in *Carousel's Creamery, L.L.C., v. Marble Slab Creamery, Inc.*[280] In that case, the Texas Court of Appeals held that disclaimer clauses in an ice cream shop franchise agreement that (1) disclaimed any representations that may have been made regarding the franchise's economic success, and (2) required the franchisee to disclaim reliance on representations regarding the franchise's economic success, did not bar a claim brought by the franchisee asserting negligent misrepresentation of the value of the franchise. The court found the disclaimer was not "an important part of the basis of the bargain."[281] Moreover, the franchisee was not represented by counsel in entering into the agreement, there was no evidence the parties had been negotiating at arms-length, and the franchisee was relatively unsophisticated.[282]

Franchisees may be able to avoid a disclaimer by pointing out that they were invited by the franchisor to rely upon a particular document that was outside the franchise agreement.[283] For example, franchisors should be cautious about representations to franchisees based on internal studies on the profitability of particular franchisees.[284] Where these studies are done in a manner that is misleading, franchisees have an argument that any disclaimers[285] that may have been in the franchise agreement should have no bearing on their reliance.[286]

Franchisees also may assert noncontradiction of the express terms of the franchise agreement when they are offering an interpretation of the agreement that requires parol evidence support. An application of how franchisees can successfully introduce parol evidence

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[280] Bus. Franchise Guide ¶ 12,748 (Tex. Ct. App. Jan. 15, 2004).

[281] *Id.*

[282] *Id.*

[283] *See, D.T. Woodard, Inc. v. Mail Boxes Etc., Inc.*, No. B228990, 2012 WL 90084 (Cal. Ct. App. Jan. 12, 2012) (unpublished); *see also OCM Principal Opportunities Fund, L.P. v. CIBC World Markets Corp.*, 157 Cal. App. 4th 835 (2007) ("because of defendant's invitation to plaintiffs to base investment decisions on defendant's offering memorandum, disclaimers of the accuracy and completeness of information in the offering memorandum did not preclude plaintiffs' reasonable reliance on that offering memorandum.").

[284] In *Woodard*, MBE conducted what it labeled "Gold Shield tests" where participating franchisees in three "cells" charged the same rate (the UPS rate) under different names, including one under the UPS name. *Woodard*, 2012 WL 90084. In seeking to have the franchisees approve an amendment to the MBE franchise agreement by which franchisees would be re-branded as "The UPS Store" and would otherwise employ the UPS trademark, MBE and UPS presented demonstrations based on data extracted from the Gold Shield tests to franchisees that stated the UPS brand had, amongst other things, the best name recognition, and had outperformed the non UPS branded cell in average daily output. *Id*. at *2.

[285] The disclaimer at issue in *Woodard* read:

> If you believe that an authorized MBE or UPS representative has represented to you that you can expect to achieve a particular level of revenue, STR, or profits as a result of joining the Gold Shield Program, we ask that you (1) immediately report the relevant details in writing to MBE's Legal Department and (2) not rely upon those representations in deciding whether or not to join the Gold Shield Program.

Id. at *8.

[286] This is particularly true where the franchisor has made representations about the reliability of the internal testing they have done. *See Woodard*, 2012 WL 90084, at *8 (documents provided to the plaintiff stated that although the gold shield test was done on a small scale, that it was a "reliable scale," and that the franchisor "consistently endeavored to confirm the reliability of the Test Center financial information.").

in such circumstances is provided by *Randall*, where the agreement also contained disclaimers that:

> (1) [t]he franchisor expressly disclaims the making of, and the franchisee acknowledges that he or she has not received, any promises or representations, express or implied, orally, in writing or otherwise of assistance, expenses, benefits, sales volumes, profits, success or any other matter except as expressly made in this agreement or the franchisor's franchise offering circular[;]" and
>
> (2) (in the UFOC) "[w]e do not furnish or authorize [our] salespersons to furnish any oral or written information concerning the actual or potential sales, costs, income or profits of your Franchise. Actual results vary from Franchise to Franchise, and we cannot estimate the results of any particular franchise.[287]

The court held that earnings claims the franchisor had allegedly made did not directly contradict the agreement other than the disclaimers – and that conflict did not merit invoking the parol evidence rule.[288]

Franchisees also may be able to sidestep no-reliance clauses by proving that the franchisor's fraudulent statements were made intentionally or recklessly. In *Cousins Subs Systems Inc. v. Better Subs Dev. Inc.*, the court, quoting Judge Hand,[289] refused to allow the franchisor to hide behind its disclaimers when franchisees could create a genuine issue of material fact as to whether there had been an intentional or reckless misrepresentation.[290] As Judge Hand explained:

> [T]he ingenuity of draftsmen is sure to keep pace with the demands of wrongdoers, and if a deliberate fraud may be shielded by a clause in a contract that the writing contains every representation made by way of inducement, or that utterances shown to be true were not an inducement to the agreement, [a party could defraud others] through the simple expedient of placing such a clause . . . in the contracts which their dupes are asked to sign.[291]

That said, while the franchisees scored a victory on the intentional misrepresentation issue, the court dismissed the franchisees' basic negligent fraud and strict liability fraud claims as barred by the no reliance clauses, the integration clauses, or the parol evidence rule. [292]

B. <u>Unintended Consequences of Disclaimer Use</u>

Franchisors have reason to use caution in drafting broad disclaimer clauses in their franchise agreements. At least one court has found that contractual provisions which expressly

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[287] *Randall*, 532 F. Supp. 2d at 1075.

[288] *Id.* at 1085.

[289] *Arnold v. National Aniline & Chem. Co.*, 20 F.2d 364, 369 (2d Cir. 1927).

[290] Bus. Franchise Guide (CCH) ¶14,705 (E.D. Wis. Sept. 30, 2011).

[291] *Arnold*, 20 F.2d at 369.

[292] Bus. Franchise Guide (CCH) ¶14,705 (E.D. Wis. Sept. 30, 2011).

waived compliance with a provision of the Minnesota Franchise Act, as well as those that would have the "effect" of waiving a provision of the act, were forbidden.[293] The *Randall* court found that a disclaimer that read "I did not make any representations about the revenues of existing franchises. If you disagree, I hereby disclaim any representations that you believe I made, You cannot rely on them[,]" given after dishonesty occurred, was an attempt to change the historical facts – and the legal effect – of the franchisor's dishonest misconduct and was prohibited by Minnesota's anti-waiver provision.[294] Thus, franchisors assume the risk that their disclaimer clauses may be found by a reviewing court to violate a state anti-waiver clause. Additionally, a franchisor may not make dishonest representations and then later attempt to cure them by requiring a franchisee to point to each particular misrepresentation at the time of entering into the agreement.[295]

As mentioned above, franchisors also should be concerned about violating federal law. The FTC Rule at Section 436.9(h)[296] and Section 436.9(a)[297] prohibits disclaimers and waivers of misrepresentations, as well as statements that are contradictory to the Franchise Disclosure Document (FDD), respectively. Although a franchisor may anticipate being shielded from a fraud claim because the franchise agreement contains a disclaimer denying any representations actually set forth in the FDD, such a practice is unlawful. The Commission recognized the bizarre state of affairs that existed when franchise agreements contained such disclaimers: "By signing a franchise agreement containing such a clause, franchisees effectively waive any rights they may have to rely on information contained in the Disclosure Document."[298] Although Section 436.9(h) clearly does not encompass general advertising materials, the Commission has clarified that such advertisements are subject to Section 5 of the FTC Act.[299]

Husain v. McDonald's Corp.[300] demonstrates that nonspecific disclaimers can harm the franchisor. In that case, a dispute arose when a franchisee sought to purchase seven McDonald's restaurants whose franchise agreements required McDonald's consent before ownership could be transferred. Husain (the purchasing franchisee) claimed that McDonald's promised him a rewrite of the franchise agreements for three of the restaurants covered by his

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[293] *See, Randall*, 532 F. Supp. 2d at 1088.

[294] *Id.*

[295] *Id*.

[296] It is an unfair and deceptive trade practice for a franchisor to:

> 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 sales negotiations.

16 C.F.R. § 436.9(h).

[297] It is an unfair or deceptive act or practice for a franchise seller to "make any claim or representation, orally, visually, or in writing that contradicts the information required to be disclosed by this part." 16 C.F.R. § 436.9(a)

[298] 72 Fed. Reg. 15,531, CCH Bus. Franchise Guide ¶ 6066.

[299] *See* The FTC Franchise Rule 108 (Susan Grueneberg & Ann Hurwitz eds., ABA Publishing 2008).

[300] Bus. Franchise Guide ¶ 14,819.

assignment agreement (the Novato, Fourth Street, and Merrydale stores). The center of the dispute was paragraph 17 of the assignment agreement, which read:

> In consideration of McDonald's consent to this Assignment *and the issuance of a rewrite to Assignee*, Assignor waives, releases, and disclaims any claim for a rewrite of the franchise for the Corte Madera … location.[301]

McDonald's asserted that the franchise agreement only promised a rewrite of the franchise agreement for the Corte Madera franchise. The franchisee sought injunctive relief which was granted; the lower court understood such a disclaimer to be ambiguous and susceptible to the construction advanced by the franchisee. On appeal, the court, considering the franchisor's challenge to the grant of the preliminary injunction, studied paragraph 17 and recognized it was titled "ASSIGNMENT AND CONSENT TO ASSIGNMENT OF FRANCHISE TO AN INDIVIDUAL PURCHASER[.]"[302] The words "Franchise" and "Restaurant" were expressly defined to refer to all six franchise agreements covered by the agreement.[303] This lack of clarity supported the franchisee's claim. The court also reviewed another provision cited by McDonald's (paragraph 22) that disclaimed any offer of a new franchise, and stated no franchise or offer would exist absent a separate additional writing signed by the franchisor; this language contradicted the language of paragraph 17, which expressly promised a new franchise, Corte Madera. The court of appeals reasoned that "if paragraph 22 is not inconsistent with that promise, there is no reason to suppose it would be inconsistent with a promise of rewrites for other locations."[304] A close reading of the paragraph revealed that it discussed "future franchises for additional McDonald's restaurants[,]" and the agreement did not exclude the possibility of offers for existing franchises in the agreement.[305] Consequently, the overly-broad language of the disclaimers led the court to believe the franchise agreement encompassed the other franchises.

IX. NOTICE PROVISIONS AND CONTRACTUAL STATUTES OF LIMITATIONS

A. Franchisor Use of Clauses Requiring Notice of Claims

Freedom of contract provides the prospective parties to a franchise agreement with the opportunity to customize their future dealings by incorporating procedures and mechanisms that best suit the franchise business model. The default, fallback rules of applicable contract law may not be in either party's best interests, especially where claims can be asserted for the first time years after the underlying events occurred and often too late for any corrective action.

One possible method of accelerating communication of defaults or claims is the implementation of a notice system into the franchise agreement, by which the franchisor and franchisee agree to notify each other of defaults or potential legal claims within a certain time period. This can manifest as a warning system, for instance, where a franchisor binds itself to

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[301] *Id.*

[302] *Id.*

[303] *Id.*

[304] *Id.*

[305] *Id.*

give notice of defaults and an opportunity to cure to franchisees. Even when clauses like this are used, close attention to detail is required to avoid unintended consequences, as often occurs with recycling of language from prior agreements. In one case involving the KFC system, a franchisor filed a complaint for breach of contract and sought a declaratory judgment concerning the enforceability of franchise agreements. The parties entered a settlement agreement staying litigation, reinstating the franchisees, and allowing more than a year to sell the franchises. In exchange, the franchisees agreed that any "failure . . . to comply strictly" with monetary covenants and operational standards would be grounds to lift the stay and terminate the franchisees. Under the notice system the parties established, the "franchisees would be given notice of default and ten days from that notice to cure the default, 'provided, however, that KFC shall not be obligated to give more than one such notice during any 120 day period.'"[306] The franchisor gave notice of three separate defaults, each approximately three weeks apart, and then, three weeks later, sent notice of termination of the franchise agreement and attempted to reinstate litigation. The court refused to lift the stay or allow franchise termination because it interpreted the notice provision to mean that successive violations of the same operational standard required only a single notice, rather than allowing one notice to apply to different defaults.[307] Because the franchisee defaulted on different grounds and was permitted time to cure each separate default by contract, the court declined to allow the franchisor to terminate the agreement.

B. Contractual Statutes of Limitations

Another customary notice provision used in franchise agreements is a contractual statute of limitation, whereby the parties agree that causes of action must be filed within a shorter period of time than otherwise allowed by law. These provisions can be used to obtain summary judgment on claims that may otherwise have proceeded to trial.[308] One court found the following contractual statute of limitations clause sufficient to bind the franchisee:

> Any and all claims…arising from or relating to this agreement or the relationship among the parties *shall be barred* unless an action or legal proceeding is commenced *within one (1) year* from the date the claimant knew or should have known of the facts giving rise to such claims

This clause was interpreted to be sufficiently broad to cover all of the franchisee's claims, including: fraudulent inducement, breach of the implied covenant of good faith and fair dealing, negligent misrepresentation, intentional misrepresentation, and unfair and deceptive trade practices.[309] Applying the discovery rule limitations period, the court concluded that by the end of the franchisee's first full year of operation in 2004, the basis for a claim "was clear," noting that "one cannot reasonably contend that, at least by December 2006 after closing the store due to crippling losses, [franchisees] did not have notice of the harm caused . . . ."[310]

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[306] *KFC Corp. v. Springfield Food Sys., Inc.,* Bus. Franchise Guide (CCH) ¶ 14,558 (D. Mass. Feb. 14, 2011).

[307] *Id*.

[308] *Krumholz v. AJA, LLC*, 691 F. Supp. 2d 252, 256 (D. Mass. 2010) (emphasis added).

[309] *Id.*

[310] *Id.*; *see also Guirguis*, 2010 WL 715514, at *2 (noting no dispute that the statutory limitations period was shortened by the following provision: "[A]ny and all claims arising out of or relating to this agreement, the relationship

(continued...)

The event that triggers the running of the statute of limitations, contractual or statutory, can be a crucial factor in determining whether a case goes forward. One of the benefits of contractual time limits is that the franchisor can tailor the triggering event that starts the clock on the statute of limitations, such as including the date when the franchisee "should have known of the facts giving rise to such claims," rather than actual discovery. The length of time by which the contract shortens the state's statute of limitations can impact the effectiveness of the provision. Shortening the limitation to a year may be reasonable.[311] Franchisees often make public policy arguments against validity of these clauses or contend that their claims are not barred under their individual circumstances. Franchisees may contend that they lacked knowledge of or did not discover a franchisor's violation of the franchise agreement until the latest possible date so that the franchisee can ensure continued validity of claims.[312] Anticipation of these arguments is another reason franchisors should remain aware of franchisees' activities and performance.[313]

The bi-lateral or unilateral nature of shortened statute of limitations can also have an impact on a court's evaluation – and enforcement – of such clauses.[314] In *Martrano v. Quizno's Franchise Co.,* the franchisor argued that the franchise agreements were not substantively unconscionable because they did not so unreasonably favor the party with greater bargaining power as to shock the conscience.[315] The court considered the totality of the provisions to determine if they would be deemed unconscionable, noting that the provisions at issue might not be problematic when considered separately.[316] Although dismissive of the franchisees' unconscionability argument as premature, the unilateral nature and drastic shortening of the time limit troubled the court, particularly because the agreement allowed the franchisor to exercise "unbounded" discretion in mandating the franchisees' supplier transactions.[317] The court in *Martrano* also seemed to consider whether the franchisor was alleged to have engaged in a system of "strong-arming" on a broader scale.[318]

(...continued)
of developer and [Dunkin' Donuts] or developer's operation of the unit, brought in any forum by any party hereto against the other, must be commenced within two (2) years after the discovery of the facts giving rise to such claim or action, or such claim or action shall be barred, except for financial obligations of developer").

311 *Martrano v. Quizno's Franchise Co., L.L.C.*, No. 08-0932, 2009 U.S. Dist. LEXIS 52025, at 88 (W.D. Pa. June 15, 2009) ("Defendants cite *Smith v. Am. Equity Ins. Co.*, 235 F. Supp.2d 410, 412 (E.D. Pa. 2002) for the general proposition that a bi-lateral one-year contractual limitations period may be reasonable").

312 *Krumholz*, 691 F. Supp. 2d at *254-55.

313 *Id.*

314 *Martrano*, 2009 U.S. Dist. LEXIS 52025, at *88 (W.D. Pa. June 15, 2009) (noting that the limitations period was not the same for both parties because certain franchisee obligations to pay fees survived.)

315 *Id.* at 92-93.

316 *Id.* at 93.

317 *Id*.

318 *Id. at 89-90* ("The Defendants' alleged practices of selling/over-selling/re-selling and exploiting Quiznos franchises through a combination of fraudulent representations/omissions, onerous contractual provisions and operational practices, and 'strong-arming' which frequently resulted - as assertedly intended - in little or no franchisee profit and ultimate default, appear to be just the sort of overreaching that the doctrine of unconscionability is meant to guard against.").

The standards for upholding a contractual statute of limitations appear to be fairly permissive. For example, contractual statutes of limitations generally are honored in Pennsylvania so long as they are not manifestly unreasonable.[319] Franchisees have argued, however, with some success, that contractual time limitations do not apply for a number of reasons, some on the basis that they are unconscionable. Even if a contractual time limitation is ultimately enforced, plaintiffs can keep courts from granting motions for summary judgment by alleging facts such as equitable tolling.

Parties can dispute contractual statutes of limitations without challenging the validity of the entire agreement. Franchisors should ensure that this is possible through severability provisions. Both parties also can argue the facts of when the claim arose or was discovered.[320] A franchisor may not be able to secure summary judgment based on a contractual time limit if a dispute regarding the timeliness of the claim exists. Courts sometimes refuse to dismiss if the plaintiff presents factual questions regarding the claim, such as whether there was equitable tolling of the limit.[321] Prior admissions or documentation of disputes, particularly in communications between the franchisor and franchisee, can significantly impair arguments seeking to circumvent a contractual limitations period. In *Guirgis v. Dunkin' Donuts*, the franchise agreement required commencing an action "within two (2) years after the discovery of the facts giving rise to such claim or action."[322] Implicitly finding this period reasonable, the trial court noted that it "could not ignore" a document indicating that the franchisee admitted to discovering the franchisor's breach three years before filing suit, forecasting the grant of summary judgment to the franchisor.[323]

The litigation management benefits of a contractual limitation provision in a franchise agreement can be significant, but the provisions must also be balanced with the impact the limitation can have on franchisors. If the contractual limitations are overlooked or forgotten, a franchisor's claims can also be extinguished after the specified period runs,[324] as many of these clauses apply equally to both the franchisor and franchisee. Accordingly, franchisors should

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[319] *See, e.g.* 42 PA. CONS. STAT. § 5501(a) ("Under PA law, parties may agree by contract to shorten the statute of limitations as long as the period specified is not 'manifestly unreasonable."), *S.T. Hudson Eng'rs, Inc. v. Camden Hotel Dev. Assocs*., 747 A.2d 931, 934 (Pa. Super. Ct. 2000).

[320] *Guirguis*, 2010 WL 715514, at *2-3.

[321] *See, e.g., Martrano*, 2009 U.S. Dist. LEXIS 52025, at *9 n.6, *11-*12, note 6 (W.D. Pa. June 15, 2009) ("Elhilu v. Quiznos Franchise Co., LLC, Case No. 06-CV-07855, 2008 U.S. Dist. LEXIS 109435, currently pending before Judge Cooper in the Central District of California on behalf of SNO franchisees in that State…By Opinion of April 3, 2008, the Court denied Defendants' Motion to Dismiss, concluding that dismissal could not be based on a (1) contractual statute of limitations bar given the factual issues and questions of, e.g., equitable tolling . . . .").

[322] *Guirguis*, 2010 WL 715514, at *2-3.

[323] *Id.*

[324] *Compare Korangy v. Mobil Oil Corp.*, 84 F. Supp. 2d 660, 662 (D. Md. 2000) ("Notwithstanding notice by Dealer to Mobil, *any claim by Dealer shall be waived and barred unless asserted* by the commencement of a lawsuit in a court of competent jurisdiction *within 12 months* after the event, action or inaction to which such claim relates" (emphasis added)), *with Top Dog Ventures, LLC v. PK Operations, Inc.*, No. 31174(U), at 5 (N.Y. Sup. Ct. 2008) ("Any and all claims and actions arising out of or relating to this Agreement, the relationship of the Franchisee and Franchisor, or Franchisee's operation of the Franchised Business, brought *by any party hereto against the other, shall be commenced within one (1) year* from the occurrence of the facts giving rise to such claim or action, or such claim or action shall be barred" (emphasis added)).

exercise caution when implementing contractual statutes of limitations or when varying their duration or terms from prior franchise agreements. Unwary franchisors have lost claims against franchisees due to contractually shortened statutes of limitations, and courts show little sympathy to franchisors who are often the drafters of franchise agreements.[325]

C. Franchisee Strategies in Responding

Franchisees have had mixed results in invalidating a contractual statute of limitations by demonstrating such a provision diminishes or harms their rights under other law. For example, in *Bailey v. AmeriQuest Mortgage Co.*, the plaintiffs convinced the district court that the one-year limitations period in the arbitration agreement between the parties, which failed to provide for greater liability for a willful violation, "denies plaintiffs 'access to a remedy Congress made available to ensure violations of the statute are effectively remedied and deterred'" and, therefore, the limitations period was unenforceable because it limited the statutory remedies otherwise available.[326] The Court of Appeals for the Eighth Circuit reversed, finding that – absent "fraud or overwhelming economic power[--]" "when an agreement to arbitrate encompasses statutory claims, the arbitrator has the authority to enforce substantive statutory rights, even if those rights are in conflict with contractual limitations in the agreement that would otherwise apply[.]"[327]

Franchisees likely will have success challenging contractual statutes of limitation if they can show either that the contract was: (1) an adhesion contract; (2) a "product of overreaching[;]" or (3) that the contractual provision was "unreasonably short."[328] Demonstrating the existence of an adhesion contract requires more than merely offering the franchise agreement into evidence. In *Protter v. Nathan's Famous Systems, Inc.*, plaintiff franchisee alleged fraud and violation of the New York State Franchise Act.[329] The court found that the plaintiff's claims were time-barred pursuant to a provision in the parties' franchise agreement that limited "any and all claims and actions arising out of or relating to the Agreement, the relationship of Franchisee and Franchisor, or Franchisee's operation of the franchised business[.]"[330] Plaintiff had only one year under the provision to bring suit. The court enforced the provision, and rejected the plaintiff's argument that one year was unreasonable.[331] *Protter* has been followed by other New York courts even when a plaintiff alleges a fraud and enforcing the limitations period means a plaintiff loses the benefit of tolling during the discovery

[325] *Tinder Box Int'l, Ltd.,* 2010 U.S. Dist. LEXIS 55452, at *6-*7 (unpublished) ("Plaintiff's president, however, signed the franchise agreement on behalf of Tinder Box International, Ltd.; so at the very least, plaintiff (as a corporate entity) had imputed knowledge of the contract's terms. Moreover, at least three of plaintiff's employees were involved in administering its franchise agreements, and their failure to anticipate the expiration was simply unreasonable.").

[326] Civil No. 01-545, 2002 WL 100391 (D. Minn. Jan. 23, 2002) (unpublished), *rev'd* 346 F.3d 821 (8th Cir. 2003).

[327] *Bailey v. Ameriquest Mortgage Co.*, 346 F.3d 821, 823-24 (8th Cir. 2003).

[328] *Protter v. Nathan's Famous Sys., Inc.*, 667 N.Y.S.2d 301, 246 A.D.2d 585 (1998).

[329] *Id.*

[330] *Id*. at 301, 246 A.D.2d at 585.

[331] *Id*. at 301, 246 A.D.2d at 586.

period.[332] As a result, franchisees may argue that there has been a continuing violation of the franchise agreement and that, therefore, the contractual statute of limitations period should be tolled, but where the alleged violation is an action the franchisor had discretion to take under the contract, this argument likely will fail.[333]

Franchisees also should be aware of state laws that declare illegal contractual statutes of limitation and contractual provisions that serve the same purposes. Consider *Coyote Portable Storage*, where two separate provisions were argued by the parties as establishing/not establishing a waiver of the right to bring suit. The franchisee sought to rely on the following provision to establish no waiver of its right to bring suit had occurred:

> § 22.2 [Plaintiffs] and [PODS] *shall not be deemed to have waived any right* reserved by this Agreement *by* virtue of any custom or practice of the parties at variance with it; *any failure, refusal or neglect by [Plaintiffs]* or [PODS] *to exercise any right under this Agreement* (*except as otherwise provided in this Agreement*) . . . .[334]

The franchisor countered by pointing to the very next provision of the franchise agreement:

> § 22.3 Notwithstanding the foregoing, and except as otherwise prohibited or limited by applicable law, *any failure, neglect, or delay by [Plaintiffs] to assert any breach* or violation of any legal or equitable right arising from or in connection with this Agreement *shall constitute a waiver* of such right and shall preclude the exercise or enforcement of any legal or equitable remedy arising therefrom, *unless written notice specifying such breach or violation is provided to [PODS] within 12 months* after the later of: (a) the date of such breach or violation; or (b) the date of discovery or facts (or the date the facts could have been discovered, using reasonable diligence) giving rise to such breach or violation.[335]

The plaintiffs in this case failed to provide notice within the twelve-month time limit. Plaintiffs' principal testified he became aware of the alleged contractual violation in late spring 2006. Plaintiffs did not provide written notice until January 2008, and did not file a complaint until April 30, 2009. The franchisor asserted the failure to bring the claim within a year after its discovery constituted a waiver of the right to bring the claim. The court rejected the franchisor's argument on three grounds. First, the court believed that the terms of § 22.2 (any failure, refusal, or neglect by) meant the franchisees actions did not constitute a waiver. Second, the court held that inaction alone would be insufficient to demonstrate waiver: "PODS fails to point to any evidence that Plaintiffs intended to relinquish a known right, other than their alleged silent

[332] *See, Top Dog Ventures, LLC.*, No. 31174(U). The *Top Dog Ventures* court, in dismissing plaintiff's argument enforcing the contractual statute of limitations violated public policy, simply stated that "this requirement [a court imposed tolling period] cannot be imposed when a contract specifies what the shortened statute of limitations period will be." *Id*.

[333] *Id*.

[334] *Coyote Portable Storage, LLC,* No. 1:09-CV-1152-AT, at *19.

[335] *Id.* at 19-20.

acquiescence."[336] Third, the court agreed with the franchisees that the waiver provision was void through application of Fla. Stat. § 95.03.[337]

X. CONCLUSION

The model for drafting franchise agreements is not changing anytime soon; neither is the inclusion of so-called "boilerplate" provisions intended to promote uniformity and predictability, but which frequently leads to unintended consequences. Because these provisions so often are the cause for dispute, contracting parties should take particular care when drafting them, realizing that *they are not just boilerplate.*

[336] *Id.* at 21 (referencing *Alston v. Alston*, 960 So. 2d 879, 881 (Fla. App. 4th Dist. 2007)).

[337] *Id.* at 22 (" 'Any provision in a contract fixing the period of time within which an action arising out of the contract may be begun at a time less than that provided by the applicable statute of limitations is void' " (citing FLA. STAT. § 95.03).).

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