WHAT HAPPENED TO MY SETTLEMENT AGREEMENT?

DRAFTING, ENFORCING AND LITIGATING SETTLEMENT AGREEMENTS

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I. GENERAL OBSERVATIONS ON SETTLEMENT

According to www.uscourts.gov for the period April 1, 2009 – March 31, 2010, 227,702 civil cases were brought to a close in the nation’s federal district courts. Of those cases, about 19 percent were terminated without court action – voluntary dismissal, most probably. About 80 percent were terminated by some court action before, during, or at the final pre-trial conference. And, significant to this discussion, only 1.3 percent of the cases were terminated during or after a jury or nonjury trial. Therefore, for any case filed in a federal district court during that one-year period, there was probably about a 99 percent chance that it would settle, and about a 1 percent chance that it would be tried.

Trial lawyers, including franchisor and franchisee trial lawyers, spend a lot of time learning skills for that 1 percent opportunity. They market those skills and hope to attract clients by convincing them that when the time comes for battle, they are the warriors to be hired. As an example, a lawyer (who shall remain nameless) who advertises himself as a litigator for franchisees, has a section on his website entitled “How You Can Recover the Losses Caused by Your Franchisor.” Other sections of the site directed to franchisees are: “If You Are Being Threatened by or Wish to Sue Your Franchisor” and “Actions by a Franchisor that Might Provide Justification for a Franchisee to Sue his Franchisor” (listing 22 such “actions”). Finally, he lists 50 companies or public entities that he has “successfully taken action against” as counsel for franchisees. Clearly this attorney is not promoting his settlement expertise. While not nearly as blatant, most franchisor and franchisee lawyers do not advertise their ability or track record in settling cases. You will not find in their marketing materials any statements such as “Best Settling Lawyer in Town!” or “We'll Get a Good Settlement for You!”

Nevertheless, all trial lawyers in the franchise arena know when they begin a case that settlement is the more likely and practical result. As a case progresses, costs and fees mount, and litigants often begin to focus more clearly on the opponent’s position and their own risk of loss. Settlement becomes a more acceptable option. Judges, mediators, and arbitrators push settlement, and eventually most litigants become convinced that they will be better served by resolution of their dispute on their own terms rather than by running the risk of an unfavorable resolution by a third party. Hence, it is readily understood why so few cases are tried and so many are settled. This is not a new proposition. Consider the following advice from a prominent Illinois trial lawyer in 1850: “Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often the real loser – in fees, expenses and waste of time.” Abraham Lincoln, Notes from a Law Lecture, 1850, as quoted in Ronald C. White, Jr., A. Lincoln 177 (2009).

To be sure, as in the days of Lincoln and well before, public policy favors settlement in lieu of litigation. See generally, 15A Am. Jur. 2d, Compromise and Settlement § 1 (2000). Settlement “involves an agreement that a substituted
performance is acceptable instead of what was previously claimed to be due; thus each party yields something and agrees to eliminate both the hope of gaining as much as he previously claimed and the risk of losing as much as the other party previously claimed." Id. Courts promote that policy, sometimes by less than gentle persuasion. Judges routinely schedule settlement conferences for the litigants. Mandatory mediation is in effect for many courts, and even though not mandated, voluntary mediation to accomplish settlement is now the procedure of choice to resolve disputes in almost every jurisdiction.

The policy of the courts to promote settlement over litigation is grounded in the following assumptions: disputes are resolved faster, less expensively, and with the greater likelihood that peaceful relations between the parties will follow. Id. § 6. Therefore, it is ironic that the settlement process itself sometimes generates litigation between the parties. Disputes may arise, for example, as to whether negotiations have led to a binding settlement agreement. And those disputes have not escaped the world of franchisor/franchisee litigation.

II. DEAL OR NO DEAL?

The law applicable to resolution of whether a binding settlement agreement has been made is the same for franchisors and franchisees as for other litigants. Settlement agreements are nothing more than contracts, and disputes concerning them are resolved in reliance on general contract principles. Silicon Image, Inc. v. Genesis Microchip, Inc., 271 F. Supp. 2d 840 (E.D. Va. 2003), aff’d, 176 F. Appx. 109 (Fed. Cir. 2006). Therefore, a binding settlement agreement must be the product of a mutual agreement between the parties. There must be a meeting of the minds on all material terms or there is no enforceable settlement agreement. All material terms must be sufficiently definite to enable a court to give them an exact meaning. Hensley v. Alcon Labs, Inc., 277 F.3d 535 (4th Cir. 2002); Intersections, Inc. v. Loomis, No. 1:09cv597, 2010 U.S. Dist. LEXIS 118080 (E.D. Va. Nov. 3, 2010).

A. Effect on Settlement of a Contemplated Later Agreement

Every day the settlement of cases is explored by counsel for franchisor and franchisee litigants in oral discussions, emails, letters, texts, twitters, and the like. Regardless of how offers and counteroffers are communicated, counsel for franchisor and franchisee litigants usually contemplate the need for a signed, written settlement agreement to bind the parties to the settlement terms. When they fall short of that mark, disputes can arise as to whether a binding settlement was reached at some point during the negotiations. Counsel and their clients may be surprised to find that the law of compromise and settlement has previously pushed them over the line to a binding settlement.

The distinction between preliminary negotiations and completed contracts is often involved in cases where the parties contemplate
the execution of a written agreement. Parties may enter into a binding informal or oral agreement to execute a written contract. On the other hand, it is possible and frequently occurs that the parties will contemplate reducing their agreement to writing before it will be considered complete, in which case there is no contract until the writing is executed. The difficulty, of course, is into which category the parties' agreement or understanding falls.

On the one hand, it has been held that where it was understood that the contract should be formally drawn up, and put in writing, the transaction is nevertheless complete and binding, absent a positive agreement that it should not be binding until so reduced to writing and formally executed. This is the position adopted by both Restatements, the drafters recognizing that, though the parties may intend to memorialize their agreement, the memorial is not necessary in the absence of a statute requiring it. On the other hand, it has been said “if it appears that the parties, although they have agreed on all the terms of their contract, mean to have them reduced to writing and signed before the bargain shall be considered as complete, neither party will be bound until that is done, so long as the contract remains without any acts done under it on either side.” The question then is how to determine whether the parties who mean to reduce their contract to writing intend to be presently bound or whether they intend that the contract shall not be considered as complete. Ultimately, the question is one of fact as to the intention of the parties. Surely, the determinant cannot be the mere fact that a writing is to be prepared, since in both cases the parties intend to memorialize their agreement.


State law applicable to contract formation and the effect of a later contemplated agreement is controlling. As an example, the law of Virginia on this issue has been stated and applied as follows for more than a century:

If, though fully agreed on the terms of their contract, they (i.e., settling parties) do not intend to be bound until a formal contract is prepared, there is no contract, and the circumstances that the parties do intend a formal contract to be drawn up is strong evidence to show that they did intend the previous negotiations to amount to an agreement.

Boisseau v. Fuller, 96 Va. 45, 30 S.E. 457 (1898).

Application of this principle requires the court to resolve a mixed question of law and fact in order to decide whether a binding settlement agreement has been made. The U.S. District Court for the Eastern District of Virginia and,
subsequently, the U.S. Court of Appeals for the Fourth Circuit were called upon to make such a determination in franchise litigation between a franchisor and its terminated franchisee in *Dunkin’ Donuts Inc. v. Lavani*, 86 F.3d 1149, 1996 U.S. App. LEXIS 11870 (4th Cir. 1996).

Lavani was a Dunkin’ franchisee who had defaulted on his payment obligations under his franchise agreement. After Lavani failed to cure his defaults, Dunkin’ terminated his franchise agreement and filed suit in federal court to enforce termination. Lavani counterclaimed. Counsel for the parties then began settlement discussions by letter and by telephone, prompted by the federal district judge who *strongly* encouraged the parties to settle their differences.

The communication that took place between counsel for the parties is significant to an understanding of the district and circuit courts’ rulings and how contemplation of a formal written settlement agreement can affect settlement. Here is a chronology of pertinent events:

<table>
<thead>
<tr>
<th>DATE</th>
<th>EVENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before November 29, 1994</td>
<td>Offer of settlement by Dunkin’ to Lavani, followed by Lavani’s rejection of offer and counteroffer to Dunkin’.</td>
</tr>
<tr>
<td>November 29, 1994</td>
<td>Counteroffer by letter from counsel for Dunkin’ faxed to counsel for Lavani with six terms:</td>
</tr>
<tr>
<td></td>
<td>(1) Dunkin’ buys “business, franchise, lease, equipment, and signs” for $40,000;</td>
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<tr>
<td></td>
<td>(2) Assets to be lien-free and Lavani to comply with bulk sales law;</td>
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<tr>
<td></td>
<td>(3) Lavani to close stores by February 1, 1995 and meet all franchise obligations through closing;</td>
</tr>
<tr>
<td></td>
<td>(4) Full releases and dismissal of case;</td>
</tr>
<tr>
<td></td>
<td>(5) Confidentiality agreement; and</td>
</tr>
<tr>
<td></td>
<td>(6) Full accounting of fees and rent through closing.</td>
</tr>
<tr>
<td>November 29, 1994</td>
<td>Letter from counsel for Lavani to counsel for Dunkin’ in response, refusing term number 1 and offering to sell business, franchise, lease, equipment, and signs for $46,000, and rejecting term number 3, counter-proposing closure by December 26 and payment of</td>
</tr>
<tr>
<td>DATE</td>
<td>EVENT</td>
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<tr>
<td>December 1, 1994</td>
<td>Phone conversation between counsel for Dunkin’ and counsel for Lavani about terms, followed by letter from counsel for Lavani to counsel for Dunkin’ confirming “our agreement” on six terms as recited, to include Dunkin’s purchase of described assets for $46,000, but supplies and raw materials not to be conveyed. Request to counsel for Dunkin’ for confirmation that this is our agreement.</td>
</tr>
<tr>
<td>December 1, 1994 (later that day)</td>
<td>Letter from Dunkin’s counsel to Lavani’s counsel stating that letter sent on behalf of Lavani does not accurately recite terms. Dunkin’ says Lavani added “supplies” to term number 1 as an item that will not be sold to Dunkin’. Dunkin objects.</td>
</tr>
<tr>
<td>December 2, 1994</td>
<td>Letter from Lavani’s counsel to Dunkin’s counsel stating that Lavani must keep supplies and raw materials, raising new issue about what “equipment” to be sold.</td>
</tr>
<tr>
<td>December 8, 1994</td>
<td>Letter from counsel for Lavani to counsel for Dunkin’ stating that Lavani will not sell raw materials and supplies to Dunkin’. He has a third-party buyer.</td>
</tr>
<tr>
<td>December 9, 1994</td>
<td>Letter from counsel for Dunkin’ to counsel for Lavani stating that equipment issue raised in December 2 letter is not a problem. Dunkin’ sends draft of formal settlement agreement for review by counsel for Lavani.</td>
</tr>
<tr>
<td>December 14, 1994</td>
<td>Letter from Dunkin’s counsel to Lavani’s counsel stating that UCC search reveals a lien on the equipment that must be satisfied before closing on settlement.</td>
</tr>
<tr>
<td>December 14, 1994</td>
<td>Letter from Dunkin’s counsel to Lavani’s counsel stating that Lavani’s terms regarding sale of raw materials and supplies are okay with Dunkin’; encloses revised settlement agreement to recite those terms. Draft settlement agreement leaves closing date blank, but Dunkin’ has said it must be no later than February 1, 1995.</td>
</tr>
<tr>
<td>DATE</td>
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<tr>
<td>December 14 – 20, 1994</td>
<td>Several calls by counsel for Dunkin’ to counsel for Lavani to ask about acceptability of revised agreement. No response from counsel for Lavani.</td>
</tr>
<tr>
<td>December 20, 1994</td>
<td>Letter from counsel for Dunkin’ to counsel for Lavani asking for position on terms of revised settlement agreement and asking for closing date to insert in agreement.</td>
</tr>
<tr>
<td>December 22, 1994</td>
<td>Letter from Lavani’s counsel to Dunkin’s counsel requesting changes to four paragraphs in revised settlement agreement.</td>
</tr>
<tr>
<td>December 23, 1994</td>
<td>Letter from Dunkin’s counsel to Lavani’s counsel refusing to agree to several of Lavani’s requested changes.</td>
</tr>
<tr>
<td>December 29, 1994</td>
<td>Letter from counsel for Lavani to counsel for Dunkin’ proposing resolution of four changes. As to closing date, counsel for Lavani states: “I will be in a better position to set a closing date once we have an acceptable settlement agreement in place.”</td>
</tr>
<tr>
<td>January 4, 1995</td>
<td>Letter from counsel for Dunkin’ to counsel for Lavani agreeing to Lavani’s December 22 resolution of four terms. Counsel for Dunkin’ encloses further revised settlement agreement incorporating agreed resolution of four terms and asks for execution. Closing date still blank.</td>
</tr>
<tr>
<td>January 12, 1995</td>
<td>In telephone call with federal district judge, Lavani’s counsel reports his client has not signed settlement agreement and has “buyer’s remorse.” Judge tells lawyers he wants case settled and instructs them to get it done ASAP.</td>
</tr>
<tr>
<td>January 12, 1995</td>
<td>Judge enters order reciting that case is settled and dismisses action with prejudice (not sent to counsel yet).</td>
</tr>
<tr>
<td>January 20, 1995</td>
<td>Dunkin’s counsel calls Lavani’s counsel to ask about status of settlement documents. Lavani’s counsel says he sent documents to his client, but his client won’t respond and he is scheduled to meet with client on January 20.</td>
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<tr>
<td>DATE</td>
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<td>----------------------------------------------------------------------</td>
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<tr>
<td>January 26, 1995</td>
<td>Dunkin’s counsel calls Lavani’s counsel regarding status. Lavani’s counsel says he met with client, and client refuses to sign settlement agreement. Counsel for Lavani says he is withdrawing, and client is looking for new lawyer.</td>
</tr>
<tr>
<td>January 27, 1995</td>
<td>Lavani’s counsel writes to judge stating he has received judge’s January 12 order dismissing case; states that he thought matter was settled but cannot get client to sign settlement documents, so he is filing motion to set aside order and seeking permission to withdraw as counsel.</td>
</tr>
<tr>
<td>January 27, 1995</td>
<td>Lavani’s counsel files Motion to Vacate Order stating: “To date, Mr. Lavani has not yet accepted the proposed settlement agreement and this matter has not been settled.”</td>
</tr>
<tr>
<td>February 1, 1995</td>
<td>Date that Dunkin’ stated was last day to close on settlement. No settlement documents signed. No closing.</td>
</tr>
<tr>
<td>February 3, 1995</td>
<td>Letter from counsel for Dunkin’ to counsel for Lavani stating that terms of settlement offered by Dunkin’ but not accepted by Lavani included closing on settlement no later than February 1, 1995. Dunkin’ considers terms of settlement offered to be rejected and repudiated. Offer is now withdrawn.</td>
</tr>
<tr>
<td>February 3, 1995</td>
<td>Judge grants Motion to Vacate Order but denies Lavani’s counsel’s motion to withdraw.</td>
</tr>
<tr>
<td>February 16, 1995</td>
<td>Counsel for Lavani calls counsel for Dunkin’. Lavani has seen other counsel, who advised him to settle. Lavani has now signed settlement agreement. Counsel for Lavani asks counsel for Dunkin’ if Dunkin’ will now settle on previously offered terms.</td>
</tr>
<tr>
<td>February 22, 1995</td>
<td>Letter from Dunkin’s counsel to Lavani’s counsel. Dunkin’ is no longer interested in settling on terms previously discussed.</td>
</tr>
</tbody>
</table>
March 6, 1995  Status conference call with Judge. For first time, counsel for Lavani asserts that case was settled on December 1, 1994, and that Lavani is entitled to enforce settlement terms.

March 8, 1995  Lavani files Motion to Enforce Settlement Agreement alleging settlement occurred on December 1, 1994.

April 4, 1995  Hearing is held on Motion to Enforce Settlement Agreement. Lavani testifies that he disagreed with two provisions in proposed Settlement Agreement and refused to sign it. Judge rules:

(1) “the law of Virginia is that where the minds of the parties have met and they are in agreement as to that, there is a contract, if they intend to be bound by what they have agreed to. And that’s true even though there is the intention to reduce the agreement to a formal contract, later to be prepared.”

(2) “By January 4, 1995, there was an agreement on all of the terms . . .”

(3) “. . . On January 4th, Dunkin’ said it agreed to all the terms listed in Lavani’s December 29 letter. Dunkin’ prepared an amended settlement agreement but it contained language that varied from the agreed term as to an accounting.”

(4) January 27 letter from counsel for Lavani “could have been more artfully worded,” but it does convey a desire that Lavani and counsel “would go forward with the settlement transaction.” “It could have been a lot more clear.”

(5) There was a settlement agreement concluded on January 4, that both parties are bound by it and that it should be enforced.

(6) As to failure of parties on January 4 to have agreed on a closing date, “a reasonable date is inferred.”
### DATE | EVENT
--- | ---
April 4, 1995 | Order entered granting Motion to Enforce Settlement Agreement.
April 14, 1995 | Motion by Dunkin’ for Rehearing, to Amend or Alter Finding and Order and/or to Vacate Order.
May 1, 1995 | District court denies Dunkin’s motion with one insignificant modification to order. “The Defendants’ Motion to Enforce Settlement Agreement is granted to the extent that it seeks a determination that an enforceable settlement agreement was reached by January 4, 1995, the terms of which are fully and accurately embodied in the document drafted by Plaintiffs . . .”; “it is the judgment of the court that it is binding as an agreement and should be fulfilled.” That is, the last version of the Settlement Agreement, which was never executed, was enforced.

Dunkin’ appealed the decision to the Fourth Circuit. On May 24, 1996, the Fourth Circuit affirmed the district court’s decision, stating that:

By January 4, the parties had mutually assented to the material contractual provisions, and Dunkin’ has failed to point to any contractual term on which the parties had not agreed as of that date . . . [N]one of the correspondence between the parties’ counsel expressed any intent that a binding agreement depended on formal execution of the written documents.

The court held that the representations made by counsel for Lavani after January 4 were “irrelevant to a determination of the parties’ intent to be bound as of January 4.” The parties simply agreed to memorialize their settlement with a formal document but did not make the contract subject to that condition, the court concluded.

The parties’ failure to agree on a closing date before February 1 did not affect formation of the settlement agreement, the court held, because the parties had not made time of the essence. Counsel for Lavani’s representations to the court that the matter was not settled, followed by his assertion that it was settled on December 1, did not compel reversal of the district court’s finding, the court concluded.

The lesson of this case is that if any party does not intend to be bound by a settlement agreement until a formal written agreement is signed by all parties,
that party should expressly say so as soon as possible and should recite that a
binding settlement is conditional upon the parties’ execution of a final written
settlement agreement. Otherwise, the parties may find that earlier
communications created a binding agreement, no matter how unfair or
unwarranted such a finding may seem.

More recently, California Sun Tanning, USA, Inc., a franchisor of tanning
salons, was involved in a similar dispute with a terminated franchisee. California
Sun Tanning, Inc. v. Electric Beach, Inc., Bus. Franchise Guide (CCH) ¶ 14,332
(3d Cir. 2010). California Sun discovered that its Wilmington, Delaware
franchisee, Electric Beach, Inc., had underreported gross sales and failed to pay
$50,000 in royalties. California Sun terminated the franchise, but Electric Beach
did not cease operation. So California Sun filed a lawsuit in the Eastern District
of Pennsylvania to enjoin Electric Beach’s continued operation.

Shortly after the lawsuit was filed, counsel for the parties began settlement
discussions by letter and email. California Sun proposed that the parties enter
into an Asset Purchase Agreement (“APA”) for California Sun’s purchase of the
franchisee’s store assets for $100,000, less expenses, along with a full mutual
release. Discussion between counsel followed. Then counsel for Electric Beach
drafted for California Sun outlining his understanding of agreed terms:
sale of the assets for $85,000; mutual release; mutual cooperation in the sale;
closing by January 22, 2008; and all conditioned upon acceptance of the terms
by one of Electric Beach’s principals. Counsel for California Sun responded by
email noting after each term “AGREED,” but with some minor conditions that
were ultimately fulfilled. The principal of Electric Beach emailed that the terms
were “fine.” California Sun said it would circulate a draft APA promptly. Counsel
for California Sun then notified the court that “the parties have agreed in principle
to amicably resolve their differences” and asked for 30 days to have the
agreement reduced to writing.

Without agreement on the terms of the written APA or execution of it, the
parties then began making the transfer, and California Sun assumed control over
the franchisee’s store. The purchase price was placed in escrow pending
execution of the APA.

Then problems developed. California Sun found objectionable conditions
in the shop, discovered that the franchisee had several unpaid debts for store
operation, and discovered that Electric Beach had removed some of the store’s
assets. The parties could not agree on resolution of these issues, and the APA
was not signed. So Electric Beach filed a motion to enforce the settlement it
alleged had been reached in the exchange of emails. After a two-day evidentiary
hearing, the district court ruled that settlement had been reached by the
exchange of emails, and it granted the franchisee’s motion.

The franchisor appealed to the Third Circuit and lost. One of its grounds
for appeal was that the emails did not constitute an enforceable agreement; that
by providing for preparation and execution of an APA, the parties manifested an intent not to be bound until the APA was signed.

Citing Pennsylvania law, the Court noted that “where the parties have agreed on the essential terms of a contract, the fact that they intend to formalize their agreement in writing but have not yet done so does not prevent enforcement of such agreement.” The court found that the parties, by their counsel’s emails to each other, had reached a binding settlement agreement.

We find the material terms of the agreement pellucidly clear, and the parties’ intent to be bound thereby equally evident from the record. We also find lacking any evidence that the parties believed that the enforceability of any agreement would be contingent on the execution of a writing memorializing its terms. . . . Accordingly, we agree with the District Court’s conclusion that the parties entered into an enforceable settlement agreement.

Id. (citation omitted).

If, in his email exchange with counsel for the franchisee, counsel for California Sun had recognized that a transfer of store assets in settlement would require an on-site inspection and that the inspection might raise unknown issues affecting execution of the APA, he could have protected his client from the unfortunate developments that occurred. That protection could have been achieved by adding a statement such as: “These terms are conditional upon California Sun’s inspection of the store, upon its inventory of assets, and upon execution by the parties of a written APA. Until such execution by the parties, there is no binding settlement.”

B. Settlement in Mediation

Mediations are particularly vulnerable to application of the deal-or-no-deal dilemma as controlled by the anticipation of a formal written settlement agreement. Mediators are trained to ensure that any agreement reached by the parties is reduced to a writing before adjournment. But the nature of mediation often leads to hurriedly prepared, handwritten records of agreed terms with the expectation that a more formal agreement will be drafted and signed in due course. When the formal agreement process collapses, one party or another may assert that a binding agreement was reached at the end of the mediation session.

In Iron & Silk, Inc. v. Champion Arts, Inc., Bus. Franchise Guide (CCH) ¶ 12,567 (Cal. Ct. App. 2003), for example, a franchisee of a martial arts system sued the franchisor for various causes of action arising out of the franchisee’s operation of the franchise. After the case was filed, counsel arranged for private mediation of the dispute. At the end of the day-long session, an agreement on terms was purportedly reached, and a four-paragraph memorandum was
prepared and signed by both parties and their counsel. Significant to this decision, the memorandum provided that:

(a) “the undersigned hereby enter into the following settlement agreement as a full and final settlement of all claims . . .”

(b) franchisee will pay franchisor an agreed sum “upon the execution of a final settlement agreement . . .”

(c) a periodic payment will begin one month “after execution of the final settlement agreement . . .”

Id.

No “final settlement agreement” was ever signed by the parties. The settlement later blew up, and the franchisor filed a motion to enforce settlement, asserting that the mediation memorandum constituted a binding agreement. The franchisee opposed the motion, saying that because the memorandum contemplated a formal settlement agreement to be prepared later and signed by the parties, and that never happened, there was no enforceable settlement.

The Court noted that the applicable law was California’s law of contracts, which provides that:

[A] contract will be enforced if it is sufficiently definite (and this is a question of law) for the court to ascertain the parties' obligations and to determine whether those obligations have been performed or breached . . . Stated otherwise, the contract will be enforced if it is possible to reach a fair and just result even if, in the process, the court is required to fill in some gaps. . . . The failure to reach a meeting of the minds in all material points prevents the formation of a contract even though the parties have orally agreed upon some of the terms or have taken some action related to the contract. . . . When something is reserved for the future agreement of both parties, the promise can give rise to no legal obligation until such future agreement.

Id. at 36,719 (citations omitted).

Applying that law, the court found that the mediation memorandum was sufficiently definite to allow the court to determine the parties’ obligations and whether they had been performed or breached. The court rejected the franchisee’s argument that the memorandum was just an agreement to agree, finding that its terms were not made conditional upon the later execution of a final settlement agreement. “The reference to a final settlement agreement suggests only that the parties intended to work out details of the transaction; it is entirely
consistent with a mutual manifestation of consent to the material terms of the agreement," the court stated. *Id.*

The same issue arose from mediation in *Intersections, Inc. v. Loomis*, *supra*, decided by the U.S. District Court for the Eastern District of Virginia. This was not a franchise case, but it illustrates the issue well for mediation of franchise litigation. It involved a dispute over the purchase of stock, with plaintiff purchaser alleging fraud and conspiracy by the seller. The district court judge referred the case to a U.S. magistrate for mediation. At the end of mediation, the parties agreed to terms for resolution of the case, and such terms were reduced to an unsigned, handwritten "Term Sheet" prepared by the magistrate. The parties contemplated that a formal written settlement agreement would be prepared and signed later.

Although drafts passed back and forth, no formal written settlement agreement was ever signed by the parties. Plaintiff then filed a motion to enforce the settlement as set out in the Term Sheet. The motion was heard by the magistrate who had presided at the mediation. He recommended to the district court judge that the motion be granted, but the district court judge refused to accept the magistrate’s recommendation.

Although the parties reached a tentative agreement during the settlement conference . . . they explicitly contemplated that they would ultimately be bound only by a written, signed, fully integrated settlement agreement. That is why the Term Sheet states that a written settlement agreement was to be signed on or before January 22, 2010, and that all the material events related to the settlement were expressly tied to the execution of a written agreement . . .

The complexity of the issues involved and the amount of money at stake in this case only buttress the conclusion that the parties anticipated resolving the matter by means of a signed agreement setting forth all relevant events. *Id.*

The district court’s ruling was influenced by two items of evidence: First, one of the parties testified that he did not understand the handwritten Term Sheet to be the final binding settlement. Second, the Court found that the draft settlement agreement included terms not found in the Term Sheet, which " . . . demonstrates that the tentative settlement reached at the January 14, 2010 mediation was incomplete and that there was no legally enforceable 'meeting of the minds' between the parties."

The court’s finding here -- that the Term Sheet was not a binding settlement agreement because it was clear that the parties contemplated
preparation of a final written agreement, even though the Term Sheet did not expressly state that settlement was conditional upon execution of such agreement – is the opposite of the district court’s finding in Dunkin’ v. Lavani – that because the parties did not provide in their letter exchanges that a binding settlement was conditional upon execution of a final written settlement agreement, a binding agreement was made on January 4, 1995.

These cases illustrate the importance of fully appreciating the law of compromise and settlement in the jurisdiction where settlement is reached. That point was brought home to KFC Corporation in Miller v. KFC Corp., Bus. Franchise Guide (CCH) ¶ 11,912 (N.D. Tex. 2000). At a voluntary settlement conference, the parties orally agreed on terms for settlement. KFC promptly began to perform those terms, only to be confronted by the plaintiff with a demand for changes in the terms. KFC moved to enforce the settlement agreement but lost the motion because Rule 11 of the Texas Rules of Civil Procedure provided that the court could not enforce any settlement unless it was in writing, signed, and filed with the court or unless it was made in open court and entered of record. Argued exceptions were held not to apply.

III. SETTLEMENT WITH FRANCHISEES WHO WILL REMAIN IN THE SYSTEM

For this discussion, we will assume that: the franchisor terminated the franchise agreement for cause; the franchisor filed suit to enforce termination; and the parties subsequently agreed to settle their differences on terms that included having the franchisee continue in the system and reducing those terms to a written settlement agreement.

A. Reinstatement of the Franchise Agreement

If the parties want to continue their franchise relationship, the franchisor must reinstate the previously terminated agreement. Reinstatement is often made conditional upon the franchisee’s subsequent performance of its obligations under the franchise agreement, or upon its performance of the settlement agreement terms, such as payment of a note or payment for raw materials or supplies on a COD basis or other such terms reflecting the agreed modification of their relationship. A typical conditional reinstatement provision might state:

[Sample]

Conditional Reinstatement of Franchise Agreements.

FRANCHISOR hereby reinstates the Franchise Agreement retroactive to the date of its termination, but such reinstatement is conditional upon performance by
FRANCHISEE of all obligations recited in the reinstated Franchise Agreement, in this Settlement Agreement, and in the Exhibits hereto.

In lieu of immediate cessation of operation of the franchised business, reinstatement of the franchise agreement is sometimes agreed upon for the sole purpose of allowing the franchisee to operate while it tries to find a buyer for the business. Reinstatement conditioned on the franchisee’s sale of its franchise may be accompanied by a signed termination agreement to be held in escrow pending the franchisee’s compliance with the agreed conditions. A failure to sell the franchisee’s business on the agreed terms results in activation of the termination agreement. A typical provision for reinstatement for purposes of a sale might state:

[Sample]

Sale of Franchise.

1. FRANCHISEE will make a good faith effort to sell all of its right, title and interest in the franchised business and will submit to FRANCHISOR on or before [date certain], a fully executed Purchase and Sale Agreement for transfer of all of its right, title, and interest in the franchised business to a purchaser to be approved by FRANCHISOR.

2. FRANCHISEE and the prospective transferee of the franchised business shall comply with all of the provisions contained in the Franchise Agreement concerning transfer, as well as with the standards, requirements, policies, and procedures generally used by FRANCHISOR in such transactions.

3. The prospective purchaser must demonstrate to FRANCHISOR, prior to the closing, the ability to operate the franchised business satisfactorily and to comply fully with the terms and conditions of the newly issued franchise agreement. The prospective transferee must successfully complete FRANCHISOR’s training. All deficiencies in the franchised business premises identified by FRANCHISOR must be cured prior to closing. If any deficiencies are not cured to FRANCHISOR’s satisfaction prior to closing, FRANCHISOR shall have the right not to approve the sale. The prospective purchaser must assume operation of the franchise immediately upon closing or transfer of the franchise. All amounts due FRANCHISOR, including, but not limited to, the applicable transfer fee, must be paid at or prior to closing.
4. FRANCHISOR reserves the right to approve the terms of the Purchase and Sale Agreement and transfer, which approval will not be unreasonably withheld.

5. Closing on sale of the franchised business shall occur no later than [date certain].

6. Time is of the essence in performance of FRANCHISEE’s obligations under this paragraph.

B. ‘Short Leash’ Provisions

Provided state law permits, franchisors and franchisees sometimes settle their differences by reinstating the franchise agreement but curtailing or modifying some of the franchisee’s rights or obligations contained in the agreement. Such modifications often include one or more of the following:

- The franchisee’s waiver of any notice of default and opportunity to cure a default provided in the franchise agreement;

- Continuing to require written notice of default but shortening the applicable cure periods;

- Immediate termination of the franchise agreement upon default without further notice to the franchisee;

- Reduction of past due receivables to a note and immediate termination of the franchise agreement upon any default on the note;

- Cross-default provisions among the franchise agreement, the settlement agreement, and agreements ancillary to settlement;

- Modification of a franchisee’s terms for purchase of materials, products, or supplies from the franchisor, such as COD only;

- Imposing a minimum royalty payment each week (especially in cases where there is presumed to be underreporting of gross revenues upon which royalty and advertising fees are paid).

In settlement, franchisors and franchisees sometimes provide that a franchisee’s performance of its settlement obligations is to be secured by one of the following:

- A consent judgment order, fully endorsed and held in escrow by the franchisor or its counsel, to be presented to the court on agreed terms (for example, upon any additional default);
A termination agreement signed by the franchisee and held in escrow by the franchisor or its counsel, to be put into effect upon defined defaults of settlement obligations by the franchisee, with notice of such action to the franchisee;

A typical security-for-performance provision might state:

[Sample]

**Security for Performance.** Upon execution of this Settlement Agreement and the Promissory Note and other documents described in this Settlement Agreement, FRANCHISEE shall perform all of its obligations under the reinstated Franchise Agreement, the Promissory Note and this Settlement Agreement fully and on time, including but not limited to payment of all sums due to FRANCHISOR; submission of all gross sales reports; submission of all P&L’s, balance sheets and bank statements to FRANCHISOR; and full cooperation with FRANCHISOR in its monitoring of the franchised business conducted by FRANCHISEE. Time shall be of the essence in the performance by FRANCHISEE of all obligations to FRANCHISOR under the agreements noted above. As security for performance of its obligations, FRANCHISEE will execute simultaneously with its execution of this Settlement Agreement the Termination of Franchise Agreement and Release document attached as Exhibit [ ] (the “Termination Document”). The executed Termination Document shall be delivered to and held in escrow by [name of individual counsel and/or firm], counsel for FRANCHISOR in this transaction, and such Termination Document shall not be effective unless and until FRANCHISEE defaults on any obligation owed to FRANCHISOR under the reinstated Franchise Agreement, the Promissory Note, or this Settlement Agreement. Any default by FRANCHISEE under any of the foregoing documents shall be a default under all others. In the event of such default, the escrow agent named herein shall then be authorized to remove the Termination Document from escrow and put it into immediate effect. The escrow agent shall then send notice of such action to FRANCHISEE at [address] and FRANCHISEE shall then comply with all post-termination obligations under the Franchise Agreement and pay FRANCHISOR all sums then due, including the balance due under the Promissory Note;

- A perfected lien on franchisee assets;
• Personal guarantees of all franchisee individuals and spouses and, if the franchisee is a business entity such as a corporation, limited liability company, or partnership, personal guarantees of shareholders, managers, parties, and owners of any interest in the entity.

C. Caveat About Reinstatement

1. Reinstatement of Unmodified Franchise Agreement

Before reinstating a previously terminated franchise agreement, franchisors should examine the requirements of the FTC Rule and applicable state registration/disclosure and relationship statutes. Is pre-reinstatement disclosure or registration by the franchisor required by the FTC Rule or state franchise statutes if the franchise agreement to be reinstated is not modified in any way? Is disclosure or registration of a modified franchise agreement required before reinstatement can be lawfully made? Do agreed modifications violate state relationship laws?

The authors have not found any case, FTC informal advisory opinion, or other administrative ruling or opinion analyzing the applicability of FTC Rule’s disclosure requirements to franchise agreement reinstatement. The authors offer no personal opinions on the issue here. But analysis of the issue requires consideration of the following:

• Whether the franchisee to be reinstated is now a “prospective franchisee” again or whether, despite the franchisee’s terminated status, it is considered an existing franchisee;

• Whether reinstatement is the “sale of a franchise” under the FTC Rule; and

• If reinstatement is the “sale of a franchise,” whether it is one of the exceptions to disclosure.

Regardless of the opinion one draws from this analysis, as a practical matter, franchisors probably do not make re-disclosures before settling with a terminated franchisee by reinstatement of the terminated franchise agreement. The risk of an FTC action for Rule violation is probably remote, and the reinstated franchisee is not likely to get very far with a claim for damages at some later date premised on the franchisor’s failure to make pre-reinstatement re-disclosures. So while the issue is interesting, it seems more academic than practical.
2. Reinstatement of Franchise Agreement with Modifications

In settlement, a franchisor will sometimes agree to a franchisee’s continued operation only if the reinstated franchise agreement is modified. Agreed modifications often curtail or eliminate franchisee rights under the franchise agreement, such as the right to receive written notice of a default and opportunity to cure before the franchisor can terminate the agreement. Does the FTC Rule require a franchisor to re-disclose a terminated franchisee before reinstating the franchisee under the previously terminated franchise agreement with material modifications? Again, the authors have found no case, opinions, or administrative rulings answering that question.

Some state regulatory statutes, however, require registration of modifications to previously registered franchise agreements before a franchisor may impose them on its franchisee. Consider, for example, the pre-sale disclosure and registration requirements of the California Franchise Investment Law, Cal. Corp. Code § 31000 et seq. Section 31018 of that law expressly provides that “a material modification of an existing franchise, whether upon renewal or otherwise, is a “sale” within the meaning of this section.” Section 31125 requires state approval of material modifications before they can be made effective. That section also provides an exception for “any modification of a franchise agreement with an existing franchisee of a franchisor,” but only if each of certain conditions is met. One of those conditions deals with settlement of franchisor-franchisee disputes:

The proposed modification [must be] in connection with the resolution of a bona fide dispute between the franchisor and the franchisee or the resolution of a claimed franchisee or franchisor default, and the modification is not applied on a franchise systemwide basis at or about the time the modification is executed. A modification shall not be deemed to be made on a franchise systemwide basis if it is offered on a voluntary basis to fewer than 25 percent of the franchisor’s California franchisees within any 12-month period.

Id.

Whether “short leash” modifications such as those noted above can be implemented without compliance with disclosure and registration requirements of the California Franchise Investment Law depends on the nature of the modification because another condition to the exemption provides that the modification must not “substantially and adversely impact the franchisee’s rights, benefits, privileges, duties, obligations, or responsibilities under the franchise agreement.” Therefore, any settlement term that curtails a franchisee right or benefit under the reinstated franchise agreement arguably is captured by this
provision, negating the franchisor’s exemption from pre-reinstatement regulatory compliance.

Further, another exemption condition is that the franchise agreement modification “does not waive any right of the Franchisee under the California Franchise Relations Act, but the modification may include a general release of all known and unknown claims by a party to the modification.” § 31125(c)(1)(B). Section 20020 of the California Franchise Relations Act provides for termination of a franchise for good cause only after receipt of written notice of default and reasonable opportunity to cure. Therefore, for any franchisor-franchisee relationship subject to the California Franchise Investment Law and the Franchise Relations Act, settlement that would include reinstatement of the previously terminated franchise agreement, as modified by the elimination of written notice for subsequent defaults or the elimination or extreme curtailment of an opportunity to cure preceding termination, would violate the Franchise Relations Act and Franchise Investment Law unless there was full compliance with the Investment Law’s disclosure and registration requirements before reinstatement.

Moreover, because the Franchise Relations Act has an anti-waiver provision, modification of the reinstated franchise agreement to eliminate written notice of default and reasonable opportunity to cure before any termination for good cause would violate California’s public policy and thus would be void. § 20010.

Similarly, the pre-sale regulatory requirements for franchise sales under Hawaii’s Franchise Investment Law, Hawaii Rev. Statutes, Title 26, § 482 E.1 et seq., exempt “the exchange or substitution of a modified or amended franchise agreement . . . where there is no interruption in the operation of the franchise business of the franchisee, and no material change in the franchise relationship.” § 482E.4(a)(5). Other state statutes have similar provisions. See e.g., Michigan Franchise Investment Law, Michigan Compiled Laws § 445.1506(e).

Is the elimination, upon settlement, of franchise agreement terms requiring written notice of default and reasonable opportunity to cure before termination a “material change in the franchise relationship” that would disqualify a franchisor from the benefit of the exemption? If the terminated franchisee continued to operate its business without interruption, despite the franchisor’s termination of the operative franchise agreement, would reinstatement of even the unmodified franchise agreement exempt the franchisor from the disclosure or registration requirements of Hawaii’s statutory law?

There are no definitive answers to these questions. To be sure, franchisors and franchisees settle litigation by reinstating the terminated franchise agreement and modifying the franchisee’s rights and obligations under the agreement without a re-disclosure of the FDD and modified agreement and without state registration of the modified agreement. In the absence of any
known judicial or administrative decision, it is enough to note that in some states, some modifications may technically violate applicable state disclosure or registration statutes, and franchisors might be required to treat the reinstatement of any franchise in the state by compliance with its registration and/or disclosure requirements. It is clear, however, that certain “short lease” modifications of a reinstated franchise agreement will violate some state relationship laws, voiding such modifications or, worse yet, subjecting the franchisor to claims for violation of such laws.

D. Releases

A settlement agreement usually provides for a mutual releases of all claims arising through and including the date of settlement. This will wipe the slate clean for the ongoing relationship of franchisor and franchisee. If any claims are not to be released, they should be spelled out clearly. A typical mutual release might state:

[Sample]

Releases. Upon execution of this Settlement Agreement, FRANCHISEE thereupon releases and forever discharges FRANCHISOR as well as its parents, subsidiaries, predecessors in interest, successors, and assigns, to include all officers, directors, agents, servants, and employees of such companies, of and from all debts, demands, actions, causes of action, contracts, claims, obligations, and liabilities which any of the releasing parties now has, or ever had, against FRANCHISOR or any corporation affiliated with any of them from the beginning of the world through and including the date of this Settlement Agreement arising out of or in connection with the Franchise Agreement and/or operation of all FRANCHISOR franchised businesses, including, but not limited to, any and all state or federal antitrust claims, securities law claims, breach of contract claims, fraud and misrepresentation claims, breach of fiduciary duty claims, unfair trade practices claims (state or federal), and any other claims and causes of action whatsoever, whether now known or hereafter discovered.

E. Enforcement

In order for either party to be able to enforce the settlement agreement without having to file a new action, the order dismissing the pending litigation should incorporate the settlement agreement and provide that the court retains jurisdiction to enforce the agreement. Kikkonen v. Guardian Life Ins. Co., 511 U.S. 375 (1984); Lipman v. Dye, 294 F.3d 17 (1st Cir. 2002).
IV. SETTLING WITH FRANCHISEES WHO ARE LEAVING THE SYSTEM

A. Terms for Ending the Relationship

When a franchisor and franchisee part ways, a settlement agreement can, first and foremost, set out the terms for ending their relationship. In addition to memorializing the parties’ agreement on how any disputes are being resolved, the settlement agreement is likely to provide for giving releases and indemnifications, refraining from disparagement, maintaining confidentiality, and providing mechanisms for enforcement of the parties’ bargain. Certain terms of a settlement agreement with a departing franchisee may mirror the post-termination obligations of the franchise agreement itself. Most franchise agreements, for example, include provisions for ceasing all use of trademarks, de-identifying the franchised location, and returning confidential and proprietary materials to the franchisor, as well as covenants against competition and solicitation.

Still, the termination and post-termination obligations of the franchise agreement may not cover all issues that can arise in ending the relationship. For example, while the franchise agreement may call for transferring the phone number for the franchised business back to the franchisor, it may not contemplate transferring or discontinuing websites, Facebook pages, or Twitter accounts, discontinuing contacts with customers or others in LinkedIn networks, or relinquishing any other social media site associated with the franchise. Provisions in the settlement agreement can address those issues.

1. Terminating the Franchise Agreement, Paying Sums Owed

Termination of a franchise relationship may involve issues of payment of franchise fees, advertising contributions, product purchases, rents, and perhaps future royalties. The settlement agreement must address sums owed, as well as performance of other obligations. A typical provision for termination and payment of sums owed in a settlement agreement might state:

[Sample]

Upon the execution of this Settlement Agreement and the payment of the sums set out in Section [ ] below, the Franchise Agreement between FRANCHISOR and FRANCHISEE shall be terminated, and FRANCHISEE shall have no further liability under the Franchise Agreement except for the post-termination obligations existing in subsections [ ] and the obligations set forth in this Settlement Agreement.

FRANCHISEE currently owes to FRANCHISOR and the Franchisor Advertising Fund the amount of $[ ] (“Back Fees”).
Concurrently with the execution of the Settlement Agreement, FRANCHISEE shall pay to FRANCHISOR the Back Fees in full in cash.

2. Complying with Post-Termination Obligations

The franchise agreement will almost always include detailed post-termination obligations that a franchisee must meet when the agreement ends. These typically require the franchisee immediately to:

- Cease using the franchisor’s trademarks, trade name, and trade dress or any trademarks, trade name, or trade dress similar to those of the franchisor;
- “De-identify” the premises by removing signage and altering the location’s physical appearance to distinguish it from the look of the franchised business;
- Return any confidential and proprietary material, such as operations manuals, training materials, proprietary software, and customer lists;
- Cease using the telephone number of the franchised business and transfer that number to the franchisor;
- Cease using any website associated with the franchisor;
- Refrain from competing with, or soliciting customers from, the franchise system for a certain time period within a certain territory.

Regardless of what the franchise agreement provides, however, the enforceability of restrictions on competition and solicitation may vary from state to state, as state laws dictate. (This will be discussed further in Section IV.A.2.f below.)

a. Ceasing Use of Trademarks, Trade Name

The franchise agreement itself will certainly prohibit use of the system’s trademarks, trade name, and trade dress after termination, and the Lanham Act will prohibit such use as a matter of law. Nevertheless, including a provision in the settlement agreement on this topic permits the parties to make clear and easily provable how and when the surrender of the trademarks, trade name, and trade dress is to occur.

A typical settlement agreement provision for ceasing all uses of trademarks, trade names, and trade dress might state:

[Sample]
From the effective date of this Settlement Agreement forward, neither FRANCHISEE nor anyone acting on behalf of or in concert with FRANCHISEE, shall use [franchise system’s trademarks or trade names] (collectively, the “Franchise System’s Marks”) or any trademarks or trade names confusingly similar to them, in connection with any business or other commercial activity. This restriction includes without limitation use of the Franchise System’s Marks in connection with any domain name or any social media site.

b. Ceasing Use of Trade Dress, De-Identification

The settlement agreement also provides an opportunity to clarify when de-identification must occur and what is to be included in de-identification. Depending on the franchise system’s trade dress, de-identification can be quite involved. Many franchisors include with the settlement agreement a de-identification checklist. A typical settlement agreement provision for de-identification might state:

[Sample]

By [deadline], FRANCHISEE shall take all steps necessary to de-identify its location as having been associated with the Franchise System. In that regard, FRANCHISEE shall permanently cover or remove all FRANCHISOR signage and building fascia and shall ensure that FRANCHISOR’s trade dress, trade name, and logos are covered up, painted over, or removed, so that there is no customer confusion as to the origin of goods and services coming from the former franchised location.

Depending on the Franchise System’s trade dress, the settlement agreement’s de-identification provision may also need to provide for changing color schemes and destroying business cards, receipts, stationery, forms, advertising and promotional materials, and other items.

Typically, the settlement agreement will allow for a site visit by a representative of the franchisor to confirm that de-identification is complete. Some settlement agreements also provide a self-help remedy to the franchisor in case the franchisee does not comply with its obligations to de-identify. A typical provision might state:

[Sample]

If the de-identification obligations set forth above are not met, FRANCHISOR shall have the right, upon [number] days’ written notice, to take such actions as are reasonably
necessary to complete the de-identification of the former franchised location. FRANCHISEE hereby agrees that FRANCHISOR has the right to enter the premises for this purpose, and that such entry will not be deemed a trespass. FRANCHISEE shall be liable to FRANCHISOR for all costs reasonably necessary to complete the de-identification.

Alternatively, the settlement agreement may specify that the franchisor would suffer irreparable harm and be entitled to injunctive relief if the franchisee fails to de-identify as promised.

In some cases, when a holdover franchisee steadfastly refuses to de-identify, the franchisor may even seek an order from the court requiring de-identification and providing for the United States Marshal to visit the former franchised location to prevent a breach of the peace while representatives of the franchisor supervise or assist with the de-identification. The costs for the attendance of the United States Marshal are typically paid by the franchisor, but the order may allow for recovery of those costs from the franchisee in any final judgment. Having a settlement agreement provision such as the one above may make this remedy easier to obtain.

c. Return of Confidential, Proprietary Materials

The settlement agreement should ensure the return by a date certain of the franchisor’s confidential and proprietary materials, such as the operations manual, training materials, software (including any programs that print the franchise system’s name or logo on receipts and other items), customer lists, and any other items that may constitute trade secrets. This provision should cover any copies in the franchisee’s possession as well. The settlement agreement should provide that any materials not returned are to be destroyed, with their destruction affirmed in writing by the franchisee.

A typical settlement agreement provision for return of these materials might state:

[Sample]

By [deadline], FRANCHISEE shall return to FRANCHISOR [list of materials considered confidential and proprietary (the “Trade Secrets”)], including all copies of the Trade Secrets in FRANCHISEE’s care, custody, or control, and shall make no further use of the Trade Secrets for any purpose. FRANCHISEE acknowledges that the Trade Secrets are the property of FRANCHISOR and that any use of the Trade Secrets by FRANCHISEE, or by anyone acting on behalf of or in concert with FRANCHISEE, after the Effective Date of this Settlement Agreement constitutes a misappropriation of trade secrets and
an unfair trade practice that will cause FRANCHISOR to suffer irreparable harm. FRANCHISEE further agrees and acknowledges that FRANCHISOR is entitled to protect the Franchise System against such irreparable harm by obtaining a preliminary injunction against FRANCHISEE, without the requirement of posting any security.

d. Transfer of Telephone Number

The telephone number for a franchise can be one of the biggest bones of contention when the franchise relationship ends. Thus, it is important to reach a clear understanding in the Settlement Agreement regarding what happens to the telephone number and whether the Franchisee can intercept and redirect calls to a new number, even if it surrenders the existing number to the Franchisor.

A typical settlement agreement provision for return of the telephone number to the franchisor might state:

[Sample]

Upon the execution of this Settlement Agreement, FRANCHISEE immediately shall cease using the telephone listing [number] (the “Telephone Listing”) in any form and shall cooperate with FRANCHISOR to transfer possession of the Telephone Listing to FRANCHISOR. FRANCHISEE understands and agrees that if it does not transfer the Telephone Listing to FRANCHISOR, then FRANCHISOR will suffer irreparable harm and may protect the Franchise System from such harm by obtaining a preliminary injunction against FRANCHISEE, without the requirement of posting any security.

e. Ceasing Use of Other Media Associated with Franchise System

Social media has provided franchisees many new and different avenues for advertising, marketing, and promoting their franchised business using the system’s brand. Franchisees may have established webpages, Facebook pages, LinkedIn profiles, Twitter accounts, and other presences on social media platforms, in each case using some form of the franchise system’s brand. Franchise agreements -- particularly older forms of franchise agreements -- may not cover these issues as part of the franchisee’s post-termination obligations. The settlement agreement provides a way to address them.

The settlement agreement should require a franchisee leaving the system to shut down any Internet site or social media site using the franchise system’s name or trademarks or to transfer those sites to the franchisor. After gaining
administrative rights to a site, the franchisor can redirect traffic from that site to its own site. A harder issue is preventing a departing franchisee from taking with it the “following” it may have gained on sites such as Twitter and LinkedIn. To address this issue, the settlement agreement may include a non-solicitation provision related to those contacts as well.

The settlement agreement must also make clear that the departing franchisee cannot start a new site using any name or trademark confusingly similar to the franchise system’s name or marks and may not redirect traffic from its old sites to its new site.

A typical settlement agreement provision for ceasing use of Internet sites and other forms of communication using the franchisor’s trademark or trade name might state:

[Sample]

Immediately upon execution of this Settlement Agreement, FRANCHISEE shall either transfer to FRANCHISOR or discontinue any websites and other social media sites using the Franchise System’s trade name or trademarks or any derivative or variation of them (the “Franchise Sites”). FRANCHISEE shall not redirect visitors to the Franchise Sites to any other site without the express written consent of the FRANCHISOR. FRANCHISEE shall not use FRANCHISOR’s trade name or trademarks or any derivative or variation of them in any other website or social media site.

f. Refraining from Competition

Franchisors typically want to protect their interests by prohibiting a departing franchisee from continuing to operate a similar business in the franchised territory or from soliciting customers of the franchised business. Some jurisdictions are more hostile than others to covenants against competition. Where such covenants are allowed, they are most likely to be held enforceable if the following conditions are met: the franchisor has a protectable interest (such as its goodwill); the restriction is reasonably related to that interest; the restriction is no wider in geographic scope or duration than is necessary to protect that interest, and the restriction does not impose any undue hardship or violate public policy. See, e.g., Sylvan Learning, Inc. v. Gulf Coast Education, Inc., No. 1:10-CV-450, 2010 U.S. Dist. LEXIS 107160, Bus. Franchise Guide (CCH) ¶ 14,472 (M.D. Ala. Oct. 6, 2010) (holding that both Alabama and Maryland law would apply these principles in holding a non-compete agreement enforceable).

A typical settlement agreement provision for refraining from competition with the franchise system would state:
[Sample]

FRANCHISEE understands and agrees that pursuant to the post-termination covenant against competition at section [ ] of the Franchise Agreement, FRANCHISEE shall not engage in any activity in its former franchised location, or at any other location within [number] miles of its former franchised location, which involves the sale of products or services offered by the Franchise System. FRANCHISEE understands that this covenant is ancillary to the Franchise Agreement.

Some agreements add restrictions that may vary with time, such as provisions barring a franchisee from operating a similar business not only within "x" miles of its former franchised location, but also within "x" miles of any then-existing franchised location within the system. Such restrictions are sometimes held invalid because they do not permit the franchisee to know precisely what limitations it will be bound to at the time of signing the agreement. See, e.g., Atlanta Bread Co. Int'l v. Lupton-Smith, 663 S.E.2d 743 (Ga. App. 2008) (in the context of a franchise agreement, invalidating a covenant against competition because it allowed the prohibited territory “to shift and/or expand during the course of the agreement” as new franchised locations were added to the system); aff'd 679 S.E.2d 722 (Ga. 2009); superseded by statute O.C.G.A §§ 13-8-2, 13-8-2.1, and 13-8-50-59 (2010) (making restrictive covenants easier to enforce and permitting Georgia courts to blue-pencil restrictive covenants).

As a corollary to the non-compete provision, a franchisor may require the departing franchisee to turn over its customer list or to sign a letter to its former customers stating that it is no longer an authorized representative of the franchisor and no longer offering the products or services offered by the franchisor.

Non-solicitation provisions may also be useful if there is a concern that a departing franchisee will try to take with it the contacts developed while in the system. A typical non-solicitation provision in a settlement agreement might state:

[Sample]

For [time period] following the execution of this Settlement Agreement, FRANCHISEE shall not solicit or attempt to solicit any individual within [geographic area] who was a customer of the FRANCHISOR at the time of execution of this Settlement Agreement (“Target Customers”) for the purpose of advertising, marketing, promoting, selling, or offering for sale goods or services that are the same as or similar to those offered by the FRANCHISOR at the time of execution of this Settlement Agreement. Target Customers shall include any
individuals or entities to whom FRANCHISEE sold or offered for sale goods or services of the Franchise System or any customer or prospective customer who FRANCHISEE learned of or became acquainted with during the franchise relationship. FRANCHISEE hereby acknowledges that any solicitation of the Target Customers by FRANCHISEE, or by anyone acting on behalf of or in concert with FRANCHISEE, after the Effective Date of this Settlement Agreement constitutes a misappropriation of FRANCHISOR’s proprietary information and goodwill that will cause FRANCHISOR to suffer irreparable harm. FRANCHISEE further agrees and acknowledges that FRANCHISOR is entitled to protect the Franchise System against such irreparable harm by obtaining a preliminary injunction against FRANCHISEE, without the requirement of posting any security.

In TEKsystems v. Hammernick. Case No. 10-cv-819 (D. Minn. filed March 10, 2010), non-solicitation and non-compete provisions are being tested for the first time in the context of social media. In this case, now pending, an employee left TEKsystems to work for a competitor and then contacted her former colleagues and customers through her personal LinkedIn account, inviting them to visit her new office and learn about “some of the stuff we are working on.” TEKsystems sued the former employee, alleging that she had violated both restrictive covenants. With franchisees actively promoting their businesses through social media, often with the franchisor’s encouragement, this case illustrates the importance of guarding against competition through these new media.

Because non-competition and non-solicitation provisions are not enforceable in all jurisdictions, the settlement agreement should include a provision to try to ensure enforcement to the maximum extent that the law allows and to prevent the entire agreement from being invalidated because of a provision that may be held to violate public policy. Thus, the settlement agreement might state that:

[Sample]

If a court of competent jurisdiction or other trier of fact deems any provision of this Settlement Agreement unenforceable, then that provision shall be reformed and interpreted in such a way that it is valid and enforceable to the maximum extent permitted by law, consistent with its original intent.

Despite these efforts, not all states will agree to “blue-penciling” to preserve any part of a covenant held not to be objectionable.
B. Non-Disparagement Provisions

When a franchisor and franchisee part company, there can be plenty of ill will and plenty of desire to vent. Non-disparagement provisions in a settlement agreement can be useful in minimizing the spread of defamatory or disparaging comments in that situation.

A franchisor, for example, may condition settlement on the franchisee’s representation and warranty that it will not disparage the franchisor or any officers, employees, fellow franchisees, or other members of the franchise system. If such statements have been published already, the franchisor may consider making it a condition of settlement for the franchisee to take steps to minimize the resulting damage, including, for example:

- Deleting any defamatory or disparaging communications from websites, social media sites, or other media;
- Correcting any false or mistaken statements in the same media where the statements were made;
- Taking down or transferring to the franchisor any gripe sites or slam sites; and
- Agreeing to refrain in the future from making defamatory or disparaging statements regarding the franchisor or any officers, employees, fellow franchisees, or other members of the franchise system, as well as any such statements about the franchisor’s goods or services.

A non-disparagement clause simply permits a party to seek redress for disparagement as a breach of contract, rather than as a tort. A claim for breach of a non-disparagement clause is different from a claim for defamation in important respects. For example, while truth is a defense to defamation, a negative statement can be disparaging even if it is true.

Non-disparagement clauses can be hard to enforce, however, and remedies for violations should be carefully considered. For example, the settlement agreement may include a liquidated damages provision, if state law allows it. The settlement agreement’s non-disparagement clause also should expressly address communications made through social media or by email. Finally, the clause should include a carve-out for instances where it is essential for the party to respond candidly to an inquiry required by law.

A typical non-disparagement provision in a settlement agreement might state:
FRANCHISEE and FRANCHISOR each agree not to make any disparaging remarks, whether orally, in writing, or electronically, in any media, including without limitation via print publication or other writing, spoken communication, email, or social media, concerning the other, including officers, directors, or employees of the other, or about the other’s products, services, character, reputation, actions, omissions, business expertise, or business methods. FRANCHISEE and FRANCHISOR each agree and acknowledge that the reputation of the other is of a unique character and value and that any disparaging remarks regarding the other would cause reputational harm that would be difficult to measure. Thus, if either party violates the provisions of this section it shall pay to the other as liquidated damages, and not as a penalty, the sum of $[ ] for each such violation. Notwithstanding any other provision of this Section, FRANCHISEE and FRANCHISOR each reserve the right to communicate candidly with anyone as necessary in order to comply with legal process or to convey information to a party’s business, legal, tax, or other similar advisers.

Although the provision above is mutual, non-disparagement clauses often are not. Either party, before insisting on a non-disparagement provision in a settlement agreement, should consider how it would react if the other party insisted that the provision be mutual.

C. Releases, Covenants Not to Sue

When a franchisor and franchisee terminate their relationship, they generally want to take all steps necessary to ensure that any disputes that may have existed between them do not come back to life. The most common step to achieve that end is a release in a settlement agreement.

A release is a contract that extinguishes legal claims, and thus, the person who executes it must have the capacity to form a valid contract. Richard Rosen, ed., Settlement Agreements in Commercial Disputes: Negotiating, Drafting & Enforcement § 9.01[B] (Wolters Kluwer) 2010. A “warranty of capacity” typically is included in a settlement agreement. Such a provision might state:

All Parties to this Settlement Agreement hereby warrant and represent that they have the capacity and authority to enter into this Agreement and to bind their principals, if any, in the capacity set forth below. FRANCHISEE and FRANCHISOR
each warrants and represents that this Settlement Agreement is a valid and binding obligation on its part that is enforceable according to its terms.

To be enforceable, a release must meet two basic requirements: it must be supported by consideration and it must be given freely and intentionally. Consideration can constitute many things other than money, including, for example, the grant of mutual releases or the grant of consent to transfer a franchise.

Releases may be voided on grounds such as fraud, duress, or mistake. Although terminations often involve businesses in financial distress, that condition alone does not constitute duress. Likewise, merely “driving a hard bargain” does not constitute duress. 2 Gladys Glickman, Franchising, § 13.02[4] and nn 215, 218 (Matthew Bender) 2011. See, e.g., Hyman v. Ford Motor Co., 142 F. Supp. 2d 735 (D.S.C. 2001) (defining duress under South Carolina law as coercion that puts one in such fear that he or she is “bereft” of the quality of mind essential to the making of a contract, so that the contract is obtained as a result of that state of mind); Lee v. GNC Franchising, Inc. Bus. Franchise Guide (CCH) ¶ 12,717 (9th Cir. 2003). Generally, a party’s representation by counsel throughout the negotiation and execution of a release will defeat any argument of duress. See, e.g., Hyman, 142 F. Supp. 2d 735 (observing that duress will rarely be found when the party giving a release is represented by counsel while negotiating the release). Thus, a settlement agreement may include a provision making such representation clear. Such a provision might state:

[Sample]

In entering into this Settlement Agreement, FRANCHISEE and FRANCHISOR each represents that it has relied upon the legal advice of its attorneys, who are attorneys of its own choice, and that the terms of the Settlement Agreement have been completely read by it and explained to it by its attorneys, and that these terms are fully understood and voluntarily accepted.

Releases should, of course, be given in writing. Some states require that a release be in writing (either by direct requirement or by the application of their statute of frauds) or be agreed upon in open court to be enforceable. See Rosen at 9.01[B] at nn 19-20 (citing N.Y. C.P.L.R. § 2104; Tenn. Code Ann. § 29-34-101; Fla. Stat. Ann. § 46.015; and Va. Code Ann. § 8.01-35.1).

Releases executed upon the termination of a franchise relationship “generally are given effect by the courts but are scrutinized closely” and are narrowly construed. See Glickman at § 13.02[4]. Thus, for example, a court is not likely to enforce a release that purports to discharge liability for claims arising from actions and transactions that have not yet occurred. See, e.g., Hardees Food Sys., Inc. v. Oreel, 32 F. Supp. 2d 342 (E.D.N.C. 1998) (holding that claims
which accrued after a general release was executed are not discharged by the release); 3M v. Graham-Field, Inc., Bus. Franchise Guide (CCH) ¶ 11,191 (S.D.N.Y. April 9, 1997) (holding that alleged conduct, not related to termination, that occurred after a release was executed was not covered by a release of all existing claims arising out of a distributor relationship and all claims arising out of the termination of the relationship).

A general release is not likely to extinguish liability for claims not known or contemplated by the parties when they execute the release unless the parties expressly indicate that they intend to release such unknown claims. See Rosen at § 9.01[D]. A few states have provided by statute that a general release does not cover claims that a party is unaware of upon executing the release where such claims, if known, would have materially affected the settlement. Id. (citing Cal. Civ. Code § 1542; Mont. Civ. Code § 28-1-1602; N.D. Cent. Code § 9-13-02; S.D. Codified Laws § 20-7-11). Even under these states’ laws, however, parties can expressly waive the protection of the statutes and release unknown claims by following specific procedures which include making express waivers. Id.

An unconditional release in a settlement agreement with the full component of “bells and whistles” might state:

[Sample]

Mutual General Releases. In consideration of the mutual covenants contained in this Settlement Agreement and for other good and valuable consideration, the receipt and legal sufficiency of which are hereby acknowledged, FRANCHISEE (individually and in his/her capacity as shareholder and owner of [franchised business]) and his/her/its heirs, dependents, executors, administrators, successors, assigns, agents, legal representatives, predecessor-, successor-, affiliated-, subsidiary-, and parent-corporations, as the case may be, on the one hand, and FRANCHISOR, and each of its officers, directors, employees, assigns, agents, legal representatives, predecessor-, successor-, affiliated-, subsidiary-, and parent-corporations, as the case may be, on the other hand, unconditionally and without reservation, hereby release, acquit, and forever discharge each other and each other’s respective past, present, and future officers, directors, shareholders, employees, predecessor-, successor-, affiliated-, subsidiary-, and parent-corporations, assigns, attorneys, agents, legal representatives, heirs, dependents, executors, and administrators, as the case may be, from any and all manner of claims, counterclaims, cross-claims, actions, causes of action, rights, disputes, controversies, judgments, debts, agreements, contracts, performance bonds, payment bonds, promises, representations, misrepresentations,
allegations, demands, obligations, duties, suits, expenses, assessments, penalties, charges, injuries, losses, costs (including, without limitation, attorneys fees and costs incurred), damages (including, without limitation, compensatory, consequential, statutory, or punitive damages), sanctions, and liabilities of every kind, in law or in equity, civil or criminal, administrative or judicial, contract, tort, or other, which each ever had, now has, or ever may have in the future against each other, whether now known or unknown, claimed or unclaimed, asserted or unasserted, suspected or unsuspected, discovered or undiscovered, accrued or unaccrued, anticipated or unanticipated, direct or beneficial, contingent or fixed, for or by reason of any matter, cause, or thing, including without limitation any claims arising out of, resulting from, or in any way related, directly or indirectly, to (i) the Lawsuit, (ii) the Franchise Agreement, or (iii) any other actions or omissions of the Parties prior to the effective date of this Settlement Agreement (the “Released Claims”). Without limiting the generality of the foregoing, the Parties agree and acknowledge that this Settlement Agreement is intended to be a general, total, and complete release by and among the Parties, except as expressly reserved otherwise in this Settlement Agreement.

Reservations. Notwithstanding anything contained in this Settlement Agreement to the contrary, the Parties hereby expressly reserve any and all rights and obligations arising under this Settlement Agreement and agree and affirm that the releases set forth above have no effect upon, and in no way constitute a release, waiver, acquittal, or discharge of the Parties’ rights and obligations set forth in this Settlement Agreement.

On the other hand, in some situations a release may be conditioned upon the performance of certain obligations. These obligations, typically for the franchisee to perform, may range from payment of money to return of confidential materials to transfer of a telephone number or website to de-identification of the former franchised location. When conditions are imposed on one party, the releases typically are not stated as one mutual release, but instead, each party’s release of the other is stated separately. The conditions may be included in the type of “Reservations” section illustrated immediately above or may be stated in a separate paragraph.

A typical provision for such a condition might state:
Notwithstanding anything contained in this Settlement Agreement to the contrary, the release of FRANCHISEE contained in Section [ ] above will be of no force and effect until FRANCHISEE has performed all obligations set forth in Section [ ] above to the reasonable satisfaction of FRANCHISOR.

A covenant not to sue offers another vehicle for settling claims. Those who give a covenant not to sue do not relinquish their claims, but instead agree not to initiate litigation against specified parties. Rosen at § 9.04. A covenant not to sue does not affect the liability of third parties, because it is merely an agreement that the parties to the covenant will refrain from exercising certain legal rights against each other. Id. Thus, a covenant not to sue can be useful in cases when a settlement will not resolve all disputes against all parties.

A typical covenant not to sue might state:

**[Sample]**

FRANCHISOR covenants and agrees that it will not initiate or prosecute any claim against FRANCHISEE that constitutes or is a necessary part of those claims asserted in [identify lawsuit involved]. Nothing in this covenant not to sue will operate to prevent FRANCHISOR from initiating or prosecuting any claims against FRANCHISEE which are not expressly identified in the covenant not to sue, or to prevent FRANCHISOR from initiating or prosecuting any claims against any third party, irrespective of whether such third party is alleged to be a joint tortfeasor with FRANCHISEE.

D. Indemnification Provisions

Indemnification provisions are routine in franchise agreements, and they often appear in settlement agreements as well. In some cases, a settlement agreement will simply provide that the indemnification obligations of the franchise agreement remain in full force and effect. In other cases, however, the settlement agreement will restate the desired indemnification provisions (and will sometimes add additional provisions). Typically, these will require a franchisee leaving the system to indemnify the franchisor against two types of potential harms: first, any claims arising from the franchisee’s breach of a warranty or representation in the settlement agreement itself, and second, any claims by third parties that may arise from the franchisee’s operation of the franchised business. The indemnification provision typically will require the franchisee’s cooperation in responding to such claims but will reserve the right for the franchisor to control
the defense and settlement of the claims -- even though the franchisee typically is called upon to reimburse the costs of the defense and settlement.

A typical indemnification provision might state:

[Sample]

FRANCHISEE shall indemnify and hold harmless FRANCHISOR and each of its past, present, and future owners, officers, directors, employees, agents, parents, subsidiaries, and affiliates (collectively, the Indemnified Parties): (1) for the breach of any warranty or representation of FRANCHISEE under this Settlement Agreement; and (2) for and from any claim, cause of action, or demand asserted by any third party against the Indemnified Parties arising from an act or omission of FRANCHISEE or any of its owners, officers, directors, employees, agents, parents, subsidiaries, or affiliates made in connection with the operation of the [franchised business]. In connection with any such third-party claim, cause of action, or demand, FRANCHISEE shall cooperate with the Indemnified Parties in the defense of and response to the claim, cause of action, or demand and shall reimburse FRANCHISOR for all obligations, damages, and taxes for which it is held liable and for all costs of defense or response reasonably incurred by FRANCHISOR, including without limitation reasonable attorney's fees, costs of investigation and proof of facts, court costs, and other litigation expenses. The Indemnified Parties shall notify FRANCHISEE in writing of any claim, cause of action, or demand for which indemnification is sought within [number of] days after learning of the claim or as soon as is reasonably practicable. The Indemnified Parties shall have the right to control the defense and settlement of any such claim.

E. Enforcement Provisions


   a. Choice of Forum

Franchisors typically want to have lawsuits or other forms of dispute resolution conducted on their home turf, and they provide for that through forum selection clauses. If a dispute is already in litigation, the settlement agreement should provide for the agreement to be enforced exclusively by the court where the litigation is pending. The agreement also should provide for the court to retain jurisdiction to enforce the agreement. On the other hand, if a settlement agreement is reached in a dispute that is not the product of an active lawsuit, forum selection still may be at issue.
A number of states have laws that require franchisors to be amenable to litigation in the state where the franchisee is located. And states such as California, Michigan, and Illinois have enacted legislation prohibiting the enforcement of forum selection clauses all together. ABA Section of Antitrust Law, Franchise and Dealership Termination Handbook at p. 80 (2004) (citing Cal. Bus. & Prof. Code § 20040.5 (1007 & West 2003); Mich. Comp. Laws. Ann. § 445.1527(f) (West 2003); 815 Ill. Comp. Stat. § 705/4 (2000) (prohibiting enforcement for litigation but not for arbitration)).

But the forum selection clause should not be viewed in a vacuum. Notwithstanding some states' prohibition of contractual stipulations as to forum, if the performance of the franchise agreement or settlement agreement takes place in the jurisdiction where the franchisor wishes to prosecute its claims, then the franchisor may be able to assert personal jurisdiction as a basis for getting its choice of forum.

In federal court lawsuits based on diversity jurisdiction, federal law, specifically 28 U.S.C. § 1404(a), governs whether to give effect to the forum selection clause in an agreement. Stewart Org., Inc. v. Ricoh Corp., 487 U.S. 22, 32 (1988) (holding that federal law, specifically 28 U.S.C. § 1404(a), governs district courts’ decisions on whether to give effect to forum selection clauses). In the Fourth Circuit, for example, forum selection clauses are deemed unreasonable only if: “(1) their formation was induced by fraud or overreaching; (2) the complaining party ‘will for all practical purposes be deprived of his day in court’ because of the grave inconvenience or unfairness of the selected forum; (3) the fundamental unfairness of the chosen law may deprive the plaintiff of a remedy; or (4) their enforcement would contravene a strong public policy of the forum state. Allen v. Lloyd’s of London, 94 F.3d 923, 928 (4th Cir. 1996) (citations omitted).

b. Choice of Law

As with the choice of forum, franchisors typically want to have lawsuits or other forms of dispute resolution conducted under the law of their home state, and they provide for that in their franchise agreements and settlement agreements. Even if an agreement provides that a certain state’s law will govern, however, that provision is not always respected. Choice of law provisions can be successfully attacked if there are insufficient contacts with the state whose law is provided for in the contract, if the designated law is contrary to a fundamental policy of the state with a greater interest in the matter, or if a state franchise relationship law overrides the choice of law provision.

That said, however, many courts rely on the Restatement (Second) of Conflict of Laws § 187 (1988), which is “weighted toward providing parties the freedom to mold their contract in any fashion that they see fit, so long as no fundamental policy is violated.” ABA Section of Antitrust Law, supra, at p. 83.
Most states have adopted the Restatement’s “most significant relationship” test. Id.

V. STATE FRANCHISE STATUTES MAY LIMIT SETTLEMENTS

Before executing any settlement agreement, it is important to make sure that relevant state registration and relationship laws do not impose any limitations that run counter to the provisions of the agreement.

Some states, for example, outlaw the waiver or release of rights accorded a franchisee under these registration and relationship laws. See Martin G. Gilbert and Allan P. Hillman, Settlements and Releases in Franchise Disputes: How to Make Sure It’s Over When It’s Over, (American Bar Association 30th Annual Forum on Franchising) at 31 and n. 22 (citing state statutes).

VI. CONFIDENTIALITY OF SETTLEMENTS

Franchise systems are based on franchise agreements having provisions that are as uniform as possible from franchisee to franchisee. Yet settlements, by definition, are tailored to the specific circumstances of the disputes or other occurrences that precipitate the settlements. Franchisors may prefer to keep the terms of settlement agreements confidential, particularly when the agreements give concessions that are out of the ordinary.

A typical bi-lateral confidentiality provision in a settlement agreement would state:

[Sample]

Confidentiality. The Parties hereby agree to keep this Settlement Agreement and its terms and conditions strictly confidential and not to disclose them to any third party; provided, however, that: (a) this Settlement Agreement may be disclosed and its contents admitted in any dispute between and among the Parties, except as otherwise provided herein; (b) this Settlement Agreement may be disclosed to the Parties’ attorneys, accountants, advisers, and insurers for purposes of facilitating tax or other business advice or services, if the Parties take all reasonable steps to cause such persons to maintain the confidentiality of the Agreement; (c) this Settlement Agreement may be disclosed to the extent that the disclosing party reasonably believes such disclosure to be required by any laws, regulations, or guidelines. However, this provision shall not be construed to prohibit any Party from disclosing the fact that settlement has occurred.
But existing statutes and regulations – including the Amended Franchise Rule – limit franchisors’ ability to keep terms confidential. See 16 C.F.R. §§ 436-437. The Amended Franchise Rule’s requirements for disclosing litigation provide that franchisors must disclose, with limited exceptions, all material settlement terms for prior actions, whether or not a settlement agreement is confidential. Id. at § 436.5(c).

Under the Amended Franchise Rule, a franchisor also must disclose whether it has required any franchisee to execute a confidentiality clause, defined by the rule to include “any . . . settlement provision that directly or indirectly restricts a current or former franchisee from discussing his or her personal experience as a franchisee in the franchisor’s system with any prospective franchisee.” Id. at § 436.1(c).

VII. INTERNATIONAL SETTLEMENTS

Settlement issues in the context of international franchising are even more complex than in the context of domestic franchising. In most cases, the international franchise relationship will be based on a master franchise agreement where the international partner will serve as both the franchisee and the franchisor. The international master franchise agreement will overlay onto the more typical unit franchise agreement. While there are many issues that both the unit and the master franchise agreement will share in common, there are additional considerations that both the franchisor and franchisee should keep in mind.

The master franchise relationship will contain variables that are not usually prevalent in a domestic franchise relationship. First, there likely will be a difference in language, culture, and the established judicial system. In most cases, there will be a language barrier between the franchisor and the franchisee, even if that barrier is subtle. Contracts require precise language, and language subtleties can be difficult to understand unless the parties use the services of a good translator before entering into the master franchise agreement. If it becomes necessary to enforce the terms of the master license agreement, the franchisor’s ability to navigate the master franchisee’s legal system may be challenging, to say the least. Binding arbitration can provide a friendlier process, but even so, at some time, an arbitration award will need to be confirmed and implemented in the jurisdiction where the franchisee or its business is located. Navigating the bureaucracy involved in this process can be daunting.

A. Frequently Arising Disputes that Are Settled

There are predominantly three types of problems that can undermine a master franchise relationship: adherence to the agreed upon development
schedule; non-payment of franchise royalties; and operational problems that translate into misuse of the franchisor’s trademarks or other intellectual property. When the master franchisee fails to meet the agreed development schedule, the master franchisee and the franchisor may settle their differences by retention of the master franchisee on revised terms. But in cases where the master franchisee fails to pay royalties or misuses the franchisor’s marks, the ultimate outcome, more often than not, will be a settlement involving termination.

B. Settlements with Master Franchisees Who Fail to Meet Development Schedule

It is not unusual for a master franchisee to agree to an over ambitious development schedule because the master franchisee wants the deal and wants to impress the franchisor with its abilities within the territory being licensed. By the same token, the franchisor may wish to deal only with one master franchisee in the territory and thus may grant that master franchisee a territory that is problematic for development.

The prospect of a higher master franchise fee may drive the franchisor to give the master franchisee a larger slice of the pie along with an unrealistic development schedule. For example, it would not be surprising for a franchisor to award one master franchise for the entire country of China. What does that master franchisor do when it realizes that the master franchisee cannot possibly develop the country or region in accordance with its development schedule? In such a case, the master franchisor could terminate the master franchise agreement. But given that other franchised or company units already may exist, how does the master franchisor compromise this fundamental breach of the master franchise agreement?

Keeping the master franchisee in business likely will be the preferred settlement option unless the master franchisor already has someone to take over the master franchise relationship from that master franchisee. Because this is not usually the case, the master franchisor must seek other settlement options that are more expedient, and that may be more realistic given the international relationship.

One form of settlement would be to reset the development schedule to a more realistic time frame. Coupled with that settlement option, the master franchisor may also want to limit the size of the exclusive territory granted to the master franchisee. If the situation is very serious, with no prospect that the master franchisee can further develop the territory, then it may be necessary to eliminate all exclusivity rights and prohibit the master franchisee from developing any more franchises, while allowing it to continue to operate franchises then in existence. Given that enforcement of any settlement option in the master franchisee’s local judicial system will be problematic, flexibility will be the order of the day.
If a settlement agreement is reached, it should be as formally executed as possible. In other jurisdictions, stamps and seals on any bilateral agreement take on a significance not imagined in the United States. As an example, in an attempt to enforce a settlement agreement in China, the franchisor was put to the bureaucratic test of having to supply not only a signed copy of a settlement agreement but also a certification from the Secretary of State’s office before the local in-country court would look at the agreement.

Maintaining any sustained contact with the master franchisee and its attorney, if any, may be difficult, so a master franchisor should make great efforts to get a settlement in an acceptable form as quickly and efficiently as possible. Franchisors also should be forewarned that international master franchisees are not terribly receptive to long and elaborate agreements.

As discussed later in this section, if there is no hope of keeping the relationship alive, then the franchisor should develop a complete exit strategy for the master franchisee or the master franchisor, if they choose to exit the territory.

C. Settlements with Master Franchisees Who Fail to Pay Royalties or Misuse the Franchisor’s Marks

The other two issues that are likely to cause considerable friction between the master franchisor and master franchisee are non-payment of fees and misuse of the master franchisor’s intellectual property. To the extent these issues can be settled without termination, then the same rules apply where settlement is specifically tailored to keep the master franchisee in the chain. But if termination is necessary, then the master franchisor will want to include a number of provisions in the settlement agreement.

1. Intellectual property

The most important feature of the settlement agreement will be disposition of the intellectual property. Failure to accurately document the transfer will cause the franchisor innumerable headaches when it comes time to grant a subsequent master franchisee or unit franchisee the use of the master franchisor’s intellectual property. It is not enough to have the master franchisee relinquish its use of the master franchisor’s intellectual property, including trademarks, trade dress, and trade names. To fully protect the master franchisor’s exclusive right to the intellectual property, the master franchisee must fully assign all of its right, title, and interest in and to all intellectual property, including phonetically translated names and marks.

All intellectual property should be properly identified in the settlement document, and any registration numbers should be listed appropriately. The assignment of intellectual property also should contain a conveyance of the goodwill associated with the franchisor’s marks. Since it may be necessary to file this assignment with the local trademark office, the assignment should be made
as a separate document from the settlement agreement. Again, all seals, stamps, and acknowledgements should be included in the assignment document.

2. Existing Unit Franchises

Another issue to address in the settlement agreement is who will be responsible for operation of the existing unit franchises that remain in operation after settlement. If the master franchisor wants to continue operation of those unit franchises or assign them to a successor master franchisee, then it should make sure that assignments of these franchise agreements are executed by all interested parties. If these unit franchises have extrinsic value, the various laws of applicable jurisdictions may require the master franchisor to purchase them at their fair market value.

3. Advertising Issues

Similarly, it will be necessary to determine whether there is any advertising fund and if so, what money is available or outstanding. To the extent that the master franchisee has not properly accounted for these funds, then arrangements will need to be made to replenish the accounts or determine some other resolution that will be acceptable to all parties, especially to the unit franchisees.

4. Real Estate

If the master franchisee is acting as a sublessor to the unit locations, then the master franchisor will need to make sure that the settlement agreement provides for an assignment of the sublease agreements, as well as the master lease agreements that the master franchisee may have signed.

5. Cooperation

The settlement agreement should contain a cooperation clause requiring the master franchisee to cooperate with the master franchisor in all aspects of the retransfer of the franchise rights. This cooperation should include assisting the master franchisor in refranchising the territory.

6. Non-competition

Even if covenants against competition are enforceable in the country where the master franchise agreement is being performed, the master franchisor may find it difficult to enforce a non-compete without a franchisee’s agreement. In some countries, the remedy of injunctive relief is rare or non-existent. To the extent a covenant is enforceable, then, as in the United States, its coverage must be reasonable as to geographic scope and duration.
7. Employment Relationship

A master franchisor extricating itself from an international franchise relationship should provide in the settlement agreement that neither the master franchise agreement nor the settlement agreement creates an employer-employee relationship, and that the master franchisee is not the agent of the master franchisor. The agreement also should include an indemnification provision in the event of a contrary finding. Such a provision will not necessarily provide the master franchisor with iron clad protection, but it will at least address the issue. The employment laws of the country at issue should be examined and a legal opinion obtained to determine whether the master franchisor’s exercise of any termination provisions would put it in an employment relationship with the unit franchisee or any of the master franchisee’s corporate personnel.

8. Incentives

The settlement agreement can contain a number of provisions regarding jurisdiction, venue, choice of law, language, and alternatives for dispute resolution. No matter what these provisions provide, the master franchisor should accept the fact that at some time it will need to come to the master franchisee’s venue to enforce whatever remedial provisions are contained in the settlement agreement.

From a practical perspective, the carrot works far better than the stick in these situations. If the master franchisor owes the master franchisee any money as a result of the settlement, that money should be withheld or placed on a progressive payment schedule when all of the various conditions in the settlement agreement have been met.

If the master franchisee owes money to the master franchisor or has agreed to pay damages or a liquidated amount, it may be in the master franchisor’s best interest to agree to liquidate or abrogate a certain portion of the debt when the master franchisee performs or provides all of the assurances and assistance contemplated by the settlement agreement. Otherwise, the master franchisor may risk being unable to collect the debt and may find itself spending more money and time on enforcement than would have been spent on incentives to induce performance pursuant to the settlement agreement.

VIII. CONCLUSION

The great American satirist Ambrose Bierce defined a litigant as “a person about to give up his skin for the hope of retaining his bones.” Ambrose Bierce, The Devil’s Dictionary (1911), available at http://www.thedevilsdictionary.com/. The high rate of settlements today shows that many recognize the kernel of truth in that dark definition. But unless they are handled carefully, agreements intended to settle disputes sometimes generate even more litigation, rather than
lasting peace. The authors hope this brief discussion of drafting techniques and other lessons learned will help franchise counsel and their clients reach settlement agreements that are effective, enforceable, and free from further litigation, so that all concerned can keep both skin and bones.