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BASICS TRACK: FRANCHISE LITIGATION

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Iris Figueroa Rosario is a principal in Gray Plant Mooty's Washington, D.C. office. She represents clients (including franchise clients) in federal and state courts and before international arbitration panels on a variety of litigation matters.

She counsels clients on their franchise business issues, including: reviewing contracts and suggesting revisions; counseling clients on the termination of their franchisees or distributors and drafting default and termination notices; updating clients' franchise disclosure documents and franchise agreements; working with clients on franchise lease issues; and drafting settlement agreements, promissory notes, and mutual releases.

Iris is a 2001 graduate of the American University Washington College of Law. She is admitted to practice law in Virginia and the District of Columbia.



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Jon Labukas is an associate in Quarles & Brady's Commercial Litigation Practice Group, based in Washington, D.C. Mr. Labukas focuses his practice on franchise and distribution litigation, where he represents franchise and other business clients in federal and state courts, including complex multi-party lawsuits. Mr. Labukas has also represented clients in various forms of alternative dispute resolution forums throughout the United States, including before the American Arbitration Association, JAMS, and United States Arbitration & Mediation. Much of his practice involves handling franchise relations and the enforcement of post-termination covenants.

Mr. Labukas also has significant experience in managing complex electronic discovery issues, including retrieving electronically stored information for review and production and managing electronically stored information for use in litigation and arbitration matters.



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Alaina Karsten completed her undergraduate education from Nova Southeastern University, where she received a B.A. in History and a B.S. in Legal Studies, both with distinction, and a minor degree in Global Issues. She graduated magna cum laude from the University of Miami School of Law in May 2009.

Alaina's practice focuses on complex commercial litigation, in a variety of matters, including labor and employment, landlord tenant, commercial contracts, and franchise law, appellate practice and representation of creditor's rights in bankruptcy proceedings. Ms. Karsten represents businesses and individuals in the restaurant, retail, automotive, pharmaceutical and beauty and health industries, among others. Ms. Karsten advises both franchisees and franchisors regarding legal issues in connection with the operation of their businesses. Ms. Karsten has experience in drafting and preparing franchise disclosure documents and state registrations. In addition, Ms. Karsten handles a variety of general business transactions, including formation of companies and franchise associations.

Federal and State Franchise Laws



Federal and State Franchise Laws

- Franchise litigation is unique because:
 - It's regulated at the federal level
 - It's also regulated at the state level, with various states requiring a franchisor to register the franchise disclosure document
 - Various states also regulate the relationship between the franchisor and franchisee, and these laws sometimes overrule the terms in the franchise agreement

Litigating Franchise Cases

- What does the franchise agreement say about venue?
- Is personal jurisdiction waived?
- Does it first require the parties to mediate?
- What does it say about arbitration?
- Are all these clauses null and void by a franchise statute?
- For franchisor, was the notice of default or termination timely served pursuant to the agreement or franchise law?
- For franchisee, is the default at issue curable?

Jurisdiction



Jurisdiction

- Personal Jurisdiction
 - Specific Jurisdiction: Focuses on a subset of contacts between the defendant and forum state. *See Burger King v. Rudzewicz*
 - Two franchises cases weighing specific jurisdiction: *Baskin-Robbins Franchising LLC v. Alpenrose Dairy, Inc.* and *Red Robin Int'l, Inc. v. Lehigh Valley Rest*

Jurisdiction

- Diversity Jurisdiction
 - Citizenship requirement and LLCs – *Grupo Dataflux v. Atlas Global Group*
 - \$75,000 threshold
- Federal question
 - Franchisors commonly file trademark and trade dress claims
 - Franchisees commonly file RICO claims

Arbitration



Arbitration

- Why Arbitration?
 - Costs
 - Speed
 - “Confidentiality”
 - Relaxed Pleading and Evidentiary Standards (i.e. Flexible Process)
 - Larger Party Control

Arbitration

- Speed
 - Federal Court (Median):
 - 27 Months from filing to Trial
 - Arbitration (Average):
 - 11.6 Months From Filing to Hearing

Arbitration

- Private vs. Confidential
 - AAA Statement of Ethical Principles
 - “An arbitration proceeding is a private process. In addition, AAA staff and AAA neutrals have an ethical obligation to keep information confidential. However, the AAA takes no position on whether parties should or should not agree to keep the proceeding and award confidential between themselves. The parties always have a right to disclose details of the proceeding, unless they have a separate confidentiality agreement.” (emphasis added)

Arbitration

- Arbitration Becoming Traditional Litigation?
 - Discovery in Arbitration
 - Limited Though Expanding In Arbitration
 - Dispositive Motions
 - Increasingly Available In Arbitration

Arbitration

- Procedural Issues In Arbitration
 - Scope of Arbitration Provision
 - Class Action Waivers
 - Carve Outs
 - Enforcement (Including Appeal)

Procedural Matters

- Motion to Stay for Mediation or Arbitration
 - As discussed previously, most franchise agreements provide for mediation or arbitration
 - Before deciding to proceed in federal or state court, a party needs to review the franchise agreement closely
- Removal to Federal Court
 - Must be timely done
 - Fraudulent joinder



Other Motions

- Motion to transfer venue or *forum non conveniens*
 - Venue clause – permissive or mandatory
 - *Atlantic Marine Const. Co. v. U.S. Dist. Court for W. Dist. Of Texas* and – motion to transfer venue should be denied “only under extraordinary circumstances unrelated to the convenience of the parties”
 - Interplay with state franchise statutes

Injunction

- Standards for an injunction
 - success on the merits of the claim(s), irreparable harm, balance of the equities favors the party moving for an injunction, and public interest
- Obtaining an injunction is often the end of the case
- Franchisors file to enforce post-termination obligations
- Franchisees file to prevent a termination or other immediate action

Typical Franchisor Claims and Franchisee Defenses



Typical Franchisor Claims and Franchisee Defenses

- Non-Payment
- System Standards
- Competition
- Infringement

Typical Franchisor Claims and Franchisee Defenses

- Failure to Comply With System Standards
 - Drafting Considerations
 - Allow for system modifications
 - Curable vs. non-curable breaches
 - Joint employer issues
 - Enforcement
 - Only way to ensure consistent customer experience
 - Contractual based
 - Train, Inspect, Document, Remedial Action

Typical Franchisor Claims and Franchisee Defenses

- Failure to Comply With System Standards (cont'd)
 - Coaching and Counseling (culture of enforcement)
 - Action Plans
 - Temporary Closure
 - Deny Right to Products and Programs
 - Self-Help (and send the franchisee the bill)
 - Injunctive Relief
 - Termination

Typical Franchisor Claims and Franchisee Defenses

- Competition Claims
 - In-term vs. post-term covenant not to compete
 - Reasonable restraint on trade?
 - Time, geographical scope, legitimate business interests
 - Protect trade secrets, confidential information, and customer relationships

Athlete's Foot Mktg. Assocs., Inc. v. Zell Inv., Inc., 2000 WL 426186, at *7 (W.D. Pa. Feb. 17, 2000) (“Other . . . franchisees . . . may be watching to see if [the defendant] is permitted to breach its non-compete covenant, which would establish a potentially catastrophic precedent and a ‘domino’ effect whereby a series of franchisees leave the fold to establish competing business at or near the location of their [franchise] store(s).”).

Typical Franchisor Claims and Franchisee Defenses

- Trademark Infringement
 - Trademark is one of the most valuable components of a franchise system
 - Franchisors take protection seriously (at least they should)
 - Injunctions
 - Easy "in" to Federal Court (Lanham Act)

Typical Franchisee Claims and Franchisor Defenses

- Am I part of a franchise?
 - FTC Rule, 16 C.F.R. Parts 436 & 437
 - Trademark
 - Control and Assistance
 - Franchise Fee
 - Be sure to check state franchise or relationship statutes

Typical Franchisee Claims and Franchisor Defenses

- Is my franchisor my employer?
 - Naik v. 7-Eleven, Inc., CIV. 13-4578 RMB/JS, 2014 WL 3844792, at *4 (D.N.J. Aug. 5, 2014)(allegations sufficiently state a claim under FLSA)
 - Haitayan, et al. v. 7-Eleven, Inc., Case No. CV 17-7454-JFW, 2018 WL 1626248 (C.D. Cal. Mar. 14, 2018)(judgment as a matter of law in favor of franchisor)

Typical Franchisee Claims and Franchisor Defenses

- Disclosure Claims – Franchisor Said What?
 - Financial Performance Representations
 - FTC Rule:
 - [i]t is an unfair or deceptive act or practice in violation of Section 5 of the Federal Trade Commission Act for any franchise seller covered by part 436 to:
 - ...
 - (c) [d]isseminate any financial performance representations to prospective franchisees unless the franchisor has a reasonable basis and written substantiation for the representation at the time the representation is made, and the representation is included in Item 19 (§ 436.5(s)) of the franchisor's disclosure document

Typical Franchisee Claims and Franchisor Defenses

- Disclosure Claims – Franchisor Said What?
 - I am going to make how much money in how little time?
 - You analyzed my territory and the projected gross sales are what?
 - The difference between actionable FPRs and puffery.
 - What about pro formas?

Typical Franchisee Claims and Franchisor Defenses

- Disclosure Claims – Franchisor Said What?
 - What can a franchisee recover?
 - Look to state statute
- Franchisor Defenses
 - Integration clauses and questionnaires
 - Compare *Randall v. Lady of Am. Franchise Corp.*, 532 F. Supp. 2d 1071, 1089 (D. Minn. 2007) with *Steak n Shake Enterprises, Inc. v. Globex Co., LLC*, 110 F. Supp. 3d 1057 (D. Colo. 2015), *aff'd*, 659 Fed. Appx. 506 (10th Cir. 2016)
 - Reliance - was it reasonable?

Typical Franchisee Claims and Franchisor Defenses

- Operations claims
 - Territorial Encroachment
 - *Michael D. Bryman and Janice P Handlers Bryman v. El Pollo Loco, Inc.*, Case No. MC026045, is currently pending in the Superior Court of California, County of Los Angeles
 - Claims for violation of the implied duty of good faith and fair dealing

Typical Franchisee Claims and Franchisor Defenses

- Failure to provide . . .
 - Training and Support;
- Mismanagement of . . .
 - Advertising Fund
- Pricing Claims
 - You want me to charge how much?

Be sure to check applicable state relationship statutes to see whether a franchisor's contractual failures are separately actionable under state statute!

Typical Franchisee Claims and Franchisor Defenses

- Termination, Transfer and Renewal
 - “Good Cause” requirements
 - Failure to provide notice
 - Materiality of the Breach

Typical Franchisee Claims and Franchisor Defenses

Tim Hortons USA, Inc. v. Singh, 16-23041-CIV, 2017 WL 4837552, at *2 (S.D. Fla. Oct. 25, 2017)

“... [T]he results here (i.e., largely, though not completely, a victory for the franchisor) are merely a logical consequence of the nature of franchising. Indeed, one of the leading treatises on franchising urges counsel to give the prospective franchisee client a ‘*Miranda* warning’ about franchising and then explain to the client that ‘the contract probably is one-sided, enforceable and ... entail risks that are different from and usually above and beyond the ordinary business risks associated with business ownership [.]’”

Citing RUPERT M. BARKOFF ET AL., *FUNDAMENTALS OF FRANCHISING* 333 (4th ed. 2015).

Typical Franchisee Claims and Franchisor Defenses

- The Small Business Administration Franchise Loan Transparency Act (H.R. 3195) and the Fair Franchise Act (H.R. 3196).



Conclusion



Questions?



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