

“Franchise Law 2010 – Recent Developments”

by

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Recent case decisions provide valuable guidance and assistance for franchisees that are needed when pursuing or defending their rights as against franchisors. In a brief article such as this one, it is impossible to touch upon all of the decisions that impact franchisees, or to discuss in detail the applicability of the decisions to any particular situation.

While we highlight decisions from certain state jurisdictions, one must always keep in mind that each state has its own law, and a decision of another state is not precedent binding on a court; however, the decision may serve as guidance on any one of the many issues for which there is no clear precedent within a particular state’s jurisprudence. Remember that franchise agreements (like all agreements) are typically governed by the law of the state specified in the agreement, that being the law that the parties have agreed shall govern the terms of the agreement.

I turn now to some influential franchise case decisions involving hotels and other industries, but since franchise law is involved the decisions are important to hotel franchise cases.

Introducing Evidence Otherwise Excluded By The Terms Of The Franchise Agreement

In a Minnesota case (Randall v. American Lady) the franchisor sought to exclude evidence because the agreement stated that it contained the entire agreement between the parties and that no other materials or representations are part of the agreement. The Court invoked a two-prong analysis to justify the admission of extrinsic evidence: (1) the Court considered alleged statutory violations as a basis for admitting evidencing regarding issues outside the contract, and (2) the court considered the franchisees’ allegations sounding in tort based on claims of fraud (actual misrepresentation) or negligent misrepresentation. The Court relied on prong-2 in ruling that evidence outside the agreement was admissible because it did not directly contradict the provisions of the agreement. The narrow test for admissibility fashioned by the Court provides franchisees with an opportunity to introduce evidence otherwise inadmissible. The Court did not need to rule on prong -1 but suggested that this might also justify the admission of the extrinsic evidence.

When positioning a lawsuit for a successful settlement or trial the admissibility of evidence is critical. It is important to note that the Minnesota Court analyzed law from other states, many of which have decisions consistent with the ruling in Minnesota, and some like New York, which might be less favorable to franchisees on this issue.

Fighting lawsuits against franchisors is difficult. This case is important to franchisees in somewhat leveling the playing field, in advancing the legal theories that enable a franchisee to best present its case.

Liquidated Damages Update – Unfortunately LD’s Are Often Upheld

First, keep in mind that the party seeking to void the liquidated damages provision has the burden to show that the provision does not comply with state law. Different states have varying tests to determine the enforceability of the liquidated damages. Typically, states require that the provision be reasonable, that actual damages be difficult to ascertain at the time of entering into the contract, and that the provision not be intended as a penalty but rather a reasonable forecast of damages at the formation of the contract. How the courts formulate and apply tests to make a determination varies.

Wisconsin – In a recent 6th Circuit case involving La Quinta, the court justified 36 months of “Recurring Fees” as follows: (1) Recurring Fees for the duration of the contract would have been greater than the liquidated damages; (2) The Court considered intangibles such as loss of brand recognition and loss of geographic presence; and (3) At the time of entering into the contract, the amount of the damages was a reasonable forecast of actual damages, and was consistent with industry standards. This case is not good for franchisees. The 6th Circuit includes WI, KY, TN, and OH. Franchisees need to keep the appellate court’s position in mind, even though the Court only considered Wisconsin law.

New Jersey - The difficulty in assessing damages, intention of the parties, the actual damages sustained, and the bargaining power of the parties all affect the validity of a liquidated damages clause. The overall single test of validity is whether the liquidated damage clause is reasonable under the totality of the circumstances. In a 3rd Circuit case involving Days Inn, the District Court in New Jersey concluded: (1) The parties were of comparable bargaining power; (2) The parties intended for Days Inn to receive at a minimum \$204,000 in the event that the franchisee breached the franchise agreement; and (3) Actual damages were very difficult to assess.

In assessing all liquidated damage challenges, franchisees need to consider the discussion by the Court in this Days Inn case, which considered the complexity of the industry and factors affecting revenue, all of which depend upon a percentage of monthly gross room revenues, that can drastically fluctuate from month to month depending upon factors such as the national, regional, and local economy, the travel patterns of vacationers, the entry or withdrawal of competitors from the market, and the effort, skill and resources of the licensee. Further, regarding reasonableness, the Court opined, the formula represents a compromise between the three years typically required to bring a new construction replacement into the chain, and the eighteen months required to build up the revenue stream of a conversion replacement that could hypothetically be in place immediately after termination.

Similar decisions around the country can be found. Franchisees should understand that liquidated damages are regularly upheld by courts in many jurisdictions. Any challenges to liquidated damages are necessarily fact specific, and can under the right circumstances be challenged. Often the challenge will result in a negotiation that may lessen the obligation.

Franchisees are well advised to seek counsel knowledgeable in franchise law when negotiating or litigating liquidated damages or other claims with franchisors. These are very technical legal issues that require the experience and expertise of attorneys who work in this area. Fortunately,

AAHOA has done an excellent job of identifying qualified counsel throughout the country capable of assisting the membership. Franchisees using consultants to negotiate legal issues are cautioned that these consultants often lack the full legal understanding of the legal implications and may compromise the franchisee's legal rights in the process.

Mitch Miller is the founder of the Miller Law Group, a full-service hospitality law firm representing hotel owners and management companies throughout the United States, and allied member of AAHOA. Mr. Miller is also a member of the Franchise Law Committee of the California State Bar Association. For more information about the firm visit millerlg.com, or contact Mr. Miller at 650-566-2290 or mmiller@millerlg.com