

2018 IFA

# LEGAL SYMPOSIUM

• May 6-8 | Washington, DC

# Stop Invading My Space: *Encroachment Issues in Franchising*

Jennifer Dolman

*Osler, Hoskin & Harcourt LLP, Toronto, Ontario Canada*

Scott Korzenowski

*Dady & Gardner, P.A., Minneapolis, MN*

Erik Wulff

*DLA Piper LLP (US), Washington, D.C*

# You have no space!

---

Pre-1977: Territories were *per se* unlawful  
(*United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967))

1977: Territories no longer *per se* unlawful  
(*Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977))

# Now you can invade my space!

---



1984: SCOTUS endorsed territories.

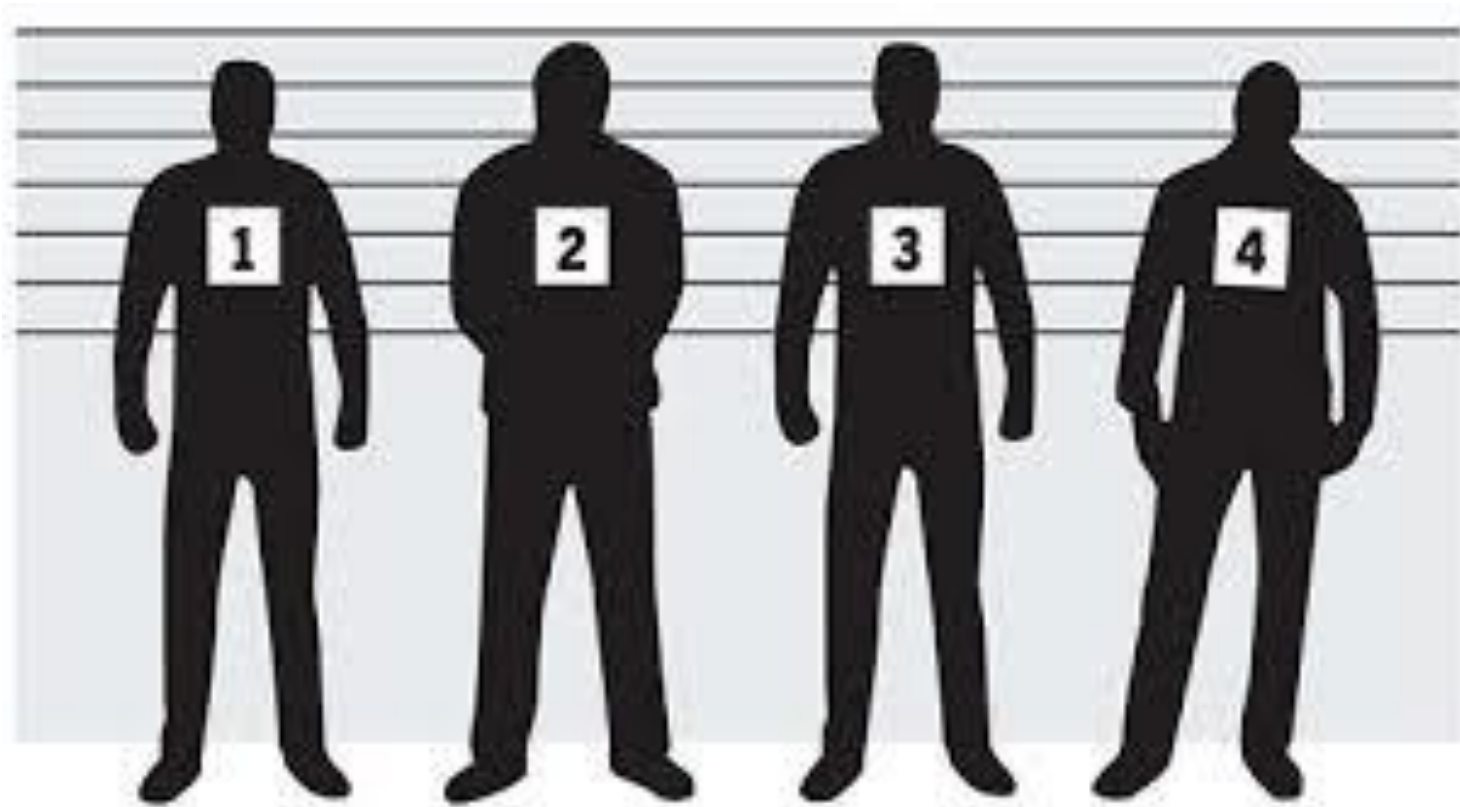
*(Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984))*

# Stop invading my space

---

## Here's the lineup:

- State of the law
- Bricks and mortar
- Multi-brands
- E-commerce



# Stop invading my space

---

## The state of the law:

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

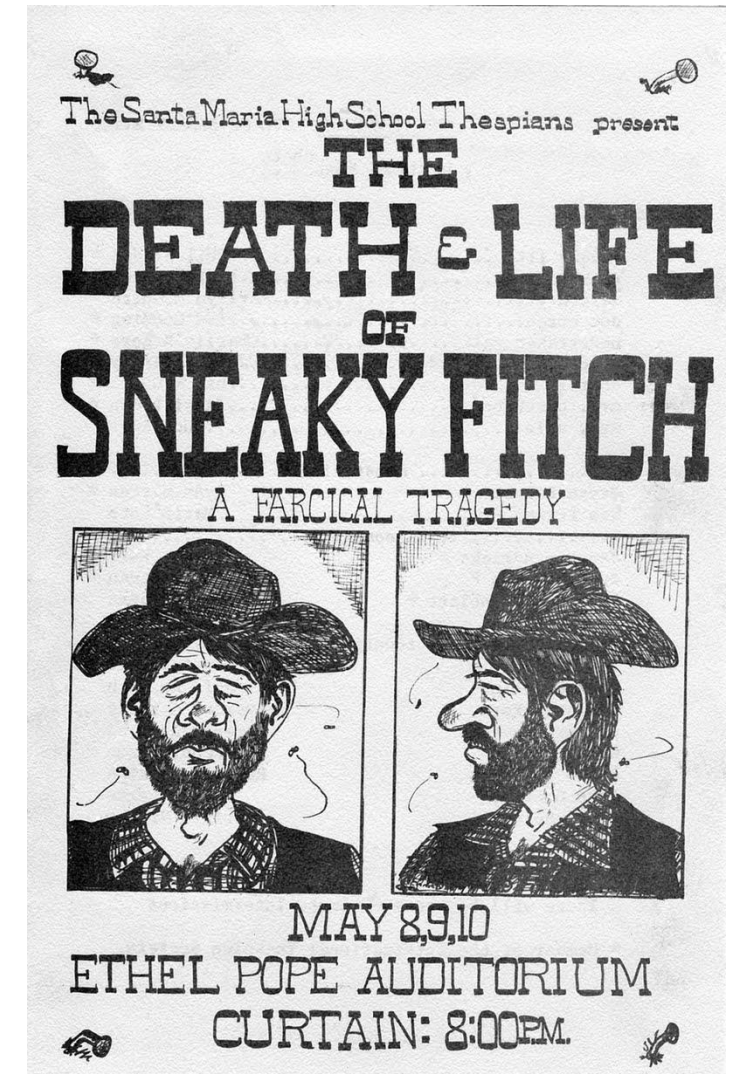


# Stop invading my space

---

## The state of the law:

- Has *Bryman* resurrected *Scheck*?
- *Scheck* no exclusive territory  
(but no right to open others)

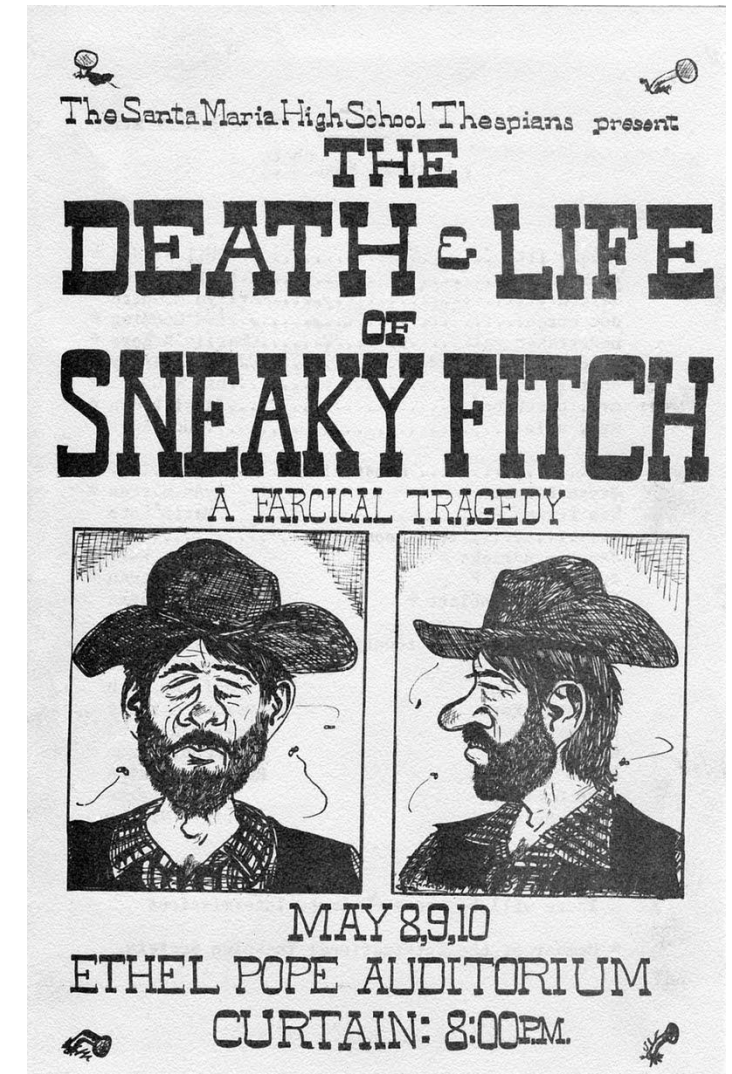


# Stop invading my space

---

## The state of the law:

- *Bryman*: right to open others  
(but unconscionable)



# Stop invading my space

---

The lesson of *Scheck* and *Bryman*?

Pigs get fat, hogs get slaughtered



# Brick and mortar encroachment

---

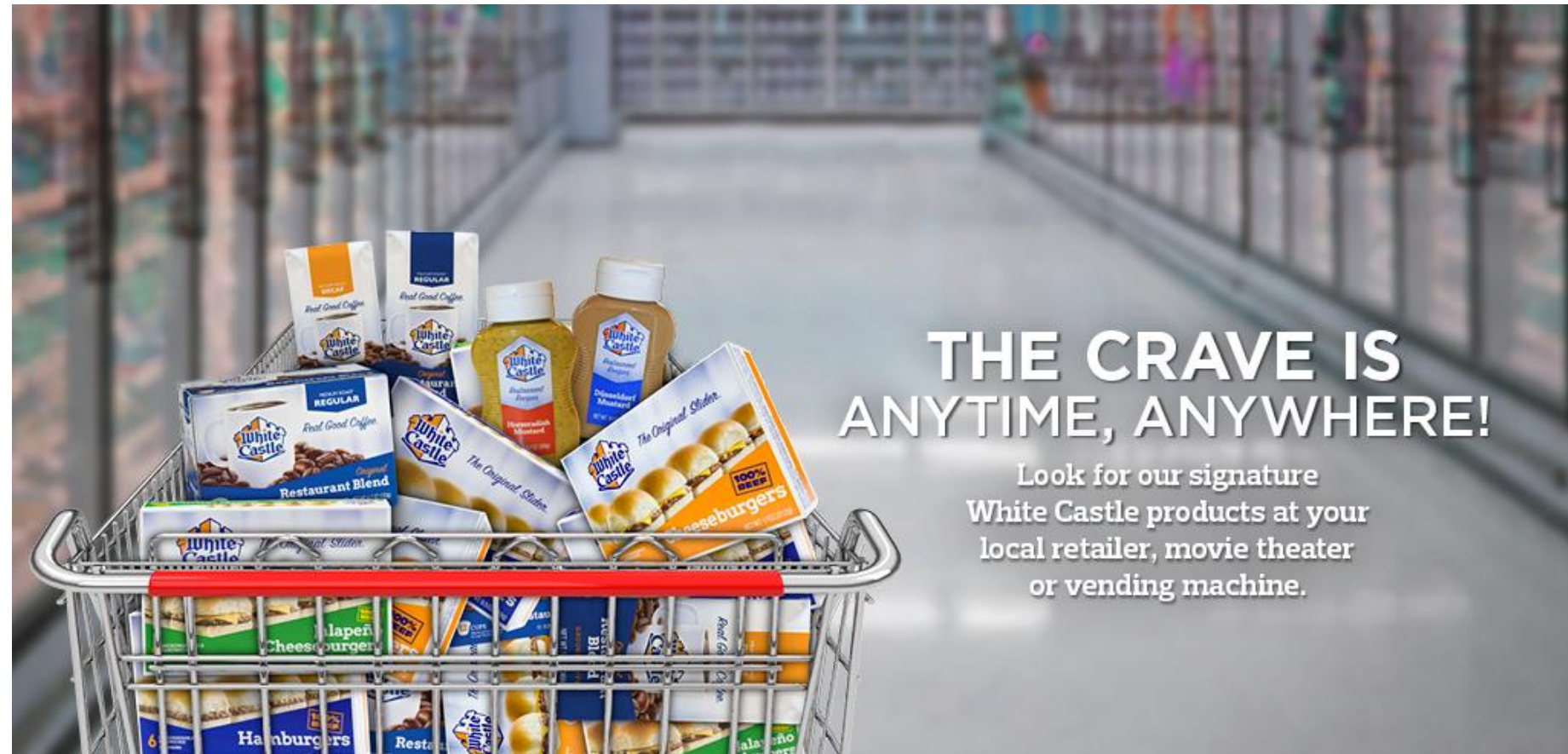
## Geographical encroachment



# Brick and mortar encroachment

---

## Product/service encroachment



# Brick and mortar encroachment

---

## Brand expansion encroachment

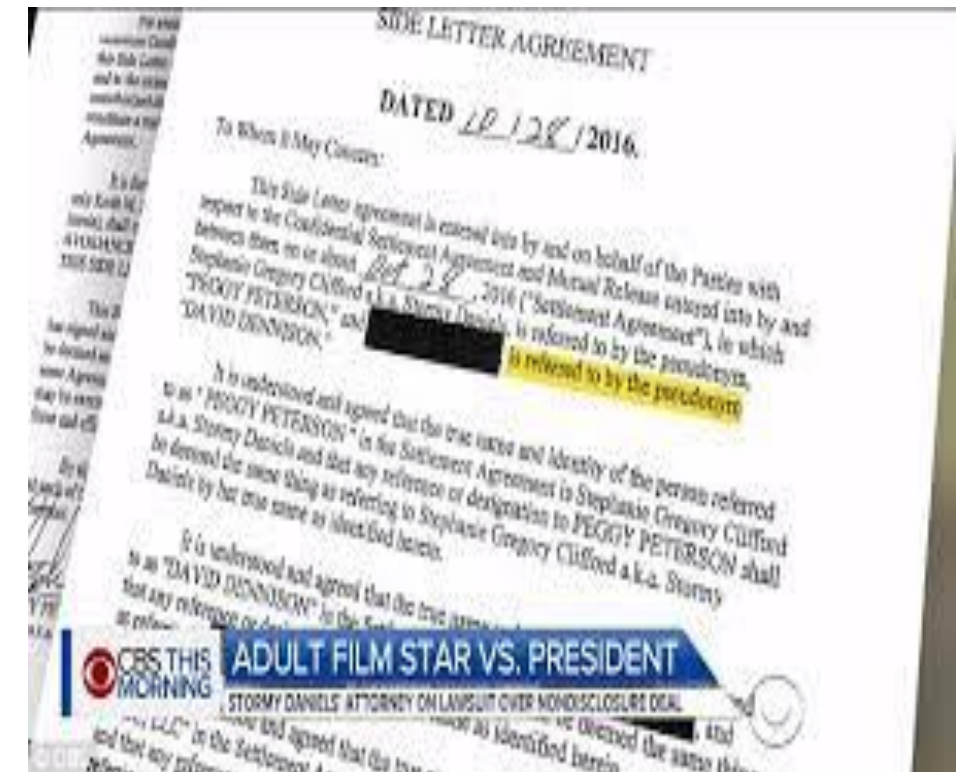
So Porsche Design



# Brick and mortar encroachment

## Contractual provisions:

- How much territory?
- How to define the territory?
- Scope of the exclusivity?



# Brick and mortar encroachment

---

## How to define a territory?

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



# Brick and mortar encroachment

---

## Reservation of rights:

- Brand only
- Alternative channels
- E-commerce
- Others?



# Brick and mortar encroachment

---

## Litigation strategies for franchisees:

- Get involved early
- Request development policy
- Show lost cash flows
- Good faith and fair dealing



# Brick and mortar encroachment

---

## Litigation strategies for franchisors:

- Rely on your FA
- Rely on your growth plan
- Point out process
- Highlight considerations

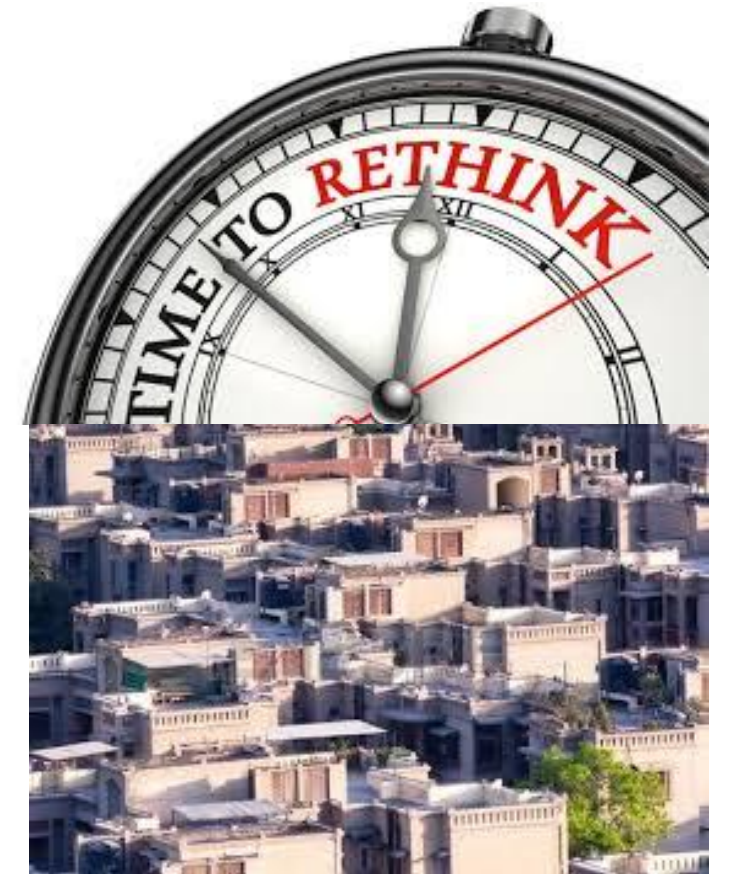


# Brick and mortar encroachment

---

## Issues to consider:

- How aggressive is too aggressive
- How much intra-brand competition
- Franchisee ROI
- Ability to grow



# Brick and mortar encroachment

---

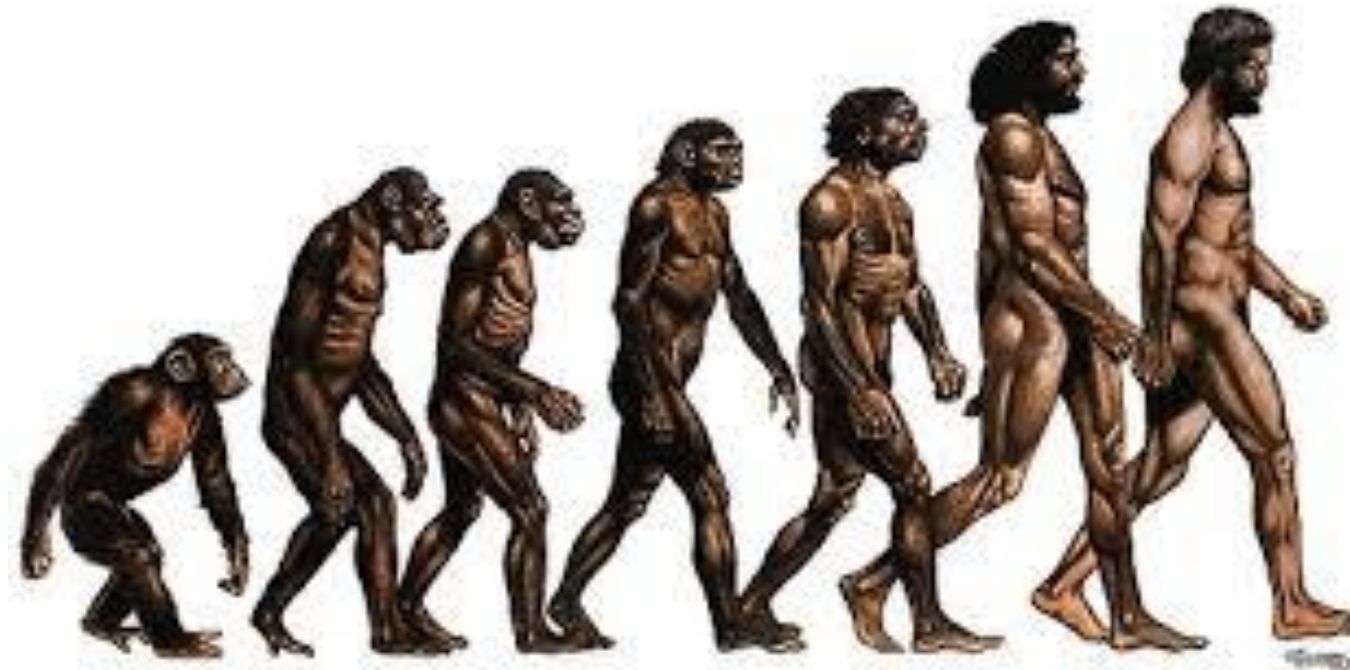
## Questions?



# Multi-brand franchisors

---

## Evolution of the Model



# Multi-brand franchisors

---

## Cross-brand encroachment issues:

- Contractual commitments
- Absence of statutes



*Carl's Jr.*



*Hardee's*

# Multi-brand franchisors

---

## Franchise agreements:

- Typically address intra-brand
- Unless FA protects concept

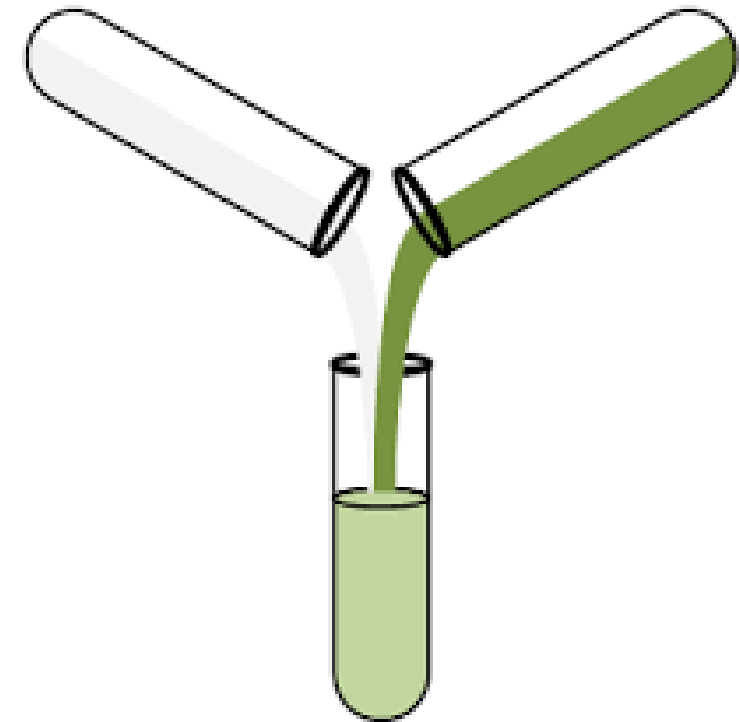


# Multi-brand franchisors

---

Other issues:

- Dilution of distinctiveness



Dilution

# Multi-brand franchisors

---

## Questions?



# E-commerce/alternative dist.

---

## Why e-commerce?

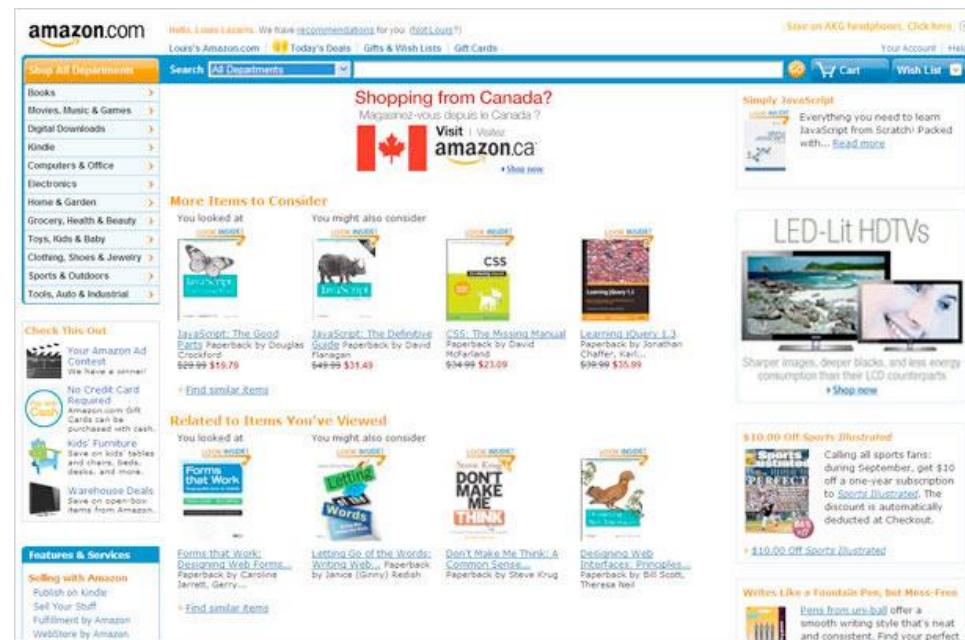
- Easier and convenient
- 80% of Americans made online purchases in '16



# E-commerce/alternative dist.

## Why e-commerce?

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



# E-commerce/alternative dist.

---

## Why e-commerce?

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



# E-commerce/alternative dist.

---

## THE amazon EFFECT

- The ongoing evolution and disruption of retail
- Amazon = 43% of all 2016 retail sales in the U.S.

# E-commerce/alternative dist.

---

## THE amazon EFFECT

- 2016: Amazon sales of just over \$3.5 billion in Canada
- Franchisors now need to be omnipresent

# E-commerce/alternative dist.

---

## E-commerce impact on franchise relationship

- 3 key issues:
  - ✓ Territorial encroachment
  - ✓ Brand protection
  - ✓ Drafting more comprehensive contract provisions



# E-commerce/alternative dist.

---

## E-commerce impact on franchise relationship

- No Canadian case law on internet encroachment
- Look to non-internet encroachment law for guidance



# E-commerce/alternative dist.

---

## E-commerce impact on franchise relationship

- Canadian courts use two methods of analyses:
  - ✓ Contractual interpretation of the agreement
  - ✓ Applying the duty of good faith or fair dealing



# E-commerce/alternative dist.

---

## Other alternative distribution channels

- Franchisors are selling products to non-franchised stores:
  - ✓ Department stores
  - ✓ Grocery stores
  - ✓ Pharmacies
  - ✓ Convenience stores
  - ✓ Kiosks



# E-commerce/alternative dist.

---

## Other alternative distribution channels

- Courts will apply same considerations as above:
  - ✓ Agreement terms
  - ✓ Covenant of GF & FD



# E-commerce/alternative dist.

---

## Other alternative distribution channels

- Introduction may create conflict
- What actually constitutes the franchise system?



# E-commerce/alternative dist.

---

## Covenant of good faith & fair dealing

- Canadian courts will look beyond K language:
  - ✓ Has franchisor taken into account the franchisee's interests?
  - ✓ Is franchisee getting a reasonable return on its investment?



# E-commerce/alternative dist.

---

How franchisors can face this new territory:

- Franchise Agreement should contain language for:
  - ✓ Non-exclusive territories
  - ✓ Broad reservation of rights



# E-commerce/alternative dist.

---

## Litigation strategies:

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



# E-commerce/alternative dist.

---

## Litigation strategies:

- Reserve methods of sales for franchisor
  - ✓ Do not allow court to interpret franchise agreement



# E-commerce/alternative dist.

---

## Questions?

