



**Basics Track:
Franchise Litigation**

From Dispute to Resolution

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BIG PICTURE

- When and why does franchise litigation happen?
- What are the most common claims?
- Where will the fight occur, and how will it be conducted?

When and Why Does Litigation Happen?

- What are the drivers?
- What are the costs?
- What are the alternatives?

Life Cycle of a Franchise Relationship

- Disputes and litigation can arise relating to each stage
 - Pre-sale disclosure and negotiations
 - Contract performance
 - Contract termination
 - Post-termination activities

Common Drivers of Litigation

- For the franchisor:
 - Failure to pay fees
 - Non-compliance with system standards
 - Abandonment
 - Breach of post-term obligations

Common Drivers of Litigation

- For the franchisee:
 - Pre-sale misrepresentations
 - Lack of business profitability
 - Lack of support, guidance, or training
 - Encroachment
 - Wrongful termination

Business Costs of Litigation

- Litigation is frequently a last resort (for good reason):
 - Litigation costs and fees
 - Disclosure requirements
 - Significant management disruption
 - Negative morale impact on the existing system
 - Threat of injunction or adverse monetary judgment

Alternatives to Litigation

- Franchisors/franchisees may have several alternatives:
 - Forbearance, Probation, training, and rehabilitation (commonly used for deficient sales performance but can be used for a variety of issues)
 - Approved transfer or franchisor “buyout” (rather than termination)
 - B2B pre-litigation negotiations
 - Pre-litigation neutral-led mediation

What are the Most Common Claims?

- Franchisee's potential claims
- Franchisor's most common claims
- Substantive defenses
- Remedies

Franchisee's Potential Claims

- Pre-sale claims:
 - Based on state statutes, regulation, and common law
 - Improper/inadequate franchise disclosures
 - Fraud and financial misrepresentations
 - Unfair and deceptive trade practices

Franchisee's Potential Claims

Post-sale claims:

- Breach of contract/good faith and fair dealing
 - Training, advertising, support services
 - System changes
 - Supplier issues
 - Encroachment
- Refusal to consent to transfer/sale
- Unlawful termination/nonrenewal
- Violation of state relationship laws

Franchisor's Potential Defenses

Procedural defenses:

- Choice-of-law and inapplicability of franchise statutes (wrong law)
- Transfer/removal/compel arbitration (wrong place)
- Statutory and contractual limitations (wrong time)
- Franchisee's release of claims

Franchisor's Potential Defenses

Substantive defenses:

- Merger, integration, and anti-reliance clauses
- Statutory “good cause” for termination
- Franchisee’s failure to comply with contract (beware of anti-waiver provisions)
- Economic loss doctrine

Franchisor's Potential Claims

- During the relationship:
 - Failure to pay fees
 - Non-compliance with system standards
 - Unauthorized in-term competition
 - Poaching employees

Franchisor's Potential Claims

- After the relationship:
 - Trademark/trade name infringement (Lanham Act)
 - Non-compete/non-solicitation violations
 - Disclosure of confidential information and trade secrets

Franchisee's Potential Defenses

- Post-sale defenses (sometimes counterclaims):
 - Unlawful termination (e.g., no “good cause,” notice/cure period, etc.)
 - Non-compete illegality
 - Injunction enforcement defenses (e.g., no “irreparable harm”)
 - Franchisor's failure to mitigate its damages
 - Franchisor's material breaches

Available Franchisor Remedies

- Contract damages (incl. lost profits and attorneys' fees)
- Injunction (de-identify; stop competing)
- Declaratory relief (i.e., termination was lawful)
- Post-termination remedies:
 - Recovering unpaid royalties, advertising fees, products/services invoices
 - Liquidated damages and “final payments” under the franchise agreement
 - Lost future royalties and fees based on abandonment or material breaches

Available Franchisee Remedies

- Rescission and restitution
- Contract damages (incl. lost profits or fair market value?)
- Injunction (do not shut me down)
- Statutory or contractual attorneys' fees

Temporary Restraining Orders and Preliminary Injunctions

Early injunctive relief can provide significant leverage. Seeking it escalates the dispute (and fees), but there may be good reason:

- Some state laws create presumption of irreparable harm
- Franchisor protecting IP, trade secrets, proprietary info, customer goodwill, public health, etc.
- Franchisee preserving sole income source

Arbitration can provide emergency relief. (*For Example, AAA Rule 38*)

Where and How?

- Arbitration and forum (venue) disputes
- Stages of litigation

Pre-Litigation Strategic Considerations

- Where litigation is unavoidable, parties have several important pre-suit strategic considerations:
 - What venue should we sue in?
 - Is there an enforceable agreement to arbitrate?
 - What law applies? Will it enforce or override the contract language?
 - Should we seek an immediate injunction?
 - Litigation holds and document preservation
 - Pre-litigation internal and external investigations

Litigation versus Arbitration

- Litigation:
 - Public record
 - More discovery tools and immediately binding orders
 - Dispositive motions and waiting times
 - Opportunity for a jury trial
 - Full appeal rights
 - Higher attorneys' fees on average
- Arbitration:
 - Confidential
 - Opportunity for streamlined discovery
 - Informal evidentiary process
 - Experienced arbitrator(s)
 - Limited appeal right
 - Higher upfront fees and arbitrator costs

Time-consuming Procedural Issues

- Manage expectations re: time to resolution. Litigation is often bogged down with early (and pricey) procedural battles:
 - Removal and/or remand
 - Choice-of-law
 - Forum-selection clauses/ transfer motions
 - Arbitration fights
 - Jurisdictional issues
 - Motions to dismiss and amended pleadings

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Questions?