Stop Invading My Space: Encroachment Issues in Franchising

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You have no space!

Pre-1977: Territories were *per se* unlawful


1977: Territories no longer *per se* unlawful

(Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977))
Now you can invade my space!

1984: SCOTUS endorsed territories.

Stop invading my space

Here’s the lineup:

• State of the law
• Bricks and mortar
• Multi-brands
• E-commerce
Stop invading my space

The state of the law:

• Largely a function of contract
• *Scheck* and now *Bryman v. El Pollo Loco*
• State statutes in Iowa, Indiana and Hawaii
• Trademark and dealer statutes
  (change in competitive circumstances)
Stop invading my space

The state of the law:

• Has *Bryman* resurrected *Scheck*?
• *Scheck* no exclusive territory
  (but no right to open others)
Stop invading my space

The state of the law:

• *Bryman:* right to open others
  (but unconscionable)
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The lesson of *Scheck* and *Bryman*? Pigs get fat, hogs get slaughtered
Brick and mortar encroachment

Geographical encroachment
Brick and mortar encroachment

Product/service encroachment

THE CRAVE IS ANYTIME, ANYWHERE!

Look for our signature White Castle products at your local retailer, movie theater or vending machine.
Brick and mortar encroachment

Brand expansion encroachment

So Porsche Design
Contractual provisions:
• How much territory?
• How to define the territory?
• Scope of the exclusivity?
Brick and mortar encroachment

How to define a territory?

- Be specific
- Beware of boundary changes
- Can it change?
- Does it work?
Reservation of rights:

- Brand only
- Alternative channels
- E-commerce
- Others?
Brick and mortar encroachment

Litigation strategies for franchisees:
• Get involved early
• Request development policy
• Show lost cash flows
• Good faith and fair dealing
Litigation strategies for franchisors:

• Rely on your FA
• Rely on your growth plan
• Point out process
• Highlight considerations
Brick and mortar encroachment

Issues to consider:
• How aggressive is too aggressive
• How much intra-brand competition
• Franchisee ROI
• Ability to grow
Brick and mortar encroachment

Questions?
Multi-brand franchisors

Evolution of the Model
Multi-brand franchisors

Cross-brand encroachment issues:

• Contractual commitments
• Absence of statutes

Carl’s Jr.  Hardee’s
Multi-brand franchisors

Franchise agreements:
• Typically address intra-brand
• Unless FA protects concept
Multi-brand franchisors

Other issues:

• Dilution of distinctiveness
Multi-brand franchisors

Questions?
Why e-commerce?

- Easier and convenient
- 80% of Americans made online purchases in ‘16
E-commerce/alternative dist.

Why e-commerce?

- 2016: Canadian e-commerce sales were $19.2 billion
- 2016: 60%-40% domestic-foreign retailers ratio
Why e-commerce?

• In 2019, 10% of Canadian retail spending will be online
• 11% forecasted for U.S.
• Retailers need to adapt
• Cross-channel commerce
E-commerce/alternative dist.

THE
amazon EFFECT

• The ongoing evolution and disruption of retail
• Amazon = 43% of all 2016 retail sales in the U.S.
E-commerce/alternative dist.

THE AMAZON EFFECT

• 2016: Amazon sales of just over $3.5 billion in Canada
• Franchisors now need to be omnipresent
E-commerce/alternative dist.

E-commerce impact on franchise relationship

• 3 key issues:
  ✓ Territorial encroachment
  ✓ Brand protection
  ✓ Drafting more comprehensive contract provisions
E-commerce/alternative dist.

E-commerce impact on franchise relationship

• No Canadian case law on internet encroachment
• Look to non-internet encroachment law for guidance
E-commerce/alternative dist.

E-commerce impact on franchise relationship

• Canadian courts use two methods of analyses:
  ✓ Contractual interpretation of the agreement
  ✓ Applying the duty of good faith or fair dealing
E-commerce/alternative dist.

Other alternative distribution channels

- F’ors are selling products to non-franchised stores:
  - Department stores
  - Grocery stores
  - Pharmacies
  - Convenience stores
  - Kiosks
E-commerce/alternative dist.

Other alternative distribution channels

• Courts will apply same considerations as above:
  ✓ Agreement terms
  ✓ Covenant of GF & FD
E-commerce/alternative dist.

Other alternative distribution channels

• Introduction may create conflict
• What actually constitutes the franchise system?
E-commerce/alternative dist.

Covenant of good faith & fair dealing

• Canadian courts will look beyond K language:
  ✓ Has franchisor taken into account the franchisee’s interests?
  ✓ Is franchisee getting a reasonable return on its investment?
E-commerce/alternative dist.

How franchisors can face this new territory:

- Franchise Agreement should contain language for:
  - ✓ Non-exclusive territories
  - ✓ Broad reservation of rights
E-commerce/alternative dist.

Litigation strategies:

• Delineate how franchisor plans to deal with:
  ✓ E-commerce activities
  ✓ Internet sales, and/or
  ✓ Alternate channels of distribution
E-commerce/alternative dist.

Litigation strategies:
• Reserve methods of sales for franchisor
  ✔ Do not allow court to interpret franchise agreement
E-commerce/alternative dist.

Questions?