



RAISING THE BAR

IFA LEGAL SYMPOSIUM
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Basics Track: Franchise Litigation

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Roadmap

- ❖ Character Introductions
- ❖ Choosing Forums
- ❖ Common Franchisee Claims
- ❖ Common Franchisor Claims
- ❖ Seeking Remedies

Bob Belcher



- Owner of Bob's Burgers, LLC
- New York Resident
- Company Sells "Bob's Burgers" Restaurant Franchises
- Franchise Locations Throughout the United States
- New to the Business of Franchising

Teddy Francisco

- Long-time Customer, Turned Business Owner
- New Jersey Resident
- Recently Became Franchisee and Operator of Multiple Bob's Burgers Locations



Arbitration or Litigation?



Hypothetical #1:

- Teddy is fed up with Bob's Burgers. He believes that the franchisor has breached its obligations under the franchise agreement and Teddy wants to assert claims against Bob's Burgers, LLC. However, he is unsure whether he wants to submit a demand for arbitration or file a complaint in court. The franchise agreement for the location at issue provides that claims can be asserted in either forum.
- Teddy is not concerned about the cost of the litigation, but wants to make sure that the dispute is resolved quickly and by someone that understands the nature of the franchise claims he is asserting. What is his best option?

Arbitration vs. Litigation

Benefits of Arbitration

Time
Flexibility
Cost
Expertise
Confidentiality



Arbitration vs. Litigation



Benefits of Litigation

Discovery

Motion Practice

Jury Trial

Appellate Rights

Hypothetical #2:

- After much deliberation, Teddy has decided to bring his lawsuit in court. He wants to assert a breach of contract claim against Bob's Burgers, LLC for \$100,000.00. He wants to know if he can file his lawsuit in federal court. He also wants advice on where he should file his complaint.
- What considerations do we need to know before properly advising Teddy? Do we need to obtain any more information about the dispute in order to provide the right answer?

Jurisdictional Issues

Personal Jurisdiction

- Focus is on the Defendant
- State Long Arm Statutes Can Establish Jurisdiction
 - Minimum Contacts with Forum State + Cannot Offend “Fair Play & Substantial Justice”



Jurisdictional Issues

Personal Jurisdiction Continued

Burger King v. Rudzewicz

- Franchise dispute between franchisor (FL Resident) and former franchisee (MI Resident)
- Breach of Contract and Lanham Act/Trademark Violation claims brought against franchisee in the United States District Court for the Southern District of Florida
- Defendant objected on personal jurisdiction grounds
- Holding: Communications and payments to BK in Florida were sufficient to constitute a “substantial and continuing” relationship with Florida

Jurisdictional Issues

Personal Jurisdiction Continued

Rocky Mt. Chocolate Factory v. Arellano, No. 17-cv-0582-WJM-CBS, 2017 U.S. Dist. LEXIS 173159, at *2 (D. Co. Oct. 19, 2017)

- Franchisor brought suit in Colorado district court against franchisee for trademark infringement
- Franchisee moved to dismiss on personal jurisdiction grounds
- Court found that franchisee barely met minimum contacts needed BUT forcing them to litigate would have offended notions of fair play and substantial justice
 - (1) Parties never executed a franchise agreement but franchisor allowed franchisee to operate using its marks
 - (2) Plaintiff would be able to get the same relief in Nevada
 - (3) Most witnesses located in Nevada

Jurisdictional Issues

Subject Matter Jurisdiction

Federal Question Jurisdiction

- 28 U.S.C. § 1331: action must “aris[e] under the Constitution, laws, or treaties of the United States”
- Claim arises under federal law only if “a right or immunity created by the constitution or laws of the United States is an essential element of the plaintiff’s cause of action”

Diversity Jurisdiction

- 28 U.S.C. § 1332
- Parties must reside in different states (or if either party resides in foreign country)
- Amount at issue must **exceed** \$75,000 exclusive of costs

Common Franchisee Claims



Hypothetical #3:

- Teddy thinks he might have made a mistake getting into the restaurant business. He's not making nearly as much as he thought he would have and he told his wife Denise: "I just don't understand. The sales representative from Bob's Burgers, LLC said I was going to bring in at a minimum 30% profits once everything started rolling, but I'm not making anything close to that!"
- Denise tells him maybe he should think about consulting with a lawyer about the sales representative's statement – does she have a point?

Hypothetical #3:

YES!!!!

The circumstances of the statement (whether there is a reasonable basis for the claim and whether that representation is disclosed in Item 19 of the FDD) will be *pivotal*.

Financial Performance Reps

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

Financial Performance Reps

Little FTC Acts

- NO Private Right of Action under FTC
- Franchisees utilize many “Little FTC Acts” across U.S. Jurisdictions (i.e., Texas Unfair and Deceptive Trade Practices Act, Massachusetts Little FTC Act)
 - Violation of FTC Act = per se violation of Little FTC Acts
 - Some Little FTC Acts are inapplicable to franchises (see NJ Consumer Fraud Act)
 - *Gentle Laser Solutions, Inc. v. Sona Int’l Corp.*, 2008 U.S. Dist. LEXIS 47645 (D.N.J. June 19, 2008): Defendants, a manufacturer and the personal representative of an officer’s estate, could not be held liable under N.J. Stat. Ann. § 56:8-2 of the New Jersey Consumer Fraud Act (CFA) in connection with the sale of a laser hair removal franchise, as a franchise was not “merchandise” within the meaning of N.J. Stat. Ann. § 56:8-1(c).
- Major headaches may ensue

Financial Performance Reps

Would the situation have been different if:

- Teddy took over a pre-existing franchise location through the execution of an Assumption Agreement?
- Teddy was an existing franchisee?
- A sales representative said nothing to Teddy, but he did research on his own and came to that 30% profit margin conclusion?
- Maybe, if the representation was based on historical data from the franchise location
- Yes because the party must be a ***prospective franchisee***
- Yes because Teddy investigated without involvement or representations from franchisor

Financial Performance Reps

If there is no Item 19 disclosure, franchisor should not be providing **any** financial information to the prospective franchisee

. . . But sometimes statements may slip through the cracks

Franchisor Defenses to FPR Claims

- Integration Clauses
- No Representation Clauses
- No Reliance Clauses
- Franchisee Questionnaires
- Forum Selection Clauses
 - But beware of states that have anti-waiver statutes (i.e. California)

Duty of Good Faith and Fair Dealing

- Franchisees rely heavily on this theory
- Parties to all contracts are expected to behave honestly, fairly, and in good faith in connection with their contractual rights, obligations, and responsibilities
- Implied duty in all contracts
- Seen throughout franchising disputes, whether dealing with (termination issues, nonrenewal issues, etc.)



Duty of Good Faith and Fair Dealing

Nonrenewal Litigation

Robinson v. Charter Practices International, 2015 WL 1799833 (D. Or. Apr. 16, 2015)

- FA allowed renewal under then existing FA
- For entire term (10 years) and other locations, franchisee allowed to compete and was aware of other locations
- Franchisor told franchisee that renewal depended on then existing FA, which would require franchisee to divest
- Franchisee would otherwise qualify for renewal
- Franchisee asserted claims for declaratory judgment, breach of contract, breach of good faith and fair dealing, waiver, promissory estoppel, and judicial estoppel and sought \$20M

Duty of Good Faith and Fair Dealing

Nonrenewal Litigation

Robinson v. Charter Practices International, 2015 WL 1799833 (D. Or. Apr. 16, 2015)

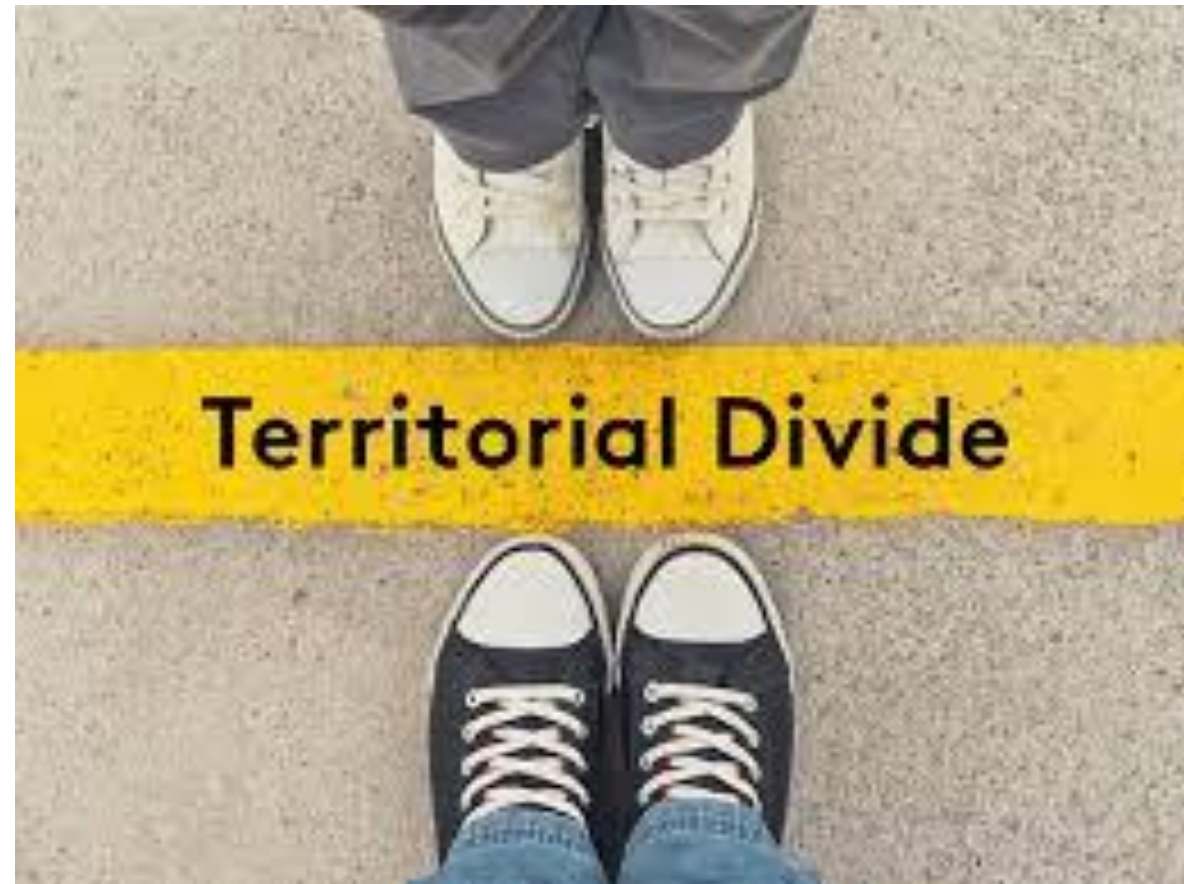
- “Because the renewal provisions . . . stated that renewal [required] Robinson’s execution of ‘CPI’s then-current [FA] and that the terms of that form agreement could differ in both specified and unspecified ways from [the original FA], CPI’s insistence that Robinson execute a form of agreement that contained unwaived non-competition provisions notwithstanding its partial waiver of the analogous provisions of the original agreement was not in violation of the express terms of the parties’ contract.”
- “Prior course of conduct under previous contracts will not operate as a waiver of an express stipulation in a new contract.”

Key fact: CPI told Robinson of intent 18 months before

Hypothetical #4:

- Teddy recently opened a Bob's Burgers franchise location in Chicago (the first of its kind in the city), and the numbers are doing great. His revenue and profits are way up, and he's incredibly excited about the future.
- Realizing the popularity that Chicagoans have for Bob's Burgers, Bob thinks its time to grow in the market. He grants two new franchisees the rights to open franchise locations in Chicago (not far from Teddy's restaurant), and decides to also has started plans to open a corporate owned restaurant in the area too.
- Teddy is furious and wants to protect his revenue – does he have a basis?

Encroachment



- Encroachment claims are likely to occur when certain territorial rights of the franchisee are infringed upon by the franchisor
- Best way to avoid these claims: **DON'T PROVIDE EXCLUSIVE RIGHTS**
 - McDonald's as example – no territorial rights provided.
 - Any reasons other than avoiding encroachment claims?

Encroachment

Handlers-Bryman v. El Pollo Loco Inc., 2017 WL 9772377 (Cal. Super. Ct.)

- Franchisee for over 16 years
- Franchisor granted franchisee permission to develop new sites, but claimed that franchisor imposed terms/conditions that were impossible to meet
- Franchisor developed new company-owned location close to franchisee (36% population overlap and 40% sales loss) and planned to develop two more
- Franchisee had no exclusive rights
- Franchisee claimed that franchisor used franchisee's sales and other information for franchisor's benefit

Encroachment

Handlers-Bryman v. El Pollo Loco Inc., 2017 WL 9772377 (Cal. Super. Ct.)

- Court found franchise agreements failed to properly disclose the franchisee's protected territory and did not offer them the right to operate the two locations built by the franchisor
- Court invalidated the franchisor's right to develop company-owned locations as unconscionable
- Should be limited to its facts, but distinction drawn between franchisee/company-owned locations

Hypothetical #5:

- Teddy's not so great at balancing his books – as a result, he has failed to pay Bob's Burgers, LLC royalty fees for the month of April as it relates to his restaurant in Illinois.
- The Franchise Agreement provides that the franchisor can terminate the agreement for non-payment, without providing the opportunity to the franchisee to cure.
- How should we advise Teddy if he wants to fight the termination?

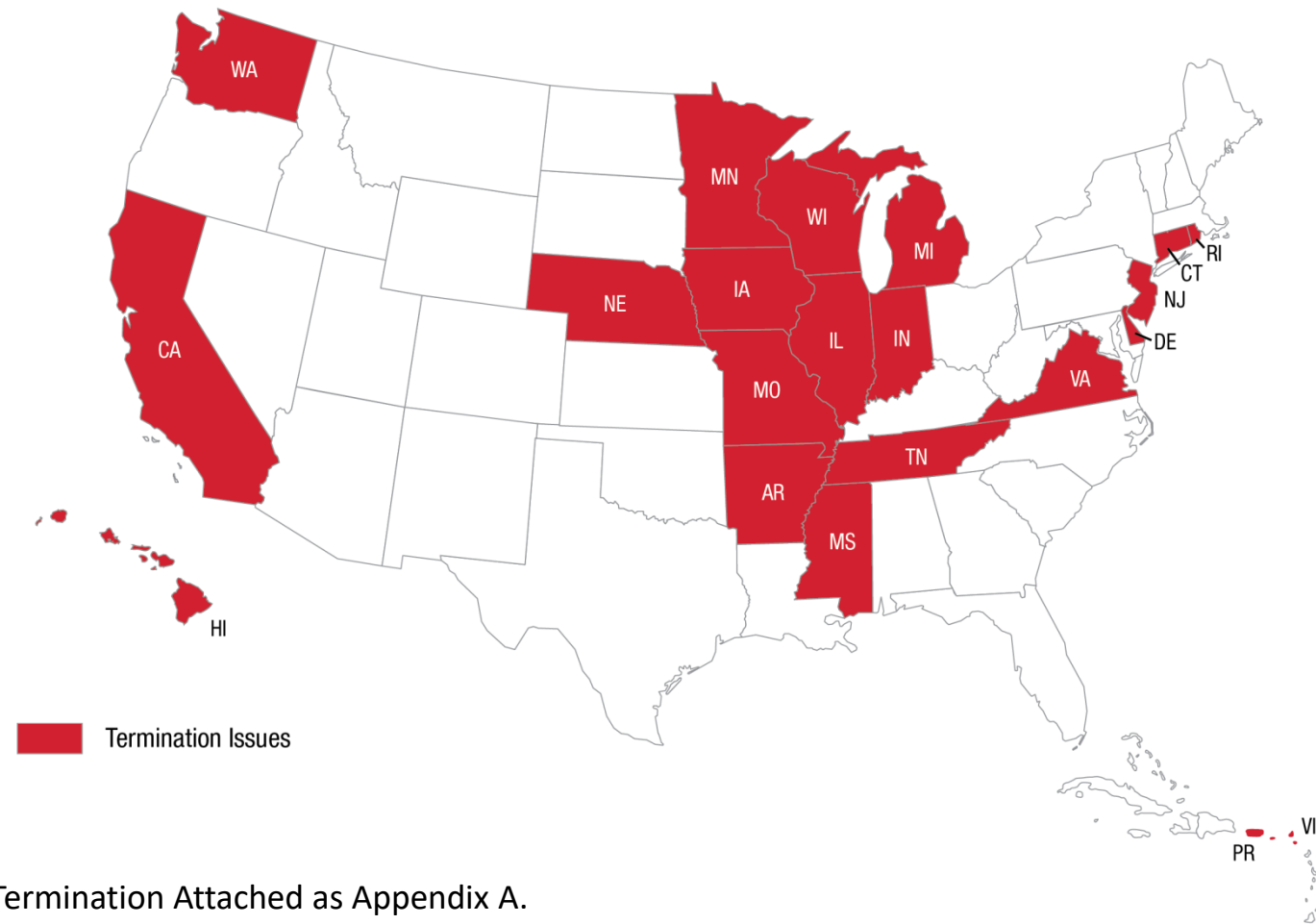
Wrongful Termination

- Most Common Claim/Defense Asserted By Franchisees
- **Look to the Franchise Agreement**
 - Defaults Subject to Notice + Cure
 - Defaults Subject to Notice + No Cure Period
- **Look to State Statutes**
 - Are the Parties Subject to Any Relationship Statutes?
 - Potential for GREATER Notice + Cure Periods Than What the Franchise Agreement Contemplates



Wrongful Termination

Franchise Relationship Laws in the Following States May Add Additional Notice/Cure Requirements



*Summary of State Relationship Laws Regarding Termination Attached as Appendix A.

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Wrongful Termination

Franchise Relationship Laws in the Following States May Add Additional Notice/Cure Requirements

- **CT, DE, IN, MS, MO, NE, NJ, & U.S. V.I.:** No cure period required, but notice must be properly provided
 - 60 day notice (CT, NE, NJ)
 - 90 day notice (DE, IN, MS)
 - 120 day notice (U.S. V.I.)
- **HI, IL, MI, WA:** Cure period must be “reasonable” and notice period required (no enumerated timeframe)
- **AR, CA, IA, MD, MN, RI, WI:** cure period required
 - 30 day cure (AR, MD, RI)
 - 60 day cure (MN, WI)
 - Reasonable cure = not less than 60 days (CA)
 - Reasonable cure = between 30 and 90 days (IA)
 - If monetary defaults, then RI and WI decrease to 10 day cure
- **VA, P.R.:** No notice period required

Transfer/Assignment Issues

“Unreasonably Withholding Consent” Claims

- Burden is on the franchisee to prove franchisor’s conduct is unreasonable
- Fact intensive analysis necessary to determine reasonableness
- Business/commercial grounds generally considered an acceptable justification

Claim Can’t be asserted by third-parties:

“The obligation not to unreasonably withhold approval for the transfer of interests in a franchise runs between the franchisor and franchisee; **it does not extend to third parties**, such as Franchisees, **who seek to obtain the franchise.**” *Popeyes, Inc. v. Tokita*, No. 87-3011, 1993 U.S. Dist. LEXIS 13295, at *12 (E.D. La. Sep. 21, 1993).

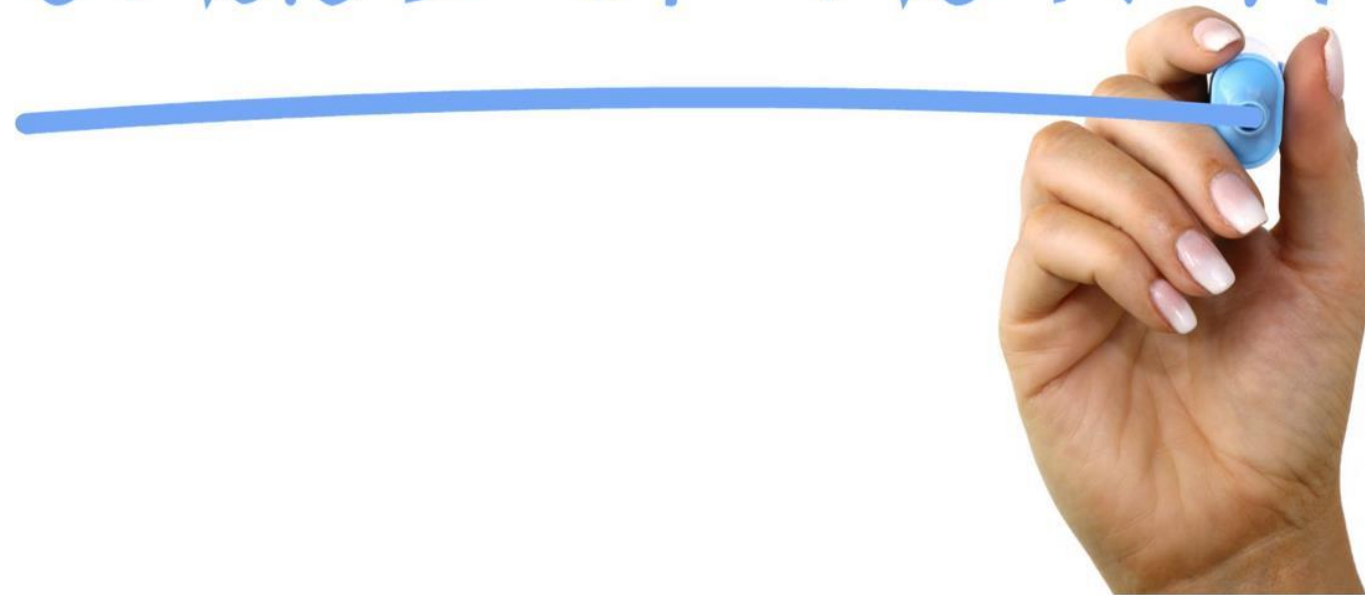
Inadequate Support



- Lack of training, advertising, operational guidance, etc.
- Can be more difficult to prove if Franchise Agreement is written with discretion to Franchisor
- Implied duty of good faith and fair dealing
- Crafting narrative key
- Business judgment – just because franchisee disagrees with the type of support given does not mean the support is improper

Common Franchisor Claims

CAUSE OF ACTION



Monetary Default/Failure to Pay

Rent, Royalties, Advertising Fees, etc.

Cure period often required – make sure to check language of the Franchise Agreement and whether any relationship laws apply

Can use default to achieve further accommodations/concessions (favorable terms, releases, etc.)

Must weigh amount owed vs. time/cost/effort associated with the decision to terminate and initiate subsequent litigation

Abandonment

“a franchisee who abandons his or her franchise by closing it before the end of a license agreement’s term may not bring a wrongful termination action against the franchisor who later terminates the agreement” *Zeidler v. A&W Restaurants, Inc.*, 301 F.3d 572, 574 (7th Cir. 2002)

Franchisor must be cautious/understand the facts associated with the abandonment

Common franchisee response: franchisor’s bad faith/conduct caused the abandonment



Violation of System Standards

- 90% of customers who read online review claimed that positive information influenced their decision*
- Companies lose 10 guests for every 1 that complains**
 - 13% of those unhappy guests will tell more than 20
 - 90% of unhappy guests will not do business again
 - 95% of those unhappy guests will return if the issue is resolved quickly

*Customer Satisfaction Processes: Surveys and Reputation Management, Franchising World – www.franchisingworld.com/customer-satisfaction-processes-surveys-and-reputation-management.

**Nancy Bigley, Implementing a Web-Based Satisfaction Program, Franchising World – www.franchise.org/implementing-a-web-based-satisfaction-program.

Violation of System Standards

Enforcing Brand Standards: Surveys

HLT Existing Franchising Holding LLC v. Worcester Hospitality Group, LLC, 994 F. Supp. 2d 520 (S.D.N.Y. 2014)

- Franchisee operated hotel for 8 years, investing more than \$700,000 in improvements
- Hilton standards used to create uniformity in the chain, tested compliance through quality assurance evaluations and guest surveys
- Testing: 4 failures during renovation, 2 passes, 9 subsequent failures
- Multiple chances to cure
- Franchisee terminated and filed suit challenging use of surveys as grounds for termination

Violation of System Standards

Enforcing Brand Standards: Surveys

HLT Existing Franchising Holding LLC v. Worcester Hospitality Group, LLC, 994 F. Supp. 2d 520 (S.D.N.Y. 2014)

- Guest surveys not hearsay – show what guests report
- Bad faith rejected: “If guests consistently found the Hotel’s service to be lacking . . . that is meaningful information to the franchisor, whether the hotels’ service was, in some sense, objectively bad.”
- “Evaluation process that Hilton used for the Hotel is the same process it uses for its entire Hampton chain of 1,800 hotels, including those it franchises and those it owns . . . [this shows] evenhandedness . . . Hotel inspectors also have substantial expertise . . . SALT surveys are used for the entire family of Hilton hotels.”

Post-Termination Claims



Post-Termination Claims

Injunctive Relief

- Common relief sought in post-termination context
- Factors:
 - Likelihood of Success on the Merits
 - Irreparable Injury
 - Balance of Harms Favors Movant
 - Not Adverse to Public Interest



Trademark Infringement Claims

Lanham Act Claim – Franchisor Must Show:

- It has ownership rights in the trademark
 - Defendant has used the mark
 - Defendant's use of the mark likely to cause consumer confusion
-
- Can Be Brought in State or Federal Court



Trademark Infringement Claims

Martinizing Int'l, LLC v. BC Cleaners, LLC, 855 F.3d 847 (8th Cir. 2017)

- Franchisor entered into agreement with KM Cleaners
- KM Cleaners entered into Asset Purchase Agreement with third party (BC Cleaners) without franchisor's consent and continued to use franchisor marks
- Franchise relationship between franchisor and KM Cleaners was not terminated prior to transfer
- Franchisor asserted Lanham Act violation against franchisee LLC and member-managers and moved for default judgment after defendants' failed to appear
- On appeal, court reversed default judgment award

Trademark Infringement Claims

Martinizing Int'l, LLC v. BC Cleaners, LLC, 855 F.3d 847 (8th Cir. 2017)

- Appellate court found that franchisor **failed to prove it was entitled to monetary damages**
 - The fact that the franchisor did not terminate the agreement was key:
“continued operation of the stores under franchise agreements that had not been terminated obviously caused no customer confusion whatsoever.”
 - Cease & Desist letter (sent by franchisor) invited BC Cleaners to become an authorized franchisee (implicitly granted a reasonable period of time for defendants to decide whether to accept)

Covenant Not to Compete

Reasonableness is key – what factors are considered?

- Length of time restriction
- Geographical area covered
- Restraint on former franchisee opportunities
- Public policy concerns

Peterbrooke Franchising of Am., LLC v. Miami Chocolates, LLC: 2-year restriction covering 25 miles from former franchise location found enforceable

- Court found that the non compete was “reasonable as to time, geographic limitation, and line of business”
- Precedent: Florida courts have held that covenants not to compete are reasonably necessary to protect a franchisor's legitimate business interest in re-entering the market formerly serviced by a terminated franchise.

Confidential Information/Trade Secrets



Defined as: any confidential information that has (a) commercial value, (b) by virtue of being kept secret, and (c) reasonable steps have been taken to keep/maintain confidentiality

Confidential/proprietary information related to operations, preparation, training, etc.

Often found to be enforceable by courts

Common Remedies

- **Damages**
 - Compensatory - Direct damages for actual economic loss
 - Lost profits
 - Punitive – used to punish defendant
 - Intentional wrongful conduct (i.e., fraud)
 - No recovery under breach of contract
 - Liquidated
 - Reasonable measure of compensation for breach when damages are difficult to prove
- **Injunctive Relief** – require franchisor/franchisee to do or cease doing something
 - Enforce obligations while parties are operating under agreement/relationship
 - Post-termination covenants
- **Rescission** – unwinds the franchise agreement/relationship
 - Franchise disclosure statutes
 - Common law claims: fraud, misrepresentation, etc.

Thank You



Questions?



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Appendix A

STATE	NOTICE	GROUND S	CITATION
Arkansas	90 days and 30 days cure	Good cause	AR ST s 4-72-204
California	60 days and cure	Good cause (substantial noncompliance)	CA BUS & PROF S 20020
Connecticut	60 days	Good cause (substantial noncompliance with material obligation)	CT ST s 42-133f
Delaware	90 days	Good cause and good faith	DE ST TI 6 s 2552 DE ST TI 6 s 2555
Hawaii	Reasonable time for notice and cure	Good cause or according to nondiscriminatory terms of franchisor	HI ST s 482E-6
Illinois	30 days and cure	Good cause (failure to comply with terms of FA)	IL ST CH 815 s 705/19
Indiana	90 days	Good cause (material violation of FA) and good faith	IN ST 23-2-2.7-1, 7-3
Iowa	30-90 days and cure	Good cause (legitimate business reason, material violation of FA)	IA ST s 523H.7

Appendix A

Michigan	30 days and cure	Good cause (failure to comply with terms of FA)	MI ST 445.1527
Minnesota	90 days and 60 days cure	Good cause (substantial noncompliance)	MN ST s 80C.14
Mississippi	90 days		MS ST s 75-24-53
Missouri	90 days		MO ST s 407.405
Nebraska	60 days	Good cause	NE ST s 87-404
New Jersey	60 days	Good cause (substantial noncompliance)	NJ ST 56:10-5
Rhode Island	60 days and 30 days cure	Good cause (failure to comply with terms of FA)	RI ST s 6-50-4
Washington	30 days and cure	Good cause (failure to comply with terms of FA) or 4 willful and material breaches of same term in 12 months	WA ST 19.100.180
Wisconsin	90 days and 60 days cure	Good cause (substantial noncompliance with essential terms)	WI ST 135.02 WI ST 135.03 WI ST 135.04

Appendix A

Virginia		Reasonable cause and no undue influence	VA ST s 13.1-564
Puerto Rico *click image to view statute		Just cause notwithstanding the contract terms	10 LPRA s 278a, 278a-1
Virgin Islands *click image to view statute	120 days	Good cause	12A VIC s 131, 132