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Recent Franchise Law Blogs

10 Key Considerations for Due Diligence in Buying a Franchise

When considering a franchise opportunity, it is critical to conduct your due diligence. Buying a franchise is a substantial, long-term investment, and your success or failure will hinge in large part on the actions, omissions and obligations of your franchisor.

Franchise due diligence is an involved process that takes time, effort and a commitment to finding real answers instead of simply trying to validate your interest in the franchise. The following is a list of 10 examples of steps prospective franchisees can take to learn more about their potential franchise opportunities:

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Are Franchisees Just "Middlemen"?

When was the last time you visited a Starbucks franchise? You might be surprised to learn that the answer is, "Never." Starbucks is among the largest chains in the world not to franchise, and CEO Howard Schultz had this to say about why all Starbucks locations are company-owned:

"To me, franchisees are middlemen who would stand between us and our customer... If we had franchised [as some executives wanted to in the 1980s], Starbucks would have lost the common culture that made us strong."

So, are franchisees really just "middlemen" who get in the way of providing quality service to the customer?

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Riding the Court Circuits -- Recent Franchise Law Snippets

Bedford Nissan, Inc. v. Nissan North Am., Inc., 2016 U.S. Dist. LEXIS 149762, United States District Court for the Northern District of Ohio (October 28, 2016) (Plaintiffs were four Nissan dealers in Northeast Ohio who alleged that Nissan entered into agreements with a competing dealer in the Cleveland Metropolitan Market whereby secret cash and quarterly incentive payments were made only to the favored dealer. In finding that the plaintiff dealer adequately set forth a violation of the Robinson-Patman Act, the Court relied upon Plaintiffs' allegations that the combination of cash and quarterly incentive payments secretly offered to preferred dealers resulted in the subsidization of the preferred dealers' wholesale car prices. According to the Court, "As a result of Nissan NA's price discrimination, a preferred dealer can significantly undercut a competing non-preferred dealer's retail prices with no negative impact on its bottom line because, at the end of every quarter, the preferred dealer will receive a quarterly incentive payment not received by the competing non-preferred dealer.");

Pirtek USA, LLC v. Twillman, No. 6:16-cv-01302-Orl-37TBS, 2016 U.S. Dist. LEXIS 138811 (M.D. Fla. Oct. 6, 2016) (The Court granted Plaintiff's Motion for Preliminary Injunction to enforce the franchisor's post-term covenant not to compete. Plaintiff Pirtek USA, LLC ("Pirtek"), the franchisor, sued the franchisees claiming "the Twillmans" breached certain confidentiality obligations and covenants not to compete and fraudulently induced the disclosure of confidential and proprietary information, which the Twillmans then used to create and operate a competing business. Pirtek, in its motion for preliminary injunction, sought to enjoin the Twillmans' continued use of the confidential information and their operation of a competing business known as American Hydraulic Services, LLC ("American Hydraulic"). According to the Court, Pirtek had made a preliminary showing that the Twillmans established and continued to operate a competing industrial hose business which employed technicians formerly employed by a competing franchisee that provided the same goods and services supplied by Pirtek in and around the territory contemplated by the Franchise Agreement.);

Van Wie Chevrolet, Inc. v. Gen. Motors, LLC, 2016 NY Slip Op 06583, 38 N.Y.S.3d 662 (App. Div.) (October 2016) (The primary issue raised on appeal was whether defendant, General Motors, LLC (GM), violated the New York Auto Franchise Law when it approved the relocation request of a competing Chevrolet dealer in the Syracuse area, but failed to give notice thereof to plaintiff, Van Wie Chevrolet, Inc., which was another Chevrolet dealer in the same area. The Court concluded that no violation of the statute occurred. Article 4.3 of the Dealer Agreement provided that GM had no obligation "to provide notice for a dealer replacement or relocation, and such events are within the sole discretion of GM pursuant to its business judgment." Further, according to the Court, the Dealer Agreement "unmistakably expressed" terms regarding relocations, and therefore there was no implied duty of good faith that could be read into the agreement. Also, no fiduciary relationship existed between GM and its franchisee since "the parties were experienced for-profit entities in a commercial setting and plaintiff's simple allegations of reliance on another was insufficient to establish a fiduciary relationship.");

LC Franchisor, LLC v. Valley Beef, LLC, No. 4:15-CV-00383-JCH, 2016 U.S. Dist. LEXIS 136790 (E.D. Mo. Oct. 3, 2016) (The franchisee disputed whether Lion's Choice's termination of the Franchise Agreement was proper, and more specifically, whether Valley Beef was insolvent pursuant to the terms of the Franchise Agreement. Thus, the primary issue before the Court was one of contract interpretation, in that the parties disagreed as to

the meaning of the term "insolvency." Ultimately the Court adopted the franchisor's argument that the franchisee's balance sheet-which the Parties agreed "correctly reflected" all of Valley Beef's assets and liabilities at the time-demonstrated that Valley Beef was insolvent. Case law relied upon by the Court supported the principle that an entity's balance sheet served as evidence of its "fair value.");

Ramada Worldwide, Inc. v. Pac. Rim Dev., LLC, No. 15-8190 (KM), 2016 U.S. Dist. LEXIS 139599 (D.N.J. Oct. 6, 2016) (After Pacific Rim, the hotel franchisee, unilaterally terminated the Franchise Agreement by ceasing to operate the facility as a Ramada hotel, Ramada acknowledged termination of the Franchise Agreement and advised Pacific Rim that it was liable for outstanding Recurring Fees, as well as liquidated damages for premature termination in the amount of $532,000. When the franchisee failed to appear in court, Ramada was awarded a default judgment in the total damages amount of $810,322.64.)

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Franchise Law Articles

Franchisee Prevails Early on Covenant of Good Faith and Fair Dealing Claim

One of the few tasks more daunting than trying to get Kant, Nietzsche and Plato to agree on a definition of 'the good life' is that of struggling to get two courts to agree on the legal meaning of the covenant of good faith and fair dealing. Indeed, some Courts vociferously object to using the phraseology itself, arguing that the word 'covenant' must be replaced by the word 'duty.' Other courts refuse to allow such a claim to be prosecuted unless the claimant also pleads a concomitant and redundant breach of an explicit provision in the contract. And, a few other courts adamantly deny the existence of the covenant of good faith and fair dealing.

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FORMATION AND OPERATION OF JOINT DEALER AND FRANCHISEE GROUPS

In the face of franchise or distribution discord, franchisees and dealers often look to form a dealer or franchisee group to confront their franchisor or supplier. Sometimes these groups take the form of larger franchisee or dealer associations, and other times they manifest themselves as smaller more informal multi-plaintiff or multi-client alliances, either in or out of court. Not only is there strength in numbers, but there also is client cost-savings arising out of joint legal representation.

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