THE GOLDSTEIN LAW GROUP, P.C.

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FRANCHISE TRENDS

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*SERVING CLIENTS THROUGHOUT THE COUNTRY**

ANNOUNCING FORMATION OF GOLDSTEIN PATEL

Jeff Goldstein and Asvin Patel are pleased to announce the formation of a new informal franchise consulting group that will be called Goldstein Patel. Asvin Patel, a well-known and highly respected franchise hotelier, has teamed up with Jeff Goldstein, the founding partner of The Goldstein Law Group, to form the new consulting group.

Goldstein Patel will provide a broad array of consulting services that will directly complement the legal services currently provided by The Goldstein Law Group. Goldstein Patel will offer the following services:

- Termination and Liquidated Damages Claim Negotiations.
- Expert Witness Support.
- Litigation Support.
- Mediation Services.
- Franchise Agreement Formulation.

Patel stated that he believed that Goldstein Patel is uniquely situated to meet the requirements and challenges of franchisees in today's competitive marketplace. "As far as we are aware, there are no national firms that have the expertise or resources to provide under one roof both legal and consulting services to franchisees." Patel continued pointing out that he and Goldstein have worked together successfully in the past on many projects. "Jeff has always relied on my business experience and I on his legal expertise. We believe that our new group will provide significant benefits to the franchise community."

Goldstein explained that he had the idea to form Goldstein Patel after many of his clients came to him with legal problems that could and should have been avoided. "Even in cases where franchisees have themselves or through consultants been able to negotiate favorable settlements or agreement terms, they appear consistently to have been unable to adequately memorialize these benefits in writing."

Goldstein explained that the new group, in conjunction with the law firm, will provide to franchisees "the best of both possible worlds." Goldstein indicated that he anticipated that in most circumstances the costs to franchisees of using both the law firm and the consulting group should be less than those charged by law firms and consulting groups by themselves. "This will be a win-win situation for franchisees."

LANDMARK FEDERAL COURT RULING PROTECTS FRANCHISEES, DEALERS, AND SMALL BUSINESSES

The United States District Court for the District of New Jersey set precedent in ruling definitively that franchisors may no longer hide behind sophisticated merger and integration clauses in franchise agreements and in disclosure circulars to shield themselves from fraud and other misrepresentations by their sales and marketing staff. **Travelodge Hotels, Inc. v. Honeysuckle Enterprises, Inc., No. 02-2889, 2005 U.S. District Lexis 2522 (D.N.J. Feb. 16, 2005).** The Federal Court's decision was so significant in the franchise world that the Court submitted the Opinion for publication.

Jeffrey M. Goldstein, founding partner of The Goldstein Law Group, PC, a litigation boutique in Washington, DC and New Jersey, and lead counsel for the prevailing franchisee, commented that "This decision is somewhat devastating to franchisors in that it removes the sharp fangs from integration clauses that up until now had been used by franchisors to feast freely at the financial tables of franchisees". Goldstein also pointed out that this decision was significant in that it would definitely affect literally hundreds of thousands of franchise and dealer agreements throughout the country, all of which contain merger and integration clauses.

In the **Travelodge** case, the franchisee, Honeysuckle Enterprises, claimed that Travelodge salesmen had fraudulently induced it into signing a 15-year franchise agreement to operate a Travelodge in Missouri. Specifically, Honeysuckle claimed that Travelodge salesmen, during the negotiations for the sale of the franchise, showed Honeysuckle Denial data which was represented by the salesmen as showing

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**Jeffrey M. Goldstein is admitted to practice in Pennsylvania, New York, Massachusetts and Washington, D.C. Mr. Goldstein appears on behalf of franchisees in courts in many other states through Pro Hac Vice admission. This is advertising material. The information contained herein is informational only, and not legal advice. It is not intended to create an attorney-client relationship. This Franchise Trends publication contains general information on legal issues and is not a substitute for legal advice from a qualified attorney.*

tens of thousands of reservations being turned away in Honeysuckle's area. Evidence presented by Honeysuckle showed that the reservation Denials were actually in no way reflective of reservations turned away.

Travelodge's primary defense to these allegations was that Honeysuckle's evidence of fraud cannot be considered by a jury because the parol evidence rule and the merger clause in the franchise agreement prohibited the introduction of oral promises to alter or vary the franchise agreement. The merger clause, hidden within the prolific boilerplate language in the franchise agreement, stated that Honeysuckle could not later claim that Travelodge's salesmen and marketing staff had made any misrepresentations to Honeysuckle. Honeysuckle's counsel argued that the parol evidence rule should make an exception for claims of fraud. The Federal Court agreed with Honeysuckle, and held that the evidence of fraud was admissible notwithstanding the parol evidence rule, the integration clause, and the disclaimer of reliance in the franchise agreement.

Federal Court Rules That Ramada Is Not Entitled to Liquidated Damages for Early Termination by Franchisee

The United States District Court for the District of New Jersey ruled in favor of two Ramada hotel franchisees, MBJS Inc. and Mulraj Gandhi, the latter of which had operated a Ramada hotel in Ohio. In the suit, Ramada sought to collect from MBJS and Gandhi an estimated $400,000 to $500,000 in damages and attorney's fees. Earlier last year, the Court ruled that Ramada was not entitled to collect any of the significant liquidated damages Ramada had demanded. MBJS and Gandhi were represented by Jeffrey M. Goldstein, founding partner of The Goldstein Law Group, a commercial litigation boutique that specializes in representing franchisees and dealers in litigation across the country.

The dispute between the franchisees and Ramada arose when MBJS and Gandhi attempted to terminate their franchise agreement "early," before the full term of the fifteen-year franchise agreement had run its course. Under the terms of the franchise agreement, which was initially signed in 1997, MBJS and Gandhi were permitted to end the franchise agreement early without any penalty on the fifth anniversary of the opening date of the hotel, but only if the franchisees had never suffered an uncured default. The Ramada franchise agreement provided that in the event the franchisees were terminated for any reason they would be liable to Ramada for a significant penalty or liquidated damages.

After MBJS and Gandhi opened the hotel in 1997, Ramada and the franchisees weathered a stormy business relationship. While the franchisor repeatedly failed the franchisees on quality inspections, the franchisees complained bitterly that the franchisor had failed to provide them with necessary business and marketing support. Finally, Ramada terminated the franchisees, based on alleged multiple quality inspection failures.

Shortly thereafter, Ramada and its franchisees entered into a reinstatement agreement bringing the hotel back on line as a Ramada hotel. Even after the reinstatement, MBJS and Gandhi claimed that, because they again were not receiving from Ramada crucial support, their hotel was unable to operate profitably as a Ramada. Accordingly, the franchisees exercised their early termination right under the franchise agreement and so notified Ramada that they would no longer operate as a Ramada hotel. In giving their notice under the early termination provision of the franchise agreement, MBJS and Gandhi believed that they would not be liable for any of the penalty damages that they otherwise would have been responsible for as a result of the early termination.

Ramada refused to acknowledge the early termination; instead, Ramada terminated the franchisees for their having attempted to exercise their early termination right, arguing that the franchisees' early termination right no longer existed. Ramada took the position that the reinstatement agreement had voided the early termination right that previously existed in the initial 1997 franchise agreement. According to Ramada, because the underlying franchise agreement had been rendered null and void before the reinstatement agreement was signed, the franchisees' right to terminate the agreement early was no longer a part of the franchise agreement and therefore could not have been revived through the reinstatement agreement.

In ruling for the franchisees, the Court accepted the arguments made by Goldstein that the reinstatement agreement revived all of the rights and obligations under the original franchise agreement as it existed when it was first signed. In essence, the Court agreed with the franchisees that the term "reinstatement" referred to the terms of the franchise agreement at the time the franchise agreement was signed, not at the time the reinstatement agreement was signed. Thus, even though the Court recognized that the franchisees had indeed lost their early termination right shortly before the reinstatement agreement was signed, it held that the reinstatement agreement had fully revived the early termination right.

Goldstein commented that the Court's ruling was consistent with both law and equity. Goldstein pointed out that the Court explicitly stated in its opinion that "both justice and common sense dictate that this Court find that the reinstatement agreement reinstated all of the terms of the license agreement, including the early termination right." Goldstein indicated that this case was a win not only for the Ramada franchisees, but for all franchisees around the country: "Franchise law is and has historically been indisputably weighted heavily in favor of franchisors. But this case will help tip the scale towards a more even balance between franchisors and franchisees. Accordingly, we hope that the decision will lead franchisors to embrace more equitable and reasonable modes of dealing with their franchisees."

Federal Jury Finds That H&R Block Wrongfully Terminated Franchisee

For the first time ever, a Federal Court Jury in Arizona rendered a verdict against H&R Block, the largest tax preparation franchisor in the world, finding that it had wrongfully terminated one of its franchisees. The former franchisee, Margaret Miller, had worked for twenty years as a Block franchisee before she was wrongfully terminated by Block. At the time of Block's wrongful termination Miller owned three Block tax preparation offices in Arizona.

Jeffrey M. Goldstein, lead counsel for Miller's trial team, stated, "we are all very happy with the jury's verdict. Many people told Ms. Miller that she didn't stand a chance at trial on her case against Block; the jury, however, disagreed."

The jury's verdict was a major loss for Block, which had sought to collect from Miller approximately $800,000 – includ-

ing $200,000 in alleged lost royalties and an estimated $600,000 of attorney's fees incurred by Block over the three years of litigation. In addition to losing its bid to collect damages and fees of almost $800,000 from Miller, Block also lost its request that the Court enforce Miller's post-term covenant-not-to-compete, which would have prohibited Miller from operating her independent tax business that she had been operating since the wrongful termination.

Block vigorously prosecuted the Federal Court litigation arguing to the jury that Miller was properly and necessarily terminated because she allegedly refused to remove unapproved Block signage and trademarks. Miller countered that the signage issue was a pretext for Block's desire to take for itself Miller's three tax preparation offices. Indeed, at trial, Miller presented evidence that Block had repeatedly attempted unsuccessfully to purchase for itself Miller's tax business.

Goldstein also expressed great satisfaction that Block was unsuccessful in its attempt to shut down Miller's independent tax business. "The use of covenants-not-to-compete by franchisors is especially egregious in wrongful termination cases like Miller's where, after a divorce from its franchisor, the franchisee has no way to earn a living other than to continue to work within the industry covered by the franchise." Goldstein pointed out that courts around the country regularly enforce these restrictive and harmful covenants against franchisees. Goldstein stated, "although the chances of a franchisee prevailing on a covenant-not-to-compete case are not very great, they are not impossible. In fact, two years ago a Block franchisee in Minnesota, represented by The Goldstein Law Group, successfully rebuffed Block's attempt to enforce a post-term covenant-not-to-compete similar to the one at issue in Miller's case."

Premises Liability

The law on liability for franchisor or distributor liability for the wrongdoing of franchisees, dealers and third parties is not always clear. This is because, in addition to the general common law, or non-statutory law applicable to these issues, many franchise and dealership agreements have provisions that do not fit easily into black letter law regarding respondeat superior. Whether based on common law, or contractual provisions, it is important to understand that many unstated policy considerations often govern the outcome of these disputes.

For instance, a fast food Arby's franchisor was not liable for a franchisee's negligent hiring and supervision of one of its employees who during his scheduled working hours shot and killed one person and permanently disabled another; the franchisee had sole control over the hiring and supervision of its employees. ***Kerl v. Arby's Inc.***

However, courts have also held that a franchisor or distributor is vicariously liable for the tortious acts of its franchisee or dealer when an agency relationship exists and the challenged conduct is within the scope of the agent's authority. In turn, this depends on the degree of control retained by the principal over the details of the work that is being performed. Although the franchisor – Stanley Steemer – had a 21-page franchise agreement regarding the operations of the franchise, this was insufficient to show that the franchisor had daily control of the day-to-day operations of the franchisee. ***Miller v. Stanley Steamer.***

In addition, a plaintiff hotel patron sued a defendant franchisor for personal injuries she sustained when she was assaulted at the hotel. Although the franchise agreement required the Ramada franchisee to maintain its operations in conformance with a detailed agreement and operations manual, the Court found that the defendant Ramada did not exercise day-to-day control over the operations of the hotel; accordingly, the franchisee, and not the franchisor, would be liable for failing to inform the patron of the crime rate in the hotel's vicinity and on its property. Hayman v. Ramada.

On this issue of third-party liability, it is crucial that you have competent advice on how your franchise or dealership agreement addresses premises liability. In ***Zeidler v. A&W Restaurants*** the U.S. District Court for Illinois held that a fast food franchisor was justified in terminating a franchisee who did not procure liability insurance for its franchise as required under the franchise agreement. Notably the Court refused to even consider the franchisee's argument that the franchisor had terminated the franchisee for other unrelated reasons.

Further, in addition to making absolutely sure that you have obtained competent legal advice regarding the franchise or dealership agreement before signing the agreement, it is just as crucial that after an injury occurs on your premises you obtain the advice of a skilled litigator in the face of the refusal of an insurance company to honor a claim covered by your insurance policy. In ***West America Insurance Co. v. AV&S***, the U.S. Court of Appeals for the Tenth Circuit held that an insurance company was obligated to defend negligence claims against the franchisor and several franchisees as a result of a very tortured analysis of the relationship between the "separation of insureds" provision and "auto exclusion" clause in the agreement.

What should I know about insurance as a small business?

As a threshold issue, your franchise or dealership agreement may dictate both the amount and type of insurance you are required to have. Compliance with the agreement may, for example, require all-risk physical damage coverage, commercial comprehensive and general liability insurance policies (covering you, the franchisor, and its subsidiaries), or statutory Workers Compensation and Employers Liability insurance. The franchise agreement may require coverage of at least 80% of the replacement cost of your business and full coverage for 12 months of Business Interruption. Sometimes, a franchisor requires that you choose insurance companies that are "reasonably acceptable" to the franchisor, and requires that you provide proof of your insurance before opening your business.

In other instances, the franchise or dealership agreement may refer you to an Operations Manual to explain the type of insurance you may be required to have. Some may require that the insurance carrier be rated "A" or better, or may actually name a preferred insurer. Issues that you should consider and resolve before purchasing insurance include:

- Does my insurance name me individually, my company, the franchisor, and its subsidiaries?
- Does the amount meet the minimum requirements as required by the franchise agreement?
- Does the type of insurance meet the minimum requirements as required by the franchise agreement?
- Do the minimum insurance requirements set forth in the franchise agreement meet my own business needs and take into account all of my assets?
- In short, does my insurance protect me from liability both from third parties and from the franchisor?

Alcoholic/Malt Beverages

Carlson Distributing Co. v. Salt Lake Brewing Co. L.C., Where a brewer breached a distribution agreement by terminating it without just cause, the terminated beer distributor was not entitled to recover lost profits because the distributor only presented evidence of its lost gross profits, but the law required evidence of lost net profits.

Granholm v. Heald. The U.S. Supreme Court ruled that Michigan and New York laws permitting in-state wineries to make direct sales to consumers in their respective states at terms not available to out-of-state wineries violated the Commerce Clause of the U.S. constitution and was not permitted under the Twenty-First Amendment.

Bellboy Corp. v. Allied Domecq Spirits and Wine USA Inc. A liquor distributor's pricing system, a depletion-based incentive program, was found not to be price discrimination in violation of the Robinson-Patman Act because it was available to all wholesalers.

Bacardi U.S.A., Inc. v. Premier Beverage, Inc. The reasonableness of a liquor supplier's termination of a distributor was better suited for Kansas state court than for federal court because certain issues could not be litigated in federal court.

Legislation

Wisconsin Fermented Malt Beverages

With limited exceptions, a 2004 Wisconsin enactment provides wholesalers of fermented malt beverages with compensable rights to the brands of beer they currently distribute. If a brewer or out-of-state shipper terminates an agreement for distribution of a brand of beer and chooses to have its brand of beer distributed in the same territory by a different wholesaler, the law mandates that the successor wholesaler must compensate the terminated wholesaler for the fair market value of the distribution rights for the territory.

Service Stations/ Convenience Stores

The US Supreme Court has ruled that the constitutional test of a Hawaii statute capping the rent that oil companies could charge a gasoline station lessee should not be whether the statute substantially advances legitimate state interests, in deciding whether the statute effected a Fifth Amendment governmental taking of private property. ***Lingle v. Chevron USA Inc.***, US Sup. Ct, P. 13, 069.

A gasoline station franchisor could have violated the Petroleum Marketing Practices Act (PMPA) by improperly relying on the "loss of the franchisor's right to grant possession of the leased marketing premises through expiration of an underlying lease" as grounds for ending the franchise relationship between the parties. The franchisor's actions were exactly what Congress intended to prohibit with the enactment of the PMPA, according to the court. ***Mustang Marketing, Inc. v. Chevron Products Co.***, CA-9, P 13,059.

Farm Equipment/ Industrial Equipment

Andale Equipment v. Deere & Company. The Tenth Circuit upheld a $955,270.00 award granted to a John Deere dealership, after the court found that an oral promise by Deere & Company to Andale Equipment, Inc. that it would relocate a competing dealership and give Andale Equipment, Inc. an exclusive territory constituted a binding agreement.

Elliot & Frantz v. Ingersoll-Rand. A Federal Court in Pennsylvania held that under New Jersey law a construction equipment manufacturer can terminate a distributorship agreement without cause. The Court held that the parties were of substantially equal bargaining power and that the written agreement allowed for termination by either party without cause.

Nacco Materials Handling v. Toyota Materials Handling. A breach of the exclusivity provision cannot constitute " good cause" for termination under the Tennessee Farm Implements and Industrial Equipment Dealer Law because the manufacturer violated the dealer law by threatening litigation and termination of the dealer's agreement after learning that the dealer was negotiating a possible agreement with a competing supplier.

Farm Equipment/Industrial Equipment

Legislation

Florida — Amendments to its agricultural equipment dealer law extend the notice requirement prior to termination or the expiration of a dealer agreement from 90 days to 180 days. The amendments require one-year advance written notice before termination of a franchise because of the dealer's failure to meet marketing criteria or market penetration terms.

Virginia — The Virginia Farm Machinery Dealer law was amended to add that a supplier is not required to provide notice of right to cure to a dealer if the reason for the termination, cancellation, or nonrenewal of the dealer is for good cause as defined under the law.

Real Estate Dealerships and Franchises

Real Estate Corp. v. Century 21 Real Estate Inc. A federal court affirmed the district court's grant of a permanent injunction barring a Puerto Rico real estate broker from using the federally registered trademark of a nationwide real estate franchisor that had not yet conducted business in Puerto Rico, where Plaintiff argued that the franchisor presented no evidence of deliberate infringement and failed to establish a likelihood of confusion.

Century 21 Real Estate Corp. v. CLTM Associates. A federal court held that a real estate office franchisor was not entitled to summary judgment under New Jersey Law on its claim that a franchisee breached its franchise agreement, where the franchisor alleged that the franchisee failed to pay royalty fees and the franchisee alleged that the franchisor failed to list it on the franchisee directory website, causing lost business and referrals.

Century 21 Real Estate Corp., v. Dignennaro Real Estate Inc. A federal court held that a former real estate franchisee was in contempt of court for violation of an injunction prohibiting it from marketing real estate under the designation of "Century 21," where it failed to visually inspect the properties that were for sales to insure they bore no infringing signage.

Century 21 v. Magee. A federal court in California held that a real estate franchisee's use of a mark similar to the franchisor's

federally registered mark constituted trademark infringement and unfair competition because of the likelihood of confusion that it caused.

Negotiating Lease Agreements

- **Abandonment of the Property -** Many leases have clauses stating that if you vacate all or part of the property you are in default and can be liable for substantial damages. Protect your rights, eliminate liability by including a clause that you have the right to vacate the property so long as you continue to pay the rent.
- **Acceleration Clauses -** Do not sign leases containing language allowing the landlord to accelerate payments upon any conditions.
- **Mitigation of Damages -** Insist on express language mandating that the landlord use its best efforts to re-let the premises upon termination so as to minimize his damages.
- **Leases and Franchise Agreements -** Ensure that if your franchise agreement has specific provisions relating to your lease such as allowing an assignment to the franchisor or another franchisee, the lease must include a similar provision.
- **Commencement Date -** Include language allowing you to terminate the agreement and get your deposit back if the landlord does not turn over the premises on the required time.
- **Anchor Stores -** Include language allowing for rent reductions if Anchor Stores or a significant number of non-anchor tenants go out of business or move to another location and their premises remain empty.
- **Contingencies -** If your interest in the property is based on a proposed business and is contingent upon financing or a franchisor's acceptance of your application, insert language to protect against the possibility that these events may not occur. Do not leave yourself liable simply because you believe the deal will happen.
- **Option to Renew -** With real estate prices continuing to rise in most areas of the country, a key provision is ensuring that you have the option to renew the lease at set terms once the term of the agreement has concluded.
- **Restrictive Covenants and Non-Compete Clauses -** When a lessee has multiple businesses providing the same or similar products a restrictive covenant or non-compete clause can limit the owner's ability to run similar stores/ restaurants in the surrounding area even when the businesses are not in direct competition with each other.
- **Exclusive Use -** Shopping centers and malls will frequently grant exclusive use provisions which limit the type of competition the Landlord can rent space to in the complex.
- **Personal Guarantees -** Since many businesses are owned by limited liability companies, landlords frequently ask for a personal guaranty to be signed by the principals. If your company is financially strong, do not sign a personal guaranty. If you have to sign a guaranty, limit your liability by having it only apply to the first year or two of the lease or cap the dollar amount of the guarantee.

The Bite of the Guaranty

Nearly all franchise agreements now require that individual principals of the franchisee (and sometimes others as well) execute a "guaranty" as part of the franchise agreement. The purpose for the franchisor is to be sure that, even if the corporate franchisee becomes insolvent, the franchisor will be able to collect on any debts owed by the franchisee. For the franchisee, this requirement strips away much of the individual financial protection of using a corporate or limited liability entity to become a franchisee. To make matters even more onerous for the franchisee, many franchisors now require not only the principal or principals of the franchisee entity to become guarantors, but also minority shareholders and even the spouses of the principals or shareholders. It is essential that guarantors understand their liability under the franchise agreement's guaranty provision, and recognize that their potential individual liability can be as great as that of the franchisee entity.

The basis for the guaranty in most instances lies in the notion that the guarantor himself or herself, and not just the corporate entity, benefits from the franchise agreement. In a recent case in which the guarantor argued that the franchise relationship had been in place (without any guaranty) before the franchise agreement and guaranty were signed, the court held that the guarantor received nothing in exchange for his guaranty, and therefore the guaranty would not be valid. ***Century 21 Real Estate Corp. v. CLTM Assoc.***

Another recent case out of Louisiana state court brings to light the issue of jurisdiction over guarantors. While franchisees are generally subject to the jurisdiction of the courts in the state in which the contract specifies, the guarantor, who is further removed from the franchise agreement itself, might not be. In ***Holiday Hospitality Franchising v. Grant*** the court held that the guarantor, who signed the guaranty two years after the franchise agreement was negotiated, was not subject to jurisdiction of the Georgia courts as was provided in the franchise agreement.

Management Companies

While in some situations a franchisee may sublease from a franchisor, in some instances a franchisee may deal directly with a management company for their leasing issues.

A federal district court did not abuse its discretion by failing to award treble damages under the Lanham Act to a hotel licensor for a hotel management company's infringement of its trademarks. The hotel licensor offered no non-punitive reasons for the damages enhancement. ***Ramada Franchise Systems, Inc. v. Boychuk***.

The language of a settlement agreement between a hotel franchisor and a franchisee unambiguously required the franchisee to provide an executed copy of a hotel management agreement between the franchisee and a third-party hotel management company as a condition of entering into a new agreement with the franchisor. By failing to secure and present an appropriate management agreement to the franchisor in a timely fashion, the franchisee violated both the terms and intent of the settlement agreement. ***Ramada Franchise Systems, Inc. v. Jai Shyam, Inc***.

Even though a settlement agreement contained a choice of law provision selecting Minnesota law, the law of South Dakota correctly applied to a dispute over the settlement agreement between a restaurant franchisee and its franchisor management company because the most significant contacts were in South Dakota. The agreement was signed and negotiated in South Dakota, the restaurant was located in South Dakota, and most of the investors were from South Dakota. ***Dunes Hospitality, LLC v. Country Kitchen International, Inc***.

Some Advice on Advice

Franchise consulting companies have recently begun advertising that they are able to provide "all solutions to all people." In turn, many clients and potential clients of The Goldstein Law Group, PC, have asked us whether franchise consulting companies have the ability to provide them with effective solutions to their business problems.

The short and simple answer is "sometimes yes" and "sometimes no." So long as consulting companies limit their services to traditional areas (e.g., feasibility studies, market analyses, growth strategies, industry choices, industry surveys), they can be helpful in providing business solutions to franchisees and dealers.

On the other hand, when consulting companies expand their services to include legal issues, beyond their traditional expertise (e.g., litigation, tax issues, lease and purchase agreement reviews), they can be detrimental to franchisees. For instance, there are now consulting companies who claim to have the expertise to negotiate, review and finalize legal documents. Similarly, there are those who claim that they and their associates have the skills necessary to resolve complex legal disputes, even those pending in court. When franchise consulting companies venture outside their areas of expertise, they have the potential to worsen rather than solve franchisees' problems.

So, then, why do franchisees consider using consulting companies who lack the expertise and experience necessary to professionally address their legal problems? Our clients and potential clients have attempted to answer this in two ways. First, they have suggested that using a non-lawyer for litigation disputes and the negotiation of legal documents is "less expensive" than using a law firm. Second, they have suggested that, by using business consultants who are former officers or employees of franchisors, they will obtain outcomes that only a former "insider" could obtain. Neither of these is very realistic.

With regard to the first issue, that of alleged cost effectiveness, it appears that some business consultants charge a flat price for a franchise review and negotiation; the numbers we have heard are between $2500 and $3000. Putting aside for the moment the inability of a non-lawyer to properly and effectively review any legal document – and certainly not an agreement that has a ten-year term and spans over 50 single-spaced pages – the review and negotiation by an attorney with expertise in commercial litigation and franchise work should run under $1500. The concept of someone holding themselves out to franchisees as an expert also suggests the ability of the claimed expert to do the job in less time than a non-expert.

Further, a consulting company's former ties with a franchisor are not likely to result in substantially better franchise terms than the franchisee would otherwise obtain. Indeed, in 2006, most franchisors offer their franchise agreements on a "take it or leave it" basis. Although there sometimes is some wiggle room for negotiation on a few terms — most notably "exit windows," royalty rates, exclusive territories, initial fees, contract duration and capital investment or punch list items – many other terms are not subject to negotiation or modification. The chances of a franchisee obtaining favorable concessions on these issues depends much more on the size of the franchisee or the strength of the relevant market, rather than on the identity of the consultant or lawyer.

In addition to placing calls to a franchisor and asking it to provide contractual concessions, the person handling a franchisee's negotiations must have the legal expertise to perform two other very crucial tasks. First, in the event the franchisee has been successful in negotiating certain terms, the terms must be drafted artfully in a way that will be recognized and acknowledged by a Court if a dispute about the terms later arises. As every good businessman should know, even a comma or semicolon in the wrong place can destroy a franchisee's business.

Second, regardless of whether a franchisee has been able to obtain any concessions from the franchisor, it is imperative that the franchisee obtain a full and complete understanding of the legal meanings and consequences of the terms that are contained in the franchise agreement. For instance, an attorney is able to explain whether under a particular state's laws a franchisee must have every future dispute heard in only an exclusive arbitration or in state court in his franchisor's back yard, or that a covenant not to compete or exclusive territory is rendered void by any immaterial default of the franchisee; this permits the franchisee to up front, before he signs the agreement, assess the potential legal consequences of the franchise agreement. At the end of the day, these consequences – not necessarily the monetary terms of the franchise agreement – will spell the difference between success and disaster.

In cases where a legal dispute arises during the term of the franchise agreement, the same two issues – cost and the need for legal expertise – appear to be relied upon by franchisees and dealers in choosing whether to use a business consultant or an attorney to assist in resolving the dispute. First, with regard to cost, some business consultants charge a flat price to "try to resolve or settle" the monetary dispute. Prices charged by some business consultants for this run close to $3900-$4000, with concurrent promises by the business consultant that he will save the franchisee "at least that much" in settling the franchisee's dispute. Such promises, however, are somewhat disingenuous; it is not difficult – and in many cases a slam dunk – to get a franchisor to initially lower its damages demand by many thousands of dollars to settle a case up front. The difficult and more relevant question is whether the franchisor's legal claims have any legs.

Some franchisees have suggested that paying a business consultant a $4000 fee is less than they would otherwise have to pay an attorney to settle their cases; again this is in most circumstances incorrect. Looking at costs alone, in the event a franchisee chooses to try to settle a legal dispute before the case results in full scale litigation, and asks his attorney to do so, the charges for a lawyer to make a few phone calls or write a couple of letters to a franchisor (the services provided by most non-legal consultants), should run no more than $2000.

Second, the terms upon which a franchisee's dispute ought to settle, should be based upon the strength of the franchisee's legal claims or defenses; assessing these strengths is exclusively within the province of an experienced litigator. It is patently obvious that it would be self- defeating – if not incredibly expensive – for a franchisee or dealer with very strong legal claims or defenses to settle by paying the same amount of damages to a franchisor as would a franchisee with very weak legal claims. Without the advice and analysis of an experienced litigator, such a costly error is likely to occur.

We live in a relatively litigious society. Given this reality, for a franchisee to attempt to negotiate and finalize a franchise agreement, or to attempt to settle a legal dispute, without the expert advice of an experienced litigator, is no better than bringing a knife to a gunfight.

Franchising in the New Millennium

Encroachment on Your Franchise

DO bargain for specific language in the contract which grants you an exclusive territory.

DON'T assume that an "exclusive territory" provision means that your franchise won't have competition. Find out exactly what this means to the franchisor and what territory is covered. Sometimes a franchisee may face significant competition even with an "exclusive territory." Get any agreements in writing.

DO bargain for a "right of first refusal" which would give you the option of purchasing potentially encroaching franchises.

DO bargain for a specific period of time to develop your franchise before competing franchises are allowed to enter your territory.

DON'T fall short of objective performance standards. It will hurt any arguments you make for an exclusive territory with other franchises you purchase. If there are competing franchises, a store that meets performance standards will have an edge on the competition.

Franchise Termination Provisions

DO demand that a franchisor give you notice of any default and an opportunity to cure.

DON'T sign any agreement which does not allow an opportunity for cure.

DON'T accept a termination-at-will clause.

DO be familiar with the default provisions and termination provisions of your contract.

DON'T stop paying fees, misuse the franchisor's mark or violate core provisions of the agreement while it is in effect.

DON'T undertake retaliatory conduct or any other conduct that a franchisor could argue constitutes default or justifies termination without first consulting a litigation attorney.

DON'T ignore termination or default letters even if you believe that you have done nothing to violate the contract.

Adhesion Contracts and Unconscionability

DON'T sign a contract that has terms that you are not willing or able to honor.

Release of Potential Claims

DON'T sign a release without first consulting a litigation attorney.

DO consult a litigation attorney to know what claims you are arguably releasing.

Transferring the Franchise to a New Owner

DO try to obtain provisions that require the franchisor to base his decision regarding consent on objective, reasonable factors.

DON'T agree to a global release of any claims as a condition of obtaining consent.

DO be clear on what the agreement requires in order to transfer the franchise.

DO try to meet the criteria specified in the agreement as closely as possible. Not only will this make approval easier, it may also maximize the value of your investment.

Non-renewal of Franchise Contracts

DO bargain for a provision that permits you to renew your franchise as long as you are in substantial compliance with the agreement.

DO know what substantial compliance means according to your agreement.

DO make sure you are in substantial compliance at the time you have to exercise your option to renew.

Dispute Resolution, Choice of Law, Choice of Forum

DON'T give up your right to a jury trial as part of the agreement.

DON'T agree to go to court in a jurisdiction that is inconvenient to you.

DON'T accept any forum selection without first consulting a litigation attorney.

DO try to go to a court near you if you have to litigate the dispute.

DO attempt to have disputes decided by a jury.

Covenants not to Compete with a Franchisor

DON'T agree to a covenant not to compete.

DON'T agree to any restrictions that are not directly related to the place and type of business you are pursuing.

DO look carefully at who is prohibited from competing, even if the covenant seems reasonable.

Oral Agreements

DO get every single promise in writing even if the bargaining representative says you don't need it.

DO assume that anything told to you beyond the terms of the contract is unenforceable.

DON'T ever rely on oral statements.

Jeffrey Goldstein is a nationally-recognized franchise legal expert, and is a frequent guest speaker and columnist on franchise issues in various franchise magazines and newsletters. Goldstein represents franchisees in all types of franchise systems in courts throughout the United States. Goldstein welcomes comments regarding this article or any questions you may have regarding other legal issues associated with the operation of your business. Goldstein can be reached at: 202-293-3947 (office); 202-359-0441 (cell).

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