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PRESENTED BY:

Michael Einbinder
Einbinder & Dunn LLP
New York, New York

John R. Gotaskie, Jr.
Fox Rothschild LLP
Pittsburgh, Pennsylvania

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I. INTRODUCTION

This paper provides an overview of common issues that arise in the franchise relationship involving the franchise agreement, including pre-suit resolution, where and when to file a lawsuit, and a general overview of franchise litigation and arbitration. It examines these issues from both the franchisee's and franchisor's perspective, and covers commonly asserted claims and defenses by both parties.¹

II. PROCEDURAL BATTLES

Parties to franchise agreements should be mindful of important details that govern where, what, when, how, and by whom franchise disputes are handled. Details such as jurisdiction, venue, choice of law, and forum (arbitration vs. litigation) are customarily part of most contracts, and frequently incorporated into most franchise agreements. Despite entering into binding contracts, disputes over these provisions arise in the context of franchise disputes. One reason for these disputes is that franchisors and franchisees are frequently located in different states. The party filing the dispute will race to file in the most convenient forum to gain what it perceives as the "home court advantage." On occasion (and as discussed below), a state-specific franchise relationship statute may impact these procedural disputes via an "anti-waiver" provision that limits the parties' ability to contract outside of the application of the statute, which may mandate that any dispute between the franchisor and franchisee take place in the courts of that state in a trial-by-jury. Whether arguing over the enforceability of the arbitration clause, jury-trial waiver, jurisdiction, or venue, there is generally a consistent body of law that is applied, so that parties can know the strengths and weaknesses of prevailing on procedural battles.

III. FEDERAL AND STATE FRANCHISE LAWS

Many disputes that arise in the franchise context arise under federal and state franchise laws, which originate from the sale of the franchise or govern the franchise relationship. Compliance with disclosure and other requirements is crucial to avoid liability. Federal and state regulations were enacted to address historical abuse in franchising, setting clear standards especially involving the sale of franchises. Depending upon which state you are in, there are additional hurdles and barriers to entry into the franchise sales market for franchisors and franchisees.

In the United States, the sale of every franchise must meet federal requirements, in addition to certain state disclosure and registration statutes.² Federal Franchise Rule 16 C.F.R. § 436 (the "FTC Rule") contains the majority of the federal presale obligations and related regulations promulgated by the Federal Trade Commission (the "FTC").

¹ This paper has been prepared by IFA members and reviewed and revised by the individuals listed on the title page. It is intended to be used solely as an educational tool and to foster discussions about franchise disputes and related legal issues. The views expressed in this paper do not necessarily reflect the views of those individuals or their respective employers, law firms or clients.

² *State Franchise Laws*, <https://franchise.law/state-franchise-laws/> (last visited April 5, 2025).

The number one directive from the FTC is that a franchisor must provide prospective franchisees an appropriate franchise disclosure document, or an “FDD,” at least 14 days before entering into a franchise agreement for the sale of a franchise or accepting any payment connected with the franchise sale. The purpose of the FDD is to provide prospective franchisees with information about the franchisor, the franchise system, and the agreements they will need to sign so that they can make an informed decision before deciding to make the investment in the franchise.³

The FDD must include twenty-three (23) items ranging from contact information, the trademark that the franchisees will use, a description of the business, and language that includes the estimated cost of the franchise investment.⁴ It is important to note that while the FTC rule establishes the requirements for the FDD, FTC staff do not review or approve the FDD in advance of publication. Therefore, a prudent prospective franchisee should consult with an experienced franchise lawyer to make sure they perform the proper due diligence before signing up. Despite the federal regulation, the FTC Rule does not confer a private right of action on an aggrieved franchisee. However, this does not change the burden for the franchisor. All franchisors must be diligent and truthful, and must adhere to the Rule requirements, as FTC staff can investigate and bring actions in federal court for violations.⁵

Beyond the FTC Rule, twenty-five States impose additional requirements on franchisors to either register or file in order to remain in compliance with state law by way of state statutes. Registration states require franchisors to register the FDD and other franchise information on an annual basis.⁶ Other states have what are called “business opportunity” laws, which regulate the sale of business opportunities in those states. Although franchises and business opportunities are different, these states require that franchises be filed before they can be sold under some circumstances.⁷ Depending on the state, the filing may be annual, one time, or none at all if a franchisor utilized a registered trademark with their brand. The remaining twenty-five states and the District of Columbia do not have franchise sales statutes.⁸

³ 16 CFR §436.2

⁴ 16 CFR §436.5. The complete list of 23 items can be found in the following article: *The 23 Items Your Franchise Disclosure Document Must Include*, <https://www.entrepreneur.com/franchises/the-23-items-your-franchise-disclosure-document-must/254051> (last visited April 4, 2025).

⁵ See, e.g., *F.T.C. v. BurgerIM Group USA, Inc.*, No. 2:22-CV-825 (C.D. Cal. Feb. 2, 2022); *F.T.C. v. Minuteman Press*, 53 F. Supp. 2d 248, 258 (S.D.N.Y. 1998).

⁶ There are 14 registration states that require franchisors to register the FDD and other information on an annual basis: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. See *State Franchise Laws*, <https://franchise.law/state-franchise-laws/> (last visited April 4, 2025).

⁷ There are 11 states with business opportunity laws or laws that require that franchises be filed before they can sell franchises: Connecticut, Florida, Georgia, Kentucky, Louisiana, Maine, Nebraska, North Carolina, South Carolina, Texas, and Utah. While not a franchise statute, Oregon has the Oregon Trade and Regulation and Practices Act (Or. St. §650.005). See *State Franchise Laws*, <https://franchise.law/state-franchise-laws/> (last visited April 4, 2025).

⁸ The 25 states are: Alabama, Alaska, Arizona, Arkansas, Colorado, Delaware, District of Columbia, Idaho, Iowa, Kansas, Massachusetts, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Ohio, Oklahoma, Pennsylvania, Tennessee, Vermont, West Virginia, and Wyoming. See *State*

Additionally, a number of states have special laws whose stated purpose is to protect local franchisees. For example, some state franchise relationship laws may require particular timing of notice of non-renewal, and some states also require “good cause” for the franchisor not to renew the relationship.⁹ Most of these statutes define “good cause” to be conduct imputable solely to the franchisee, such as failure to comply with a material provision of the franchise agreement. When a franchisor terminates or, in some instances, non-renews a franchise agreement, the terminated or non-renewed franchisee may seek to invoke the protection of the franchise law in the state in which the franchisee is located, notwithstanding the fact that the agreement provides that the law of the franchisor’s state applies or permits the termination or non-renewal for something less than the state’s definition of “good cause.”¹⁰

A. State vs. Federal Court

The franchise agreement will likely specify the choice of law, jurisdiction, and forum for any litigation occurring in court. The determination of whether the matter should be filed and heard in state or federal court depends on the nature of the substantive claims, where the parties reside, and whether or not the franchise agreement has a mandatory venue clause. The court must have authority to decide the claim (i.e. subject matter jurisdiction) and authority over the parties (i.e. personal jurisdiction). If either are lacking, the case will likely be subject to a venue transfer or dismissal.¹¹ Furthermore, if the franchise agreement contains a valid forum selection clause, the Supreme Court has held that forum selection clauses will control in all but the most exceptional circumstances.¹²

1. Personal Jurisdiction

The issue of personal jurisdiction commonly arises when a franchisor and franchisee are in different states and disagree over where their dispute should be resolved. Naturally, each party wants to litigate in their own backyard. Personal jurisdiction is a constitutional requirement: the United States Constitution, as well as state

Franchise Laws, <https://franchise.law/state-franchise-laws/> (last visited April 4, 2025).

⁹ States and Territories that require “good cause” for non-renewal are Arkansas, California, Connecticut, Delaware, Hawaii, Indiana, Iowa, Minnesota, Nebraska, New Jersey, Puerto Rico, Rhode Island, U.S. Virgin Islands, and Wisconsin.

¹⁰ For an in-depth review of case law, see Thomas M. Pitegoff, Choice of Law in Franchise Agreements, *Franchise Law Journal* L.J. 1 (1989-1990).

¹¹ Venue is governed by the statutory framework at 28 U.S.C. § 1391, Venue generally; § 1404, Change of Venue; § 1406, Cure of Waiver of Venue Defects, and Fed. R. Civ. P. 12(b), Defenses and Objections, the procedural basis to dismiss or transfer venue.

¹² See *Atlantic Marine Constr. Co. v. U.S. Dist. Court for the W. Dist. of Tex.*, 134 S. Ct. 568 (2013) which is an in-depth procedural ruling that discusses forum selection clauses (i.e. when parties have agreed to a forum selection clause, a district court should ordinarily transfer the case to the forum specified in that clause). Moreover, a forum selection clause may be enforced by a transfer motion under Section 1404(a) rather than a motion to dismiss under Section 1406(a) or FRCP 12(b)(3). For a comprehensive discussion of *Atlantic Marine* and its progeny, see Earsa Jackson and Jim Meaney, *Forum Selection Clauses After Atlantic Marine*, American Bar Association 37th Annual Forum on Franchising, October 15-17, 2014.

law, requires that the parties have “certain minimum contacts with the forum” in which the court sits such that exercising jurisdiction over the parties “does not offend traditional notions of fair play and substantial justice.”¹³ Since most states’ long-arm statutes extend the boundaries of personal jurisdiction as far as the constitutional requirements, most courts combine the analysis into a single inquiry in determining if the requirements of due process are satisfied.¹⁴

Many courts have found that the franchise agreement and payments required thereunder to the state where the franchisor is headquartered to be sufficient minimum contacts to pass the threshold constitutional question. Absent express language consenting to jurisdiction in the franchise agreement, the Courts will examine whether it is foreseeable that the parties would litigate in the state in question.

But what does foreseeability mean? *Burger King v. Rudzewicz* is the seminal case involving a termination of a franchise agreement that examined the issue of personal jurisdiction.¹⁵ There, the franchisor plaintiff, Burger King, based in Florida, sued franchisee defendants based in Michigan in United States District Court for the Southern District of Florida using Florida’s long arm statute for breach of contract and trademark infringement under the Lanham Act. Burger King claimed the court’s diversity jurisdiction pursuant to U.S.C. §1332, and its original jurisdiction over federal trademark disputes under U.S.C. §1338(a). Burger King alleged that the franchisees breached their franchise agreement “within the jurisdiction of the court by failing to make payments to its place of business in Miami, FL.” Ultimately, the court held the defendant franchisees had or should have had a reasonable expectation that they could be summoned to a Florida court for claims arising out of the franchise agreement because they had made communications and payments to Burger King in Florida. These contacts were sufficient to constitute a “substantial and continuing relationship” with Florida such that due process would not be violated. Hence, the contacts and communications made jurisdiction in Florida foreseeable for the franchisees.

Since *Burger King*, newer cases involving franchising have taken a deeper dive into the jurisdictional analysis. However, what happens when the franchise agreement is silent? The Court may look to factors such as visits by the franchisee to the headquarters of the franchisor, in addition to payments made and received from headquarters to show that the franchisee should have foreseen that they would have to litigate in that state.¹⁶

2. Subject Matter Jurisdiction

¹³ *International Shoe v. Washington*, 326 U.S. 310 (1945).

¹⁴ *Inamed Corp. v. Kuzmak*, 249 F.3d 1356, 1359-60 (Fed. Cir. 2001) (determining whether personal jurisdiction exists over out-of-state defendant involves two inquiries: whether a forum states’ long arm statute permits service of process, and whether the assertion of personal jurisdiction would violate due process).

¹⁵ *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985)

¹⁶ *Baskin Robbins Franchising, LLC v. Alepenrose Dairly, Inc.*, 825 F.3d 28 (1st Cir. 2016). See also *Red Robin Int’l, Inc. v. Lehigh Valley Rest. Group, Inc.*, No. 15-CV-02602-REB-KLM, 2016 WL 397559, at *1 (D. Co. Feb. 2, 2016).

Subject matter jurisdiction involves the type of claim at issue. Both federal and state courts must have the ability to hear the specific kinds of claims at issue to establish subject matter jurisdiction. Although state courts maintain general (sometimes called “plenary”) jurisdiction over a person and can hear any type of claim arising under federal or state law, federal courts are granted limited subject matter jurisdiction over specific types of actions. Unless the federal statute at issue specifies that the federal courts have exclusive jurisdiction, it is to be exercised concurrently with that of state courts. The Lanham Act, which governs trademark infringement actions, is an example of a federal statute that provides for concurrent jurisdiction in state and federal court.

Unlike state courts, litigants seeking to be heard in federal court must meet certain thresholds in order for the federal court to obtain subject matter jurisdiction. A party wishing to litigate in federal court must either show that the suit arises under a federal question or that there is diversity of citizenship.

a. Federal Question Jurisdiction

Claims that arise under the United States Constitution, a federal law, or a treaty of the United States belong in the category of federal question jurisdiction. The Lanham Act, and claims that arise under federal anti-trust or RICO laws, are examples of claims that invoke federal question jurisdiction.

b. Diversity of Citizenship

Diversity of citizenship is established if the franchisor and franchisee reside in different states (or if either party resides in a foreign country) and the amount at issue exceeds \$75,000, exclusive of costs.¹⁷ As with all federal cases, there are heightened pleading requirements. “It is long settled law that a cause of action arises under federal law only when the plaintiff’s well-pleaded complaint raises issues of federal law.”¹⁸ A plaintiff seeking to invoke federal diversity jurisdiction must plead facts in the complaint to “show that there is ‘complete diversity’ among all parties, such that no party has the same citizenship as any party on the other side.”¹⁹

Maintenance of an action in federal court based on diversity of citizenship may be problematic when the defendant, as in most franchising cases, is a corporation. A corporation is deemed a citizen of “any state by which it is incorporated and the state where it has its principal place of business.”²⁰ Problems may arise if the corporation has offices in one state in which it holds its board meetings and transacts its financial affairs, but carries on a large part of its actual business operations in other states. Generally, courts look to the activity of the corporation rather than the location of its boardroom or executive offices.²¹ Limited liability companies (LLCs) are citizens of every state in which

¹⁷ 28 U.S.C. §1331(a).

¹⁸ *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58, 63 (1987).

¹⁹ *Reid v. The Wailers*, 606 F. Supp. 2d 627, 629 (E.D. Va. 2009) (citing 28 U.S.C. §1332(a)).

²⁰ 28 U.S.C. §1332(c)(1).

²¹ See *Kelly v. U.S. Steel Corp.*, 284 F.2d 850 (3d Cir. 1960) (holding that the principal place of business of

any individual member is a citizen.²² Many courts require a party who requests a court to exercise diversity jurisdiction over an LLC to affirmatively plead or allege the citizenship of each member of the LLC, which can be a complicated and difficult endeavor given the potential breadth and non-public nature of an LLC's membership. Pleading or alleging the citizenship of an LLC may be further complicated if the LLC in question includes another LLC as a member (in which case, it may be necessary to also affirmatively plead the membership of that member-LLC).

The majority of franchise disputes are litigated in federal court rather than state court because they typically involve monetary claims or legal rights valued at more than \$75,000 and they arise between franchisors and franchisees or vendors who are often located in different states. In cases where the only relief sought is an injunction or a declaration of rights (and not the recovery of damages), the \$75,000 jurisdictional requirement is measured by the value of the rights to be vindicated.

3. Forum Selection Clauses

Generally, franchisors and franchisees typically would prefer to litigate or arbitrate in their respective home venues. A forum selection clause can dictate where a dispute will be heard. Franchise agreements usually contain a forum selection clause that provides that all or certain types of disputes between the franchisor and franchisee are required to be filed in a state or federal court where the franchisor is located. Some franchise agreements contain mandatory forum selection clauses for most claims that can arise but reserve the right to sue in the franchisees' home state courts for particular claims, such as enforcing post-term trademark rights or non-compete covenants.

In the franchise context, battles over forum selection clauses arise when the franchise agreement is not carefully drafted to contain a mandatory clause. However, even with a carefully drafted franchise agreement, disputes arise over the scope of the clause and whether it covers the claims in issue.²³ More often, disputes over the enforceability of the forum selection clause may ensue. Federal law governs the enforceability of forum selection clauses in diversity cases, and recognizes only three exceptions to their enforceability: (1) that the inclusion of the forum selection clause in the agreement was the product of overreaching; (2) that the party challenging the enforcement will, for all practical purposes, be deprived of its day in court because of the inconvenience or unfairness of the selected forum; and (3) that the enforcement of the forum selection clause would contravene a strong public policy of the forum state.²⁴

United States Steel Corporation was in Pennsylvania where the greater part of the staff was located, and not in New York where its board met, it did its banking business, and from which dividends were mailed).

²² See *Americold Realty Trust v. ConAgra Foods, Inc.*, 136 S. Ct. 1012, 1016-17 (2016); *Lindley Contours, LLC v. AABF Fitness Holdings, Inc.*, 414 F. App'x 62, 64 (9th Cir. 2011); *Johnson v. Columbia Properties Anchorage, LP*, 437 F.3d 894, 899 (9th Cir. 2006).

²³ See, e.g., *PH Lodging Tomball, LLC v. Holiday Hosp. Franchising, LLC*, No. CV H-21-1803, 2021 WL 5902922 (S.D. Tex. Dec. 10, 2021).

²⁴ See *M/S Breman v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972) which held that forum selection clauses were "prima facie valid and should be enforced unless enforcement is shown by the resisting party to be

Typically, it is the franchisee who will challenge the forum selection clause. It is rare that a franchisee can successfully challenge a forum selection clause on the basis of fraud because of the unambiguous form of the clause itself, which is almost always sufficient to defeat a claim that the franchisor misled the franchisee into thinking it was something different than what it says on its face or that the franchisor would not enforce it. Claims of inconvenience or unfairness are equally difficult to overcome because the party claiming such must show that it cannot afford to litigate its claims in the contractually chosen forum, but that it can afford to litigate if the case proceeds in the forum where the case was filed.

Franchisees have more often successfully challenged forum selection clauses on the basis that they contravene a strong public policy of the forum state. In fact, the franchise and business opportunity statutes in several states contain anti-waiver language, which purport to override any contractual language that amounts to a waiver of protection of the state statute. Most anti-waiver provisions prohibit franchisors from forcing franchisees to waive coverage under state law.²⁵ While most do not void a contractual provision establishing a forum outside the franchisee's home state,²⁶ some state statutes have venue statutes applicable to the franchise relationship which franchisees will rely heavily upon to construct some relief from the broad holding of *Atlantic Marine, infra*.²⁷

B. Pre-suit Considerations of Dispute Resolution

There are advantages and disadvantages to both arbitration and litigation. The pathway to resolving franchise disputes is usually set out in the contractual terms of the franchise agreement, or other operative agreements governing the parties' relationship. The dispute resolution clause of a contract is an important part of the agreement that should not be glazed over. Whether or not your contract has a valid arbitration clause can influence the overall outcome of the dispute. Generally, if the governing contract has a valid arbitration clause, the dispute will be resolved in arbitration. In instances where the contract is silent, the dispute will be resolved in court.

unreasonable under the circumstances". In essence, forum selection clauses were enforceable provided they were freely negotiated and not the result of "fraud, undue influence, or overweening bargaining power." *Id.* at 407 U.S. at 12-13.

²⁵ See *Fam. Wireless #1, LLC v. Auto. Techs., Inc.*, No. 15-11215, 2015 WL 5142350, at *5 (E.D. Mich. Sept. 1, 2015) (holding forum selection clause was invalid under Minnesota Franchise Act because it required litigation to be conducted outside of Minnesota, but nonetheless granting defendant-franchisor's motion to transfer).

²⁶ See *Holiday Hosp. Franchising, LLC v. J & W Lodging, LLC*, No. 1:17-CV-01663-ELR, 2018 WL 11224379 (N.D. Ga. Feb. 8, 2018) (denying franchisee-defendant's motion to transfer to United States District Court for the District of Minnesota and holding that forum selection clause in which franchisee agreed to submit to the non-exclusive jurisdiction of specific Georgia did not violate the Minnesota Franchise Act because it did not amount to a waiver of the franchisee's right to file suit in Minnesota); *Ramada Worldwide, Inc. v. Grand Rios Invs., LLC*, No. CIV.A. 13-3878 KM, 2013 WL 5773085, at *2-3 (D.N.J. Oct. 23, 2013) (applying same analysis).

²⁷ See Earsa Jackson and Jim Meaney, *Forum Selection Clauses After Atlantic Marine*, American Bar Association 37th Annual Forum on Franchising, October 15-17, 2014 for a detailed chart of venue statutes applicable in the franchise context at pp. 17-23.

As part of franchise agreements that contain arbitration clauses, the parties will have agreed that disputes be resolved through binding arbitration, likely with a carve out for access to courts in certain cases such as trademark infringement or matters where emergency relief may be needed. Even in franchise agreements that hold each party responsible for their own attorney's fees in arbitration, some franchise agreements specify that if a party attempts to bypass the agreed upon arbitration clause by filing a suit in court, it will result in the losing party paying all attorneys' fees to defend the litigation.

C. Arbitration vs. Litigation: Pros and Cons

Proponents of arbitration commonly point to several perceived advantages it offers over litigation, court hearings, and trials. The benefits of arbitration are often debated, and the perspective of those benefits usually depends on which side you are sitting on—franchisee or franchisor—and whether you are bringing the claim or defending it. The three most commonly promoted benefits of arbitration are the following: (1) time, (2) cost, and (3) flexibility. Arbitration is favored because of its procedural simplicity, confidentiality, and faster results—although whether arbitration actually secures a more expedient result in complex commercial cases is open for debate.²⁸ Litigation, on the other hand, is typically preferred over arbitration due to its lower upfront costs because it avoids certain baked-in upfront costs of arbitration like relatively high arbitration filing fees, administrative fees, and arbitrator's compensation fees. Litigation is also a preferred option for those who wish to try their case to a jury, which many perceive as potentially advantageous for franchisees, especially if the litigation is venued in the franchisee's local forum. Litigation also affords the parties broader rights and opportunities to take discovery, file dispositive motions, and to appeal adverse decisions, which, depending on the circumstances of the dispute, may be favored.²⁹

By the time a franchise dispute gets to a place where a court or arbitrator is asked to intervene, the franchisor and the franchisee have likely gone through some type of pre-dispute resolution process or efforts (often mandated by the terms of the franchise agreement) that have failed, and they have exhausted all other means. The parties are typically eager to get the matter resolved at that point. The goal of arbitration is to allow the parties to work together peacefully and confidentially to resolve their dispute. The confidentiality that arbitration brings is often a driving force for why franchisors prefer to include arbitration provisions in their franchise agreements, as it avoids the details of a narrow dispute between it and one of its franchisees detrimentally affecting its relationship with its network of franchisees more broadly.

In any forum, whether it is litigation or arbitration, the longer a dispute takes to decide, the more costly it becomes. Time is money. This is so, not only because of initial filing fees, but also the costs of retaining outside legal counsel and arbitrators, as they are typically compensated by the hour or by tiered flat rates depending on how much time

²⁸ See Dawn Johnson, Kathy Kotel, and Brian Schnell, *To Arbitrate or Not to Arbitrate and How to Draft Accordingly*, American Bar Association 46th Annual Forum on Franchising, November 1-3, 2023 at 2-8.

²⁹ *Id.* at 8-12.

a matter takes. Other factors, including operation of the franchised business and the ultimate disposition being left in limbo while the dispute is resolved is disruptive and chaotic for the franchisee and their employees. These same concerns obviously also impact a franchisor's approach to litigation or arbitration, as expensive and protracted litigation is costly to franchisors and often leads to disruption of mid-level and senior management's business responsibilities because these individuals can be heavily involved in litigating the dispute—*i.e.*, sitting for depositions, attending hearings, aiding outside counsel's document discovery efforts, etc.

While arbitration can be less costly than litigation, the entry fees are higher than traditional litigation. Arbitrations typically require filing and advanced administrative fees up front. Hence, for matters that resolve early, arbitration can prove to be far more costly than traditional litigation if looking at filing fees alone. At the same time, arbitrations generally move faster to resolution, and that speed is a benefit of the higher upfront costs.³⁰ However, these figures are not truly comparing “apples to apples,” as they include the arbitrator's compensation costs but not the cost of private attorney's fees to litigate. It is still open to debate whether litigation or arbitration is the most cost effective for early resolution. And, in some instances, the early presence of a neutral third party (like an arbitrator) who has significant latitude to broker an expedited negotiated resolution between the parties can have real benefits that are worth the upfront cost of engaging that arbitrator to preside over the dispute.

1. Time: How fast is arbitration vs. litigation when completed?

Arbitration is designed to be a prompt and efficient administration of disputes, offering parties faster, final decisions while having access, even without an attorney, due to its simple procedures. On average, it takes 222 days—or 75% of the process to reach a hearing stage with the American Arbitration Association (“AAA”).³¹ According to the AAA, only one-third of the cases filed with AAA-ICDR will reach the hearing stage.³² Nearly two-thirds of disputes filed settle before the first hearing, many of which without accruing any arbitrator compensation.³³ Conversely, a case filed in the United States District Court takes more than twelve months or longer to get to trial, far longer than cases adjudicated by an arbitration hearing.³⁴ Moreover, a case begun in District Court that is appealed takes on average 21 months longer than arbitration to finally reach completion.³⁵ Although these time-to-resolution statistics vary based on the District Court hearing the

³⁰ See *The Pros and Cons of Using Arbitration Instead of Litigation*, <https://www.nolo.com/legal-encyclopedia/arbitration-pros-cons-29807.html> (last visited April 4, 2025).

³¹ American Arbitration Association, *Filing Considerations*, <https://go.adr.org/covid-19-filing-considerations.html> (last visited April 4, 2025).

³² *Id.*

³³ *Id.*

³⁴ American Arbitration Association, *Measuring the Costs of Delays in Dispute Resolution*, <https://go.adr.org/impactsofdelay.html#:~:text=Cost%20to%20Business%20with%20a%20Delay%20in%20Resolution&text=Direct%20losses%20associated%20with%20additional,than%20%24180%20million%20per%20month> (last visited April 4, 2025).

³⁵ *Id.*

dispute and the congestion of that particular court's docket.³⁶

How quickly an arbitration proceeding is completed depends on several factors, including the agency and its arbitration rules, the complexity of the matter, the conduct of the other side, and the arbitrator. Depending on the arbitration agency and its rules, some arbitrations can be completed in six months or less. However, if the matter becomes contentious or is particularly complex with substantial document discovery and many depositions, arbitrations can extend well over a year or more, making the timing similar to that of a traditional litigation case, thereby undermining why many favor arbitration.

2. Informal, Flexible Procedures

Arbitration is a less formal process than a traditional court proceeding. Due to its simplified rules of evidence and procedure, it is more accessible to unrepresented (pro se) parties. The setting of an arbitration is more relaxed. Even scheduling arbitration hearings is more flexible than trials—they can be scheduled around the availability of the parties, and even occur on nights and weekends as the arbitrator is a private party and does not have to adhere to a public court schedule. An arbitration is typically held in a conference room versus a courtroom, and the procedural rules are relaxed. Unlike a judge, an arbitrator does not have to follow precedent of outcomes in prior cases or exclude evidence based on state or federal rules, since arbitration decisions are not published.

Arbitrators have significant discretion as to what evidence will be allowed to be submitted.³⁷ Therefore, arbitrators can consider key information that would not be admissible in court. They are also able to exercise discretion in making decisions without the same restraints as a court.

3. Limited Discovery

Discovery can be one of the most intrusive and costly parts of litigation. Franchisors typically want to avoid discovery of their confidential information and the tactical advantages that can be employed in litigation if certain information was to be made public. Arbitration often dispenses with discovery procedure (i.e., interrogatories, depositions, request for production of documents) in full or in part by which each party obtains information and documents from the other party related to the dispute. Notably, however, the attorney-client privilege generally applies in arbitration much like it does in court.³⁸

³⁶ For further discussion of time-to-resolution statistics for arbitration compared to federal court litigation, see Dawn Johnson, Kathy Kotel, and Brian Schnell, *To Arbitrate or Not to Arbitrate and How to Draft Accordingly*, American Bar Association 46th Annual Forum on Franchising, November 1-3, 2023 at 5, n.10.

³⁷ See, e.g., AAA Commercial Arbitration Rules, R-34(b). Evidence. “The arbitrator shall determine the admissibility, relevance, and materiality of the evidence offered and may exclude evidence deemed by the arbitrator to be cumulative or irrelevant.”

³⁸ See, e.g., AAA Commercial Arbitration Rules, R-34(c). Evidence. “The arbitrator shall take into account applicable principles of legal privilege, such as those involving the confidentiality of communications between a lawyer and client.”

In litigation, franchisees may seek to use discovery as to the treatment of other franchisees who allegedly are similarly situated to inflict maximum litigation expense on the franchisor and thereby increase settlement leverage, which would typically not be available in arbitration. Such discovery may or may not be allowed. Given the broad standards applicable to the discovery process and courts' general reluctance to make relevance determinations at the discovery stage, potentially invasive discovery may be permitted even if the responsive material ultimately is deemed inadmissible at trial or on summary judgment.³⁹

4. Confidentiality

Unlike court proceedings, which are open to the public, arbitration proceedings are usually held in private. Franchisors are especially concerned about disclosure of their trade secrets and intellectual property, in addition to their policies or other franchisees information, which in a franchise system, can be dangerous if used against them. AAA Commercial Rule R-25, for example stated in pertinent part, "[a]ny person having a direct interest in the arbitration is entitled to attend hearings." The public is not a "person having a direct interest in the arbitration." Since the hearings are not typically open to the public and because arbitration is conducted pursuant the agreement of the parties, the parties can, and often do, agree to keep the entire arbitration and all related information and documents confidential.

Moreover, arbitration decisions, unlike court decisions, are not published. This means that access to an arbitrator's decisions and the details, including the confidential information and documents that were included in the arbitration, do not make their way into the public domain.⁴⁰

Court proceedings generally cannot be kept confidential from the public. In fact, with today's modern court systems, most dockets are publicly searchable online. Parties who desire to keep information private must take steps to do so by way of seeking protective orders or moving to seal certain documents. However, there is no guaranty that such motions will be granted as they are up to the Judge's discretion.

5. Finality

One of the main differences between arbitration and litigation is the finality of the award. An arbitration award is generally final and non-appealable, while a court judgment is usually subject to at least one appeal of right, and other discretionary appeals.⁴¹ The

³⁹ *Cohn v. Taco Bell Corp.*, 147 F.R.D. 154 (N.D. Ill. 1993) (allowing requested discovery concerning other franchisees as potentially indicative of bad faith); *Burger King Corp. v. C.R. Weaver*, 169 F.3d 1310 (11th Cir. 1999) (affirming denial of discovery with respect to other franchisees).

⁴⁰ Note that, when enforcing an arbitration award in court or if a party moves to set aside the award, the award will become part of a court's file unless confidentiality, such as a protective order, is sought and obtained from the court.

⁴¹ The major US-based arbitral institutions (American Arbitration Association, or "AAA", International

opportunity to appeal in court can keep litigation going for years.⁴²

Under long-standing federal law, U.S. courts are reluctant to interfere with an arbitrator's interpretation and application of law. Accordingly, arbitral awards are given great deference by U.S. courts. In fact, the US Supreme Court held that it is the arbitrator's construction of the contract that was bargained for, and the "arbitrator's construction holds, however good, bad, or ugly."⁴³

This can be viewed favorably, or unfavorably, depending on whether you agree with the arbitrator's decision. An arbitrator's award is hard to shake. Although an arbitration award can be challenged in court, an award will be vacated only in extremely rare and limited circumstances, such as where the award was procured by fraud or where the arbitrator has exceeded his or her powers.⁴⁴

One of the biggest risk factors for any party litigating in court versus arbitration is the effect of a binding judgment and precedent, as it relates to new claims. If a case is litigated to final judgment and the decision is unfavorable, the court's decision could be binding in subsequent litigation.

6. No Opportunity for a Jury Trial

One last thing to consider is that parties who agree to arbitrate likewise waive their right to a jury trial. In arbitration, the arbitrator not only hears and decides issues and arguments raised by the parties before the final hearing, but also acts as the ultimate decision-maker at the final hearing. In litigation, except in certain circumstances, the parties typically can have their case heard and decided by a jury if they desire.⁴⁵ Depending on the story of the case, a jury trial can be a substantial benefit over arbitration, especially where a party's case appeals to emotion or notions of fundamental unfairness. If the issues in a case are complicated or technical, a jury trial may not be the right option. Either way, jury trials can be very expensive and last for days or weeks, depending on the issues, as compared with arbitration, which is shorter and less expensive.

Institute for Conflict Prevention and Resolution (CPR) and JAMS now provide for appellate arbitration procedures. Parties can agree to appellate arbitration procedures as part of the arbitration agreement. Arbitration Compared to Litigation. Practical Law Litigation and Practical Law Arbitration, *Arbitration vs. Litigation in the US*, Practical Law Practice Note w-006-5897.

⁴² *Arbitration vs. Litigation: The Choice Matters*, <https://www.wnj.com/Publications/Arbitration-vs-Litigation-The-Choice-Matters> (last visited April 4, 2025).

⁴³ *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2071 (2013); see also *Benihana, Inc. v. Benihana of Tokyo, LLC*, at *14 (S.D.N.Y. July 15, 2016) (noting that appellate courts review factual determinations made in a bench trial for clear error but in the context of a challenge to an arbitral ruling, federal courts may not review findings of fact even for manifest disregard).

⁴⁴ This is the general rule under the Federal Arbitration Act. See 9 U.S.C. § 10. Individual states may have different standards.

⁴⁵ Oftentimes, parties to a franchise agreement contractually agree to waive trial by jury.

D. Other Concerns Involving Franchise Disputes

1. Ongoing Relationship of Parties

Whether in litigation or arbitration, while either is pending, the franchisee still needs to operate its business and protect its investment, and the franchisor must manage and develop the brand and protect brand standards. Thus, when a dispute arises, the resolution of the same does not always mean the end of the franchisor-franchisee relationship.

2. Potential Systemwide Impact of Franchise Disputes

Due to the unique structure of the franchise system in that it is set up for uniformity, an unfavorable decision in litigation could have far-reaching consequences across a franchise system, especially due to the accessibility of online case decisions across the United States. While defaults are reviewed on a case-by-case individual basis, a franchisee may argue that the franchisor waived its rights in another circumstance by not defaulting a similarly situated franchisee.

In addition, a franchisee may claim discrimination if they are not treated the same as other franchisees, regardless of whether the matter is litigated or arbitrated. The reality is that franchisees speak to one another, and while the individual agreements may be confidential between the parties, franchisees may try to seek discovery of the treatment of other franchisees to prove their case.

IV. PRE-SUIT RESOLUTION

A. Mediation

Mediation is a negotiation assisted by a neutral third party, whose role is to help those involved in a particular dispute clarify their business interests, overcome obstacles to communication, and fashion an efficient and realistic resolution of the matter.⁴⁶ Mediation is either mandatory (i.e. required under the franchise agreement) or optional (parties voluntarily seek intervention), and is typically the last step before litigation, but the first step in dispute resolution involving a neutral third party. Depending on the type and size of the dispute, mediation can be a cost-effective approach to dispute resolution.

Compared to a full arbitration or litigation of the matter on the merits, mediation entails a limited expenditure of time by counsel to bring the mediator up to speed on the issues, facts, and legal arguments involved, as well as attendance by counsel and an executive with settlement authority at a mediation session that typically lasts one or two days.⁴⁷

⁴⁶ Peter Klarfeld, Michael Lewis, and Peter Silverman, *Mediating Franchise Disputes*, American Bar Association 32nd Annual Forum on Franchising (Oct. 14-16, 2009).

⁴⁷ *Id.*

Mediation is most beneficial when parties come to the table open minded, and are seeking to avoid the time, expense, and risk of litigation or arbitration. Many franchise agreements require mediation in advance of the commencement of a lawsuit or arbitration. Whether or not such mediation has been conducted, federal courts have the authority to require the parties to mediate.⁴⁸ The advantages of mediation benefit both franchisees and franchisors alike, as the process aims at reaching a voluntary settlement before litigation. In addition, mediation can provide a “reality check” to the parties by providing a disinterested evaluation of the strengths and weaknesses of the case before committing to an expensive arbitration or litigation. The downside of mediation is that since it is non-binding, if the parties do not reach an agreement, or do not follow through on an agreement reached, the time and money spent on mediation is lost and the parties are left to commence arbitration or litigation to resolve the dispute, increasing the overall cost of the dispute. Mediation can also be unfruitful if the parties lack sufficient information to meaningfully participate. That is, exchanging discovery prior to mediation often greases the wheels and puts the parties in a better position to engage in meaningful settlement discussions.⁴⁹

As noted, given the potential benefits of mediation, many franchisee agreements contain mandatory mediation provisions requiring the parties to pursue mediation of a dispute before bringing a lawsuit.⁵⁰ While mediation during a dispute is almost always a worthwhile endeavor, pre-suit mediation may not always be as effective or beneficial as mediation during a lawsuit or arbitration, and franchisors should therefore consider the pros and cons of mandatory pre-suit mediation before including such clauses in their franchise agreements.⁵¹ From the franchisees’ perspective, it is also imperative to know about any contractual limitations periods or statutes of limitations that may run during pre-suit mediation. In such cases, it may be worthwhile to enter into a tolling agreement before mediation if a limitation period is on the horizon and if that is not possible, it may be best to filed suit or a demand for arbitration to stop the clock, regardless of a pre-suit mediation provision. While mediation itself involves expense, including mediator and attorneys’ fees, if successful, mediation can avoid the far more substantial expense and distraction of full-blown litigation.⁵² Additionally, mandatory pre-suit mediation allows franchisors to deescalate potentially volatile situations and to try to resolve a dispute before it turns into

⁴⁸ “A district court’s local rules may provide an appropriate source of authority for ordering parties to participate in mediation.” *In re Atl. Pipe Corp.*, 304 F.3d 135, 140 (1st Cir. 2002). Recognizing that this authority is not necessarily unlimited, the First Circuit ultimately found that “it is within a district court’s inherent power to order non-consensual mediation in those cases in which that step seems reasonably likely to serve the interests of justice.” *Id.* at 145.

⁴⁹ *In re Diocese of Buffalo, N.Y.*, 634 B.R. 839, 844 (Bankr. W.D.N.Y. 2021) (finding that mediation was premature until the parties exchanged discovery in order to “enable their meaningful participation in the mediation process.”)

⁵⁰ For an in-depth discussion of mandatory mediation provisions, including examples of such provisions that court have enforced, see Ronald T. Coleman, Jr. and Justin M. Klein, American Bar Association 37th Annual Forum on Franchising, October 15-17, 2014 at 24-27.

⁵¹ *Id.* at 25-26.

⁵² *Id.* at 25.

a lawsuit the franchisor would be required to disclose on its FDD.⁵³

But, when parties mediate before a lawsuit, they often do so with an incomplete understanding of the facts and the other side's positions, hindering the parties' ability to evaluate the strengths and weaknesses of their case and causing the parties to become more entrenched in their positions.⁵⁴ Additionally, before litigation, parties are often overly optimistic about their chances for prevailing in litigation and less willing to compromise, and only after incurring the costs of protracted litigation and discovery do they become more willing to negotiate.⁵⁵ For these reasons, pre-suit mediation can often be challenging, and franchisors should consider these challenges in crafting mandatory pre-suit mediation provisions in their franchise agreements.⁵⁶

As a matter of contract law, mandatory pre-suit mediation provisions are generally enforceable if well-drafted and unambiguous. When a party sues without first complying with a mandatory pre-suit mediation provision, the defendant may seek to enforce the provision by, for example, moving to dismiss the complaint, to stay the litigation pending mediation, or to compel mediation.⁵⁷ Many courts have granted such requests and enforced mandatory pre-suit mediation provisions.⁵⁸ Some courts, however, have declined to enforce mandatory pre-suit mediation provisions for reasons such as concluding that the provision is ambiguous in a way that renders mediation somehow unfair or futile⁵⁹ or finding that the defendant waived the mediation provision by participating in the litigation.⁶⁰

B. Work-out Agreements, Forbearance, and Probation Agreements

Before resorting to litigation or arbitration, franchisors often will offer franchisees

⁵³ *Id.*

⁵⁴ *Id.* at 26.

⁵⁵ *Id.* at 26.

⁵⁶ *Id.* at 25-26.

⁵⁷ *Id.*

⁵⁸ *Id.* at 24-26 (citing *R&F, LLC v. Brooke Corp.*, 07-2175-JWL, 2008 WL 294517 (D. Kan. Jan. 31, 2008) (enforcing mandatory mediation clause in franchise agreement and staying case pending mediation); *Delamater v. Anytime Fitness, Inc.*, 722 F. Supp. 2d 1168, 1177 (E.D. Cal. 2010) (enforcing mediation clause and dismissing complaint without prejudice); *Tattoo Art, Inc. v. Tat Int'l, LLC*, 711 F. Supp. 2d 645, 649-50 (E.D. Va. 2010) (enforcing mediation clause in licensing agreement and dismissing plaintiff's complaint without prejudice); *Brosnan v. Dry Cleaning Station Inc.*, C-08-02028 EDL, 2008 WL 2388392 (N.D. Cal. June 6, 2008) (enforcing mediation provision and dismissing complaint without prejudice); *Addy's Harbor Dodge, LLC v. Global Vehicles U.S.A. Inc.*, 4:11-CV-01065-RBH, 2011 WL 5110130 (D.S.C. Oct. 26, 2011) (enforcing mediation provision in dealer agreement and staying litigation pending mediation)); see also *MaggieMoo's Int'l, LLC v. G & R Moojestic Treats Inc.*, No. CIV.A. WMN-04-1694, 2004 WL 6251588 (D. Md. June 14, 2004) (enforcing mandatory mediation clause in franchise agreement and compelling mediation and staying litigation); *Riverside Portable Storage, Inc. v. PODS, Inc.*, No. 1:07-CV-22973, 2008 WL 11333800 (S.D. Fla. Feb. 6, 2008) (same); *Two Guys, Inc. v. Nick-N-Willy's Franchise Co., LLC*, No. C11-5537BHS, 2011 WL 4596692 (W.D. Wash. Oct. 3, 2011) (enforcing mediation clause in marketing agreement and dismissing complaint).

⁵⁹ See Ronald T. Coleman, Jr. and Justin M. Klein, American Bar Association 37th Annual Forum on Franchising, October 15-17, 2014 at 27 (citing *Cumberland & York Distributors v. Coors Brewing Co.*, No. 01-244-P-H, 2002 WL 193323 (D. Me. Feb. 7, 2002)).

⁶⁰ *Id.* (citing *DVDPlay, Inc. v. DVD 123 LLC*, 930 So. 2d 816, 820 n. 2 (Fla. Dist. Ct. App. 2006)).

alternative solutions to resolve their defaults by coming to an agreement and giving the franchisees time to fix the problem. In situations where the franchisees are good operators but have fallen behind on their financial obligations, some franchisors might offer payment plans or promissory notes rather than termination, so that the franchisee can stay open and operating. A payment plan or promissory note gives the franchisee time to pay back overdue royalties while getting back on their feet but still maintain their “good standing” in the franchise system. In situations where operational compliance is an issue, a franchisor may offer the franchisee a probation agreement. A probation agreement requests a formal commitment for measured improvement within a specified time period when the franchisee is struggling with operational defaults, in exchange for an un-contested termination. Both options help avoid the time and expense of arbitration or litigation.

In situations involving multiple defaults, franchisors may offer ad-hoc work out agreements to fit the needs of a particular fact pattern, especially when a franchisee has varying degrees and types of defaults and arbitration or litigation could become complex and costly for both parties. This becomes even more pragmatic if the franchisee’s situation is fraught and delicate. For example, when a franchisee with many franchises holds substantial debt to the franchisor and to other creditors, the franchisor should proceed cautiously with an open mind toward creative commercial resolutions because arbitration or litigation could create adverse outcomes for all parties, including large numbers of closures, uncollectible debts, and unnecessary legal fees throwing good money after bad, and of course, bankruptcy.

Rather than push the franchisee out of the system, the franchisor may be better served by collaborating with the franchisee to find a resolution that moves the franchisee to more solid ground while gradually rectifying defaults and debts. A franchisor may structure a work out agreement in multiple parts or stages, combining various requirements such as payment plans, commitments to make operational improvements, and even agreed-upon timeframes for a struggling franchisee to sell specific locations. This allows a franchisee the opportunity to simplify their portfolio, redirect their efforts, and, if needed, to use purchase proceeds from the sale of locations to address any amounts owed to the franchisor.

Whether it be a straightforward payment plan or an intricate workout agreement, prudent franchisors should view alternative resolutions to arbitration or litigation as an opportunity to avoid the costs and time of arbitration or litigation, to work with the franchisee toward rehabilitation, and to identify and secure outcomes that benefit the franchisor but may not always be available or guaranteed in arbitration or litigation (such as a timeframe to sell off locations). But often times such agreements are not possible or do not come to fruition, and the parties end up arbitrating or litigating their dispute.

V. ARBITRATION

For the reasons described above, many franchise agreements contain written arbitration clauses. But even faced with such agreements, franchisees occasionally seek

to avoid arbitration. They do this either by filing their own lawsuit against the franchisor in federal or state court, or by challenging the jurisdiction of an arbitration tribunal after an arbitration demand is made by a franchisor, either during the pendency of the arbitration (if they participate in the arbitration) or when the franchisor moves to confirm the award (if they do not).⁶¹ In many of these situations, the arbitrability of the franchise dispute is the first issue to be litigated.

The Federal Arbitration Act⁶² (“FAA”) is the law that governs arbitration agreements in franchise relationships “involving” interstate commerce between franchisors and franchisees, and because virtually all franchise relationships “involve” interstate commerce, the FAA is the lens through which courts will typically render decisions, even if state franchise statutes exist. Procedurally, where a franchisee initiates a potentially arbitrable lawsuit in court, the franchisor will often petition or motion to compel arbitration of the claims under Section 4 of the FAA and will seek to stay or dismiss the lawsuit pending arbitration under Section 3 of the FAA. In that case, the parties must litigate whether the dispute is arbitrable. And before that analysis can be made, the parties may even need to litigate the threshold question of who has the authority to decide the arbitrability question: a court or an arbitrator?

A. Arbitrability.

The question of “arbitrability” refers to the threshold issue of whether an arbitrator has the authority to rule on a dispute. The three primary arbitrability questions are (1) whether there was an agreement to arbitrate between the parties; (2) whether the parties’ current dispute is within the scope of that agreement; and (3) whether the agreement to arbitrate is enforceable.

Whether an arbitration agreement exists at all is sometimes litigated in the context of an agreement that one party claims not to have signed or otherwise consented to, in which case there may need to be a “mini trial” on that issue before the main dispute can even begin. This issue is not common in the franchise context, but at times an arbitration clause in a franchise agreement may be enforced by or against a non-signatory, as discussed below.

Whether the dispute at issue is within the scope of the parties’ arbitration clause is more often litigated. By enacting the Federal Arbitration Act, Congress declared a national policy favoring arbitration and the Supreme Court has held that any questions regarding arbitrability should be decided with a healthy regard for this policy.⁶³ As a result, the scope of arbitration clauses are to be construed broadly, and arbitration

⁶¹ *Stone v. Theatrical Inv. Corp.*, 64 F. Supp. 3d 527, 533 (S.D.N.Y. 2014), *reconsideration denied*, 80 F. Supp. 3d 505 (S.D.N.Y. 2015) (president and shareholder was held jointly and severally liable for arbitration award even though he was not a party to the agreement because he participated in arbitration and did not object to arbitrator’s exercise of jurisdiction over him).

⁶²The FAA is a statute enacted in 1925 that provides the basic legal principles applicable to arbitration in the United States, codified at 9 U.S.C. §1-16.

⁶³ *Moses H. Cone Mem’l Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983).

should not be denied “unless it may be said with positive assurance that that arbitration clause is not susceptible of an interpretation that covers the asserted dispute.”⁶⁴ In more recent years, the Supreme Court has clarified that this scope “presumption” in favor of arbitration applies only where a valid arbitration agreement is ambiguous as to whether it covers the dispute at hand, and only if that presumption is not rebutted.⁶⁵ In practice, many franchise agreements’ arbitration clauses are worded broadly to cover “any and all” disputes between the parties, making the scope question straightforward. But some franchise agreements provide certain carveouts from arbitration, and whether the parties dispute falls outside a carveout (particularly in the injunction context) can be hotly disputed.⁶⁶ The AAA rules explicitly state that an “arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim.”⁶⁷ Similarly, the JAMS rules provide that “jurisdictional and arbitrability disputes, including disputes over the formation, existence, validity, interpretation or scope of the agreement under which Arbitration is sought, and who are proper Parties to the Arbitration, shall be submitted to and ruled on by the Arbitrator.”⁶⁸

As for enforceability, arbitration agreements are “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for revocation of any contract.”⁶⁹ Thus, when courts exercise jurisdiction under chapter two of the FAA, they apply federal law to whether an agreement to arbitrate is enforceable.⁷⁰ The validity presumption in favor of arbitration under the FAA creates a preemptive effect on state statutes that preclude or undermine arbitration, such as laws that would prevent parties from placing class action waivers in their arbitration agreements.⁷¹

But a franchisee may still raise common law defenses to the enforceability of an arbitration clause, such as fraud, unconscionability, adhesion, or lack of mutuality of understanding, or some other inequity. So long as these generally apply contract defenses that do not target or interfere with arbitration specifically, they may be a basis to invalidate an arbitration agreement after a fact-based inquiry. That said, the Supreme Court has clarified that under the FAA, an arbitration clause within a broader agreement,

⁶⁴ *David L. Threlkeild & Co., v. Metallgesellschaft Ltd*, 923 F.2d 225, 250 (2d Cir. 1991), *cert. dismissed*, 501 U.S. 1267 (1991).

⁶⁵ *Granite Rock Co. v. Int’l Bhd. of Teamsters*, 561 U.S. 287, 301, 130 S. Ct. 2847, 2858, 177 L. Ed. 2d 567 (2010).

⁶⁶ See, e.g., *Archer & White Sales, Inc. v. Henry Schein, Inc.*, 935 F.3d 274, 279 (5th Cir. 2019); *Blanton v. Domino’s Pizza Franchising LLC*, 962 F.3d 842, 848 (6th Cir. 2020). Both these cases grapple with the important question of whether certain arbitration carveouts apply to the parties’ agreement to have arbitrability decisions themselves arbitrated, discussed more fully below in discussing delegation.

⁶⁷ See AAA Commercial Arbitration Rules and Mediation Procedures, Rule 7(a).

⁶⁸ See JAMS Comprehensive Arbitration Rule 11(b).

⁶⁹ 9 U.S.C. § 2.

⁷⁰ See *Smith/Enron Cogeneration Ltd. P’ship, Inc. v. Smith Cogeneration Int’l, Inc.*, 198 F.3d 88, 96 (2d Cir. 1999).

⁷¹ See *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 352, (2011).

such as a franchise agreement, is considered a contract within a contract.⁷² The FAA “provides that a written provision for arbitration in any maritime transaction or a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”⁷³

Therefore, because arbitration agreements are deemed presumptively valid, any fraud, unconscionability, illegality, or other defense must be directed to the arbitration clause itself rather than the broader agreement as a whole. For example, it is not enough for a franchisee to claim broadly that the franchise agreement contains unconscionable provisions; instead, they must specifically explain why the arbitration clause *itself* is unconscionable.⁷⁴

Finally, in addition to which substantive claims of the franchisor and franchisee are required to be arbitrated, courts presume that the parties intend arbitrators, not courts, to decide disputes about the meaning and application of particular procedural preconditions to arbitration,” such as “waiver, delay, or a like defense to arbitrability,” and “the satisfaction of ‘prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate.’”⁷⁵ That said, courts can and do often decide whether a party has waived its right to seek arbitration where that party has either affirmatively sought to have the dispute resolved in court or has actively participated in litigation.⁷⁶

B. Delegation.

A threshold issue before determining arbitrability is whether the court or the arbitrator has the authority to decide arbitrability. Unlike the presumption in favor of arbitrability, the Supreme Court held in *First Options of Chicago, Inc. v. Kaplan* that there is an inverse presumption in favor of courts—rather than arbitrators—deciding arbitrability if the agreement is silent on the issue.⁷⁷ This presumption can be overcome, however, if the parties clearly and unmistakably agree to delegate the arbitrability issue to the arbitrator, either explicitly or even by incorporation of arbitration rules such as the Commercial Rules of the American Arbitration Association, which grant that authority to the arbitrator.⁷⁸ Such provisions are commonly known as “delegation clauses” and are commonly honored by courts. Further, “the Second Circuit has declined to read *First Options* so expansively as to extend it to all questions of arbitrability. As the

⁷² *Rent-A-Ctr., W., Inc. v. Jackson*, 561 U.S. 63, 70, (2010).

⁷³ *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 400, 87 S. Ct. 1801, 1804, 18 L. Ed. 2d 1270 (1967).

⁷⁴ *Id.* at 71.

⁷⁵ *BG Grp., PLC v. Republic of Argentina*, 134 S. Ct. 1198, 1207, 188 L. Ed. 2d 220 (2014).

⁷⁶ *Morgan v. Sundance, Inc.*, 596 U.S. 411, 413, 142 S. Ct. 1708, 1711, 212 L. Ed. 2d 753 (2022)

⁷⁷ *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944, 115 S. Ct. 1920, 1924, 131 L. Ed. 2d 985 (1995).

⁷⁸ *Id.*; *Brennan v. Opus Bank*, 796 F.3d 1125, 1130 (9th Cir. 2015) (joining “[v]irtually every circuit to have considered the issue” and holding that “incorporation of the [AAA] arbitration rules constitutes clear and unmistakable evidence that the parties agreed to arbitrate arbitrability”).

Second Circuit has stated, problems of arbitrability arise in two contexts: (1) when parties disagree whether an arbitration clause covers a particular dispute; and (2), when the parties disagree not about the scope of the arbitration clause but about whether there is even a valid agreement to arbitrate in effect at a particular time.”⁷⁹

Enforceability challenges to delegation clauses are often more difficult than those to arbitration agreements, because just as an arbitration clause is a presumably valid arbitration contract within a broader container contract, an agreement to arbitrate arbitrability in a delegation clause is a presumably valid arbitration contract within a broader arbitration contract within an even broader container contract. Therefore, as the Supreme Court held in another landmark case, *Rent-A-Center, West, Inc. v. Jackson*, a validity challenge to an arbitration delegation clause—such as an unconscionability challenge—must persuade a court that the delegation agreement itself is invalid, which can be very difficult to achieve.⁸⁰

C. Non-signatory Challenges

The franchisor and the franchisee who signed the franchise agreement can expect to enforce a franchise agreement and the arbitration clause contained in it against each other. But in many franchise relationships, there are entities and other individuals who may not be parties to the franchise agreement but are fully involved in the franchisee’s business operations. These “third parties” could be family members, operating entities, employees, independent contractors, or even business associates. In many franchise relationships, there are tangential agreements such as leases, guarantees, or licenses that could involve related parties that come into play. Non-signatory issues often arise where a contracting party is a member of a group of companies, and its parent or the other subsidiaries have been involved in the commercial transaction but are not signatories to the contract.

Often times, non-signatories to arbitration agreements are compelled to arbitrate or may choose to arbitrate if they have a relationship to the party and can establish certain legal thresholds. To this end, courts generally have identified five circumstances where signatories to arbitration agreements can compel non-signatories to arbitration: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter ego; and (5) estoppel.⁸¹

⁷⁹ *Schneider v. Kingdom of Thailand*, No. 10 CIV. 2729 DAB, 2011 WL 12871599, at *4 (S.D.N.Y. Mar. 14, 2011), *aff’d*, 688 F.3d 68 (2d Cir. 2012) (citing *Acequip Ltd. v. American Eng’g Corp.*, 315 F.3d 151, 155–56 (2d Cir.2003) (internal quotations and citations omitted).

⁸⁰ 130 S.Ct. 2772 (2010).

⁸¹ See *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 631 (2009) (non-party to arbitration agreement may seek a stay under U.S.C.A. §3, 16(a)(1)(A) if the relevant state contract law allows him to enforce the agreement); *Crawford Prof’l Drugs, Inc. v. CVS Caremark Corp.*, 748 F.3d 249, 257 (5th Cir. 2014) (nonsignatory plaintiffs were equitably estopped from refusing to arbitrate); *CD Partners, LLC v. Grizzle*, 424 F.3d 795, 799 (8th Cir. 2005) (nonsignatory can enforce arbitration clause against signatory when “the relationship between the signatory and nonsignatory defendants is sufficiently close that only by permitting the nonsignatory to invoke arbitration may evisceration of the underlying arbitration agreement between the signatories be avoided or when claims presume the existence of the written agreement); *Zurich Am. Ins.*

In some cases, non-signatories can compel arbitration if they can prove that they are third-party beneficiaries to the contract. To prevail under a third-party beneficiary theory, the party seeking to compel arbitration must produce evidence of a clear contractual intent to benefit the third party.⁸²

D. Interim Relief in Arbitration.

While the specifics of injunctive relief are discussed below, even where a franchise agreement contains an arbitration clause, there is usually a judicial path for emergency relief. Commercial contracts, including franchise agreements, will specify that while all disputes must be submitted to arbitration, parties may still seek injunctive relief in the relevant court to obtain certain relief quickly.

While historically not always the case, temporary restraining orders (“TROs”) and preliminary injunctions are now available from arbitrators. In 2013, the AAA amended its commercial rules to obtain “emergency measures of protection.”⁸³ AAA’s Rule 38 provides that a party can obtain emergency relief within days. According to AAA Rule 38 (a) and (b), when a party in need of emergency relief notifies the AAA of the nature of and reason for the requested relief, “the AAA shall appoint ...within one day of receipt...a single emergency arbitrator designated for rule on emergency applications.” No later than two business days after appointment, the AAA emergency arbitrator must establish a schedule for consideration of the emergency relief. The schedule must provide a reasonable opportunity for all parties to be heard, but it need not be in person. AAA Rule 38(d) permits telephone or video conference, or written submissions.

If the emergency arbitrator is satisfied that the irreparable harm threshold has been met and that the moving party is entitled to relief, they may enter an interim order or award granting the relief, but the arbitrator must state the reasons for the order or award.⁸⁴

These emergency relief procedures in arbitration are subject to the same limitation of all arbitration awards—that the TRO or preliminary injunction is not self-enforcing (as a court order would be). Therefore, to actually enforce an interim relief ruling with the

Co. v. Watts Indus., Inc., 417 F.3d 682, 687 (7th Cir. 2005) (no grounds to compel arbitration against nonsignatory on estoppel theory since nonsignatory did not receive direct benefit); *Trippe Mfg. Co. v. Niles Audio Corp.*, 401 F.3d 529, 532 (3d Cir. 2005) (nonsignatory purchaser of assets could not be equitably estopped from challenging arbitration clause since no evidence of direct benefit) was not bound to arbitrate under NY Law); *Employers Ins. of Wausau v. Bright Metal Specialties*, 251 F.3d 1316, 1322 (11th Cir. 2001) (Plaintiff was bound to arbitrate when it assumed the contract); *Int’l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411, 416-17 (4th Cir. 2000) (Plaintiff estopped from refusing to arbitrate because rights it seeks to assert hinge on contract); *Thomson-CSF, S.A. v. Am. Arbitration Ass’n*, 64 F.3d 773, 776 (2d Cir. 1995) (court’s hybrid approach that did not fit squarely into approved theories to bind nonsignatory was rejected).

⁸² *Ex parte Stamey*, 776 So.2d 85, 92 (Ala. 2000) (holding under a third-party-beneficiary theory a nonsignatory could enforce an arbitration agreement against a signatory because the agreement specifically stated that the signatory had agreed to arbitrate disputes against the nonsignatory).

⁸³ American Arbitration Association Rules, R-38.

⁸⁴ See AAA Rule 38(e). JAMS provides a similar emergency relief in its Rule 2(c).

force of law, the prevailing party may need to have it confirmed by a court. In contested arbitrations, however, most parties will not lightly ignore an interim ruling by the same arbitrator who will be issuing the final award.

E. POST-ARBITRATION AWARD ENFORCEMENT ISSUES

Obtaining an arbitration award is not the last step for franchisees or franchisors to realize the relief requested in an arbitration proceeding. Even though it is a binding decision, an arbitration award cannot be enforced until it has been confirmed by the appropriate federal or state court. Arbitration awards can be confirmed in federal or state courts. Recently, the Supreme Court held that federal jurisdiction to confirm an arbitral award under the FAA may be based only on the award to be enforced, rather than the underlying substance of the parties' dispute, making it difficult to confirm arbitration awards in federal court where diversity jurisdiction is not present.⁸⁵ Mainly the FAA governs recognition and enforcement of arbitral awards, although other provisions of law and state laws can apply as well.

Pursuant to Section 12 of the FAA, parties have three months in which to move to vacate, modify, or correct an arbitration award after the same is filed or delivered.⁸⁶

Where the FAA applies, an arbitration award may be vacated only in limited circumstances:

- (1) The award was obtained by corruption, fraud or undue means;
- (2) Any of the arbitrators were partial or corrupt;
- (3) The arbitrators were guilty of misconduct in refusing to postpone the hearing on sufficient cause shown;
- (4) The arbitrators exceeded their powers or so imperfectly executed them that they did not make a mutual, final and definite award on the subject matter submitted.⁸⁷

The U.S. Supreme Court has held that “[i]t is only when [an] arbitrator strays from interpretation and application of the agreement and effectively ‘dispense[s] his own brand of industrial justice’ that his decision may be unenforceable.”⁸⁸ Similarly, a court may modify or otherwise correct an arbitration award only in very narrow circumstances, including where (a) there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award; (b) the arbitrator(s) have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted; or (c) the award is imperfect in matter of form not affecting the merits of the controversy, to effect the intent thereof and promote justice between the parties.⁸⁹

⁸⁵ See *Badgerow v. Walters*, 596 U.S. 1, 7, 142 S. Ct. 1310, 1316, 212 L. Ed. 2d 355 (2022).

⁸⁶ 9 U.S.C. § 12.

⁸⁷ 9 U.S.C. §10

⁸⁸ *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 687 (2010).

⁸⁹ 9 U.S.C. § 11.

Parties who seek to enforce arbitration awards must be mindful of time limits imposed by federal and state statutes, which will vary. Depending on where the party is seeking to enforce the arbitration award, it may need to wait anywhere between 30 and 90 days before filing. This allows the time that the award could be challenged to expire.⁹⁰ In practice, the party seeking to enforce the arbitration award will typically wait out the requisite period for modification and/or vacatur to ensure that the other party “waived” the ability to contest the award. But parties must be prudent and not wait too long to confirm an award, as they only have one year after the award is made to confirm.⁹¹

The application to confirm the arbitration award is straightforward. If filing under federal law, specifically 9 U.S.C. §13, the party moving for the order confirming the award should include:

- (a) The arbitration agreement; the selection or appointment, if any, of an additional arbitrator or umpire; and each written extension of the time, if any, within which to make the award.
- (b) The award; and
- (c) Each notice, affidavit, or other paper used upon an application to confirm, modify, or correct the award, and a copy of each order of the court upon such an application.

Most state statutes are similar to the FAA with respect to submission requirements.⁹² Once confirmed, the arbitration award will carry the same force and effect as a judgment, and give the prevailing party access to any post-judgment remedies in the jurisdiction where confirmed.

VI. SUBSTANTIVE FRANCHISEE CLAIMS AND FRANCHISOR DEFENSES

A. Common Franchisee Claims

Franchisee claims against a franchisor typically fall within one of three categories of claims: (i) claims arising before the parties enter into an executed franchise agreement or a recognized franchise relationship exists; (ii) claims arising during the term of the franchise relationship;⁹³ and (iii) claims arising from the end of the franchise relationship. The remedies a franchisee seeks differ depending on the nature and timing of their claims.

⁹⁰ For example, Connecticut G.S. §52-90 provides that “No motion to vacate, modify or correct an award may be made after thirty days from the notice of the award to the party to the arbitration who makes the motion” while the FAA provides for three months.

⁹¹ 9 U.S.C. § 9.

⁹² A prudent attorney should pay close attention to service of process requirements and recognition of arbitration awards by defaults in preparing the application to confirm in federal and state courts, as well as venue clauses. Also note that the award is now public. Steps should be taken to keep the award confidential, to the extent possible, if there is confidential information contained in the award.

⁹³ Traditionally, a formally executed franchise agreement signifies the beginning of a franchise relationship. But in more unusual circumstances, a franchise relationship may exist without a valid franchise agreement. For purposes of this article, references to the existence of franchise relationship assume the relationship is established through a valid franchise agreement.

1. Pre-Relationship Claims

Before a franchise relationship begins by contract or otherwise, a franchisee should complete a thorough review of the franchise opportunity to determine whether the franchisor's brand, product, and business model fit the franchisee. Along with the franchisee's due diligence, a franchisor should ensure the franchisee meets the franchisor's qualifications and standards required to operate within the franchise system.

During these initial stages, franchisees may engage in discussions and review a significant amount of material through franchise expositions, brokers, advertising, word of mouth, general research, and other sources, some provided by the franchisor or brokers and some not. The content and representations in these discussions and materials, including a franchisor's FDD, are the sources of pre-relationship claims—particularly if a franchisor or its representatives fail to strictly comply with registration and disclosure laws.

a. The FTC Rule and State Franchise Disclosure/Investment Laws

The main source of franchisee claims is the FDD required by the FTC Rule. From the franchisee's perspective, the FTC Rule is designed to protect franchisees by mandating franchisors provide franchisees with information about the purchase and operation of a franchise before franchisees pay the franchisor money or sign an agreement. The FTC Rule does not afford franchisees a statutory private right to action. As a result, such "disclosure violations" are most often asserted through either common law fraud-based claims or "Little FTC" claims commonly asserted under state Unfair and Deceptive Trade Practices Acts. Franchisees also frequently assert and include claims under state registration and relationship laws in those states enacting such protections as identified and discussed above.

b. Common Law Fraud-Based Claims

The most common claims against a franchisor based on pre-relationship conduct are common law fraud-based claims, including fraud, fraudulent inducement, and negligent misrepresentation.

Although the elements of these claims vary by state, generally common-law fraud or deceit claims require the following: (i) a false representation or concealment of a material fact; (ii) reasonably calculated to deceive; (iii) with the intent to deceive; (iv) which in fact does deceive; and (v) injury to the franchisee upon that franchisee's reasonable reliance on the false material fact.⁹⁴ The elements for a claim for fraud in the inducement

⁹⁴ *Cluck-U Chicken, Inc. v. Cluck-U Corp.*, No. 8:15-CV-2274-T-MAP, 2017 WL 10275957, at *8 (M.D. Fla.

are essentially duplicative of claims for fraud in most jurisdictions with the caveat that the intent of providing or omitting false information was to induce the franchisee into executing the franchise agreement.⁹⁵

The difference between a claim for fraud and negligent misrepresentation is the element of intent (i.e., whether the false or misleading information was intentionally communicated to the franchisee). To succeed on a claim for negligent misrepresentation, the franchisee must show: (i) that the franchisor provided false information to the franchisee; (ii) the franchisee justifiably relied on the specific information provided to their detriment; and (iii) the franchisor was negligent or did not exercise reasonable care in providing the information.⁹⁶ Depending on the jurisdiction, a franchisee may not be required to prove that the statement, representation, or fact be false but, instead, is simply materially misleading.⁹⁷

The main source of fraud-based claims is the actual or perceived differences between what a franchisee was either told during the pre-sale process or is contained in the franchisor's FDD and the franchisee's post-sale experience.⁹⁸ While required to conform all statements and discussions with the information set forth in the franchisor's FDD, franchisor representatives may sometimes exaggerate or embellish the disclosures and experiences with the brand. It is important to note, here, however, that mere puffery or opinion is typically not actionable.⁹⁹ Whether a statement is considered puffery,

June 6, 2017). The Middle District of Florida denied summary judgment to a franchisor based on disputes of material facts as to whether the franchisor fraudulently induced and materially misrepresented start-up costs. Applying Maryland law, the court noted that inaccurate projections may become fraudulent or be a misrepresentation if the franchisor knew that they were inaccurate at the time they were made.

⁹⁵ *Eclipse Medical, Inc. v. American Hydro-Surgical Instrs., Inc.*, 262 F. Supp. 1334 (S.D. Fla. 1999) (noting elements for fraud in the inducement are (1) defendant misrepresented a material fact; (2) defendant knew or should have known the statement was false; (3) defendant intended for statement to induce plaintiff to enter into contract or business relation; and (4) plaintiff was injured by acting in justifiable reliance on the statement).

⁹⁶ *Trident Atlanta, LLC v. Charlie Graingers Franchising, LLC*, No. 7:18-CV-10-BO, 2019 WL 441187, at *4 (E.D.N.C. Feb. 4, 2019).

⁹⁷ See *Coraud LLC v. Kidville Franchise Co., LLC*, 121 F. Supp. 3d 387, 393 (S.D.N.Y. 2015) (applying New York law); *Long John Silver's Inc. v. Nickleson*, 923 F. Supp. 2d 1004, 1014 (W.D. Ky. 2013) (applying Minnesota law).

⁹⁸ See *Dance Fitness Michigan, LLC v. AKT Franchise, LLC*, No. 823CV01643JVSJDEX, 2023 WL 7549894, at *7 (C.D. Cal. Nov. 13, 2023) (alleging "that the Defendants represented to Plaintiffs materially false information orally and in the franchise disclosure documents about the estimated initial investment required to open and operate a[] facility" and about "the amount of time it would take for a[] facility to open after Plaintiffs signed their franchise agreement").

⁹⁹ See *Steak n Shake Enterprises, Inc. v. Globex Co., LLC*, 110 F. Supp. 3d 1057, 1083 (D. Colo. 2015), *aff'd*, 659 F. App'x 506 (10th Cir. 2016) (statements such as the franchise would be "highly profitable" and projections regarding future profitability are "mere puffery" and cannot be the basis of a misrepresentation claim because they are predictions about the future and not the misrepresentation of an actual fact); *Kim v. H Guys, LLC*, No. 1:20-CV-03588, 2022 WL 888871, at *5 (N.D. Ill. Mar. 26, 2022) (noting that "buzzwords" such as "'strong and comprehensive management team' and an 'all-star cast of strategic advisors' probably qualify as mere puffery" whereas statement such as defendant "had 'local expertise and connections with contractors and municipalities'" and "'exclusive rights to several neighborhoods within the Chicagoland area'" do not (citations and punctuation omitted)).

opinion, or misrepresentation is typically a fact specific inquiry.¹⁰⁰

Traditional disclosure areas resulting in fraud-based claims include financial performance representations, initial investment costs, and misleading promises or guarantees related to operation, training, and support. This is not an exhaustive list because fraud-based claims may arise from any number of discussions or disclosures in almost any area of the franchise relationship. The only barometer is whether a franchisee would reasonably rely upon such a statement or omission and if such statement or omission would materially affect the franchisee's decision to enter the franchise relationship. Importantly, silence or omission also gives rise to fraud-based claims when the omitted information materially affected the franchisee's reliance on the information actually provided or communicated.¹⁰¹

Of the listed disclosure areas commonly resulting in fraud-based claims, two of the most common include financial performance representations and initial investment costs.

i. Financial Performance Representations

Financial Performance Representations or FPRs are one of the most litigated fraud-based claims and the subject of many reported decisions. The FTC Rule requires franchisors to disclose financial performance representations in Item 19 of the FDD under the FTC Rule.¹⁰² Any communications, representations, or statements from the franchisor or its representatives should strictly conform to the FPRs in the FDD.

Franchisors and their representatives do not, however, always comply with such obligations and franchise sales lore is replete with examples of FPRs occurring on the back of cocktail napkins and more sophisticated methodologies where the disclosure made in a discussion does not satisfy the Item 19 disclosures. In addition, franchisees may base claims upon instances where a franchisor's statements or representations of expected financial performance are not based on or reflective of current or past facts, data, or circumstances.¹⁰³ Likewise, a franchisee may base claims on inaccurate information about the success rate, performance, and profits of past or current

¹⁰⁰ *Steak n Shake Enterprises, Inc.*, 110 F. Supp. 3d at 1083.

¹⁰¹ See *Hanley v. Doctors Exp. Franchising, LLC*, No. CIV.A. ELH-12-795, 2013 WL 690521, at *22 (D. Md. Feb. 25, 2013). (This matter involved an Item 7 disclosure by Doctors Express based upon amounts from a current franchisee who opened the franchise operation six (6) years prior to the disclosure. In that time frame, the Medicare and insurance laws changed drastically, and the franchisor knew or should have known that this change materially altered the initial startup costs as disclosed in Item 7 and as misrepresented to the franchisees. Essentially, the Court held that the franchisee properly stated claims for fraud based on the franchisor's misrepresentations and omissions, the discrepancy and projected and actual costs, and the undisclosed facts known by the franchisor.); see also *Lunt v. Frost Shades Franchising, LLC*, No. 3:22-CV-00775, 2023 WL 3484202 (M.D. Tenn. May 16, 2023) (addressing fraud claim based on omission of litigation from Item 3 of FDD).

¹⁰² For further discussion, see Section III.

¹⁰³ See *Hanley v. Drs. Exp. Franchising, LLC*, No. CIV.A. ELH-12-795, 2013 WL 690521, at *21 (D. Md. Feb. 25, 2013).

franchisees.¹⁰⁴

Before filing a claim based on statements or representations regarding future performance or expected earnings, it is important to research the specific jurisdiction in which the claims arise because these claims are not actionable in all jurisdictions.¹⁰⁵ Some jurisdictions allow franchisors to avoid liability where such claims are disclaimed, merged, or waived with a franchise questionnaire.¹⁰⁶ Recently, however, efforts to rely on franchisee questionnaires, acknowledgements or other perceived “disclaimers” have come under fire by state regulators.¹⁰⁷

ii. Initial Investment Costs

Fraud claims arising from a franchisor’s estimate of the initial investment costs to open a franchise are also common.¹⁰⁸ Like financial performance representations, the FTC Rule requires franchisors to disclose estimated costs to the franchisee for their initial investment into the franchise through Item 7 of the FDD.¹⁰⁹ Such initial investment costs might include initial franchise fees, rent, construction or leasehold improvement costs, initial marketing fees and packages, equipment costs and packages, computer systems and software, signage, insurance, supplies, permitting, and more.

Franchisees reasonably rely on these estimates to determine the amount of capital necessary to enter the franchise relationship and whether they may meet those needs. Thus, if a franchisor provides estimates that materially fail to accurately reflect current circumstances, then such disclosures may be actionable as fraud. These claims are difficult to prove, however, absent evidence that the inaccuracies were known or should

¹⁰⁴ See *Bans Pasta, LLC v. Mirko Franchising, LLC*, No. 7:13-CV-00360-JCT, 2014 WL 637762, at *2 (W.D. Va. Feb. 12, 2014); see also *Avon Hardware Co. v. Ace Hardware Corp.*, 998 N.E.2d 1281, 1288 (Ill. App. Ct. 2013) (noting false representations of historical financial data such as the past performance of franchisees is actionable under fraud or negligent misrepresentation subject to cautionary language accompanying such representations); *Functional HIIT Fitness, LLC v. F45 Training Inc.*, No. 22-10168, 2023 WL 6367691, at *15 (E.D. Mich. Sept. 28, 2023) (addressing “allegations of fraud and negligent misrepresentation involve a series of statements made by Defendants that allegedly inflated the profitability of [] fitness studios”).

¹⁰⁵ See *Steak n Shake Enterprises, Inc.*, 110 F. Supp. 3d at 1083 (D. Colo. 2015) (noting that future profitability projections cannot be the basis of any misrepresentation claim and that representations for the future are not actionable under Colorado and Indiana law); *Long John Silver’s Inc.*, 923 F. Supp. 2d at 1019 (noting projections are generally not actionable unless the future projections were derived from false or misrepresented past or existing facts); *Functional HIIT Fitness, LLC*, 2023 WL 6367691, at *15 (noting general rule that fraud cannot be based on a promise of future conduct except “where a promise is made in bad faith without the intention to perform it” or “if the statements were intended to be, and were accepted as, representations of fact, and involved matters peculiarly within the knowledge of the speaker” (citations and punctuation omitted)).

¹⁰⁶ See Section IV.B. below.

¹⁰⁷ See NASAA Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgements (Jan. 1, 2023), <https://www.nasaa.org/wp-content/uploads/2022/09/NASAA-Franchise-Questionnaires-and-Acknowledgments-Statement-of-Policy-9-18-2022.pdf>

¹⁰⁸ See, e.g., *Dance Fitness Michigan, LLC*, 2023 WL 7549894, at *7.

¹⁰⁹ 16 C.F.R. § 436.5(g) (last visited March 15, 2023).

have been known to the franchisor.¹¹⁰

As a practical matter, however, determining whether a franchisor's initial investment disclosures are accurate is difficult without actually taking the leap into the franchise development stage. Once a franchisee is aware their initial investment costs are materially different from the estimates provided, a franchisee should take swift action rather than continuing development, opening, and operating the franchised business before claiming fraud against the franchisor because courts often find that the truthfulness or applicability of initial investment costs should be ascertainable at any point before opening the franchise.¹¹¹

c. The FTC Act and Unfair and Deceptive Trade Practices Acts

The FTC Act is a federal law aimed at protecting consumers and businesses from “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.”¹¹² While unfair competition and unfair or deceptive acts or practices are declared unlawful under the FTC Act, only the FTC is empowered to enforce it.

Since the FTC Act does not provide a private right of action to franchisees or other consumers, state legislatures enacted their own consumer protection statutes that protect franchisees and other consumers from unfair or deceptive trade practices, including those of franchisors. These statutes are known as “Little FTC Acts” or Unfair and Deceptive Trade Practices Acts.

Many of these statutory frameworks provide franchisees with a private right to action for violation of the FTC Rule, while others only provide protection to consumers/purchasers of household goods and services.¹¹³ Examples of states enacting “Little FTC Acts” that provide franchisees with a private right to action against a franchisor include, but are not limited to, Connecticut, Florida, Georgia, Illinois, New Jersey, Ohio, and Texas.¹¹⁴

¹¹⁰ See *MTR Capital, LLC v. LaVida Massage Franchise Dev., Inc.*, 17-CV-13552-TGB, 2020 WL 6536954, at *6, 9 (E.D. Mich. Nov. 6, 2020) (noting an element of both fraud in the inducement and negligent misrepresentation is that the franchisor must know or should have known that representation was false).

¹¹¹ See *MTR Capital, LLC v. LaVida Massage Franchise Dev., Inc.*, 17-CV-13552-TGB, 2020 WL 6536954, at *6, 9 (E.D. Mich. Nov. 6, 2020) (finding a franchisor violated the Florida Deceptive and Unfair Trade Practices Act but awarding the return of the franchise fee and noting that any losses suffered by the franchisee “once they began preparing and operating the franchise” “severed the causal chain” due to the franchisee’s own mismanagement); see also *Ultimate Franchises, Inc. v. Parsons*, SACV172153JVSJDEX, 2018 WL 6016153, at *4 (C.D. Cal. June 13, 2018) (finding alleged misrepresentations were barred under the statute of limitation as the franchisee failed to provide why they did not discover the falsity sooner).

¹¹² 15 U.S.C. § 45(a).

¹¹³ For example, “Little FTC Acts” in Michigan (MCL 445.903), Pennsylvania (68 Pa. Code §201-9.2), and Virginia (Va. Code Ann. § 38.2-6013), among others, do not provide protection for business entities or commercial transactions.

¹¹⁴ See Conn. Gen. Stat. Ch. 735a *et seq.*, Fla. Stat. §501.201 *et seq.*, Ga. Code Ann. §10-1-372 *et seq.*,

These “Little FTC Acts” serve as an additional avenue to combat franchisor misconduct and violations of the FTC Rule. Many of these acts apply a lesser standard or burden of proof than is typically required under common law fraud-based claims. Some Little FTC Acts essentially provide franchisees with an indirect private right to action for a franchisor’s violation of the FTC Rule or even provide that a violation of any of the FTC Rules is considered a per se violation of that state’s Little FTC Act.¹¹⁵

It is also important to consider which legal claims provide franchisees the most comprehensive damages. Under the “Little FTC Acts,” damages may include injunctive relief, attorneys’ fees and costs, treble damages, and rescission, though there are nuances in different jurisdictions. As a result, franchisees should consider which theories provide the most comprehensive damages claim under the applicable law before determining whether to assert claims under fraud-based theories or under one of the available statutory schemes. Even then, courts may limit the scope of a franchisee’s recovery. For example, the Eastern District of Michigan limited a franchisee’s recovery to the return of the initial franchise fee paid where it is possible the franchisee’s business judgment led to its full amount of damages even though the court determined the franchisor violated the Florida Deceptive and Unfair Trade Practices Act.¹¹⁶

2. Claims Arising During the Term of the Franchise Relationship

Claims arising during the term of the parties’ franchise relationship are incredibly broad in scope and may cover almost any aspect of the relationship and any type of interaction between the franchisor and franchisee. The most frequent claims arising during the term of the franchise relationship sound in contract based on a breach of the franchise agreement. But in more limited circumstances, claims against a franchisor for breach of the implied covenant of good faith and fair dealing may also exist.

a. Breach of Contract

The bases for the most common breach of contract claims asserted by franchisees are (i) a lack of support, guidance, or training; (ii) failure to properly apply or spend advertising funds; and (iii) a violation of the franchisee’s protected territory or encroachment. Although other contract-based claims exist, such as wrongful termination and failure to allow a transfer or approve a renewal of the franchise agreement, we address those claims in the section below discussing claims arising from the end of the franchise relationship.

815 ILCS 510 *et seq.*, N.J.S.A. 8C:56-8-2 *et seq.*, Oh. Rev. Code §1345.01 *et seq.*, and Tex. Bus. & Com. §17.01 *et seq.*

¹¹⁵ See, e.g., Fla. Stat. § 501.203(3)(a) (providing that a violation of any rules of the FTC Act violates Florida’s Deceptive and Unfair Trade Practices Act); Wash. Rev. Code § 19.100.190(1) (providing that a violation of Washington’s Franchise Investment Protection Act constitutes an unfair or deceptive act or practice under Washington’s Consumer Protection Act).

¹¹⁶ *MTR Cap., LLC v. LaVida Massage Franchise Dev., Inc.*, No. 17-CV-13552-TGB, 2020 WL 6536954, at *1 (E.D. Mich. Nov. 6, 2020) (finding that a franchisor violated Florida’s Deceptive and Unfair Trade Practices Act and limiting damages to the return of the initial franchise fee).

i. Lack of Support, Guidance, and/or Training

The most common franchisee claim arising during the term of a franchise relationship is the franchisor's failure to provide expected support, guidance, or training. Franchisees should understand the level of support, guidance, or training a franchisor must provide. In many instances, franchise agreements only obligate franchisors to provide support, guidance, or training on a discretionary basis which makes prevailing on such claims difficult even though franchisees believe franchisors are required to provide substantial support and guidance "as needed" to their day-to-day business operations.¹¹⁷

Successfully maintaining these actions requires franchisees to provide historical and detailed evidence of the franchisor's failure to provide adequate support, guidance, and training in accordance with the franchise agreement's obligations and the damages resulting from those failures.¹¹⁸ In some cases, franchisees may be able to show that the franchisor failed to provide proper or adequate training or failed to consistently answer a franchisee's call for help, or otherwise failing to interact or respond to the franchisee over the course of the franchise agreement.

ii. Advertising

In established franchise systems, the franchisor usually operates a national advertising fund into which the franchisees pay a specified amount pursuant to the franchise agreement. Although the advertising fund is intended to advertise and promote the entire franchise system, franchisees often complain about a franchisor's effective use of the funds or that franchisors abuse, misuse, or divert funds inappropriately.

Franchisees must carefully analyze their franchise agreements to determine how much discretion is granted to the franchisor and if there are any specific requirements or limits on that discretion or the use of advertising funds. Most franchise agreements grant franchisors broad discretion in determining how the funds are used and managed, however. As a result, a franchisor's marketing plan or advertising must result in clearly deficient efforts.¹¹⁹

¹¹⁷ See *Steak n Shake Enterprises, Inc. v. iFood, Inc.*, No. 121CV02131TWPMPB, 2021 WL 3772012, at *6 (S.D. Ind. Aug. 25, 2021) (noting that franchise agreement gave franchisor "full discretion in providing" support such as "operational guidance, training, and assistance or conduct advertising or marketing").

¹¹⁸ See *Fox v. Dynamark Sec. Centers, Inc.*, 885 F.2d 864 (4th Cir. 1989) (finding that "it was appropriate for the jury, as trier of fact, to address and to resolve the questions of whether the training provided by [franchisor] . . . was so inadequate as to constitute a breach because of bad faith performance and unfair dealing"); *Oakleaf of Illinois v. Oakleaf & Assocs., Inc.*, 173 Ill. App. 3d 637, 647, 527 N.E.2d 926, 933 (Ill. App. Ct. 1988) (finding in favor of franchisee where evidence suggested that franchisor's failure to promptly provide spares parts and its poor quality of technical help caused franchisee damages).

¹¹⁹ *JM Vidal, Inc. v. Texdis USA, Inc.*, 764 F. Supp. 2d 599, 615 (S.D.N.Y. 2011) (denying summary judgment to franchisor on advertising-related contract claims asserted by the franchisee and noting, among other things, that a "reasonable jury could conclude" the franchisor's promotion of a franchisee's opening were "half-hearted at best" and its advertising for the franchisee was "knowingly insufficient to afford it a chance at success"); *Integrity Real Est. Consultants v. Re/Max of New York, Inc.*, 213 A.D.3d 815, 818-19,

Franchise agreements also allow franchisors to use marketing funds in a variety of ways and for certain overhead and administrative expenses relating to the administration of the advertising fund. Absent clarity on permitted uses of funds, franchisees will argue the franchisor breached its contractual obligation to properly manage and utilize such funds, which may succeed if the franchisor did not properly disclose such expenses.¹²⁰ As with claims for a lack of support, the franchise agreement permits franchisors such wide discretion that succeeding on these claims is difficult.¹²¹

iii. Territorial Encroachment

As a part of the bargained-for exchange in the franchise system, franchisees typically expect to operate their franchise free from competition from both the franchisor and other franchisees in the same franchise system, as well as other streams of commerce. Franchise agreements usually memorialize that expectation by providing the franchisee with specific territorial protections and limitations, including limiting the franchisee's operation within the territorial boundaries. While the physical place of a competing franchise or corporate location within the protected territory may be an obvious basis for asserting an encroachment claim,¹²² other types of encroachment, such as sale of products in a supermarket under the encroachment provision of a franchise agreement, may also be actionable.¹²³

As franchisors' options to bring their products and services to market increase through grocery stores, discount clubs, internet sales, and non-traditional locations (such as airports and ghost kitchens) issues of territorial encroachment will also increase. As a result, franchise agreements increasingly contain provisions allowing franchisors to offer their products through other streams of commerce even though such locations are within

185 N.Y.S.3d 160, 164 (2023) (holding franchisor materially breached franchise agreement, precluding it from recovering unpaid franchise fees from franchisee, where franchisor excluded franchisee from advertising and website listings after franchisee moved locations without authorization, but obtained preliminary injunction against franchisor terminating franchise agreement; noting that franchisor needed to comply with its contractual obligations, including obligation to provide advertising, while preliminary injunction order was in effect).

¹²⁰ *Rodgers v. Ohio Valley CFM, Inc.*, 774 F.2d 1163 (6th Cir. 1985) (finding no error in jury's award of damages to franchisee for breach of contract where franchisor "never disclosed to franchisees that it was charging to the advertising fund overhead, operating, or any other expenses besides direct advertising costs" and failed to comply with its requirement to expend 1% of gross sales on advertising).

¹²¹ *Moghaddam v. Dunkin Donuts, Inc.*, 322 F. Supp. 2d 44 (D. Mass. 2004) (granting franchisor summary judgment despite allegations of diversion of money from advertising fund).

¹²² *Bryman v. El Pollo Loco, Inc.*, No. MC026045, 2018 WL 8459745, at *35 (Cal. Super. Aug. 01, 2018) (approving a jury award in an encroachment dispute against the franchisor for breach of the covenant good faith and fair dealing for opening a corporate location within 2.25 miles of the franchisee's location and invalidating as unconscionable provisions allowing the franchisor to establish new locations wherever it wants).

¹²³ *Carvel Corp. v. Noonan*, 3 N.Y.3d 182, 188, 818 N.E.2d 1100 (2004) (noting that the jury awarded franchisee for franchisor's breach of the franchise agreement and the implied covenant of good faith and fair dealing when the franchisor sold its products to supermarkets for sale).

the franchisee's protected territory.¹²⁴ Therefore, vigilance by franchisees to determine whether franchisor products are sold in their territory in an unauthorized manner or in a manner that destroys the benefit of their bargain, as well as tying such sales to decline in revenue is imperative for a franchisee to succeed on such claims.¹²⁵

b. Covenant of Good Faith and Fair Dealing

Very rarely is there an express covenant of good faith and fair dealing in the franchise agreement. Under the majority of current case law, the covenant of good faith and fair dealing is a covenant implied in the franchise agreement. Thus, the standard application varies greatly on a state-by-state basis. While every contract contains the implied covenant of good faith and fair dealing,¹²⁶ in some jurisdictions, the implied covenant of good faith and fair dealing is not actionable as a standalone claim.¹²⁷ In these jurisdictions, accompanying allegations of breach of contract are also required because the implied covenant cannot override the express terms of a contract and will not add obligations where none exist.¹²⁸

Often, franchisees are better suited to pursue such claims where the franchisor unreasonably exercises its discretion or power in such a way that it unfairly disadvantages its franchisees and frustrates the purpose of the franchise agreement.¹²⁹ A franchisor may breach the implied covenant of good faith and fair dealing in instances where it is granted the discretion to make changes or unilateral decisions under the franchise agreement and

¹²⁴ *Interim Health Care of N. Illinois, Inc. v. Interim Health Care, Inc.*, 225 F.3d 876 (7th Cir. 2000) (no breach of protected territory where servicing patients in the franchisee's territory was permissible per the terms of the contract).

¹²⁵ See *Bryman*, 2018 WL 8459745, at *35 (finding franchisor's placement of company location close to franchisee's location was unconscionable and breached covenant of good faith and fair dealing).

¹²⁶ *Moran v. Crystal Beach Cap., LLC*, No. 8:10-CV-1037-T-30AEP, 2011 WL 17637, at *3 (M.D. Fla. Jan. 4, 2011) (noting that Florida "recognizes the implied covenant of good faith and fair dealing in every contract"); *Bonfield v. AAMCO Transmissions, Inc.*, 708 F. Supp. 867 (E.D. Ill. 1989) (allowing a franchisee's claim for breach of the covenant of good faith and fair dealing to survive the motion to dismiss stage and noting that the franchisee will ultimately need to prove that the franchisor acted unreasonably and did not provide proper notice for requiring changes in its operations manual).

¹²⁷ See *Burger King Corp. v. Weaver*, 169 F.3d 1310, 1317–18 (11th Cir. 1999) (noting that to have an actionable claim for breach of the implied covenant of good faith and fair dealing, then there must also be a breach of an express term of the contract and the claims shall not be duplicate of each other); *Enola Contracting Servs., Inc. v. URS Grp., Inc.*, No. 5:08CV2-RS-EMT, 2008 WL 1844612, at *3–4 (N.D. Fla. Apr. 23, 2008) ("A cause of action based on the covenant cannot be maintained: (1) in the absence of breach of an express term of the contract; (2) to override or vary the terms of the contract; or (3) where the allegations underlying the claim for breach of the implied covenant are duplicative of those which support the claim for breach of contract.").

¹²⁸ *Id.*

¹²⁹ *Bryman*, 2018 WL 8459745, at *35 (approving a jury award in an encroachment dispute against the franchisor for breach of the covenant good faith and fair dealing for opening a corporate location within 2.25 miles of the franchisee's location and invalidating as unconscionable provisions allowing the franchisor to establish new locations wherever it wants).

the scope of that discretion is unclear.¹³⁰ Where the scope of discretion is clear, however, courts have rejected claims alleging breach of the implied covenant of good faith and fair dealing by unreasonably exercising discretion. For example, in a recent decision from the Tenth Circuit, the appellate court rejected the district court's conclusion that a franchisor that "had discretion in licensing new restaurants beyond [franchisee's] exclusivity zone" was required by "the implied covenant of good faith and fair dealing . . . to exercise that discretion reasonably and with proper motive, and not arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties."¹³¹ The Tenth Circuit recognized that "when the covenant of good faith and fair dealing comes into play, it restricts the discretion of the party bound by the covenant," but noted that "not every exercise of discretion is so bound."¹³² And because "the agreement ma[d]e[] clear that there is no right to exclusive territory, a claim that an encroachment breached the implied duty of good faith and fair dealing [could] not be asserted."¹³³ Proving claims for breach of the implied covenant of good faith and fair dealing is often more difficult than a breach of contract claim.

3. Claims Arising from the End of the Franchise Relationship

Many franchisee claims also arise from the end of a franchise relationship. Most commonly, such claims arise at the time of transfer of the franchise and upon either termination or renewal of the franchise agreement. Franchisee rights in these instances are not only subject to the rights granted by the franchise agreement at issue, but also, in certain states, franchise relationship statutes in the jurisdictions where they exist. A franchisee's best chance of succeeding on these claims arise in those jurisdictions in which franchise relationship laws exist because these laws are designed to "level the playing field" and thereby counter the franchisor's real or perceived advantages. In those times when franchise relationship statutes provide a franchisee more rights in these matters, it is also imperative to determine whether the franchise relationship statute is enforceable even faced with a contractual choice-of-law provision that requires application of a different state's laws.

a. Transfer Approval

A natural tension and difficulty between franchisors and franchisees exist when franchisees wish to sell or transfer their franchises to a third party. Franchisors include many conditions and provisions in franchise agreements arguably designed to protect the franchise system and avoid the franchisor having to accept an unqualified franchisee. As a result, franchise agreements include a franchisor's right of approval of the transaction and the proposed transferee, among others, such as a right of first refusal. In turn, franchisees resent these restrictions and believe these conditions and rights depress the

¹³⁰ See *Enola Contracting Servs., Inc.*, 2008 WL 1844612, at *3-4 (a potential claim for breach of the implied covenant and fair dealing arises when: (1) the contract is ambiguous about the permissibility of conduct, or (2) when the conduct is undertaken pursuant to a grant of discretion and the scope of that discretion has not been designated.").

¹³¹ See *Kazi v. KFC US, LLC*, 76 F.4th 993, 1001-07 (10th Cir. 2023).

¹³² *Id.* at 1006.

¹³³ *Id.* at 1005-06.

value of the business franchisees tirelessly worked to build.

Franchisee claims arising from a franchisee's attempt to sell or transfer the franchise are founded upon one of three claims: breach of contract if the franchisor fails to comply with the franchise agreement's stated terms and conditions; breach of the implied covenant of good faith and fair dealing if the franchisor fails to reasonably exercise its discretion in approving the sale or transfer; or breach of the relevant state's franchise relationship law if the franchisor fails to comply with its statutory obligations. Prevailing on the contract-based claims is difficult because franchise agreements are carefully designed to protect the franchisor's right to disapprove a proposed transfer in its sole and absolute discretion. As a result, success is often more likely in those states where franchise relationship laws contain franchisee protections in transfer situations because those statutes typically only permit a franchisor to deny a transfer request if the proposed transferee fails to meet the franchisor's "reasonable current qualifications" or a "bona fide business reason" exists.¹³⁴

b. Wrongful Termination

The most common franchisee claim arising from the end of the parties' relationship is a claim for wrongful termination by the franchisor. Such claims are also typically founded upon a breach of the franchise agreement, a breach of the implied covenant of good faith and fair dealing, or a statutory relationship law. Traditionally, statutory relationship laws provide franchisees the best avenue for success because they often impose "good cause" standards upon franchisors, including statutory notice and cure periods.¹³⁵ Although the details vary by state, states with such standards typically require franchisors to provide a reasonable period for a franchisee to cure the default and only allow termination if the franchisee fails to timely cure the default and such default is considered material. For example, a failure to pay undisputed fees or maintain system standards, selling unapproved products, abandoning the franchise, repeated defaults, and unauthorized use of the franchisor's trademark all support a termination for cause under applicable statutes.¹³⁶

Absent protections from a franchise relationship statute, franchisees must rely on the terms and conditions of their franchise agreement to protect them from a wrongful termination. A claim for wrongful termination will exist in instances where a franchisor fails to strictly follow termination procedures set forth in the parties' franchise agreement. Defaults typically requiring written notice and an opportunity to cure the default include failure to pay fees, report sales, comply with the terms of the system's operations manual, or purchase goods from approved sources. Franchise agreements also permit the

¹³⁴ See, e.g., Iowa Code §523H.5.1 *et seq.* (only allowing refusal of transfer if proposed transferee does not meet then-current reasonable qualifications); New Jersey Franchise Practices Act, N.J., Stat. Ann. §56.101 *et seq.* (requiring a bona fide business reason for refusal of transfer).

¹³⁵ As identified above, states with laws governing franchise relationships include Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Tennessee, Virginia, Washington, and Wisconsin.

¹³⁶ See, e.g., Cal. Corp. Code §20021 (setting forth reasonable grounds for termination of a franchise).

immediate termination of a franchise agreement without notice and opportunity to cure for violations that jeopardize the integrity of the relationship or brand image, such as health and safety violations and criminal conduct, as well as bankruptcy.

The inquiry into whether the termination at issue is wrongful should not end simply upon a review of the enumerated causes for termination in a statute or the franchise agreement.¹³⁷ Instead, franchisees must examine the details of the circumstances to determine whether the franchisee may contest the stated basis for termination or argue the franchisor's discretion in declaring the default and terminating the franchise violates the franchise agreement or the implied covenant of good faith and fair dealing or may be excused by a force majeure event.¹³⁸

c. Renewal or Successor Franchise Agreements

Whether codified by franchise relationship statutes or the franchise agreement, franchise agreements typically provide franchisees with the right to renew their franchise agreement or enter into a successor franchise agreement after the initial term of the franchise agreement concludes.¹³⁹ Not surprisingly, franchisee's rights with regard to a renewal or successor franchise agreement are much stronger under state franchise relationship laws that address renewal or successor rights than in the franchise agreement where the franchisee typically must comply with stated conditions to renew.¹⁴⁰ Although not universal, many statutes require franchisors to provide franchisees with a minimum amount of notice of franchisor's election not to renew a franchise agreement or for "good cause" for non-renewal to exist where most franchise agreements do not.

Franchisors often strictly control the circumstances, terms, and conditions upon which a franchisee may either renew the then-expiring franchise agreement on the same terms and conditions or enter a successor franchise agreement on then-current terms and conditions through the franchise agreement. Common conditions placed upon a franchisee attempting to renew or obtain a successor agreement include investing in capital expenditures to update the franchise's image, including signage, furniture, fixture, and equipment, materially complying with the franchise agreement throughout the term of the franchise and at the time of the expiration of the initial term of franchise, and providing the franchisor with a full general release of all claims.

¹³⁷ See *G.M. Garrett Realty, Inc. v. Century 21 Real Est. Corp.*, 17 Fed. Appx. 169, 2001 WL 980558 (4th Cir. 2001) (affirming jury finding of wrongful termination where franchisor terminated for failure to pay disputed fees because not all cause is "good cause").

¹³⁸ For further discussion of termination issues, see Ronald T. Coleman, Jr. and Elliot Ginsburg, Spotlight on Advanced Termination Issues and Incurable Defaults, American Bar Association 43rd Annual Forum on Franchising, October 27-30, 2020.

¹³⁹ States with franchise relationship laws specifically addressing renewal include Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Washington, and Wisconsin.

¹⁴⁰ See *Rogers Fam. Foods, LLC v. DFO, LLC*, No. 19-1476 (DWF/ECW), 2020 WL 5816589 (D. Minn. Sept. 30, 2020) (highlighting disparate rights between statutory protections and contract where court granted franchisor's motion for summary judgment on contract and implied covenant of good faith and fair dealing claims arising from a failure to renew the franchise agreement but denied the franchisor summary judgment on franchisee's statutory based claims).

As with transfer rights, a natural tension between franchisor and franchisee exists because franchisees often want to enjoy a renewal term of the franchise agreement on the same terms and conditions—and, importantly, fees—paid under the original term of franchise agreement while franchisors often want to “update” the franchise agreement’s terms and conditions to the then-current fees and system standards which typically change and increase over time. Therefore, franchisees should address these issues, if possible, before executing the franchise agreement. Either way, franchisees should fully understand their rights before expiration of the franchise agreement’s initial term.

B. Common Franchisor Defenses To Franchisee Claims

Franchisors respond to claims by franchisees in several ways. If the filing of a claim by a franchisee does not lead to a negotiated resolution through a mediation or discussion between counsel, franchisors may attack procedural aspects of the claim, defend the allegations and claims, and/or file a counterclaim.

1. Common Procedural Defenses of Franchisors

As discussed above, both strategic and substantive reasons support a franchisor’s decision to attack a franchisee’s claim for procedural reasons.

Often, franchisees file claims in their local jurisdiction despite the franchise agreement’s requirement for a specific court, alternate dispute resolution process, or venue. In such instance, a franchisor with its principal place of business in a different state may either remove the claim from state court to federal court along with a transfer to the franchise agreement’s chosen forum, or seek dismissal altogether. In such instances, courts generally enforce the franchise agreement’s terms where the parties selected a forum and venue.¹⁴¹ This strategy is not always successful, however.¹⁴² Franchisors seeking dismissal or stays of franchisee filed claims based on the existence of an arbitration provision are usually successful.¹⁴³

Franchisees often seek the application of the laws in their local jurisdiction, perceiving them as more favorable, or to take advantage of specific franchise relationship laws discussed above. By contrast, franchisors prefer and seek the consistent application of the laws of their principal place of business to obtain continuity and predictability in the

¹⁴¹ See *Columbia Aircraft Sales, Inc. v. Piper Aircraft, Inc.*, 3:20-CV-00701 (JAM), 2020 WL 5904939 (D. Conn. Oct. 6, 2020), *certificate of appealability denied*, 3:20-CV-00701 (JAM), 2020 WL 7353912 (D. Conn. Dec. 14, 2020) (finding a Connecticut franchisee protected under the Connecticut Franchise Act but still subject to the choice of law and forum selection clauses).

¹⁴² See *Crest Furniture, Inc. v. Ashley Homestores, Ltd.*, 120CV01383NLHAMD, 2020 WL 6375808, at *1 (D.N.J. Oct. 30, 2020) (noting that forum clauses are presumed invalid under the New Jersey Franchise Practice Act).

¹⁴³ See Section V, above.

enforcement of their franchise agreements across their entire franchise network—a network that often reaches across several states or regions throughout the country. Consequently, franchisors frequently seek to enforce a franchise agreement’s choice of law provision and typically succeed, provided the chosen law bears a substantial relationship to the parties or dispute,¹⁴⁴ although a state’s franchise relationship law may limit application of the parties’ contractually-selected law.¹⁴⁵

Another potential procedural attack on a franchisee’s claims is the assertion of the statute of limitations to those claims if those claims were not timely brought. In determining whether a statute of limitations applies, litigants must confirm the relevant period in both potentially applicable states’ statutes relating to limitations because state laws differ.¹⁴⁶ Similarly, claims arising from the same dispute under the same state’s laws may differ. For example, a claim for the breach of a franchise agreement in Illinois is ten years while a claim under Illinois’ Franchise Disclosure Act is between 90 days and 3 years depending on the nature of the claim and the franchisee’s notice of that claim.¹⁴⁷

2. Common Substantive Defenses of Franchisors

Along with factual defenses to franchisee claims, franchisors will generally assert a number of similar legal defenses. Two common legal defenses available to franchisors are the reliance upon the franchise agreement’s merger and integration clause, as well as the economic loss doctrine (or similar state doctrines—*i.e.*, the “Gist of the Action” doctrine).

Franchise agreements typically contain merger and integration clauses that state that the written franchise agreement is the entire agreement between the parties and all prior representations, understandings, and agreements are superseded by the written contract. Such merger and integration clauses are often the focal point of a franchisor’s defense to franchisee claims relying upon pre-contract claims because they often limit a franchisee’s claims or the evidence permitted at trial.¹⁴⁸

¹⁴⁴ See *Cardoni v. Prosperity Bank*, 805 F.3d 573, 581 (5th Cir. 2015) (noting requirement that of a substantial relationship to the chose state’s law).

¹⁴⁵ See, e.g., Ind. Code § 23-2-2.7-1(5).

¹⁴⁶ For example, the statute of limitations for a breach of a written contract is three years in North Carolina and five in Florida. See N.C. Gen. Stat. Ann. §1-52 and Fla. Stat. §95.11(2)(b).

¹⁴⁷ 735 ILCS 5/13-206 (providing statute of limitations of 10 years) and 815 ILCS 705/27 (setting statute of limitations for statutory violations at 90 days after delivery of notice of violation by the franchisor, 1 year after the franchisee becomes aware of facts or circumstances reasonably indicating a claim exists, or 3 years after the act or transaction constituting the violation, whichever is shorter.)

¹⁴⁸ See *Sugarlips Bakery, LLC v. A&G Franchising, LLC*, 3:20-CV-00830, 2022 WL 210135, at *11 (M.D. Tenn. Jan. 24, 2022) (finding a merger and integration clause may limit the evidence a franchisee uses to support its fraud claims, it does not bar the claims where the franchisees rely on statements in the documents themselves, including the FDD); see also *Park 80 Hotels, LLC v. Holiday Hosp. Franchising, LLC*, No. 1:21-CV-04650-ELR, 2023 WL 2445437, at *13 (N.D. Ga. Feb. 16, 2023) (finding that entire agreement clause that included language stating that it was not intended “to disclaim any representations [Defendants] made in the franchise disclosure document that [Defendants] provided to [Plaintiffs]” did not incorporate FDD into franchise agreement, but merely “clarify[ied] that the “Entire Agreement” provision d[id] not prohibit franchisees like Plaintiffs from pursuing a fraud in the inducement claim based on the

Franchisors also rely upon the economic loss doctrine to combat claims based in tort that arise from a franchisor's performance under the franchise agreement. Although each state's laws differ, the economic loss doctrine or similar doctrines generally require a contracting party to seek remedy in contract and not tort for purely economic losses. For example, claims that a franchisor negligently performed its duties under the franchise agreement.¹⁴⁹

C. Common Franchisor Claims

There are a variety of claims that are often asserted by franchisors against franchisees and either occur during the parties' normal course of operations or at the time of termination. The following sections discuss some of the more common claims asserted by franchisors against franchisees.

1. Non-Compliance with System Standards

A claim that is commonly asserted by franchisors is based on a franchisee's failure or refusal to comply with system standards. System standards are an important component of any franchise system, as they are generally established to promote efficiency in the operation of the franchised system, as well as to ensure the quality and uniformity of the goods and services provided by franchisors. If a franchisee is uncooperative or unwilling to follow system standards, the franchisor risks the possibility of weakened brand identity and/or uniformity, which can have potentially lasting effects on the system. Additionally, one franchisee's noncompliance with system standards without enforcement may lead to non-compliance by other franchisees. Therefore, franchisee compliance with system standards is an important and necessary part of any franchise system and one a franchisor typically takes seriously.

A franchisee's failure to adhere to system standards is commonly included in franchise agreements as a basis for termination. Depending on the precise violation, termination may need to be accompanied by notice and a cure period under the franchise agreement and the franchise relationship statutes discussed above.¹⁵⁰ Litigation over system standards often arises when a franchisor defaults or terminates a franchisee and the parties subsequently argue whether the termination was proper, including whether franchisors have established a clear record of noncompliance. This might include

FDD").

¹⁴⁹ See e.g., *Huddle House, Inc. v. Two Views, Inc.*, 2013 WL 1390611, at *5 (N.D. Ga. Apr. 4, 2013) (dismissing franchisee's negligence claim based upon the franchisor's alleged breach of the franchise agreement and alleged misuse of franchisee's trademarked property); *SAT Agiyar, LLC v. 7-Eleven, Inc.*, No. CV1919994MASDEA, 2021 WL 5205941, at *9 (D.N.J. Nov. 8, 2021) (finding that economic loss doctrine barred franchisee's conversion claim where franchisee did not "allege conduct that is extraneous to the contract" but relied exclusively on alleged violations of the franchise agreement (citation and punctuation omitted)). *But see Seti v. Carnell Assoc., Inc.*, 218 A.D.3d 509, 510-511 (N.Y. App. Div. 2023) (holding that gross negligence (reckless indifference or intentional wrongdoing) could be an exception to the gist of the action doctrine).

¹⁵⁰ *S&R Corp. v. Jiffy Lube Intern., Inc.*, 968 F.2d 371 (3d Cir. 1992).

documentary evidence of the non-compliance, including for example quality assurance reports, photographs, third party evaluations, customer complaints, among others.

Litigation may also involve a franchisor's pursuit of a preliminary injunction to require a noncompliant franchisee to adhere to the system standards. Several courts have recognized a franchisee's violation of a franchisor's health, sanitation, or safety standards, for example, constitutes irreparable injury to a franchisor's trademarks and goodwill that can warrant the issuance of a preliminary injunction.¹⁵¹

2. Monetary Claims

Franchisor claims for monetary default, also known as non-payment, are typically based on the franchisee's failure to pay certain monetary obligations set forth in the franchise agreement. These monetary obligations might include failure to pay royalties,¹⁵² advertising fees, or payments of products or services. These nonpayment claims are generally straightforward breach of contract actions, as most franchise agreements contain specific provisions stating that failure to pay fees when due is a material breach of the franchise agreement. Moreover, the relevant accounting for whether such payments were paid (or not paid) is easily ascertainable by the franchisor and verifiable by the court. This is especially true with electronic systems tracking sales.

More complicated situations can arise where franchisors claim that franchisees have underreported their gross sales and thereby underpaid royalties and other fees, particularly in situations where some or all sales (or the franchisee's collection on sales) are manually reported by franchisees rather than electronically tracked by point of sale systems. Because underreporting can be difficult and time consuming to authenticate, most franchise agreements allow franchisors to periodically audit franchisees' books, records, and bank accounts and to perform electronic or in person inspections. In the event an audit or inspection reveals underreporting over a certain level, franchisees are obligated to pay for the costs of the audit and attorneys' fees for any resulting litigation to recover the unpaid amounts. Underreporting is often an explicit basis for termination under many franchise agreements and has been repeatedly recognized by courts as constituting good cause for termination.¹⁵³

In some cases, franchisees will attempt to defend against nonpayment claims by

¹⁵¹ See e.g., *Baskin-Robbins, Inc. v. A. Ender, Ltd.*, No. CV-B-99-206-ECR (PHA), 1999 WL 1318498 (D. Nev. Oct. 28, 1999) (franchisor obtained an injunction requiring franchisee to comply with health and sanitation standards); see also *Dunkin' Donuts Franchised Restaurants LLC, et al v. D&D Donuts, Inc.*, 566 F. Supp. 2d 1350 (M.D. Fla. 2008); *GNC Franchising LLC, et al. v. Sala*, No. 06-00191, 2006 U.S. Dist. LEXIS 11320 (W.D. Pa. Mar. 20, 2006).

¹⁵² The majority of franchise agreements include an obligation that the franchisee pay royalties, on a weekly or monthly basis, over the term of the franchise agreement. These fees are usually calculated as a percentage of gross sales of the franchise (oftentimes between 4% and 6%), or can be a fixed amount to be paid periodically regardless of sales.

¹⁵³ See, e.g. *Dunkin' Donuts Inc. v. Taseski*, 47 F. Supp. 2d 867, 877 (E.D. Mich. 1999); *Jiffy Lube Int'l, Inc. v. Weiss Bros.*, 834 F. Supp. 683, 689 (D.N.J. 1993).

arguing that withholding payments of fees is justified, because of some action of the franchisor. These alleged prior breaches might include not providing requisite support to the franchisee or materially breaching the franchise agreement in some other way. Notably, however, the law is well settled that franchisees have two options when faced with an alleged prior breach of the franchise agreement by the franchisor.¹⁵⁴ *Jiffy Lube* and its progeny make clear that a party to a contract cannot claim the benefits of that contract (i.e. continuing use of the franchisor's marks and system), while simultaneously refusing to perform its own obligations. (i.e., monetary payment obligations). As a result, a franchisee who believes it is not getting the requisite support from the franchisor or that the franchisor breached the franchise agreement in another way can either (1) continue to pay its monetary obligations under the franchise agreement and sue the franchisor for breach of the franchise agreement, or (2) stop paying the required monetary obligations, consider the franchise agreement terminated, and cease all performance under the franchise agreement.¹⁵⁵ The latter option, however, carries the risk that the franchisee will be deemed to have improperly terminated, in which case it may be subject to lost future profit or liquidated damages from the franchisor for the franchisee's failure to perform during the remainder of the term. Depending on the circumstances, the franchisee may also face potential exposure for breach of post-termination covenants, as discussed below.

While nonpayment cases outside of the underreporting context are often straightforward, a franchisor must still make sure that it complies with the notice and cure requirements set forth in the franchise agreement. A franchisor's default or termination of the franchise agreement must adhere to the requirements set forth in the franchise agreement itself, as well as any applicable state laws. The notice should clearly state the facts constituting the default and the requirements of a successful cure, as well as the cure deadline and the consequences of a failure to cure. The default notice should be transmitted in strict compliance with the notice provisions of the franchise agreement—for example, to the specified notice address by the specified means of delivery. If litigation ensues, the value of an accurate, complete, and legally-compliant notice is crucial.

¹⁵⁴ See, e.g., *S&R Corp. v. Jiffy Lube Intern., Inc.*, 968 F.2d 371 (3d Cir. 1992) (“[W]hen one party to a contract feels that the other contracting party has breached its agreement, the non-breaching party may either stop performance and assume the contract is avoided, or continue its performance and sue for damages. Under no circumstances may the non-breaching party stop performance *and* continue to take advantage of the contract's benefits.”); *HDOS Franchise Brands, LLC v. El Paso Hot Dog, LLC*, No. : 3-21-cv-00201-AJB-BLM, 2021 WL 5629923, at *6 (S.D. Cal. June 29, 2021); *Tim Hortons USA, Inc. v. Tims Milner LLC*, No. 18-cv-24152, 2019 WL 7376768, at *3 (S.D. Fla. July 23, 2019); *Ramada Worldwide, Inc. v. Hotel of Grayling, Inc.*, No. 08-3845 (KSH), 2010 WL 2674460, at *9 (D.N.J. June 30, 2010) (“under no circumstances may the non-breaching party stop performance and continue to take advantage of the contract's benefits”); *Burger King Corp. v. Majeed*, 805 F. Supp. 994, 1003-04 (S.D. Fla. 1992) (“There is no legal support for defendants' position that, because they have asserted damage claims against [franchisor], they may therefore operate royalty and rent-free for however long their damage action remains pending. 'A franchisor's right to terminate a franchisee exists independently of any claims the franchisee might have against the franchisor. The franchisor has the power to terminate the relationship where the terms of the franchise agreement are violated.”); *Burger King v. Austin*, Bus. Fran. Guide (CCH) ¶ 9788 at 22,069 (S.D. Fla. Dec. 26, 1990).

¹⁵⁵ *Id.*

3. Abandonment

Another claim franchisors often bring against franchisees is for abandonment or closure of the franchise. This occurs when a franchisee “walks away” from the franchise prior to the expiration of the franchise agreement, or fails to operate it for a specified period of consecutive days. Many franchise agreements do not entitle franchisees to a cure period when they abandon the franchise. And, several state franchise laws provide that the franchisor may terminate the franchise immediately or upon shortened notice if the franchisee voluntarily abandons the franchise.¹⁵⁶ In other words, abandonment can be an incurable default under the franchise agreement.¹⁵⁷

Litigation sometimes ensues over what it means to “abandon” a franchise. For example, an email from a franchisee stating that he would close the store, taken in the context that he meant that it was closing for temporary reasons, was not evidence of abandonment.¹⁵⁸ This has become an important distinction in the wake of COVID-19, as certain pandemics, health emergencies, or government-ordered “lockdowns” may in some cases provide a basis to close for a limited period of time for the health and safety of employees and customers without constituting an abandonment under the franchise agreement, although it could be evidence of other breaches.

4. Non-Compete Claims

Nearly all franchise agreements contain covenants restricting the franchisee’s ability to compete with the franchisor during or after the term of the franchise agreement.¹⁵⁹ Competing businesses are usually defined as those businesses that operate in the same business sector as the franchisor, offering the same or similar goods or services. Typically, franchise agreements contain two types of covenants not to

¹⁵⁶ Ark Code Ann § 4-72-202(7)(C); Cal Bus & Prof Code § 20021(b); Ill St Ch 815 § 705/19(b); Iowa Code §§ 523H.7(3)(c), 537A.10; MN ST § 80C.14, subd. 3(a)(1); Miss Code Ann § 75-24-53; MO ST § 407.405; NE ST § 87-404; NJ ST § 56:10-5; WA ST § 19.100.180(2)(j).

¹⁵⁷ *In re Deppe*, 110 B.R. 989 (Bankr. D. Minn. 1990) (bankruptcy court held that a gas station’s failure to operate its franchised gas station for nineteen days was an incurable default); *see also Zeidler v. A&W Restaurants, Inc.* No. 99 C 2591. 2001 WL 62571 (N.D. Ill. Jan. 25, 2001) (holding that because franchisee abandoned franchise location, franchisor justified in terminating franchise agreement and franchisee could not demonstrate that termination was wrongful).

¹⁵⁸ *See Creative American Educ., LLC v. Learning Experience Systems, LLC*, No. 9:14-CV-80900, 2015 WL 2155645, at *5-6 (S.D. Fla. May 7, 2015) (Where a franchise agreement stated that the franchisor would have grounds to terminate if the franchisee ceased to operate, it was not necessarily a breach of the agreement for the franchisee to say that he proposed closing the franchise the next day. When, in context, there were operational problems that needed to be addressed in the short term, a temporary closure did not reflect abandonment by the franchisee); *but see Burger King Corp. v. Barnes*, No. 95-CV-1408, 1996 WL 529281 (S.D. Fla. Aug. 28, 1996) (holding that abandonment occurred where franchisee sent letter to franchisor stating that franchisee would be closing franchise and suspending performance of his obligations under the franchise agreement).

¹⁵⁹ For an excellent, in-depth review of non-compete clauses and enforcement thereof in franchising, the authors suggest COVENANTS AGAINST COMPETITION IN FRANCHISE AGREEMENTS, Fourth Ed. (Michael R Gray, Natalma M McKnew, and William Woodbridge Sentell III, eds., ABA Book Publ’g 2023).

compete: (1) an in-term covenant not to compete, which provides that the franchisee will not compete with the franchisor during the term of the franchise agreement; and (2) a post-term covenant not to compete, which provides that the franchisee will not compete with the franchisor for a period of time following termination or expiration of the franchise agreement.

The goal of covenants not to compete in franchise agreements is to protect the franchisor's system during the term of the franchise agreement, during some period following, or both. Specifically, covenants not to compete in franchise agreements protect the franchisor's trade secrets and other confidential business information, as well as its goodwill, market share, and name recognition.

Notably, the interpretation and enforcement of in-term and post-term non-competition clauses is controlled by state law, so it is important for franchisors and franchisees alike to review the governing state statutes or applicable common law to determine the enforceability of a covenant not to compete. Some states generally refuse to enforce covenants not to compete.¹⁶⁰ Other states have statutes that presume covenants not to compete are reasonable when they comply with certain requirements.¹⁶¹ However, most states will enforce "reasonable" restrictive covenants, and undertake the following four-part test in assessing such reasonableness. Generally, the covenant must: (1) be ancillary to an otherwise lawful contract; (2) be no greater than required to protect the franchisor's legitimate interest; (3) be reasonable and not impose undue hardship on the franchisee; and (4) not be injurious to the public.¹⁶²

On April 23, 2024, the FTC voted 3-2 to finalize and promulgate a "Non-Compete Clause Rule" that would ban all post-term non-compete agreements between companies and their workers, including employees and independent contractors.¹⁶³ As written, the rule does not categorically ban franchisor/franchisee non-competes.¹⁶⁴ On August 20, 2024, a Federal District Court Judge in Texas issued a nationwide injunction against the FTC, barring any enforcement of the non-compete rule.¹⁶⁵ The nationwide injunction has been appealed and, to date, the Trump Administration has not directed the FTC to end the appeal. Accordingly, all franchise stakeholders should stay apprised of developments in this area and whether the FTC or analogous state trade commissions eventually enact

¹⁶⁰ See e.g., CAL. BUS. & PROF. CODE § 16600; N.D. CENT. CODE § 9-08-06; OKLA. STAT. § 15-219A.

¹⁶¹ See e.g., Fla Stat. § 542.335 ("[E]nforcement of contracts that restrict or prohibit competition during or after the term of restrictive covenants, so long as such contracts are reasonable in time, area and line of business, is not prohibited."); Ga. Code. Ann. § 13-8-53 ("[E]nforcement of contracts that restrict competition during the time of a restrictive covenant, as long as such restrictions are reasonable in time, geographic area, and scope of prohibited activities, shall be permitted.").

¹⁶² *Jiffy Lube Intern., Inc. v. Weiss Bros., Inc.*, 834 F. Supp. 683 (D.N.J. 1993); *Jackson Hewitt, Inc. v. Greene*, 865 F. Supp. 1199 (E.D. Va. 1994).

¹⁶³ "FTC Announces Rule Banning Noncompetes," April 23, 2024. <https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes> (last visited April 5, 2025).

¹⁶⁴ White & Case Global Non-Compete Resource Center, February 11, 2025 <https://www.whitecase.com/insight-tool/white-case-global-non-compete-resource-center-ncrc#ftc-and-doj> (last visited April 5, 2025).

¹⁶⁵ *Ryan, LLC v. FTC*, 746 F.Supp.3d 369 (N.D. Texas Aug. 20, 2024).

rules that prohibit non-compete agreements in any context (including regulations that would restrict a franchisor's ability to insist that certain employees of franchisees enter into non-compete agreements).¹⁶⁶

a. Violation of In-Term Covenants Not to Compete

In-term covenants not to compete prohibit the franchisee from having an ownership or business interest in a “competing business” while it is also a franchisee within the franchise system. For instance, in-term covenants not to compete protect franchisors from a situation where a franchisee seeks to transplant the business, under a different name to another location, and reap the benefits of the franchisor's knowledge and confidential information while still being a part of the franchise system.

In-term covenants not to compete are generally upheld and enforced, and are subject to less scrutiny than post-term covenants. This is because franchisors have an especially strong business interest in protecting the system's confidential information from competitors while franchisees are actually receiving and using that information.

b. Violation of Post-Term Covenants Not to Compete

A post-term covenant not to compete clause restricts a franchisee's ability to have an ownership or business interest in a “competing business” following the termination or expiration of the franchise agreement for a limited period of time. Post-term covenants not to compete are intended to protect the franchisor's interest in the goodwill built up at a location in or in a community. Accordingly, post-term covenants not to compete are usually limited in duration and geographic scope.

Post-term covenants not to compete are generally subjected to more scrutiny as such clauses may be viewed as restraints on trade. However, in states where covenants not to compete are enforced, as long as the post-term covenants are reasonable, most courts will enforce them.¹⁶⁷ Post-term covenants to compete limited to one or two years

¹⁶⁶ Another relatively recent statute that may impact franchisees and franchisors alike is Minnesota's noncompete statute, effective July 1, 2023, that prospectively prohibits employers from entering into post-term noncompetition agreements with employees or independent contractors alike. Minn. Stat. Ann. § 181.988. Although the statute does not explicitly carve out the franchise relationship, in most cases franchisees likely do not fall within the scope of the new law. See *id.* (noting that an “employee” must perform services for the employer in exchange for compensation); see also *Cookie Dough Bliss Franchising, LLC v. Feed Your Soul Minnesota, LLC*, No. CV 23-1552 (JWB/TNL), 2023 WL 4901292, at *4 n.5 (D. Minn. Aug. 1, 2023) (noting that the statute did not apply to a franchise agreement that was executed before the effective date of the statute and which fell under an exception for agreements “designed to protect trade secrets or confidential information”).

¹⁶⁷ See e.g., *Rita's Water Ice Franchise Corp. v. DBI Investment Corp.*, 1996 WL 165518 (E.D. Pa. 1996). (restrictive covenant providing that franchisee could not operate in a territory 1.5 miles from its existing location for 18 months after termination was reasonable when there was testimony that it took approximately 18 months to establish a new franchise, and market research showed that customers were

and within a 25-mile radius of the franchisee's former franchised business or any other franchised business of the system have generally been upheld.¹⁶⁸ As one court noted:

A former franchisee who wishes to strike out on her own after the expiration of a franchise agreement may come to regret the limitations that her previous agreements, such as obligations to keep the franchisor's proprietary information confidential and not to compete with the former franchisor, may place on her new efforts. But that does not mean they are not legally enforceable.¹⁶⁹

Importantly, franchisors should be prepared to put forth evidence to support the basis for the length of the restriction and the geographic area of the restricted activity, as well as the legitimate business interest the covenant is designed to protect, such as to protect the franchisor's goodwill and confidential information.

Lastly, in many states, where post-term covenants not to compete are deemed overbroad, the court can modify or "blue pencil" the covenant by enforcing it to the extent the court deems reasonable. However, in a minority of states, if a covenant not to compete is overbroad in scope or duration, the court will not modify it, may strike the overly broad portions, and refuse to enforce it all together.¹⁷⁰ This is a further example why familiarity with state and common law is imperative when dealing with covenants not to compete.

5. Other Franchisor Claims

a. Trademark Infringement/Holdover Franchisee Litigation

It has been said that a trademark is "the cornerstone of the franchise system."¹⁷¹ In fact, "it is this uniformity of product and control of its quality and distribution which

drawn from an approximate three-mile radius).

¹⁶⁸ *Ledo Pizza System, Inc. v. Singh*, 983 F. Supp. 2d 632 (D. Md. 2013) (franchisor seeking preliminary injunction against franchisee and restaurant operator to comply with post-termination obligations in franchise agreement had substantial likelihood of success on merits of claim to enforce franchise agreement's two year non-compete provision, which prohibited operation of a dine in or carry-out restaurant within 10 miles of the restaurant, where the non-compete provision's geographic and durational scope was reasonable on its face, and franchisee was allegedly a skilled worker, whom franchisor gave extensive training on how to run a pizza franchise); *Get In Shape Franchise, Inc. v. TFL Fishers, LLC*, 167 F. Supp. 3d 173 (D. Mass. 2016) (under Massachusetts law, covenant not to compete was reasonably limited in both time and space where franchise agreement prohibited franchisee from operating competing business within eight miles of studio location or any other franchised studio for two years following termination of the agreement).

¹⁶⁹ *Bar Method Franchisor LLC v. Henderhiser LLC*, 1:21-CV-03357-RMR, 2022 WL 174307, at *5 (D. Colo. Jan. 16, 2022) (applying Colorado law).

¹⁷⁰ For example, South Carolina, Nevada, and Kansas are striking states. If the covenant not to compete cannot stand without the stricken portion, the covenant will not be enforced. *Labor Finders Int'l, Inc. v. Dove Enters., Inc.*, Bus. Fran. Guide (CCH) ¶ 11,723 (D.S.C. 1999) (South Carolina); *H&R Block Tax Servs., Inc. v. Circle A Enters., Inc.*, 693 N.W.2d 548, 553 (Neb. 2005) (Nebraska); *H & R Block, Inc. Lovelace*, 493 P.2d 205 (1972) (Kansas).

¹⁷¹ *Susser v. Carvel Corp.*, 206 F. Supp. 636, 640 (S.D.N.Y. 1962).

causes the public to turn to franchise stores for the product.”¹⁷² Accordingly, it is unsurprising that one of the most common claims brought by franchisors against franchisees is for trademark infringement.

When a franchise agreement terminates or expires, so does the franchisee’s license to use the franchisor’s name and trademarks. Franchise agreements, therefore, often contain provisions that require franchisees to cease use of the franchisor’s trademarks as part of the de-branding process upon termination or expiration of the franchise relationship. Sometimes, despite such obligations, franchisees ignore these requirements and continue to operate the business using the franchisor’s marks. Such franchisees are commonly referred to as “holdover franchisees.” If this occurs, the franchisor will likely have a claim for infringement of its trademarks.

Section 32 of the Lanham Act, 15 U.S.C. § 1114(1), prohibits the use, “without the consent of registrant[,]” of “any reproduction, counterfeit, copy, or colorable imitation of a register mark” in connection with the sale, offering for sale, distribution, or advertising of any goods or services that “is likely to cause confusion, or to cause mistake, or to deceive,” and imposes civil liability.¹⁷³ Similarly, Section 43(a) of the Lanham Act, 15 U.S.C. § 1125(a) imposes civil liability for unfair competition against a party for any false designation or origin likely to cause confusion as to the origin of the goods and products.¹⁷⁴

In trademark infringement actions, as in other cases, a plaintiff is generally entitled to a preliminary injunction by establishing the following four factors:

- (1) Substantial likelihood of success on the merits;
- (2) Irreparable injury will be suffered unless the injunction issues
- (3) The threatened injury to the movant outweighs the damage the proposed injunction might cause the opposing party;
- (4) If issued, the injunction would not be adverse to the public interest.¹⁷⁵

In a trademark case, one of the primary issues is whether the name used by the defendant creates a “likelihood of confusion” with the plaintiff’s trademark. In fact, in the franchise context, if the franchisee continues to use the franchisor’s trademarks after the franchise agreement terminates or expires, consumer confusion and irreparable harm are obvious (and for many years presumed). Courts have often found that the use of a franchisor’s mark by a former franchisee creates a strong risk of consumer confusion.¹⁷⁶ As such, it

¹⁷² *Id.*

¹⁷³ 15 U.S.C. § 1114(1).

¹⁷⁴ 15 U.S.C. § 1125(a).

¹⁷⁵ *McDonald’s Corp. v. Robertson*, 147 F.3d 1301, 1306 (11th Cir. 1998).

¹⁷⁶ *See e.g., Burger King Corp. v. Mason*, 710 F.2d 1480, 1492-93 (11th Cir. 1983) (“[c]ommon sense compels the conclusion that a strong risk of consumer confusion arises when a terminated franchisee continues to use the former franchisor’s trademarks...consumers automatically would associate the trademark user with the registrant and assume that they are affiliated.”); *TGI Friday’s Inc. v. Great Nw. Restaurants, Inc.*, 652 F. Supp. 2d 763, 771 (N.D. Tex. 2009); *Buffalo Wild Wings Int’l, Inc. v. Grand Canyon*

is “well-settled doctrine that a terminated franchisee’s continued use of its former franchisor’s trademarks, by its very nature, constitutes trademark infringement.”¹⁷⁷

It should be noted that the U.S. Supreme Court in *eBay Inc. v. MercExchange* held that there is no presumption of irreparable harm in patent infringement cases, and several courts extended this same analysis and holding to trademark infringement actions, undoing the presumption of irreparable harm.¹⁷⁸ Notably, in late 2020, however, Congress through the Trademark Modernization Act reinstated the presumption of irreparable harm for violations of the Lanham Act—effectively overruling *eBay*—by specifically including language in 15 U.S.C §1116(a) regarding the rebuttable presumption of irreparable harm.¹⁷⁹ It remains important for franchise attorneys to notify courts of this statutory amendment when moving for relief under the Lanham Act for trademark infringement.

For cases of trademark infringement, the Lanham Act provides several means of monetary recovery for trademark infringement including: (1) disgorgement of the defendant’s profits (i.e. money the defendant made from the use of plaintiff’s marks), (2) the actual damages sustained by the plaintiff, (3) attorney’s fees (“in exceptional cases”), and (4) costs.¹⁸⁰ However, a prevailing plaintiff is not automatically entitled to monetary recovery.¹⁸¹ Moreover, in the case of willful counterfeiting, the Lanham Act requires courts to treble either the actual damages or defendant’s profits—whichever is greater—as a penalty for a defendant’s knowing and willful sale of counterfeit merchandise, or award statutory damages ranging from \$1,000 to \$2,000,000.¹⁸²

b. Confidential Information and Protection of Trade Secrets

Trade secrets and confidential information are important aspects of many franchise systems. Confidential information and trade secrets can take the form of operations manuals recipes, formulas, business process or methods of doing business, customer lists and information, software, marketing and promotional campaigns, as well as many other forms. Due to their importance, most franchise agreements contain provisions that require the franchisee to return all confidential and proprietary information of the

Equity Partners, LLC, 829 F. Supp. 2d 836, 846 (D. Minn. 2011).

¹⁷⁷ *Burger King Corp. v. Majeed*, 805 F. Supp. 994, 1006 (S.D. Fla. 1992).

¹⁷⁸ 47 U.S. 388 (2006); *see also North American Medical Corp. v. Axiom Worldwide, Inc.*, 522 F.3d 1211 (11th Cir. 2008) (“Because the language of the Lanham Act . . . is so similar to the language of the Patent Act, we conclude that the Supreme Court’s *eBay* case is applicable to the instant case.”); *Herb Reed Enters., LLC v. Florida Ent. Mgmt., Inc.*, 736 F.3d 1239 (9th Cir. 2013) (same principle regarding irreparable harm applied to patent cases as to trademark cases)

¹⁷⁹ 15 U.S.C §1116(a); for a summary of Congress reinstatement of the presumption of irreparable harm in Lanham Act cases, *see* Kyle R. Kroll, *Trademark Litigators: Congress Reinstated the Presumption of Irreparable Harm in Lanham Act Cases*, <https://www.americanbar.org/groups/litigation/committees/commercial-business/practice/2021/congress-presumption-irreparable-harm-lanham-act-cases/#:~:text=The%20key%20insight%20for%20practitioners,in%20support%20of%20their%20motions> (last visited April 4, 2025).

¹⁸⁰ 15 U.S.C. § 1117(a).

¹⁸¹ *Id.* (monetary relief awarded consistent with the principles of equity).

¹⁸² 15 U.S.C. § 1117(b) and (c).

franchisor in the franchisee's possession upon termination or expiration of the franchise agreement. A former franchisee utilizing such information could have a substantial impact on a franchisor's business. Accordingly, courts generally hold the provisions in franchise agreements requiring the return of such information designated as confidential enforceable.¹⁸³

Claims regarding trade secrets and confidential information can be brought as breach of contract claims, as well as violation of trade secrets acts, both state and federal. Moreover, these claims may be the basis for injunctive relief and damages claims.

D. Common Franchisee Defenses to Franchisor Claims

Franchisees' options for defending against franchisor claims depends on the circumstances. For example, if a franchisor threatens an improper termination, a franchisee might seek injunctive relief to stop the termination and/or declaratory relief specifying that the termination would be improper. In addition, if an allegedly improper termination occurs, a franchisee may seek damages for lost profits or other relief against the franchisor. Similarly, a franchisee that has continued to operate as an independent business after termination may argue that the franchisor's noncompetition covenants are overbroad or based on an impermissible purpose. Finally, where a franchisor sues a franchisee for unpaid royalties, trademark infringement, or other wrongdoing, a franchisee may assert counterclaims against the franchisor, if it has legitimate grounds for doing so. The following are some examples of legal theories (both defenses and affirmative claims) that franchisees often pursue in actions against franchisors.

1. Failure to Comply with Franchise Agreement or State Law Termination Requirements

As discussed above, franchise agreements and state laws have specific termination requirements, including notice and cure provisions. For example, any notice of default should provide the franchisee with a cure period at least as long as the number of days required under the agreement and, most importantly, any applicable statute. Further, any notice should be served upon the franchisee in the manner required by the franchise agreement and/or statute. Failure to comply with such requirements may, in some cases, be held to invalidate a termination.¹⁸⁴ Practitioners should closely review state laws and notice and cure provisions of the franchise agreement in determining whether the failure to comply with such requirements is a proper defense to termination.

2. Materiality

A franchisee may argue "materiality" to attempt to defend against many claims

¹⁸³ See e.g., *JTH Tax, Inc. v. Magnotte*, No. 19-cv-11607, 2020 WL 127949, at *4 (E.D. Mich. Jan. 10, 2020) (holding that franchisor likely to succeed on merits where contract obligated franchisee to return customer lists, operations manuals, and other confidential information and franchisee "did not perform these obligations, violating the legally enforceable requirements of the [f]ranchise [a]greements").

¹⁸⁴ See e.g., *British Motor Car Distribs. v. New Motor Vehicle Bd.*, 194 Cal. App. 3d 81, 90 (1987).

brought by franchisors, including failure to adhere to system standards or performance requirements. When asserting a materiality defense, a franchisee will likely argue that the violation was not “material” to justify default and/or termination. However, courts have held that failure to meet development requirements can constitute a material breach justifying termination.¹⁸⁵ Nonpayment is also often deemed material. And in some cases, the franchise agreement will specifically state that all or certain violations are considered “material” by the parties, which courts will in many cases accept.¹⁸⁶ Issues regarding materiality are often fact specific inquiries requiring the parties and court to look at the relationship and course of dealings between the franchisee and franchisor and, thus, often require protracted litigation to resolve should the parties choose to litigate the issue of materiality.

3. Modification and Course of Dealing

Franchisees often argue that the parties’ course of dealings, oral agreements, or conduct has modified the franchise agreement by introducing new terms, or canceling or amending existing terms. Notably, however, in order to effectively modify an agreement, there must be evidence of an actual intent to modify. Courts will generally look to the parties’ mutual assent when analyzing modification by conduct; in other words, conduct that is based upon unilateral statements will likely not support modification.¹⁸⁷ Whether a modification occurred may turn on whether the acts of the contracting parties are unequivocally inconsistent with the contract right in dispute.¹⁸⁸ And, a properly worded non-waiver clause in the franchise agreements makes such a defense more difficult to assert.

4. Waiver

Franchisees often use waiver as a defense in many different contexts. When a franchisor has not previously enforced a provision of the franchise agreement against the franchisee at issue or against other franchisees, franchisees often assert that the

¹⁸⁵ See *Bennigan’s Franchising Co., L.P. v. Swigonski*, CIV.A. 306-CV-2300-BH, 2008 WL 648936, at *4 (N.D. Tex. Feb. 26, 2008) (failure to develop restaurants in compliance with development agreement is material breach); *7-Eleven Inc. v. Puerto Rico-7 Inc.*, CIV.A. 3:08-CV-0140B, 2009 WL 4723199, at *1 (N.D. Tex. Dec. 9, 2009) (same); See *Seven-Up Bottling Co. Ltd. v. PepsiCo, Inc.*, 686 F. Supp. 1015, 1023 (S.D.N.Y. 1988) (holding that termination of license agreement was proper where bottler continually failed to meet minimum sales requirements and distribution levels required by agreement); see also *Brown Dog, Inc. v. Quizno’s Franchise Co. LLC*, No. 04-C-18-X, 2005 WL 3555425, at *11 (W.D. Wis. Dec. 27, 2005).

¹⁸⁶ See *CiCi Enterprises, LP v. Fogel Enterprises, Inc.*, No. 3:22-CV-1202-E, 2023 WL 2731048, at *2 (N.D. Tex. Mar. 30, 2023) (noting that the claimed breaches were expressly stated as “material” in the franchise agreement). But see *Peterbrooke Franchising of Am., LLC v. Miami Chocolates, LLC*, No. 21-10242, 2022 WL 6635136, at *5 (11th Cir. Oct. 11, 2022) (where franchise agreement stated that compliance with certain provisions was “material,” the fact that other breaches were silent as to materiality suggested that compliance with them was not necessarily deemed material by the parties).

¹⁸⁷ See *New Eng. Surfaces, Inc. v. E.I. DuPont de Nemours & Co.*, No. 06-cv-89-P-S, Bus. Franchise Guide (CCH) ¶ 13,713 (D. Me. Sept. 14, 2007).

¹⁸⁸ See *Haynes Trane Serv. Agency, Inc. v. Am. Standard, Inc.*, 573 F.3d 947 (10th Cir. 2009) (manufacturer’s pattern of terminating with cause was insufficient to find that the contractual right to terminate without cause had been modified).

franchisor has waived the right to enforce that provision. Whether such an argument will prevail is very fact specific.¹⁸⁹ However, most franchise agreements include some iteration of a non-waiver provision that franchisors often successfully use to avoid waiver claims.¹⁹⁰ Such non-waiver clauses are both enforced and invalidated by courts based on applicable state laws and surrounding circumstances.

5. Ulterior Motive or Improper Purpose for Termination

When a franchisor terminates a franchise relationship, a franchisee might argue that the franchisor has an ulterior motive for termination. However, as long as there are adequate grounds to support the franchisor's termination of the agreement or relationship, courts generally will not consider the franchisor's motivation in terminating.¹⁹¹ However, there have been instances where courts have found that pretextual reasons for termination were improper.¹⁹²

VII. DISCOVERY ISSUES

Discovery in franchise cases will depend in large part on the nature and size of the claim, as well as whether the claim is being adjudicated in arbitration or litigation and, if so, whether the litigation is in federal or state court. In general, court discovery rules and procedures—whether under the Federal Rules of Civil Procedure or comparable state rules—will be more formal and predictable than those in arbitration, where the parties typically have the freedom to tailor their procedures to the needs of the specific case. That said, there are common discovery issues that arise with many of the most frequently litigated franchise cases.

¹⁸⁹ *LaGuardia Assocs. v. Holiday Hosp. Franchising*, 92 F. Supp. 2d 119 (E.D.N.Y. 2000) (franchisor waived its right to terminate a franchise agreement where the franchisor did not attempt to terminate until ten months after the franchisees' default on payment); *Can. Dry Corp v. Nehi Beverage Co., Inc.*, 723 F.2d 512 (7th Cir. 1983) (franchisor waived its right to terminate based on the franchisee's failure to renew in writing, as required by the franchise agreement, where the franchisor allowed the franchisee to continue to operate in the two territories and even retroactively granted a limited extension of these territorial rights); *Dunkin' Donuts Inc. v. Gav-Stra Donuts, Inc.*, 139 F. Supp. 2d 147, 157 (D. Mass. 2001) (franchisor did not waive its right to terminate the franchise agreement for criminal conduct even if it waited six years after learning of the conduct - at most, there was "mere silence" by the franchisor; and absent evidence that the franchisor took affirmative steps to waive its contractual right to terminate, there was no waiver).

¹⁹⁰ See Kerry L. Bundy, Scott H. Ikeda, *How Waiver, Modification, and Estoppel May Alter Franchise Relationships*, 30 Franchise L.J. 3, 5 (2010).

¹⁹¹ See *McDonald's Corp. v. Robertson*, 147 F.3d 1301, 1309 (11th Cir. 1998) (finding that "it does not matter whether McDonald's also possessed an ulterior, improper motive for terminating the [franchisee's] franchise agreement" where franchisees failure to comply with system food safety standards constituted a material breach of the franchise agreement).

¹⁹² See, e.g., *Bronx Auto Mall, Inc. v. American Honda Motor Co., Inc.*, 113 F.3d 329 (2d Cir. 1997) (affirming judgment enjoining franchisor from terminating franchise agreement on pretextual grounds and noting that stating a false reason for termination of a dealership franchise violates New York's Franchised Dealer Act.); see also *Tuf Racing Products, Inc. v. American Suzuki Motor Corp.*, 223 F.3d 585 (7th Cir. 2000) (affirming verdict in favor of franchisee where franchisor's reasons for terminating franchisee were entirely pretextual).

The FDD and supporting documents often provide the core of evidentiary material for a wide range of possible disputes ranging from pre-sale representations to contractual obligations to post-termination covenants. In particular, many franchisee claims alleging pre-sale misrepresentations have focused on the franchisor's financial performance representations in Item 19 or startup cost estimates in Item 7, and the franchisor's backup records and analysis for those FDD statements will be a critical component of those cases.¹⁹³

Other pre-sale claims have alleged that representations were made in communications outside the four corners of the franchise agreement and FDD, such as oral communications at "discovery day" or other oral or emails communications. Records of or pertaining to those alleged communications are critical documents in such cases, and their importance will only grow given recent developments. Historically, in some cases franchisees' claims that they relied on pre-sale misrepresentations outside of the four corners of the franchise agreement were resolved at the motion to dismiss stage because the franchisee affirmatively disclaimed relying on any such representations in the franchise agreement and contemporaneously executed questionnaires.¹⁹⁴ But recent North American Securities Administrators Association statement of policy—which forbids the use of questionnaires and other reliance disclaimers¹⁹⁵—may have the effect in future years of removing those barriers to franchisees' fraud claims. If questionnaires and other some statements are no longer the norm, many disputed fraud claims will have to be litigated through trial. In that case, franchisors' documentation and retention of salesperson training and communications throughout the sales process, including records pertinent to discovery day and training sessions, could be even more central moving forward.

Beyond the FDD, one of the most common and extensive sources of evidence for any franchise dispute will be documentation of communications between the franchisee and franchisor, as well as internal franchisee and franchisor communications. For example, Franchisors may have internal note keeping systems documenting contemporaneous discussions with franchisees, which can provide an invaluable one-document chronology of the franchise relationship.

¹⁹³ See, e.g. *Hanley v. Drs. Exp. Franchising, LLC*, No. CIV.A. ELH-12-795, 2013 WL 690521, at *10 (D. Md. Feb. 25, 2013) (alleging that data used for Item 7 and 19 was misleading); *Coraud LLC v. Kidville Franchise Co., LLC*, 121 F. Supp. 3d 387, 394 (S.D.N.Y. 2015) (question of fact as to whether Item 7 statements were misleading). But see *Yogo Factory Franchising, Inc. v. Ying*, No. CIV.A. 13-630 JAP TJ, 2014 WL 1783146, at *9 (D.N.J. May 5, 2014) (franchisee could not rely on Item 7 or Item 19 to support fraud claim because they were no more than "estimates" about future costs or performance and therefore it "cannot plausibly argue that [franchisee] reasonably relied upon these estimates of earning potential or of start-up costs").

¹⁹⁴ See *Yogo Factory Franchising, Inc. v. Ying*, No. CIV.A. 13-630 JAP TJ, 2014 WL 1783146, at *8 (D.N.J. May 5, 2014) (finding that the franchisees' "reliance on the [franchisor's] alleged prior [oral] representations is not reasonable based upon the integration clause in the franchise agreements and the franchise questionnaire," which together made any such reliance "unreasonable as a matter of law").

¹⁹⁵ NASAA Statement of Policy Regarding the use of Franchise Questionnaires and Acknowledgments, effective January 1, 2023, available at [NASAA-Franchise-Questionnaires-and-Acknowledgments-Statement-of-Policy-9-18-2022.pdf](#) (last visited April 5, 2025).

As with most commercial litigation, however, emails will often be the largest single source of discoverable material. Because official system email accounts are typically hosted through the franchisor, those communications—even internal franchisee emails—may be in the franchisor’s, rather than the franchisee’s, possession, particularly in post-termination disputes where the franchisee’s access to internal servers has been cut off. In many cases the franchise agreement or other communications will explicitly state that the franchisee has no expectation of privacy in these emails or must assign them to the franchisor after termination. This comes with benefits and burdens. Franchisors may have the benefit of early investigative tools before discovery is exchanged, but they must also take care to avoid searching franchisees’ emails beyond the scope of the parties’ reasonable expectations, particularly regarding privileged communications. Further, the disparity in access to emails often places a significant portion of the initial burden—and cost—of discovery with the franchisor.

VIII. REMEDIES

Claims brought by franchisors and franchisees give rise to a variety of different remedies, including monetary damages, injunctive relief, rescission and restitution, declaratory relief, and specific performance. Moreover, depending on the case and the contracts at issue, attorneys’ fees can be awarded in franchise disputes.

A. Contract Damages/Monetary Damages

Generally speaking, a party asserting a successful claim for breach of contract is entitled to recover damages that are directly and proximately caused by the breach of contract, and those damages are designed to restore the injured party to the position it would have been in but for the breach of the other party. The measure of recovery will vary depending upon which interests are asserted. Compensation for a breach of contract is generally limited to money damages for losses that were reasonably anticipated by the parties at the time of contracting.

One of the most common contract damages that franchisors seek from franchisees is recovery of past due royalties, technology, and advertising fees. Once a franchisor proves a breach of the franchise agreement, recovery of past due royalties and/or advertising funds is fairly straightforward requiring a calculation of the past due amounts. Interest, late fees, and attorneys’ fees are also typically recoverable where the franchise agreement provides for recovery of such amounts.

Franchisors and franchisees also seek to recover future lost profits. These damages are often characterized as lost profits, “benefit-of-the-bargain” damages, or expectation damages. For example, a franchisor might want to recover its lost future royalties, future advertising fees, or future marketing fees due to the breach. Specifically, these damages consist of monies that a party would have earned for the remainder of the franchise term had the relationship not been terminated, less any expenses that the party would save by no longer having to provide services under the agreement. Expectation damages, therefore, are the broadest form of compensatory damages and may include

actual lost profits and future lost profits.

To establish entitlement to lost profits, a party must show that: (a) the profits were within the contemplation of the parties at the time the contract was entered into; (b) their loss was the probable result of the breach; and (c) they are not too remote or speculative. Once entitlement to lost profits is established, there are two common methodologies that parties use to calculate such damages. First, parties can calculate the profits the party expected to earn in the remainder of the franchise term had the relationship not been terminated.

From the franchisor's perspective, these damages typically consist of the royalties that the franchisor would have earned had the franchisee operated its franchise business for the remainder of the franchised term—or, if the franchisee had an exclusive territory, until the franchisor could reasonably expect to relicense the territory—less any expenses that the franchisor would save by no longer having to provide operational support and other services to the franchisee. To do this, franchisor will generally need to establish a track record of franchisee sales and associated fee payments. Proving nonspeculative damages can be complicated in cases where the franchisee has not been open long, in which case franchisors may attempt to rely on the financial performance of other similarly situated franchisees in the system.

Franchisees, in turn, may seek their lost net profits from operations when they claim to have been wrongfully terminated prior to the expiration of the franchise term. Again, they generally need to establish a track record of performance and profitability. Where they have been historically unprofitable, franchisees are less likely to be granted lost profits because such calculations would be inherently speculative.

Certain franchise agreements contain liquidated damage provisions, which are contractual provisions that specify the amount of damages recoverable in the event of a breach of the agreement. While such clauses are often used in the hotel industry, they regularly appear in franchise agreements in a variety of businesses. The validity of such a provision depends upon whether it served, at the time of contracting, as a reasonable forecast of the harm that would result from a breach that is difficult to calculate with precision, or if it is instead an unenforceable "penalty clause." A liquidated damage provision becomes an unenforceable "penalty clause" if there is no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from the breach at the time they entered into the contract.¹⁹⁶ Courts assess the reasonableness of liquidated damage provisions from a totality of the circumstances perspective.¹⁹⁷ Notably, however, the burden is on the party opposing enforcement of the liquidated damage provision to show that it is not reasonable.¹⁹⁸

¹⁹⁶ See, e.g., *Ganesh, Inc. v. Days Inns Worldwide, Inc.*, Bus. Franchise Guide (CCG) ¶ 12,341, at 10 (N.D. Ohio March 21, 2002).

¹⁹⁷ See, e.g., *Days Inn Worldwide, Inc. v. BFC Mgmt., Inc.* 544 Supp. 2d 401, 406 (D.N.J. 2008); *ERA Franchise Sys., Inc. v. Brager & Assocs., Inc.*, No. 1:06-cv-1861 LTD NEW (TAG), 2007 WL 2238161, at *8 (E.D. Cal. Aug. 2, 2007).

¹⁹⁸ *Holiday Hospitality Franchising, Inc. v. 174 W. St. Corp.*, Bus. Franchise Guide (CCH) ¶ 13,399 (N.D.

B. Rescission and Restitution

Rescission and restitution are companion remedies used to restore the parties to the same position that they would have been had they never entered into the agreement. Simply put, rescission is the unmaking of a contract. In addition, restitution damages aim to put the parties to a contract in status quo ante, i.e. their respective positions before the contract was formed.¹⁹⁹ Rescission and restitution often work in concert.

Specifically, rescission is an equitable remedy that severs the relationship between the parties. Rescission relieves all parties of their contractual duties and obligations. The remedy of rescission is not given as a matter of right. Rather, a court has the discretion to allow rescission based on each individual case, its facts, and in the interests of justice.²⁰⁰ A party might seek the equitable remedy of rescission in cases of fraudulent inducement, material breach, mistake, impossibility of performance, among others.²⁰¹ Notably, however, for rescission to be awarded, the breach of the franchise agreement must be substantial and concern the essential purpose of the contract. Moreover, a franchisor's failure to comply with statutory disclosure and registration laws can also be grounds to rescind a franchise agreement.²⁰²

Restitution damages attempt to measure the benefit conferred on the breaching party, rather than measuring profits the aggrieved party would have made. In many jurisdictions, relief for rescission includes not only restitution damages of consideration provided, but also consequential damages, i.e. rescission includes complete relief to make the aggrieved party whole.²⁰³ Where rescission is awarded, the proper measure of

Ga. July 19, 2006); *Ramada Franchise Sys., Inc., v. Jacobcart, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,609 (N.D. Tex. Feb. 21, 2003).

¹⁹⁹ Restatement of Contracts, § 347 cmt. b (1932) ("In granting restitution as a remedy for breach. . . the purpose to be attained is the restoration of the injured party to as good a position as that occupied by him before the contract was made."); *Riess v. Murchison*, 503 F.2d 999, 1008 (9th Cir. 1974) (holding that the victim of a material breach "may seek restitution in which both he and the wrongdoer will be restored to the position they occupied at the time the contract was formed"), *cert. denied*, 420 U.S. 993 (1975); *Potter v. Oster*, 426 N.W.2d 148, 152 (Iowa 1988) ("Restoring the status quo is the goal of the restitutionary remedy of rescission.").

²⁰⁰ See *Billian v. Mobil Corp.*, 710 So. 2d 984, 990 (Fla. Dist. Ct. App. 1998).

²⁰¹ *Final Cut, LLC v. Sharkey*, No. X05CV085007365S, 2012 WL 310752 (Conn. Super. Ct. 2012) (franchisees entitled to rescission of purchase and franchise agreements and return of any monies paid to franchisor when franchisor made a number of material and deceptive misrepresentations which ultimately induced franchisees to purchase the franchises); *Manpower Inc. v. Mason*, 405 F. Supp. 2d 959, 976 (E.D. Wis. 2005) (District court determined that franchisee and principal shareholder materially breached and destroyed essential object of franchise agreement with franchisor by supplying temporary employees to other franchise locations outside its territories, failing to complete I-9 forms showing its employees were eligible to work in the United States, and misusing franchisor's name in violation of their agreement. Therefore, the district court granted rescission of the franchise agreement and ordered franchisee to refrain from using franchisor's trade name, trademarks and proprietary information until requisite security was provided.).

²⁰² See e.g., Cal Corp. Code § 31300.

²⁰³ *Runyan v. Pac. Air Indus.*, 2 Cal. 3d 304, 307 (Cal. 1970) (granting consequential damages for loss of income, less gross income realized from franchise operation, after franchisee's rescission of franchise

recovery is restitution of the consideration and other benefits received by the parties under the contract. For example, if a party rescinding a contract has received land, goods or other property, he is expected to return it. Importantly, parties seeking the equitable remedies of rescission and restitution should be aware that they must ultimately elect these remedies in lieu of other damages, such as expectation or reliance damages.

C. TROs and Preliminary Injunctions

Franchise disputes sometimes involve matters of great urgency where a court must act before one party suffers harm that cannot be undone or compensated in money damages. In such situations, a franchisor or franchisee may need to seek emergency relief or redress in the form of a temporary restraining order (“TRO”) and/or a preliminary injunction. A TRO or preliminary injunction is an “extraordinary remedy that may only be awarded upon a clear showing that the plaintiff is entitled to such relief.”²⁰⁴ Issues involving the need for emergency relief usually arise for franchisors in the enforcement context. Specifically, franchisors frequently seek to enforce post-termination contractual provisions such as discontinuance of use of the franchisor’s trademark and trade dress, compliance with non-compete or non-solicitation covenants, or other post-termination obligations to de-identify and cease use of confidential information or trade secrets. The risk to a franchisor’s consumer relationships, reputation, and trade secrets can lead a court to enjoin such behavior. However, without the proper evidence of irreparable harm, a court may deny the relief sought.²⁰⁵ Under most franchise agreements, franchisors also may seek emergency relief to enforce compliance with system standards, particularly in cases where a public health or safety of the franchisor’s goodwill are affected.

On the other hand, a franchisee may learn that its franchise rights and sole source of income are about to be terminated and seek emergency relief to prevent what it contends would be a wrongful termination of the franchise agreement. Such requests, however, are not always well received, because some courts consider franchise agreements to be personal service contracts and therefore not subject to the equitable remedy of specific performance.²⁰⁶ Franchisees also may seek to enjoin the franchisor

contract).

²⁰⁴ *Winter v. Natural Res. Def. Council*, 555 U.S. 7, 22 (2008).

²⁰⁵ For a list of cases, see Anne H. Baroody, Susan Meyer, and Tom Vanderbloemen, *The Current Landscape in Enforcement of Intellectual Property Rights*, American Bar Association 46th Forum on Franchising W-8 (Nov. 1-3, 2023); Paula J. Morency and Alison R. Grow, *Winning Round One: A Preliminary Injunction Motion in a Franchise Case*, American Bar Association 41st Annual Forum on Franchising (by, Oct. 11-12, 2018).

²⁰⁶ See e.g., *Burger King v. Agad*, 911 F. Supp. 1499, 1506-07 (S.D. Fla. 1995) (reasoning that franchise agreements are considered personal service contracts and as such are immune from a mandatory injunction requiring specific performance of the agreement); *N. Am. Fin. Group, Ltd. v. S.M.R. Enterprises, Inc.*, 583 F. Supp. 691, 699 (N.D. Ill. 1984) (“A franchise agreement of the type contemplated here is at least partially a contract for personal services.”); *but see Bray v. QFA Royalties LLC*, 486 F. Supp. 2d 1237, 1247 (D. Colo. 2007) (citation omitted) (“Courts have recognized that the threatened loss of a franchise business before the lawfulness of a termination can be determined constitutes irreparable harm sufficient to warrant injunctive relief.”); *LaGuardia Assocs. v. Holiday Hospitality Franchising, Inc.*, 92 F. Supp. 2d 119, 131 (E.D.N.Y. 2000) (citation omitted) (“The franchise relationship is the lifeline of the

from encroaching in its protected territory or otherwise violating rights under the franchise agreement or protections under applicable laws.

For any injunction request in federal court, the “plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest.”²⁰⁷ Irreparable harm is often the key disputed issue. The Supreme Court has rejected applying a presumption of irreparable harm in most contexts.²⁰⁸ For trademark cases, however, Congress passed the Trademark Modernization Act of 2020 which provides that a plaintiff is entitled to a “rebuttable presumption of irreparable harm” upon proof of a violation or likelihood of success on the merits under the Lanham Act.²⁰⁹

D. Specific Performance

The equitable remedy of specific performance allows a court to mandate continued performance of specific franchise agreement provisions. A common example of an action for specific performance might involve a franchisee seeking relief due to a franchisor’s refusal to allow renewal as set forth in the franchise agreement.²¹⁰ On the other hand, franchisors may use the remedy of specific performance to bring franchisees into compliance with system standards, or to enforce buyout or non-compete provisions following franchise termination.

E. Declaratory Relief

As an alternative to specific performance, so long as there is an actual controversy between them, franchisors and franchisees can seek a declaration regarding whether a party’s conduct under the franchise agreement constitutes a breach and whether the breach gives rise to a basis for termination. Declaratory judgment actions are also useful when the parties disagree as to the interpretation of a franchise agreement provision. Seeking a declaratory judgment from a court prevents a party from undertaking a course of action based on a specious reading of the franchise agreement.

Parties may seek declaratory relief pursuant to the Declaratory Judgment Act²¹¹ or its state law counterparts. The Declaratory Judgment Act provides district courts with

franchisee’s business; the franchisee’s investment of capital, time, and effort in promoting the franchisor’s goods or services—to the general exclusion of competing goods and services—would be irreparably lost upon termination. Money damages cannot make the franchisee in such situations whole.”)

²⁰⁷ *Winter*, 555 U.S. at 20.

²⁰⁸ *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391-93 (2006).

²⁰⁹ 15 U.S.C. § 1116(a) (“A plaintiff seeking [a permanent injunction] shall be entitled to a rebuttable presumption of irreparable harm upon a finding of a violation identified in this subsection in the case of a motion for a permanent injunction.”)

²¹⁰ See e.g., *Prudence Corp. v. Shred-It Am., Inc.*, 365 Fed. Appx. 859, 861 (9th Cir. 2010) (district court did not abuse discretion when it ordered renewal of franchise agreement at the original royalty rate).

²¹¹ 28 U.S.C. §§ 2201-2202 (2022).

significant discretion in granting declaratory relief.²¹² A district court may grant declaratory relief when there is a substantial controversy with sufficient immediacy to warrant the relief,²¹³ but will not grant declaratory relief for future contingent events.²¹⁴ A district court will also not grant declaratory relief if the issues are already being directly adjudicated within the litigation or there is a substantial likelihood that a declaratory judgment will not end the controversy.²¹⁵

F. Attorneys' Fees

Claims for attorneys' fees are part of many franchise litigation cases, because the majority of franchisors have standard agreements that contain either a reciprocal prevailing party attorneys' fee provision or a franchisor-specific attorneys' fee provision. However, in cases where the attorneys' fee provision is one-sided in favor of the franchisor, some state laws may require such provisions to be applied reciprocally.²¹⁶ Additionally, most state franchise statutes permit franchisees to recover attorneys' fees and expenses if it prevails on a statutory claim for rescission or damages. Attorneys' fees are also recoverable in claims under the Lanham Act, but only in "exceptional cases."²¹⁷ Courts have generally held that for attorneys' fees to be granted under the Lanham Act there must be some form of willful, deliberate, or fraudulent conduct.²¹⁸

Such attorneys' fee provisions are worth considering at the outset of the litigation as a party can find itself responsible for its opponents' attorneys' fees and expenses, or being able to recover its attorneys' fees and expenses from its opponent.

IX. CONCLUSION

As long as the business model of franchising exists, it is nearly guaranteed that there will be legal conflict between franchisees and franchisors. It is imperative for franchise practitioners to stay up to date on the latest legal developments, as well as an understanding of the franchise laws across a variety of states. As explained herein,

²¹² 28 U.S.C. § 2201(a) (district courts "may declare the rights and other legal relations of any interested party").

²¹³ See e.g., *Thompson v. DeWine*, 7 F.4th 521, 524 (6th Cir. 2021) ("To determine whether a request for declaratory relief is moot, we ask 'whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.'").

²¹⁴ *Wyatt, Virgin Islands, Inc. v. Government of the Virgin Islands by and through the Virgin Islands Dep't of Labor*, 385 F.3d 801, 806 (3d Cir. 2018) ("The conflict between the parties must be ripe for judicial intervention; it cannot be 'nebulous or contingent' but 'must have taken on fixed and final shape so that a court can see what legal issues it is deciding, what effect its decision will have on the adversaries, and some useful purpose to be achieved in deciding them.'").

²¹⁵ *Compare Postal Instant Press v. Jackson*, 658 F. Supp. 739 (D. Colo. 1987), with *Astral Health & Beauty, Inc. v. Aloette of Mid-Miss., Inc.*, 895 F. Supp. 2d 1280 (N.D. Ga. 2012).

²¹⁶ See e.g., Ca. Civ. Code § 1717.

²¹⁷ 15 U.S.C. § 1117(a).

²¹⁸ *Twin Peaks Productions, Inc. v. Publications Intern., Ltd.*, 996 F.2d 1366, 1383 (2d Cir. 1993) ("The relevant statute, 15 U.S.C. § 1117 (1988), allows recovery of a reasonable attorney's fee only in 'exceptional cases.' Such fees should be awarded only 'on evidence of fraud or bad faith.'").

franchise laws can vary by state and jurisdiction, and new decisions involving franchising are handed down from courts and arbitrators frequently. Unlike many other types of business litigation, franchise disputes and decisions can have far-reaching and system-wide consequences. This article has attempted to cover the most salient issues relating to franchise litigation, but rest assured the nature of the franchise relationship guarantees new issues are always present and will continue to arise. Ultimately, it is important to have a comprehensive understanding on established franchise laws, to know the current issues where the law may not be so settled or clear, and finally, to know that new arguments are always being made that might shape franchise litigation to come.