

Avoiding and Managing System-wide International Litigation

System-wide success and a franchisor's ability to avoid and resolve system-wide issues are often determined by the quality and strength of franchisee relationships.

BY MICHAEL DAIGLE



The mission statement isn't the first thing that comes to mind when considering how to avoid and manage system-wide litigation in an international franchise system, but perhaps it should be. Most franchisors adopt a mission statement, and most mission statements reflect the company's core objectives of "wowing" customers all the time and being "the best (insert

concept here) in the world."

Maybe it's because I'm a lawyer, but I've always found it strange to read a franchisor's mission statement that doesn't at least recognize the importance of its relationships with its franchisees. After all, isn't the real business of the franchisor to be a service provider to its franchisees? Won't happy franchisees be more apt to wow customers? And won't profitability and strong relationships with the franchisor go a long way toward making franchisees happy and, therefore, less litigious?

The International Context of System-Wide Litigation

Before discussing how to avoid it, let's understand what system-wide litigation really means in the context of an international franchise system. At first blush, it might seem like a fairly straightforward concept: it's a dispute or series of related disputes that involve all or mostly all of the franchisees in the system, the resolution of which could have system-wide implications. That's easy enough to grasp in the context of a domestic system where there's typically a single franchisor with all franchisees on essentially the same form of franchise agreement governed by the same set of laws.

Those factors create a common set of facts and legal principles that easily serve as a launching pad for wide-reaching multi-plaintiff litigation. But that critical commonality and, in fact, the availability and acceptance of litigation management procedures like the class action, will often not exist in the international context. In fact, most international franchise systems have certain inherent characteristics that

make it difficult, if not impossible, to successfully launch litigation that would span the entire system:

- Geography, culture, religious restrictions, legal requirements and availability of resources work to reduce or eliminate commonality across the system with respect to the core issues that are often at the heart of franchise litigation. This is particularly true with respect to key functions such as selling franchises, running the supply chain and administering the advertising fund, functions which are often delegated to the master franchisee for its territory. The facts surrounding these types of core issues are likely to vary significantly by country, region and master franchisee, often without a common thread. So, disputes that arise from a master franchisee's sale of the franchise or the adequacy of the support it provides to its sub-franchisees are typically specific to that master franchisee.
- Legal theories will vary depending on the franchisor's expansion methodologies. For example, the franchisor might grant area development rights and directly sign unit franchise agreements in a small country. But in a larger country, it might appoint a master franchisee who would, in turn, sell franchises and be contractually obligated to provide support to unit franchisees. In the former instance, the franchisor undertakes specific contractual obligations to, and might subject itself to a breach of contract claim asserted by, the unit franchisee; in the latter instance, the franchisor has no privity of contract with the unit franchisee, so while the unit franchisee might assert a breach of contract claim against the master franchisee, claims it might want to assert against the franchisor would have to be based on some other legal theory.
- Depending on local law and enforceability of provisions around choice of law, mandatory jurisdiction, and dispute resolution, the parties may be subject to varying legal systems and laws.
- In many countries, efficient procedural mechanisms, like the class action, aren't available to facilitate large multi-plaintiff or representative actions. Where they do exist,

(Continued on page 54)

(Continued from page 53)

they are often not as widely accepted or utilized as they are in the United States (or, perhaps, Canada), and factors such as opt-in requirements for class members, restrictions on lawyer advertising and fee arrangements, and responsibility for costs make them less attractive to franchisees and their lawyers.

These factors and others destroy the commonality that is so crucial for true system-wide litigation. As a result, international franchisors are more likely to be faced with a series of disconnected lawsuits or administrative actions in multiple countries. While system-wide litigation might be unlikely, there could be system-wide impact from the costs and resources required to defend or prosecute multiple actions in multiple countries, the negative impact on the brand globally, and the uncertainties the franchisor and the brand face as a result of the issues raised in those actions.

The certainty of a strong contract can be worth the pain.

Reducing System-Wide Litigation Risk

There are philosophies that can be adopted and actions that franchisors can take to reduce the risk of becoming embroiled in litigation that could either become system-wide or have system-wide impact:

- **Have Strong Contracts.** You should not be embarrassed by the length or the lopsided nature of the agreement. It is your agreement, and you paid to have it drafted to protect you and your brand. In many countries, people (including lawyers) are not accustomed to dealing with the kinds of lengthy franchise agreements that are prevalent in the United States, and that, in itself, can lead to painful negotiations. But the certainty resulting from a strong contract can be worth the pain. Besides, if everything else goes well, the contract

should be signed and stuck in a file drawer until it's time to renew.

- Remember, if the mission is to avoid system-wide litigation (and there certainly might be competing interests), commonality can work against you. Further, because of the ready availability of class actions in the United States, requiring litigation to be conducted in U.S. courts might not be your best choice, particularly if there otherwise is commonality with respect to core issues.
- Always include in the agreement a prominent, clearly worded class-action waiver. While their enforceability isn't always guaranteed (as demonstrated by several recent U.S. cases which have yielded completely different results), it is to your advantage to have them.
- Secure general releases at every opportunity. If, after the agreement is signed, you grant a concession (for example, extending a development schedule, adding territory, deferring royalties, agreeing to provide additional services), you should require a general release from the franchisee in order to wipe the slate clean as of that time. As with class-action waivers, these releases might be attacked should litigation later ensue. It is to your advantage to have them.
- **Be Aware of and Comply with Local Laws.** More countries are adopting laws mandating pre-sale disclosures or governing the franchise relationship. Be aware of laws that will affect your or your master franchisee's activities in each country. Choice-of-law provisions might be trumped by local law, particularly where the country in which the franchisee will operate has enacted franchise-specific laws. Even though the parties might agree on choice of law, dispute-resolution mechanisms and forum, investigate whether those agreements will be given effect by courts in the local jurisdiction should litigation arise there.
- **Respect Cultural Differences.** Culture will impact how issues are raised and, as a general rule, people outside the United States (with the exception, perhaps, of Canada and Australia) are not as litigious as they are in the United States. That is a

positive thing, but don't let the fact that franchisees are not constantly threatening to have you served with a complaint cause you to become complacent or to discount the severity of the issue.

- **Focus on Relationships.** There is very little about international development that yields quick profits or immediate results. It's fine to approach international franchising with a short-term strategy as long as you have a long-term vision to back it up. That is critical for the success and protection of the brand, for maintaining your sanity, and for avoiding or reducing the risk of major litigation. Measure success in years, not months, and recognize that signing the deal is only the beginning, or if you've developed your plans and done your due diligence on the market and the prospects, it is the middle. Never lose sight of the important role that building relationships plays in your long-term vision and strategy. That should help avoid two common mistakes that often produce the kinds of claims that grow into system-wide litigation:
- **Over-promising or under-delivering.** This is easy to do when you have no real infrastructure to support international development or operations. But if you stress the importance of building solid, long-term relationships with each of your international franchisees, you will ensure that both you and the franchisee are going in with realistic expectations and committed to doing what is necessary to expand the brand in the franchisee's market.
- **Not being selective.** Make sure that the person in whose hands you're placing your brand shares your vision for and commitment to the brand and will care as much as you do both about the brand and about a long-term relationship built on trust and respect. Investigate the prospect's prior successes and failures in bringing foreign concepts into its local market; whether the prospect is still developing

other brands that might divert its focus from or compete with yours; whether the prospect is abandoning other brands in favor of yours and, if so, why; whether the prospect has an existing infrastructure to support your brand or the resources to put one together; and, perhaps, most importantly, whether the prospect will be able to think like the owner of the brand in its market without losing sight of the fact that it's a licensee.

Building strong relationships must be the mission of every franchisor.

Managing System-Wide Litigation

Franchisors fortunate enough not to have been involved in class actions in the United States or Canada will likely be inexperienced and ill-equipped to deal

with even simple disputes involving international franchisees, much less complex, multi-party litigation or administrative actions in other countries. Here are a few tips:

- Search for and retain the right counsel in the country in which the litigation is filed. Remember the importance of culture. Retain someone who not only is experienced in franchise litigation (such experts can be hard to find in some countries) but who also shares your vision with respect to strategy and goals in the litigation.
- Don't lose track of the rest of the world. As noted above, this litigation likely only involves a specific group of franchisees in a particular country.
- Monitor the media. With the prevalence of Internet news and social media, a lawsuit in Spain can become a huge public relations issue in the United States; similarly, news of a class-action lawsuit in the United States can reach and affect franchisees, prospective franchisees and customers in Spain.
- Unless you've terminated the franchisee, continue to focus on the

relationship. If you have terminated a master franchisee, don't forget that there are unit franchisees who might not be in the fray and with whom you might not have a relationship.

- Use the relationships you've built to reach an amicable resolution. Just as focusing on the relationship is critical in reducing the risk of litigation, it can be equally critical in resolving the dispute and, as importantly, in reducing the negative impact on the brand.

What often determines system-wide success, in general, and the franchisor's ability to avoid and resolve system-wide issues, in particular, is the quality and strength of the relationships the franchisor has with its customers: its franchisees. Building strong relationships must be the mission of every franchisor. ■

Michael Daigle is a partner in the Chicago firm Cheng Cohen LLC. He has practiced in the franchising industry since 1984 and is licensed in Illinois and Colorado. He serves on the Steering Committee of the American Bar Association's International Transactions Committee. He can be reached at 312-957-8366 or michael.daigle@chengcohen.com.

Thinking about **FRANCHISING?**

Think **Franchise.org**



IFA is the only international organization that represents all segments of the franchise industry.

We know franchising.

Franchise.org is the most comprehensive Web site on franchising.

Whether you are considering buying a franchise or franchising your existing business, Franchise.org is your one-stop information source. You'll find:

- Detailed information for over 1,100 franchises— all members of the International Franchise Association (IFA), representing most of the world's best-known brands.
- A complete list of advisors, including financial services experts, attorneys and consultants.
- The most comprehensive library of franchising information available, ranging from the most basic "how-to's" to the most advanced regulatory and legal aspects.

Visit www.franchise.org today.



50
YEARS
1960-2010