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Brand-emonium: Legal Considerations for Multi-Brand Franchise Systems

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***Brand-emonium*: Legal Considerations for Multi-Brand Franchise Systems**

Franchising provides several advantages to brands looking to grow their presence in their particular markets. Once a brand develops a system for replicating the success of its concept over multiple outlets, the franchise model often enables brands to enter more markets faster and more efficiently, and thus reach more customers, than they could through company-controlled expansion.

Similar to how brands enjoy the benefits of expanding their concepts by selling franchises, some franchisors have recognized benefits from growing the number of franchised brands they operate. These brands lean on their experience operating franchised brands, their knowledge of a particular industry and/or their expertise in selling to target consumer segments to either expand their portfolios by developing new brands, or acquiring existing brands.

The hotel industry has several multi-brand franchisors, including those who develop new brands to meet rising segments of their market, or changes in the preferences of their consumers. Other examples include franchisors operating multiple fast-casual dining brands, franchisors operating multiple brands that provide various types of learning and recreational activities to children and franchisors who operate multiple fitness and health brands.

Benefits of Multi-Brand Franchising

Operating and supporting multiple brands bring unique challenges. The terms of the franchise agreements their brands use can reduce, or increase, those challenges, as outlined below. However, the increasing number of multi-brand franchisors suggests that the benefits of operating multiple brands outweigh the risks.

Developing multiple brands can enable the franchisor to capture various segments of the market while allowing each brand to become known within its particular segment. For example, a hotel franchisor can offer an affordable midscale motel brand to cost-conscious travelers, and a separate full-service brand to business travelers and consumers looking for more upscale amenities. By using terms in its brands' franchise agreements that are drafted with the intent of ensuring the brands can be operated as part of a suite of concepts (pun intended), the franchisor gives itself the flexibility to develop new brands—such as a boutique concept, an extended stay concept, or a concept with more of a hostel feel—as the preferences of travelers evolve.

Other multi-brand franchisors may develop, or acquire, brands that play to their expertise—taking what they know about operating a franchisor in a particular sector and adding brands that benefit from the franchisor's expertise to grow their market share. For example, GoTo Foods has developed what it describes as a curated collection of fast-casual food service brands that it seeks to develop using its knowledge and expertise in that sector of the food service market. Similarly, Unleashed Brands has developed a portfolio of franchise concepts that they describe as providing a variety of youth

enrichment services. Still others, like Propelled Brands, are less focused on a particular niche of the marketplace, and instead offer franchising opportunities in a variety of service industries, including beauty, signs and graphics, pet care and IT services.

Each multi-brand franchisor has specific motivations for developing or acquiring the brands it has in its portfolio. However, most enjoy similar benefits which can include the following:

- Increased negotiating power. As a franchisor's portfolio of brands grows, so does its leverage in negotiating with vendors and suppliers. This is particularly true for multi-brand franchisors whose brands require the same or similar services or products.

- Increased economies of scale. Owning and operating multiple franchise brands enables some franchisors to utilize their teams to service multiple brands. For example, field teams can be trained on the standards of the franchisor's multiple brands and utilized to evaluate, and coach, franchisees from across the portfolio in a particular geographic region. Likewise, the franchisor's executive and upper management positions can oversee the operations of multiple brands. Hotel brands, in particular, enjoy the benefit of using a single reservation system to handle reservations for franchisees throughout their portfolio of brands.

- Competitive advantages. If a franchisor's brands cover multiple segments of a market, the franchisor can capture more of the market's output, while better insulating itself from the impact of changing consumer preferences or trends within the industry. For example, a multi-brand quick service restaurant franchisor can utilize a stable of product offerings to profit from consumers regardless of whether those consumers are looking for a burger, pizza or a chicken sandwich. The benefit of diversification exists even for multi-brand franchisors who don't limit their offerings to a particular industry segment. By offering concepts spanning multiple industries, the franchisor is better protected from sudden struggles in one industry, and/or is better positioned to capture a hot trend in another.

- Increased opportunities for franchisees. Synergy between multiple brands can also provide capable franchisees with opportunities to not just own and operate multiple units of a single brand, but to own units across multiple brands that either complement each other, or build on the franchisee's strengths as an operator, all while helping the franchisee protect itself from changes in the market.

- Increased opportunities for customers. The value of, and opportunities for, loyalty programs can increase when multiple brands are united under a single franchisor—especially when those brands are in a shared industry. The brands, and their franchisees, can provide a wider range of potential benefits to customers

by enabling purchases within one brand to unlock benefits from the franchisor's other brands. This benefit is illustrated by hotel royalty programs that can give customers access to benefits across the universe of brands—say free in-room water at any of the properties operated by one of the franchisor's brands—or which can be used to access discounts at the franchisor's other brands—such as using points earned during a stay at a mid-level property on a business trip to enjoy a discounted room at one of the franchisor's resort destinations brand for a family vacation.

- Cross selling opportunities. By offering multiple brands, a franchisor can use a consumer's engagement with one brand to introduce or promote another of the franchisor's brands to that consumer. For example, Unleashed Brands' concepts offer a variety of youth enrichment services that range from tutoring, to eSports, to martial arts training. This variety enables Unleashed Brands to market several types of enrichment programs to parents who, say, first engaged with the brand by signing up for tutoring services, but who may also be interested in Unleashed Brands concepts that can encourage physical development or that offer ways of productively channeling a child's love of video games. Unified reservation systems, or other online customer interfaces, used for some, or all, of a franchisor's brands, also provide opportunities to promote the franchisor's portfolio of brands to consumers.

These, and other benefits, come with increased risks for franchisors that operate multiple brands. Those risks are illustrated in part 3 of this paper, in which we examine the potential litigation associated with multi-brand franchising, in addition to other potential consequences including brand dilution, customer confusion, and cannibalization. As always, engaging experienced franchise counsel and conducting conscious review and drafting of franchise agreement terms goes a long way to mitigating those risks. Therefore, in part II of this paper we examine some of the common franchise agreement provisions that should be considered by multi-brand franchisors and by single brand franchisors who want to make themselves attractive for acquisition by a multi-brand franchisor. However, first, in part I we address a more fundamental issue: how multi-brand franchisors structure themselves and the pros and cons of each option.

1) Structure: the Use of One Franchisor Entity Versus the Use of Multiple Franchisor Entities

There are two basic ways to structure a multi-brand franchise system: use one franchisor entity that sells franchises under multiple brands, or create a franchisor entity for each brand of which each is owned by a holding company.

Having each brand operated by a separate entity helps wall off the rest of the portfolio from liabilities incurred by a particular brand, whether those liabilities are the result of franchise compliance issues, claims arising under joint employer allegations or claims of vicarious liability. However, to recognize this benefit, the parent company, and each of its

subsidiaries must ensure they are observing corporate formalities among the brands, and within the brands. For example, if a certain team of employees are used to serve multiple brands, it will be important for the parent company to clearly identify the employer of the team, and use inter-brand contracts delineating how the team are to be engaged, and paid for.

Using multiple entities can also make future mergers and sales easier as the parent company can sell the entity owning an individual brand, or the entities owning a group of brands as individual assets. This structure also allows the parent entity to add investors to individual brands without having to sell equity in the parent entity itself.

On the other hand, there are certain advantages to operating multiple brands from a single franchisor entity. For example, the cumulative size and revenue of the portfolio may make it easier for the franchisor to qualify for large franchisor exemptions to state registration and disclosure obligations. Nine of the 14 franchise registration states have some form of exemption to their registration and/or disclosure obligations for franchisors that meet certain size criteria.[1] Generally, these exemptions require franchisors to have between $5 million and $15 million in net worth, or $1 million and a parent with $5 million to $15 million in net worth. In addition, these exemptions generally require the franchisor to have at least 25 franchisees during the five years prior to seeking to sell under the exemption and/or require that the franchisor have five years of experience operating the same type of business as the one being franchised. However, some states eliminate these experience criteria if the franchisor has more than $15 million dollars in assets.[2] New York makes the large franchisor exemption discretionary for any franchisor with less than $15 million in net worth, but makes the exemption automatic for franchisors with a net worth of at least $15 million.[3]

In addition, obtaining the required audited financials can be easier, and less expensive, if all the brands are operated through a single entity. Under the multi-entity structure, if the parent entity is going to provide goods or services that the franchisor is obligated to provide under the franchise agreement after the sale of the franchise, the franchisor's FDD must include both the franchisor's audited financials and the parent entity's audited financials.[4] In addition, if the franchisor is a subsidiary of a parent entity which is permitted under GAAP to prepare consolidated financial statements, the franchisor's FDD may

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[1] *See*, Cal. Corp. Code §31001 (West 2014) (California's large franchisor exemption); Ill. Admin. Code tit.14, §200.202(e) (1999) and 815 ILL. COMP. STAT. 705/8 (1987) (Illinois' two large franchisor exemptions); Ind. Code §23-2-2.5-3 (2015) (Indiana's large franchisor exemption); COMAR 02.02.08.10(D) (Maryland's "seasoned franchisor" exemption); N.Y. Gen. Bus. Law § 684(2)(a) and N.Y. Gen. Bus. Law § 684(3)(a) (New York's two large franchisor exemptions); N.D. Cent. Code §51-19-02 (2015) (North Dakota's large franchisor exemption); R.I. Gen. Laws §19-28.1-6(1) (Rhode Island's large franchisor exemption); 21 Va. Admin. Code §5-110-75(4) (Virginia's "seasoned franchisor" exemption); Wash Rev. Code §19.100.030(4)(b)(i) (Washington's large franchisor exemption).

[2] *See*, i.e. 815 Ill. Comp. Stat. 705/8 (1987).

[3] N.Y. Gen. Bus. Law § 684(2)(a) and N.Y. Gen. Bus. Law § 684(3)(a).

[4] 16 C.F.R. §436.5(u)(1)(5); Fed. Trade Comm'n, Franchise Rule Compliance Guide 112-116 (May 2008), https://www.ftc.gov/tips-advice/business-center/guidance/franchise-rule-compliance-guide.

include the parent's audited financial statements only if it also provides unaudited copies of its own financials and the parent entity absolutely and irrevocably has agreed to guarantee all of the franchisor entity's obligations under the franchise agreement.[5]

Using a single entity can also have administrative benefits as well. It may be easier for a single, multi-brand franchisor to prepare each brand's franchise disclosure document if portions of each FDD can be shared. In addition, it is administratively easier for the franchisor to use staff, and teams, to serve multiple brands without having to document the relationships between the employees, the teams and the individual brands.

Ultimately, decisions regarding structure should only be made following consultation with the franchisor's legal and tax advisors, as each organization is likely to have unique considerations, beyond the generally applicable considerations summarized here, that will influence how they structure their operations.

2) Franchise Agreement Provisions Multi-Brand Franchisors Need to Consider

While multi-brand franchisors enter into bilateral agreements—each granted by a single franchisor—multi-brand franchisees need to ensure the agreements give the franchisor—and its parent—the authority and flexibility to operate all of its brands in a coordinated way that enables it to maximize the benefits of its portfolio. Single-brand franchisors considering the creation of an additional brand, or who want to make their brand attractive to acquisition by a multi-brand franchisor, need to consider whether the terms of its franchise agreements expressly grant the franchisor the authority and rights needed to either develop another franchised brand, or be acquired by an entity that owns multiple franchised brands.

This section addresses how the following types of provisions may impact the operations of multi-brand franchisors:

- Acknowledgments of the franchisor's other brands;
- Area of protection provisions;
- Provisions setting out the franchisor's reserved rights;
- Provisions granting the franchisor the right to outsource the obligations of the franchisor;
- Provisions relating to the use of brand funds;
- Provisions relating to loyalty programs; and
- Provisions protecting confidential information, trade secrets and other proprietary information.

[5] 16 C.F.R. §436.1(a)(20)(i); FTC Informal Staff Advisory Opinion 06-2, Fed. Trade Comm'n (Apr 3, 2006), https://www.ftc.gov/policy/advisory-opinions/informal-staff-advisory-opinion-06-2. Note that FTC Informal Advisory Opinions have not been reviewed, approved or adopted by the FTC, and are not binding on the Commission.

a) Acknowledgments

Multi-brand franchisors should consider including terms in their franchise agreements that require franchisees to acknowledge that they are buying a franchise from a franchisor that is affiliated with multiple brands. Such affiliations will, of course, be disclosed in the franchise disclosure document. However, having the franchisee acknowledge the other brands, and how those affiliations may impact the franchisee, in the franchise agreement, is recommended. An example of one multi-brand hotel franchisor's acknowledgment is provided here:

> "You acknowledge that we are affiliated with or in the future may become affiliated with other … franchise systems that operate under names or marks other than [the trademarks licensed to you herein]. We and our affiliates may use or benefit from common hardware, software, communications equipment and services and administrative systems for reservations, franchise application procedures or committees, marketing and advertising programs, personnel, central purchasing, Approved Supplier lists, [and] franchise sales personnel (or independent franchise sales representatives)."

b) Area of protection provisions

A material consideration of any franchisee is what protections it will receive from intra-system competition—either from the franchisor, or from other franchisees. Those protections are often set out in area of protection (AOP) provisions, which may also sometimes be referred to as territory provisions. While AOP provisions typically expressly state what protections the franchisee is being granted, multi-brand franchisors should also define the limits of those protections by stating expressly what protections are not being granted.

One multi-brand hotel franchisor states upfront in its AOP provisions the protection its franchisees will receive, but then goes on to state what protections are not included. Its AOP provisions start out with the following statement:

> "Protected Territory. We will not own, operate, lease, manage, franchise or license any party but you to operate a Chain Facility in the "Protected Territory", as defined below, while this Agreement is in effect."

In this case, a "Chain Facility" is a hotel using the same brand, trademarks and system as the franchisee.

Then, the AOP provisions go on to expressly state what is not included in the protection granted under the agreement:

> "We may own, operate, lease, manage, franchise or license anyone to operate any Chain Facility located anywhere outside the Protected Territory without any restriction or obligation to you. We may grant

protected territories that overlap your Protected Territory to other Chain Facilities… We and our affiliates each reserve the right to own, (including through a joint venture or otherwise) in whole or in part, manage, operate, use, lease, finance, sublease, franchise, license (as franchisor or franchisee), or provide services to (i) distinctive separate lodging, or food and beverage marks and other intellectual property which are not part of the System, and to enter into separate agreements with you or others (for separate charges) for use of any such other marks or proprietary rights, (ii) other lodging, food and beverage facilities, or businesses, under the System utilizing modified System Standards, and (iii) a Chain Facility at or for any location outside the Protected Territory."

c) Reservation of franchisor's rights

Perhaps the most critical provisions in a multi-brand franchisor's franchise agreements are the reservation of rights provisions. Born of franchise litigation battles that centered less on what the franchise agreement said, and more on what it did not say, these provisions define the scope of a franchisee's rights by affirmatively defining not only what rights remain with the franchisor, but, as a result, what rights are not being granted to the franchisee.[6]

Reservation of rights provisions typically follow the AOP sections of the franchise agreement. While the AOP sections set out what protections the franchisee will, and will not, receive regarding the territory granted in the franchise agreement, the reservation of rights section further define the scope of the AOP rights by setting out the rights of the franchisor. Typically, they establish that the franchisor reserves all rights not expressly granted to the franchisee by the franchise agreement, and then setting out a non-exclusive list of the actions the franchisor has the right to take because they are not covered by the territorial protections granted to the franchisee.

Below is the Reservation of Rights provision from the franchise agreement of a multi-brand food service franchisor.

> "Our Reserved Rights. We reserve all rights that we do not expressly grant you in this Agreement. For example, without limitation, we have the following rights, without providing any rights or compensation to you:
>
> (i) We and/or our affiliates may establish or license franchises and/or company-owned businesses offering products or services that are similar or identical to the Approved Products using the System or elements of

[6] *See, i.e., Scheck v. Burger King Corp.*, 798 F. Supp. 692 (S.D. Fla. 1992) (in which Burger King's motion for reconsideration of the court's decision to deny its motion summary judgment was itself denied in part because of the company's "failure to make explicit in the Franchise Agreement the rights [it] claim[ed] it carved out for itself.").

the System under the Marks or any other marks anywhere outside of the Area of Protection or in Captive Audience Locations inside or outside the Area of Protection.

(ii) We and/or our affiliates may produce and/or sell Approved Products or any other products or services, and authorize others to produce and/or sell Approved Products or any other products or services, using the Marks, the System, and any other marks and/or systems we desire through any alternative channel of distribution located anywhere, including to and through (a) supermarkets, convenience stores, club stores, and other retail facilities not dedicated to the sale of the Approved Products, (b) mail order and e-commerce channels, and (c) Delivery Kitchens.

(iii) We and/or our affiliates may advertise, or authorize others to advertise, using the Marks anywhere, including inside and outside any Area of Protection.

(iv) We and/or our affiliates may acquire, be acquired by, or merge with another entity with existing businesses or franchises that are similar to or competitive with the Businesses anywhere (including inside and outside the Area of Protection (if any)) and (i) convert the other businesses to be Businesses operating under the Marks and the System (except inside your Area of Protection (if any)), (ii) permit the other businesses to continue to operate under another name anywhere (including inside your Area of Protection (if any)), and/or (iii) permit the businesses to operate under another name and convert your Franchised Business and existing Businesses to such other name."

From the perspective of a multi-brand franchisor, subparagraph (iv) is likely the most important in that it obtains the franchisee's express acknowledgement and consent to the franchisor acquiring, or merging with, entities that operate businesses that are similar to, or competitive with, the franchisee's business.

The rights set out in subparagraph (iv) may also be valuable to single-brand franchisors. The owners of single-brands who are just starting to franchise their concepts would be well-advised to include express assertions of such rights in their initial franchise agreements. Subparagraph (iv) gives the franchisor protection if it decides to start a second brand. In addition, with the increase of private equity firms buying franchised brands, making sure each and every franchisee in the system has acknowledged the franchisor's right to merge with or sell to a company

that operates similar concepts can protect both the brand, and its future potential buyer, from challenges seeking to derail a merger or an acquisition brought by franchisees that oppose being part of a system that operates similar concepts that could be viewed as competitive.

Multi-brand franchisors, and single-brand franchisors wanting to establish a structure that will facilitate becoming a multi-brand franchisor or being acquired by a multi-brand franchisor, may also want to include in their reservation of rights provisions the express authority to operate, or license other brands to operate, in the franchisee's AOP.

One restaurant concept offered by a multi-brand franchisor uses concise language to express its right to operate, or franchise other brands, both inside and outside the franchisee's territory:

> "Rights Reserved to [Franchisor]. Except as expressly limited by this Agreement, [Franchisor] retains all rights with respect to the …System, the Proprietary Marks, the sale of similar or dissimilar products and services, and any other activities [Franchisor] deems appropriate whenever and wherever it desires. Specifically, but without limitation, [Franchisor] reserves the following rights:
>
> (a) The right to establish and operate, and to grant to others the right to establish and operate, similar businesses or any other businesses offering similar or dissimilar products and services through similar or dissimilar channels of distribution, at any locations inside or outside the Protected Area under trademarks or service marks other than the Proprietary Marks and on any terms and conditions [Franchisor] deems appropriate;
>
> (b) The right to provide, offer, and sell, and to grant others the right to provide, offer, and sell, goods and services that are identical or similar to and/or competitive with those provided at the … Restaurant, whether identified by the Proprietary Marks or other trademarks or service marks, through dissimilar distribution channels (including, without limitation, the Internet or similar electronic media) both inside and outside the Protected Area and on any terms and conditions [Franchisor] deems appropriate;
> (c) The right to establish and operate, and to grant to others the right to establish and operate, businesses offering dissimilar products and services, both inside and outside the Protected Area, under the Proprietary Marks and on any terms and conditions [Franchisor] deems appropriate;
>
> (d) The right to operate, and to grant others the right to operate, [Franchisor] restaurants or Nontraditional Locations anywhere outside the Protected Area under any terms and conditions [Franchisor] deems appropriate regardless of the proximity to the … Restaurant;
>
> (e) The right to be acquired (whether through acquisition of assets, ownership interests, or otherwise, regardless of the form of transaction) by a business providing products and services similar to those provided at the

[] Restaurant, or by another business, even if such business operates, franchises, and/or licenses competitive businesses in the Protected Area."

Subsection (a) obtains the franchisee's acknowledgement that the franchisor is free to operate other restaurants, or to sell any products, including those that are similar to what the franchisee sells, from any location, as long as it uses a brand other than that licensed to the franchisee, while subsection (c) permits the franchisor to allow others to use the brand to sell products other than those sold by the franchisee in the protected territory.

In Subsection (b) the franchisee acknowledges that the franchisor can sell products, using the brand licensed to franchisees, through other channels of distribution inside and outside of the franchisee's protected territory.

Finally, subsection (e) obtains the franchisee's prospective consent to the franchisor being acquired by another business, even if the acquiring brand operates restaurants.

All four provisions obtain the franchisee's acknowledgement of some important rights that multi-brand franchisors need to be able to exercise.

The example does not include two other types of rights. First, the example does not purport to reserve any rights to the franchisor's affiliates, whether those affiliates would be a parent entity, or other restaurant brands operating under the same parent entity. Second, the example does not reserve the right for the franchisor (or its affiliates) to acquire brands that may operate other restaurants. It only reserves the right for the franchisor to be acquired by another restaurant brand.

The following example, from a multi-brand hotel franchisor, not only establishes that the franchisor may license its other brands to operate in proximity to the franchisee's location, but goes on to prohibit the franchisee from challenging the franchisor's exercise of that right:

"You further acknowledge that we and our affiliates have and retain the right to own, develop and operate, and to license others to develop and operate, hotels and lodging facilities (including, without limitation, upscale, luxury, select service, resort and garden hotels and extended stay facilities), timeshare or vacation ownership resort properties, restaurants or other business operations of any type whatsoever, under any trade name, trademark and service mark at any location except the Location, including locations adjacent, adjoining or proximate to the Location, and that these business operations may compete directly with and adversely affect the operation of the Facility. You agree that we or our affiliates may exercise these rights from time to time without notice to you, and you covenant that you shall take no action, including any action in a court of law or equity, which may interfere with our or our affiliates' exercise of such rights."

d) Provisions granting the franchisor the right to outsource the obligations of the franchisor

Multi-brand franchisors are really multiple single-brand franchisors operating under common ownership and control. Many of the benefits enjoyed by multi-brand franchisors, come from utilizing their teams, and resources, to provide services to the franchisees of more than one brand, even if these teams and resources are not employed by, or owned by, the franchisee's specific franchisor. To ensure that the franchisor has the authority to have affiliated entities, or the employees of affiliated entities, to provide services to each brand's franchisees, the franchise agreements should grant the franchisor the express right to delegate its obligations to a third party, including affiliates of the franchisor. Below is the language used by one multi-brand franchisor to reserve such rights:

> "Delegation of Performance. You agree that we have the right to delegate the performance of any portion or all our obligations under this Agreement to third-party designees, whether these designees are our agents or independent contractors with whom we have contracted to perform these obligations. If we do so, such third-party designees will be obligated to perform the delegated functions for you in compliance with this Agreement."

e) Provisions relating to the use of brand development funds

Brand funds, or marketing funds, can be flashpoints for disputes with franchisees. Typically, all franchisees pay into such funds, but not all franchisees feel they get a sufficient benefit for their contribution. Even in small systems there can be disagreement over how the franchisor is using the money contributed by franchisees to such funds. For example, disaffected franchisees that have become disagreeable because of, say, the franchisor's efforts to enforce the terms of the franchise agreement, or because of the disagreements over the franchisor's strategic decisions, can turn to scrutinizing the franchisor's use of such funds in an effort to obtain leverage in negotiations or to identify a potential counterclaim to be used as a defense strategy to claims brought by the franchisor.

However, for multi-brand franchisors there can be advantages from pooling brand fund money, or from utilizing a portion of the funds from each brand to pay for coordinated promotional efforts. For example, pooling funds can allow franchisors to benefit from economies of scale when it comes to engaging advertising professionals or purchasing advertising opportunities.

Multi-brand franchisors must ensure that their franchise agreements give them express authority to use each brand fund in coordination with the franchisor's portfolio-wide strategies, because franchisors will typically be held to strict compliance with the terms of the franchise agreements relating to use the brand development funds, and the self-imposed limitations placed on their use of the funds.

One multi-brand franchisor reserves the right to formalize its use of advertising funds from across its brands by setting up a separate fund that may be used to promote all of the franchisor's concepts. Below is the language from the franchisor's 2023 template franchise agreement reserving the right to create such a fund:

> "[Brand] Fund. Franchisor or its Affiliate reserves the right to establish an advertising fund separate from the [National Advertising Fund ("NAF")] (the "[Brand] Fund") for advertising activities related to Franchisor's affiliates. Franchisee will not contribute directly to the [Brand] Fund. When the [Brand] Fund is established, the NAF shall contribute up to 5% of its monthly balance to the [Brand] Fund. The [Brand] Fund is not audited, and Franchisor is not required to provide any financial reports or other reports of [Brand] Fund. Franchisor or its affiliate will have the right to cause the [Brand] Fund to be incorporated or operated through a separate entity our affiliates own and manage if we deem it appropriate, and the successor entity will have all of the same rights and duties."

A developing single-brand restaurant franchisor reserved for itself, or for any brands it later becomes affiliated with, more broad rights by obtaining its franchisees' consent to the following language, which was included in the section of its franchise agreement relating to the use of its brand development fund:

> "If we or any of our Affiliates operate another franchise system (each, an "Affiliate Brand") we have the right to combine the Brand Development Fund with the brand development fund for any such other franchise system and use the combined funds for the joint promotion of all such franchise systems, provided that we will endeavor to spend the Brand Development Fund Assessments reasonably so that the spending is allocated in accordance with the size of each franchise system. If we combine the Brand Development Fund with the brand development fund of one or more Affiliate Brands we have the right to separate the Brand Development Fund into two or more funds, by brand or otherwise. If we separate the Brand Development Funds, you will pay the Brand Development Fund Assessment to such fund as directed by us, if any. Even if the Brand Development Fund is not combined with the brand development fund for one or more Affiliate Brands we have the right to undertake joint programs and activities promoting the System and any Affiliate Brand."

Not all multi-brand franchisors reserve the right to pool brand development funds. The multi-brand franchisors operating some of the nation's most well-known quick service restaurant brands do not expressly reserve the right to combine brand development funds. The contributions from these well-established brands are likely sufficient to make each brand's fund self-sustaining, reducing the need to pool resources.

While pooling brand fund resources can give a multi-brand franchisor more flexibility and opportunity when crafting portfolio-wide marketing campaigns, it also increases the

likelihood of spurring complaints from franchisees who feel that they, and the brand they operate, are not receiving adequate benefit from the use of the marketing funds.

f) Provisions relating to loyalty programs and other systems

Multi-brand franchisors may also want to consider including terms expressly authorizing them to require franchisees to implement loyalty or reward programs that feature not only the franchisee's brand, but the franchisor's other brands as well.

Many multi-brand franchisors in the hotel industry already have rewards programs established that are implemented across all, or many, of their brands. Therefore, their agreements tend to refer to the specific program by name with disclosures in the FDD that describe the program as one that involves multiple brands. One hotel brand, prior to its acquisition by a multi-brand franchisor, included more general language that could be used as an example for franchisors both within and outside of the hotel industry:

> **"**Cooperative Advertising and Marketing Programs.
> We may establish and coordinate cooperative advertising, marketing and sales programs, guest services programs, guest loyalty programs, frequent traveler programs, and other similar programs or activities as we deem appropriate. These programs or activities may be on a local, regional or national basis or based on the market orientation of [Brand] Lodging Facilities, and they may include participation by lodging facilities other than [Brand] Lodging Facilities, including Affiliated Lodging Facilities. You shall participate in such programs and activities as we may prescribe. Such programs and activities may require you to incur expenses and to pay reasonable fees to us."

Also, requiring each brand to share common systems is itself common in the hotel industry. Franchise agreements for hotel brands have franchisees acknowledge that their reservations systems will be used to book stays for brands other than the franchisee's. For example, one hotel franchisor's agreement states, "[w]e have the right to provide reservation services to lodging facilities other than [your brand's] facilities or to other parties."

A review of non-hotel agreements indicates that multi-brand franchisors in other industries use less explicit language. A review of non-hotel multi-brand franchisors' FDD's and template franchise agreements accessible through state registration websites revealed that many franchisors had terms in their agreements that require franchisees to, for example, "participate in and offer to your customers all customer loyalty and reward programs, promotional programs, and all contests, sweepstakes, and other promotions that Franchisor may develop from time-to-time, which may include discount or complimentary products or services." Another family of brands included this language in their concepts' franchise agreements: "Brand Standards may regulate any one or more of the following: …issuing and honoring/redeeming gift certificates, coupons, and gift and loyalty cards and administering customer loyalty and similar programs (including gift card

programs). You must participate in, and comply with the requirements of, our gift card and other customer loyalty programs."

However, none expressly stated that the franchisor could promote the parent company's other brands through their loyalty or awards programs. While the language quoted above, and similar provisions, can be read to permit the franchisor to introduce a loyalty program that promotes multiple brands, they do not secure express authority to do so. In addition, language like that quoted above limits the loyalty and rewards programs authorized by the franchise agreement to those "that Franchisor may develop from time-to-time." That language does not appear to incorporate loyalty and rewards programs developed by the Franchisor's parent entity, or affiliate entities, and therefore could be read as limiting the parent company's ability to launch a multi-brand loyalty program.

g) Provisions relating to confidentiality

A top priority of every franchisor, regardless of its size, is the protection of its confidential information. Multi-brand franchisors should ensure that the confidentiality provisions of their franchise agreements are sufficiently broad to include not just the confidential information used by each specific brand, but also the confidential information owned or utilized by any of the portfolio's entities.

Multi-brand franchisors have the benefit of drawing from the experience of their multiple concepts to identify successful strategies, and to implement them across their portfolio of brands. In this way, elements of one brand's system may be added to the system of another brand. Likewise, training programs for franchisees of one brand may refer to elements of another brand's system, or may share training facilities with other brands, thus exposing franchisees to information about the multi-brand franchisor's other concepts. In addition, franchisees of one concept may have access to franchisees from other concepts.

Regardless of whether a multi-brand franchisor's various brands share facilities, training content or other information or strategies, the franchisor's agreement should include language obligating the franchisee to maintain the confidentiality of <u>any</u> confidential information it receives. An example of the confidentiality language used by one multi-brand restaurant franchisor is provided below:

> "The term "**Confidential Information**" as used in this Agreement means all confidential and proprietary information of FRANCHISOR or any of its Affiliates, including without limitation, this Agreement, FRANCHISOR'S or any of its Affiliates' trade dress, restaurant packaging design specifications and strategies, brand standards, any information relating to business plans, branding and design, operations manuals, including the Manual (as defined in the Franchise Agreement), and other standards, specifications and operating procedures, training material, marketing and business information, marketing strategy and marketing programs, plans and methods, food specifications (including recipes, prepared mixtures or blends of spices and other food products), details of suppliers and

> distributors, and sources of supply and distribution, sales, contractual and financial arrangements of FRANCHISOR and its Affiliates and service providers, and all other information and knowledge relating to the methods of operating and the functional knowhow applicable to FRANCHISOR'S Restaurants and the FRANCHISOR'S System and any other system or brand operated by FRANCHISOR or its Affiliates revealed by or at the direction of FRANCHISOR or any of its Affiliates to FRANCHISEE, any of its Affiliates and/or any of the Principals."

Multi-brand franchisors must carefully and diligently review the terms of their franchise agreements to ensure that the agreements give them the authority to utilize staff, programs, and funds from across their portfolio both in furtherance of their current strategies and in furtherance of any future strategies. They must also ensure that their franchise agreements clearly reserve the right for them to place and promote all of their respective brands while minimizing the likelihood of disputes with franchisees.

As stated above, more brands can mean more risk and more opportunities for disputes for multi-brand franchisors. Part III of this paper will review litigation involving multi-brand franchisors, which will help multi-brands identify language and practices that create risk.

3) Risks Associated with Operating Multi-Brand Franchise Portfolios

The hospitality and fast-casual dining sectors are experiencing a surge in the proliferation of new franchise brands, driven by changing consumer preferences, technological advancements, and fierce market competition. However, amid this expansion, legal considerations loom large, particularly concerning existing brands under the same parent company and pre-existing franchise agreements. This section delves deeper into the potential legal impacts and risks of this phenomenon, exploring case law and legal precedents to illustrate key points.

The proliferation of new franchise brands can have both positive and negative impacts on existing brands under the same parent company. While it can stimulate innovation and attract diverse consumer demographics, it may also lead to cannibalization, dilution of brand equity and unwanted litigation. For franchisors, the introduction of new brands can be a strategic move to capture market share and cater to evolving consumer needs. However, launching new brands within the same parent company presents legal complexities. Multi-brand franchisors must navigate potential conflicts of interest, ensure compliance with franchise disclosure laws, and protect intellectual property rights.

For existing franchisees, the proliferation of new brands presents a mix of excitement and apprehension. While it presents opportunities for diversification and market expansion, it also raises concerns about the franchisor's commitment to supporting existing brands and further encroachment by competing brands. Franchisees may demand greater transparency and communication from the franchisor to address these concerns. Existing franchise agreements present another legal challenge. Franchisors must review and potentially renegotiate these agreements to accommodate the introduction of new brands.

This process involves negotiation with existing franchisees to address concerns about territorial exclusivity and competitive advantage.

As to prospective franchisees, disclosure laws require transparent communication of material information to prospective franchisees, including details about existing brands and potential conflicts of interest.

a) Business Risks

i. Brand Dilution

The explosion of new brands may lead to brand dilution. While brand dilution was traditionally discussed in the context of same-brand competition, many of the large franchisors are associating their name with the family of brands. As a result, brand dilution is a risk at both the brand level and the parent company level. Brand dilution is defined as the weakening or degradation of a brand's strength, identity, or value due to various factors, actions, or circumstances.[7] It occurs when a brand's core attributes or associations become less clear, distinct, or consistent, which can result in reduced brand equity and consumer perception. There are only a finite number of markets and target demographics. Thus, with more brands, there is a greater likelihood of crossover and resulting dilution. This is especially true if the new brands owned by a multi-brand franchisor are too similar.

ii. Cannibalization

Brands within the same family can also end up competing for the same customer, driving prices lower, thereby cannibalizing each other's markets. With multiple brands competing in the same market, brands may draw sales from one another, and market cannibalization may occur. The franchisor`s capacity to take on an additional brand has already been considered, but the market`s capacity for another competitor should also be considered. The multi-brand franchisor should assess if another brand will generate enough consumer activity to be worthwhile. The franchisor should be wary of adverse effects on sales if a new brand is introduced in the same market that the franchisor already competes in.

iii. Overextending

For franchisors that are intent on growing their family of brands, there is also the risk of overextending. Many franchisors centralize costs and streamline operations among a handful of brands to create efficiencies. But, with more brands comes the need for more resource capital. The franchisor risks being spread too thin and thereby unable to devote resources necessary to grow all of its brands.

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[7] Cuofano, Gennaro. "What is Brand Dilution? Brand Dilution in a Nutshell." *FourWeekMBA*, January 16, 2024, https://fourweekmba.com/brand-dilution/.

iv. Customer Confusion

Consumer or customer confusion refers to the psychological state of consumers who are confused about the source of the merchant's products, or the relationship between brands, during the decision-making stage and purchase.[8] The explosion of brands in the marketplace increases the likelihood that customers will be confused as to difference between the brands or the association of those brands with a particular parent company. To combat this, some parent companies are expressly incorporating their umbrella brand into the name of newly created or existing brands. This may have unintended litigation consequences detailed below. In any event, multi-brand franchisors should be aware of the potential customer confusion caused by the emergence of new brands.

From a marketing standpoint, franchisors and franchisees alike should be concerned about brand dilution, cannibalization, overextension and customer confusion. Franchisors and franchisees may ultimately have a slightly different focus, i.e., franchisors are trying to build brand equity while franchisees are typically more focused on their own personal equity. However, there is no dispute that a strong brand would benefit both sides. When moving multiple brands into the same market, a franchisor must be mindful to position each brand differently to avoid the detrimental effects on their individual franchisees. Franchisees, on the other hand, must implement the policies and standards of their brands to ensure that they are properly highlighting this market position and distinguishing themselves from competing brands.

b) Litigation Risks

i. Encroachment

Typically, encroachment cases in the franchise context have arisen when a franchisor permits another franchisee (of the same brand) to open in close proximity to an existing franchisee. For franchisors that also have company-owned locations, a similar scenario sometimes arises when a franchisor opens a company-owned location in close proximity to an existing franchisee. In either instance, a Court hearing an encroachment claim will first review the Franchise Agreement to determine whether an exclusive territory was granted to an existing franchisee. As a result, these cases often simply turn on the interpretation of contractual clauses governing the protected territory. If the Franchise Agreement is silent on exclusivity or protected territory, or if the subject provisions are overly broad or unenforceable, the franchisee will often plead the claim as a breach of the covenant of good faith and fair dealing or unfair competition.

In the era of multi-brand expansion, there will likely be an increase in claims by franchisees who contend that the franchisor, or its parent company, violated their territory, engaged in unfair competition, or breached the covenant of good faith and fair dealing, by opening competing brands in their market. This will be especially true if those brands were newly created or recently acquired by the franchisor or its affiliates. By way of

[8] Tu HW, Wu DD. The impact of online travel consumer confusion on negative word of mouth: From the perspective of emotional focus response. *Journal of Tourism.* 2019;34(2):73–84.

illustrative example, consider the following hypothetical. Fictional hotel franchisors, Sleeptight, Inc. and Restright, Inc., are owned by the same parent company, Parent, Inc. Parent, Inc, recently acquired Restright, Inc. and opened new locations in the same market as five of its existing Sleeptight locations. The Sleeptight franchise agreement, as suggested in part I, only provides the franchisee with protection against the opening of additional Sleeptight locations in its area of protection clause, and expressly permits Sleeptight, Inc., or its affiliates, to open different brands in the same market. Do the Sleeptight franchisees have a claim and, if so, against which entity? As suggested above, most courts will be guided by the language of the subject Franchise Agreement. Where such language is absent, courts will typically be guided by the implied covenant of good faith and fair dealing. In several states, there are also statutory protections against encroachment.[9]

In our hypothetical above, and in most real-life instances, the franchisee only has privity of contract with its franchisor entity. Thus, any encroachment claim against a parent company of a franchisor for breach of contract or breach of the implied covenant of good faith and fair dealing faces the initial hurdle of imputing liability to the parent company. This is discussed in more detail below. But assuming a franchisee can overcome that initial obstacle, additional hurdles await. As noted in part I, many franchise agreements contain clauses governing exclusivity and making clear that areas of protection are limited to the brand operated by the subject franchisee and do not extend to the affiliated brands owned by the franchisor's parent company. Courts have routinely enforced language in Franchise Agreements that limit the franchisee's protection to the brand they were operating, especially where there is also express language authorizing the franchisor or its parent company to compete with similar products or services.[10] In addition to the express language of the Franchise Agreement, Franchisors can also often point to prior disclosures of brands that are jointly owned by the Franchisor's parent company. To overcome these hurdles, the franchisee would have to demonstrate that the association

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[9] *See, e.g.,* 4 FLA. STAT. § 817.416(2)(a); HAW. REV. STAT. § 482E-6; IND. CODE § 23-2-2.7-1; IOWA CODE § 523H.1; IOWA CODE §537A.10(6); MINN. STAT. § 80C.14 Subdiv. 1; MINN. R. 2860.4400; WASH. REV. CODE § 19.100.180(2)(f); WIS. STAT. § 135.03. This article does not delve extensively into the above state statutes, but it appears that each statute prohibits encroachment (in varying degrees) by a franchisor. If the definition of franchisor were extended to apply to affiliates or parent companies of a franchisor, these statute statutes could provide another potential area of litigation for multi-brand franchisors.

[10] *See, e.g., Kazi v. KFC US, LLC*, 76 F.4th 993, 1003-1006 (10th Cir. 2023)(enforcing clause relating to protected territory and finding the covenant of good faith and fair dealing to be inapplicable in the face of an express contractual provision); *see also Auto-Chlor Sys. Of Minn., Inc. v. JohnsonDiversey*, 328 F.Supp. 2d 980 (D. Minn. 2004)(finding that a similarity between products offered by the commonly owned competing brands was not sufficient to sustain an encroachment claim where the exclusivity provision in the Franchise Agreement was limited to the specific brands sold by the dealer and expressly permitted the distributor to offer competing products); *see also Clark v. America's Favorite Chicken Co.,* 110 F.3d 295 (5th Cir. 1997)(Court found that the Franchise Agreement unambiguously reserved the right of the franchisor to enter the franchisees' area and compete against them under a different set of proprietary marks) *see also Baymont Franchise Sys. v. Bernstein Co., LLC*, 2021 U.S. Dist. LEXIS 130154, *16 (finding that the Franchise Agreement contradicts Defendants' proposed claim as to the alleged failure to provide Defendants an exclusive territory and/or the recurring fees allegedly discussed in negotiations).

between the competing brands and/or the parent company is significant enough to violate the franchisee's brand rights.

The case of *Clark v. America's Favorite Chicken Co.,*[11] while pre-dating the recent explosion of brands, remains instructive on how Courts will evaluate encroachment claims by franchisees relating to competing brands under common ownership of the franchisor. In *Clark*, the franchisee owned and operated several Popeyes franchises in close proximity to Church's Fried Chicken restaurants, Popeyes biggest competitor in the area.[12] Through a series of mergers, the Popeyes and Church's systems came under common ownership.[13] From a marketing perspective, brand ownership for the two systems positioned the brands to appeal to different target demographics.[14] The plaintiff Popeyes franchisee filed suit claiming that the parent company, America's Favorite Chicken Co. ("AFC") breached the Franchise Agreement, breached the implied covenant of good faith and fair dealing, violated Louisiana's Unfair Trade Practices and Consumer Protection Act, and tortiously interfered with its contract.[15]

The Court of Appeals for the Fifth Circuit focused on the express language of the Franchise Agreement and found that AFC did not breach the implied covenant of good faith and fair dealing through the operation of the competing franchise systems in plaintiff franchisee's territory.[16] The relevant provision stated:

> Franchisee understands and agrees that its license under said Proprietary Marks is non-exclusive to the extent that Franchisor has and retains the rights under this Franchise Agreement:
>
> …
>
> To develop and establish other franchise systems for the same, similar, or different products or services utilizing Proprietary Marks not now or hereafter designated as part of the system licensed by this Franchise Agreement, and to grant licenses thereto, without providing Franchisee any right therein….[17]

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[11] 110 F.3d 295 (5th Cir. 1997).

[12] *See id.* at 296.

[13] *Id.*

[14] *See id.*

[15] *See id*.

[16] *See id.* at 297-98.

[17] *Id.* at 297.

The Court found that there could be no breach of the implied covenant of good faith and fair dealing because the above language expressly permitted AFC to compete against the plaintiff franchisee in its area with a different set of proprietary marks. *See id.*

Similarly, in *Kazmierski v. General Nutrition Co.*,[18] a GNC franchisee sued GNC for entering into an agreement with Rite-Aid, a national retail chain, to sell its products. Some of the national retail chain locations were located in close proximity to the subject franchisee.[19] The Franchise Agreements at issue provided the franchisee with a protected territory for two years.[20] At the end of the two-year period, the Franchise Agreement provided the franchisee with a right of first refusal to develop new locations within the protected territory, and if the franchisee did not exercise its right, GNC would be able to develop the location or grant it to a third party.[21] GNC expressly retained the right, among other things, to sell and distribute directly or indirectly any goods or services without limitation, including GNC brand vitamins under the proprietary marks or any other proprietary marks to business or individual consumers located within or outside the protected territory through the use of direct mail, mail order, Internet, catalog sales, or any other similar method; and to use and license the use of other proprietary marks in connection with the operation of vitamin, health food, nutrition, or fitness stores that are the same as, similar to or different from the franchised business and that may be located at any location; provided that the store did not carry or offer GNC brand vitamins if located within the franchisee's protected territory.[22] After the execution of the subject Franchise Agreement, GNC entered into a contract with Rite-Aid Corp., permitting Rite-Aid to sell GNC's vitamin and mineral products at Rite-Aid stores in New Jersey at discount prices.[23]

The plaintiff in *Kazmierski* filed claims against both GNC (for breach of contract and encroachment) and Rite-Aid for tortious interference. In ruling on GNC's motion to dismiss, the court, without discussion on the point, dismissed all elements of the plaintiff's breach of contract cause of action except for the encroachment claim, which survived. However, in a subsequent opinion on Rite-Aid's motion to dismiss, the Court observed that the Franchise Agreement specifically allowed GNC to enter into an agreement with third parties for the sale of vitamins that did not have the GNC brand attached to them.[24] This finding all but nullifies plaintiff's claim for encroachment because the GNC product sold at the Rite-Aid stores did not carry the GNC name.

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[18] 2000 U.S. Dist. LEXIS 20819 (D.N.J. 2000)

[19] *See id.* at *6-7.

[20] *See id.* at *4.

[21] *See id.* at *4-5.

[22] *Id.* at *5-6.

[23] *Id.*

[24] *See id.* at 12.

The *Clark* and *Kazmierski* cases emphasize the need for franchisors to make sure that the language in their Franchise Agreements limits the territorial protections to the specific brand that is the subject of the Franchise Agreement and reserves the right for it, or its affiliates, to operate competing brands in the same territory. With these protections, the majority of caselaw should provide comfort in the context of an encroachment claim by franchisees. In the absence of express contractual language regarding exclusivity and or protected territories, several courts have found that franchisors have breached the implied covenant of good faith and fair dealing.[25] While these cases involved the opening of the same brand rather than competing brands, the same result could be reached in those instances.

A cautionary case demonstrating the importance of the language of the Franchise Agreement is *Oganesov v. GNC Franchising, Inc.*[26] In *Oganesov*, the franchise agreement granted plaintiff a protected area for the entire town of Brookline, Massachusetts.[27] When the plaintiff was unable to identify a suitable location in Brookline, it opened a GNC store in Boston with GNC's permission.[28] However, the franchise agreement was not revised to reflect the change in location or to allocate a different protected territory to plaintiff.[29] The plaintiff's Boston location was in close proximity to three retail stores owned by Nature's Food Centers, GNC's primary competitor. GNC subsequently acquired NFC and its retail stores. *See id.* At trial, plaintiff testified that it believed the protected area to include the area in which the NFC stores were located.[30] GNC countered by arguing that plaintiff's protected area was "premises only".[31] The court found that the GNC stores acquired from Nature's Food Centers were within plaintiff's area of protection and thus violated the franchise agreement between the parties.[32] This finding was based, in part, on testimony that GNC was anxious to establish plaintiff's presence in Boston because it did not previously have stores in downtown Boston.[33]

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[25] *See, e.g., Scheck v. Burger King Corp.,* 756 F. Supp. 543 (S.D.Fla.1991) and *In re Vylene Enter., Inc.,* 90 F.3d 1472 (9th Cir.1996).

[26] 2002 Pa. LEXIS 113 (Pa. Ct. of Common Pleas 2000).

[27] *See* 20 Franchise L.J. 34, 36.

[28] *See id.*

[29] *See id.*

[30] *See id.*

[31] *See id.*

[32] *See id.*

[33] *See id.*

Other cases outside of the franchise context also provide a warning about the potential risk of opening or acquiring competing brands. In *P.T. Karang Mas Sejahtera v. Marriott International, Inc.*,[34] plaintiff, the owner of the Ritz-Carlton in Bali, filed suit against Marriott International, Inc. and The Ritz-Carlton Hotel Company, LLC arguing that defendants violated both its territorial rights and brand rights pertaining to its use of the Ritz-Carlton name in connection with a Management Agreement for the Ritz-Carlton Bali. The case stems from Ritz-Carlton's joint venture with Bulgari S.p.A., the Italian jewelry company, to create and operate a Bulgari Hotels & Resorts location three miles from the existing Ritz-Carlton Bali. The issue in that case was whether Marriott, in arranging for Ritz-Carlton to help develop, market, and manage the Bulgari hotel properties, violated the brand rights that plaintiff had acquired through its management agreement with Ritz-Carlton. A jury in the United States District Court, District of Maryland, found in favor of plaintiff and awarded $382,000 in compensatory damages and $10 million in punitive damages. The case subsequently settled for an undisclosed amount. The jury found that plaintiff demonstrated that Ritz-Carlton violated its fiduciary duties by operating that competing property in disregard of the franchisee's territorial rights and failing to recognize its responsibilities as an agent of the Ritz-Carlton.[35] While this case was heavily focused on agency principles that would not likely be present in the context of an encroachment claim involving a Franchise Agreement, it highlights the importance of territorial rights and brand rights.

ii. Lack of Support or Disparate Treatment

A franchisor parent company supporting multiple brands is susceptible to claims by its franchisees for lack of support. For example, if a parent company devotes more marketing resources to one of its brands at the expense of the other brands or is simply unable to provide adequate support to its increasing number of brands, it risks claims by franchisees for disparate or differential treatment, simple breach of contract, or breach of the implied covenant of good faith and fair dealing.

The case of *Hanson Hams, Inc. v. HBH Franchise Co*.,[36] illustrates potential disparate treatment claims associated with a franchisor's acquisition of a competitor. The *Hanson Homes* matter concerned the acquisition of the Heavenly Ham franchise system, of which Plaintiff was a franchisee, by a subsidiary of Defendant. Defendant was the franchisor of Heavenly Ham's major competitor, the HoneyBaked Ham franchise system.[37] Plaintiff alleged that Defendant's post-acquisition treatment of the Heavenly Ham system *vis-a-vis* its treatment of the HoneyBaked Ham system was "unfair," "deceptive," and/or "unconscionable" within the meaning of the Florida Deceptive and Unfair Trade Practices Act ("FDUTPA"), Florida Statutes Section 501.201 *et seq.* Among other things, the plaintiff claimed that the defendant parent company "favored one franchise system over

[34] 2005 U.S. Dist. Ct. Pleadings LEXIS 22292 *

[35] *See id.*

[36] 2004 U.S. Dist. LEXIS 29636.

[37] *Id.* at *1-2.

the other by way of promotion, development and support."[38] The Court conducted an extensive analysis of the FDUTPA and granted summary judgment in favor of the defendant. Among its findings, the Court stated:

> Carried to its logical conclusion, Plaintiff's argument would entitle every acquired entity to enjoy the same benefits as the acquiring entity, lest the FDUTPA be violated, regardless of the comparative size, revenue, and purchasing power of the respective entities. As applied to the facts of this case, such an entitlement "would be tantamount to subsidizing the Heavenly Ham system with money generated by the HoneyBaked Ham system." Memorandum at 3 (DE 54). There exists no support, legal or otherwise, for such an entitlement.[39]

Brand acquisitions and mergers are often the precipitating event for disparate treatment or insufficient support claims. In 2014, a Tim Hortons franchisee sued the company and its parent, Restaurant Brands International Inc., for $500 million in damages, claiming that the franchisor began misusing ad fund revenue shortly after the merger between Tim Hortons and Burger King. The suit alleged that Restaurant Brands International Inc. was collecting money from its Tim Hortons' franchisees and funneling it towards interests unrelated to the brand, and as a result increased charges for administrative costs after the merger. The suit further claimed that these charges increased even though Restaurant Brands International Inc. terminated almost half of the employees responsible for marketing. The compensation for those employees was previously paid by the fund.

As with other types of claims discussed in this section, the language of the Franchise Agreement is critical. In the *Clark* case, discussed above, the franchisee asserted that the franchisor improperly operated the two systems, specifically with how it marketed the two systems.[40] The Court found that the Franchise Agreement negated these claims because the franchisor was provided with sole discretion as to the selection of media and locale of media placement.[41] Additionally, the language made clear that the marketing was for the benefit of the entire system, not individual franchisees.[42]

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[38] *Id.* at *5.

[39] *Id*. at *23-24.

[40] *See Clark*, 110 F.3d at 298.

[41] *Id.*

[42] *Id.*

iii. Tortious Interference

Acquisitions of competing brands also give rise to potential tortious interference claims. In *Jade Grp., Inc. v. Cottman Transmission Ctrs., LLC*,[43] the plaintiff franchisees of Cottman Transmission Centers, LLC ("Cottman"), an automotive transmission repair franchise, sued Cottman, its parent American Driveline Systems, Inc. ("American Driveline") and another American Driveline subsidiary, Global Powertrain Systems, LLC (collectively "Defendants") alleging tortious interference with contract and with Plaintiffs' business relationships among other claims.

Plaintiffs asserted that American Driveline tortiously interfered in the License Agreements by: 1) deciding not to invest resources into the Cottman brand and instead focusing on its AAMCO and GPS brands; 2) purposefully undermining the Cottman brand; and 3) convincing Cottman customers to purchase remanufactured transmissions from GPS instead of encouraging them to have Cottman franchisees repair their transmissions.[44] The Court denied defendants' Motion to Dismiss for essentially two reasons. First, when viewing the facts alleged in the Complaint in a light most favorable to plaintiff, as the Court was required to do, the Court accepted that plaintiff demonstrated that "American Driveline was driven by an interest in aggrandizing itself through the growth of Cottman's 'corporate sibling,' AAMCO."[45] Second, the Court rejected defendants' claim of parent privilege and found that defendants' did not otherwise allege that the tortious interference count failed to state a claim as a matter of law.[46]

Tortious interference claims also arise in the context of a franchisor's decision to sell its products through alternative distribution channels, rather than solely through its franchised locations. In *Carvel Corp. v. Noonan*,[47] the franchisees filed suit against the franchisor, alleging that distribution of the franchisor's products in supermarkets hurt their business. The Court held the franchisees' interference with prospective economic relations claim was not valid because the franchisor's conduct did not rise to the level egregious wrongdoing because there was no independently unlawful act or evil motive.[48] The franchisor's actions were instead motivated by normal economic self-interest.[49]

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[43] 2016 U.S. Dist. LEXIS 90630.

[44] *Id*. at *14-15.

[45] *Id.* at *33-34.

[46] *Id.*

[47] 3 N.Y.3d 182 (2014).

[48] *Id.*

[49] *Id.*

iv. Alter Ego

In seeking to assert claims against its franchisor's parent company, especially claims tethered to its Franchise Agreement, a franchisee must overcome the hurdle presented by the lack of privity of contract between the franchisee and the parent company. To overcome this hurdle a franchisee may have to pierce the corporate veil or establish some other way to impute liability to the parent company. The fact that the parent and subsidiary share the same "brand" is insufficient to establish alter ego liability against the parent company of the franchisor.[50] Rather, the franchisee would have to establish that the parent company dominated the franchisor to such an extent that the franchisor had no separate existence and was merely a conduit for the parent.[51]

In the case of *Monopoly Hotel Group v. Hyatt Hotels Corp.*,[52] Monopoly Hotel Group ("Monopoly"), a master franchisee for Hawthorn International, Inc. ("Hawthorn") filed suit against Hyatt Hotels Corp. ("Hyatt"), alleging that soon after Hyatt obtained an ownership interest in Hawthorn's parent company, U.S. Franchise Systems, Inc. ("USFS"), Hyatt sought to restrict and limit Monopoly's ability to develop hotels in its contracted territory, in part, because of Hyatt's competing business interests in the territory. Monopoly claimed that Hawthorn ceased to exercise any discretion over the approval process for new developments in Monopoly's licensed territory and Hyatt became the final authority on approving or disapproving any Monopoly development project.[53] Monopoly contended that by replacing Hawthorn as the party responsible for approving projects, Hyatt was obligated to exercise good faith but breached its obligation to approve qualified franchisees and sites pursuant to the MLA.[54]

After finding that Hyatt was not a party to the Master License Agreement ("MLA") between Hawthorn and Monopoly, the Court conducted an extensive analysis as to whether Hyatt was an imputed party bound by the terms of the MLA, including under an alter ego theory.[55] In evaluating Monopoly's claim, the Court found that Hyatt was not the alter ego

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[50] *See Horowitz v. AT&T Inc.*, 2018 U.S. Dist. LEXIS 69191, 2018 WL 1942525, at *9 (D.N.J. 2018) ("[a]ccepting Plaintiffs' position would extend the alter ego doctrine, such that entities utilizing the same brand, website, and policies would be imputed as alter egos."); *see also Laverty v. Cox Enters.*, Civ. No. 18-1323 (FLW) (TJB), 2019 U.S. Dist. LEXIS 13588, at *11-12 (D.N.J. Jan. 29, 2019) (holding that subsidiary was not alter ego of subsidiary where plaintiff relied "on general corporate and marketing statements that vaguely touch on the relationship" between parent and subsidiary).

[51] *See* Mills v. Ethicon, Inc., 406 F. Supp. 3d 363, 395 (DNJ 2019).

[52] 2016 U.S. Dist. LEXIS 198922.

[53] *Id.* at*4-5

[54] *Id.*

[55] *Id.* at *76-79.

of Hawthorn because, among other reasons, Hyatt and Hawthorn's corporate forms were not used to defeat justice or allow Hawthorn to evade its responsibility under the MLA.[56]

Conclusion

The proliferation of new franchise brands in the hospitality and fast-casual dining industries offers exciting prospects for growth and innovation. However, it also brings forth significant legal challenges that must be carefully navigated. As demonstrated by the sampling of court cases noted above and other legal precedents, proactive management of these legal implications is essential for the long-term success of franchise systems in these industries. One common theme is that a franchisor can mitigate litigation risk largely through careful drafting of its franchise agreements with forethought given to potential brand acquisition and expansion. Franchisors can further mitigate litigation risk and foster sustainable growth by adhering to relevant laws, protecting intellectual property rights, and maintaining open communication with franchisees. Both sides must maintain a collaborative relationship between franchisors and franchisees to ensure mutual success.

[56] *Id.* at *79.