



Association • Forum on Franchising

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THE FRANCHISE LAWYER

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Message from the Chair By Ronald K. Gardner

Forum Chair

If you're like me, as you read this, you are preparing to travel, traveling, or already enjoying our annual get together at the 32nd Annual Forum on Franchising at the

beautiful Westin Harbour Castle in Toronto. October is my favorite month of the year, and high among the reasons is the annual meeting that brings so many of us together to share in extraordinary educational and networking activities, as well as simply being able to spend time together with old friends and make new friends who share the same professional interests.

Leading up to the Toronto meeting, I have had more members of the Forum than ever before express to me their interest in and excitement over the topics that have been programmed for this year's meeting. In particular, we have gotten extraordinary feedback about the Wednesday Intensive Program MBA Concepts for Franchise Lawyers as well as our plenary session entitled Engineering Healthy Franchise Relationships. Of course, no Forum would be complete without our signature Fundamentals of Franchising course, and the ever-popular Annual Developments plenary that we will have on Friday morning. On behalf of the Governing Committee, let me extend my sincere thanks to all of the speakers and program directors who have worked so hard to make this upcoming program one of the best ever, with very special thanks extended to Program Co-Chairs Kerry Bundy and Larry Weinberg for the hundreds of hours spent planning and coordinating this event. Our deepest thanks also go to Kelly Rodenberg, who makes all of us look better through her tireless efforts.

October is also one of my favorite times of the year because it is at the Annual Meeting that the new Governing Committee gets together. This year, I am particularly excited to welcome new GC members Karen Satterlee, who formerly served as the Chair of the Corporate Council Division, and Deb Coldwell, the former editor of the Franchise Law Journal. My good friend, Harris Chernow is returning to begin his second term as a member of the Governing Committee. We are also welcoming to the table for the first time new Franchise Law Journal editor Chris Bussert, new LADR Division Director Earsa Jackson, and new YLD Liaison Rebekah Prince. Each of these individuals has shown extraordinary commitment over the years to the Forum, and I am pleased that they now make up such an important part of the leadership of our organization.

With the new Governing Committee traditionally comes a realignment of the officers of the Forum as well. I am pleased to announce that Kerry Bundy has assumed the role of Marketing Officer, Joe Fittante has moved into the Program Officer position, Kathy Kotel has taken over as the Diversity Officer, and Karen

Bryan Cave Santa Monica, CA

Kristy L. Zastrow (2012) Dady & Garner Minneapolis, MN

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Satterlee has been installed as our liaison to the Women's Caucus, while Jack Dunham has moved into his role as the Immediate Past Chair. These folks join Harris Chernow, who is continuing in his role as the Finance Officer, Andy Scott, our current Publications Officer, and Peter Klarfeld, our Membership Officer, to round out the officers of the current Governing Committee. Clearly, the volunteer members of the Governing Committee have a lot of demands on their time.

As you hopefully have seen in articles in the *Franchise Law Journal* and *Franchise Lawyer* earlier in the year, because of the demands on the time of the members of the Governing Committee, we have asked the membership to approve an amendment to our By-laws that will increase the number of at-large Governing Committee members by three. We will formally present this amendment to the membership for approval as part of the Business Meeting at the Forum, and look forward to adding several new faces over the next couple of years. This will not only relieve some of the burden on those who are currently serving, but also help us give the many interested people who are contributing so much to the Forum an opportunity to serve at a higher level. (If you are one of those folks, please make sure you buttonhole a current or former Governing Committee member during your time in Toronto and ask about our pathways to leadership.)

Finally, as I begin my tenure as the Chair of the Forum, I do want to thank my very good friends and predecessors, Dennis Wieczorek and his successor, and our Immediate Past Chair, Jack Dunham. Both Dennis and Jack have exercised a tremendous amount of thoughtfulness and wisdom in the decisions that they have made over the last several years, all with an eye toward maintaining and expanding the outstanding reputation and programming of the Forum. Even more importantly, their friendship has made my transition into this job one of the highlights of my career.

For those of you I will see and talk to in Toronto, I am looking forward to it. To those of you who are in Toronto that I may not have a chance to greet, please enjoy yourself and accept my well wishes. And finally, for those of you who can't make it to be with us this year, my sincerest wishes for a successful 2009-2010, and I will look forward to seeing you at the Hotel Del Coronado in San Diego in October of 2010!

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By Leslie Curran Plave Koch PLC Rebekah Prince Snell & Wilmer

Whether you are new to the American Bar Association Forum on Franchising or you have been a member for years—consider getting more involved! We'd like to provide some information about the opportunities available. However, before discussing specific opportunities, it might be helpful to explain some basics about the Forum leadership.

In accordance with the Forum's Bylaws, the Governing Committee oversees Forum business. The members of the Governing Committee include the Forum Chair, Immediate Past Forum Chair, and nine At-Large Members of the Forum. At-Large Members are

nominated annually on a staggered basis by the Nominating Committee, then voted on by the Forum

membership at the annual Forum Business Meeting. In choosing the final slate of nominees each year, the Nominating Committee attempts to include representatives from different geographic regions as well as diverse and varied practices and perspectives.

The following senior appointed leaders also attend Governing Committee meetings: Editor-In-Chief of the *Franchise Law Journal;* Editor-In-Chief of *The Franchise Lawyer;* ABA Young Lawyers Division (YLD) Liaison; Director of the Corporate Counsel Division; Director of the Litigation and Dispute Resolution Division (LADR); and Director of the International Franchise and Distribution Division (IFDI). Except for the YLD Liaison who is appointed by the YLD, each Director or Editor is appointed by the Forum Chair. Each Division is run by a six member steering committee. Each publication has a staff of associate editors. Division committee members and associate editors are appointed by the Form Chair.

Each Editor-In-Chief and At-Large Member serve for a three year term. Each Division Director and the YLD Liaison serve for a two year term. The current Forum leadership includes:

Position	Name (Term Expiration)	Email Address
Chair	Ron Gardner (2011)	rkgardner@dadygarner.com
Immediate Past Chair	Jack Dunham (2011)	edunham@wiggin.com
At-Large Members	Harris Chernow (2012) Kerry Bundy (2011) Peter Klarfeld (2010) Joseph J. Fittante, Jr. (2010) Andrew Scott (2010) Leslie Smith (2011) Karen Satterlee (2012) Kathryn M. Kotel (2011) Deb Coldwell (2012)	hchernow@chernowkatz.com kbundy@faegre.com peter.klarfeld@gpmlaw.com jfittante@larkinhoffman.com andyscott@paulhastings.com mlsmith@foley.com Karen.satterlee@hilton.com kkotel@crww.com Deborah.Coldwell@haynesboone. com
Nominees for At-Large Members for 2010 - 2013	Joseph J. Fittante, Jr. (2013) Michael Joblove (2013) Leslie Curran (2013)	jfittante@larkinhoffman.com MJoblove@gjb-law.com lcurran@plavekoch.com
Editor-In-Chief of <i>Franchise Law Journal</i>	Christopher Bussert (2012)	CBussert@KilpatrickStockton.com
Editor-In-Chief of <i>The</i> Franchise Lawyer	Eric H. Karp (2010)	ekarp@wkwrlaw.com
YLD Liaison	Rebekah Prince (2011)	rprince@swlaw.com
Director of Corporate Counsel	Kathie Sunkyung Lee (2010)	Kathie.lee@starwoodhotels.com
Director of LADR	Earsa Jackson (2011)	Earsa.jackson@strasburger.com
Director of IFDI	Michael Lindsey (2010)	Michaellindsey@paulhastings.com

The Forum's Bylaws and a comprehensive list of the current Forum leadership can be found at the front of the Annual Member Directory. For additional information regarding the Forum, visit our **website**.

To be considered for Forum leadership, Forum members must make significant contributions to the Forum. While there are a variety of ways to get involved, the key is to take the initiative to volunteer and then follow through on that offer.

So, we encourage you to consider the opportunities available and find something that interests you! If you enjoy writing, the editors of the *Franchise Law Journal* and *The Franchise Lawyer* are always looking for authors. Typically, the editors have topic ideas for articles. In addition, you can contribute as an author, coauthor or editor for one of the Forum's monographs. If speaking is your preference, you can volunteer to speak at a teleconference, at Fundamentals on the Road or at another Forum program. You should also suggest topics for the annual Forum meeting. In some instances, you may find your niche in the committee work—and there is plenty to go around! Contact the division leaders to find out when there will be openings on the steering committees and whether there are special projects in the works that you might be able to help with (such as the community service event, Women's Caucus Breakfast, IFDI Breakfast or Newcomers' Event).

Now, you are thinking, "that sounds great, but a bit overwhelming. How can I dip my toe in the Forum water without drowning?" Start by talking to your colleagues to formulate a game plan. Then, approach former or current Forum leadership with questions—we assure you that you will find a receptive, collegial and friendly response! If you don't know anyone in the Forum leadership, the YLD Liaison is a great place to start. Get to know people by attending the annual Forum meeting (including Fundamentals on Franchising and the Newcomers' Event) and visit the Volunteer Table. While there is no set path to Forum leadership, initiative and commitment are sure to get you recognized as an up and comer. We urge you to get involved. The Forum needs you as part of its next generation of leaders!

Leslie Curran is a partner at Plave Koch PLC and was the YLD Liaison from 2007-09. Rebekah Prince is an associate in the law firm Snell & Wilmer and is the YLD Liaison for 2009-11.

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Lawyers Who Prepare FDDs Do Not Take On Potential Liability to Franchise Buyers, Absent Complicity in a Knowingly False Statement

By Arthur L. Pressman and Gregg A. Rubenstein Nixon Peabody LLP



Note from the Editor-In-Chief: What follows is a rejoinder to the article in the Summer 2009 edition of The Franchise Lawyer authored by Howard Bundy of the Bundy Law Firm PLLC entitled "Are Franchise Lawyers Liable to their Clients' Franchisees for Negligent Misrepresentation?"

Since the real beginning of time (which precedes the beginning of "franchising time" and is long before 1970), plaintiffs' lawyers have been on a never ending search for deep pockets to tap for wrongs done to their clients. This search takes on particular intensity

when the party primarily responsible for the offending conduct has little or nothing in its own pocket or the pocket of an available insurer. Brother Bundy's recent article in these pages attempts to further that search

by positing the notion that attorneys who help franchisors prepare franchise disclosure documents ("FDD") may be liable for negligent misrepresentations contained in the franchisor's FDD. While not entirely novel, given a lone California court's apparent willingness to allow such a claim over twenty years ago, the concept lacks merit. If adopted, it would impose a unique burden on lawyers: strict liability for a third party's actions, despite no affirmative act or duty to act by the lawyer. Such an expansion of liability is dangerous, unjustified and should be rejected.

Bundy begins his analysis by reviewing the Model Rules of Professional Conduct and cites Model Rule 4.1(a) in support. The text of 4.1(a), however, undermines potential liability in this context. Rule 4.1(a) provides that "[i]n the course of representing a client a lawyer shall not *knowingly make a false statement* of material fact or law to a third person." In the context of preparing an FDD, a lawyer makes no statement, accurate or false. The only person or entity making statements in an FDD is the franchisor. The lawyer is only the scrivener. In addition, because the Rule addresses only "knowingly false statements," the Rule has nothing to do with the situation he addresses: a lawyer's *negligent* misrepresentation. It is, therefore, unclear how Model Rule 4.1 (a) applies to this situation.

What appears to be at the heart of Mr. Bundy's argument is the notion that franchisor lawyers prepare FDDs, not franchisors. While it is true that many franchisors rely on counsel to help prepare FDDs (although many do not), the assistance that lawyers provide in the FDD preparation context is no different than the assistance they provide in drafting commercial contracts or wills for clients. The client transmits certain information to the lawyer to be put into a format that conforms to federal and state legal requirements. This transmission of information imposes no duty on the lawyer recipient to verify its accuracy or do anything with the information other than what the client has directed. Moreover, the information used to create the document, whether it is the FDD, the contract or the will, comes from the client, and the document itself is the client's deed and act, not the lawyer's. As a result, absent a lawyer's complicity in a known falsity that is intended to induce a third-party to act or rely, the client is the only party that can or should be responsible to third parties for the document's contents.

This concept of being responsible for one's own actions, but not the actions of others, is best expressed by the securities cases Mr. Bundy cites involving the preparation of opinion letters. For example, in Haberman v. Washington Public Power System, 744 P.2d 1032 (Wash. 1987), plaintiffs brought claims against a variety of professionals (lawyers, accountants and engineers) who assisted in the preparation of a bond offering. The lawyers, the court found, misrepresented the legal effectiveness of a guaranty underlying the bond transaction, and did so in an opinion letter on which they knew, or had reason to know, third party buyers would rely. The engineers went so far as to negligently certify that the power facilities the bonds were to finance were needed by the State. Id. at 1045, 1067. Unlike the typical FDD preparation, these professionals affirmatively supplied information to their clients that was included in the bond offering materials and also made personal visits and telephone calls to investors to discuss the bonds. Id. at 1068. Based on this, the court reasoned, the professionals knew that the investors had received the professionals' misinformation and would rely upon it deciding whether to invest. Id.; see also First Options of Chicago, Inc. v. Wallenstein, C.A. No. 92-5770, 1994 U.S. Dist. LEXIS 7132 (E.D. Pa. May 26, 1994) (holding that lawyer cannot be liable for negligent misrepresentation under Restatement § 552 absent a pecuniary interest in transaction); Frazier v. Southwest Sav. & Loan Ass'n, 653 P.2d 362 (Ariz. Ct. App. 1982) (holding that negligent misrepresentation claim against third-party lender will not lie absent an affirmative misrepresentation, i.e., silence will not suffice and that lender had no duty to speak when it overheard misrepresentation by seller).

The same is true in the other opinion letter cases that Mr. Bundy cites. In *Lawyers Title Ins. Corp. v. Baik*, 55 P.3d 619 (Wash. 2002), the lawyer drafted an opinion letter stating that it was responsible for closing an estate and that no taxes were due when in fact it should have known that taxes would be due and in *Mehaffy, Rider, Windholz & Wilson v. Central Bank Denver, N.A.*, 892 P.2d 230 (Colo. 1995) the lawyer drafted an

opinion letter in connection with an offering stating that a lawsuit had no merit when the lawyers knew or should have known that a lawsuit implicating the offering had merit. Liability in each is based on information that the professional directly supplies. It is that statement by the professional, for which the professional is responsible, that gives rise to the lawyer's potential liability.

As the Restatement (Second) of Torts, § 552 recognizes, it is not status that makes a lawyer responsible, but rather the fact that the lawyer affirmatively chooses to make a statement that was negligent:

One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transaction, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

As with Model Rule 4.1, the trigger for liability under the Restatement is the *supply* of false information and in the FDD context the lawyer does not supply information. The idea was expressed in a decision by the Ohio Court of Appeals, albeit from a slightly different point of view. In *Universal Contracting Corp. v. Aug*, Appeal No. C-030719, 2004 Ohio App. LEXIS 6661 (Dec. 30, 2004), the court affirmed judgment JNOV for a CEO on a negligent misrepresentation claim. *Universal* involves a contract between a general contractor and a nonprofit organization that purchases and rehabilitates properties for low-income residential housing. *Id.* at *3-4. Pursuant to the parties' agreement, the non-profit was required to provide the contractor with "reasonable evidence satisfactory to [contractor] that sufficient funds are available and committed for the entire cost of the Project." *Id.* at *4. When requested to provide such assurance, the non-profit's CEO assured the contractor that sufficient funds were available despite knowing that they were not. *Id.* at 5-6. When the project finally collapsed, the contractor obtained a judgment against the non-profit and when it could not collect, the contractor sued the CEO for negligent misrepresentation. *Id.* at *7-8.

Instead of focusing on what representations the CEO made personally, as opposed to in her CEO capacity, the *Universal* Court approached the issue by focusing on how the parties had chosen to allocate risk. *Id.* at *16-17. "Where the parties are sophisticated business entities that have contracted to protect against potential economic loss, contract principles override the tort principles embodied in Section 552, and economic damages are not recoverable except as provided in the contract or by the rules of contract interpretation. To conclude otherwise would unduly impair the parties' ability to allocate risks and duties by contract." *Id.* at *17. While *Universal* addressed parties' contractual decision to allocate risk, the FDD context presents the same conscious allocation of risk, albeit by the FTC. By its very terms, the Franchise Rule has purposefully allocated the duty to provide information and "risk" for not doing so exclusively on the franchisor. It is both an explicit and implicit decision that the only "supplier of information" in the FDD context is the franchisor and therefore it alone can be liable for any misrepresentations contained therein.

Beyond the pure legal question of liability, Brother Bundy's search for additional pockets also raises public policy concerns. If a lawyer's failure to verify the client information she receives would makes her liable to franchisees, lawyers will stop preparing FDDs, or will price the risk of liability to non-clients into fee agreements. Moreover, a lawyer is in no position to verify, in any meaningful way, most of the information that a client supplies for an FDD, except, perhaps, for matters of public record (for example, an Item 2 disclosed person's criminal or civil judgment record) which are equally available to a prospective franchisee. If a client describes its intended training and on-going support programs, is a lawyer expected to evaluate their merits and then investigate past performance? Is a lawyer expected to conduct an independent analysis of the range of initial investment that the client provides? Why would a lawyer become a "guarantor" of clients' representations? If Brother Bundy has his way, the result will almost certainly be less compliant, and more bare-bones FDDs that are more difficult to understand, and likely convey less meaningful information,

all to the detriment of prospective franchisees.

The question that neither Brother Bundy nor we address is what happens when a lawyer knows that information provided by the client for inclusion in the FDD is incorrect. Say, for example, when a client tells the lawyer that no one disclosable in Item 2 has a fraud conviction, and the lawyer knows otherwise because the law firm's accounting department did due diligence on the prospective client before accepting the client and its promise to pay for legal services. Does the lawyer confront the client, is the client's response protected by attorney-client privilege, does the lawyer withdraw from the engagement if the client intends to go forward without disclosing the conviction, does the lawyer make the transactional lawyer's equivalent of a "noisy" withdrawal by taking some action to bring the Item 2 discrepancy to someone's attention, and who's attention? While the answers to these questions are unclear, it is clear that the lawyer's action is not the negligent misrepresentation Brother Bundy addresses. Rather, these are intentional acts that may implicate conspiracy, fraud or other intentional torts that suggest alternative bases for liability, which is the fitting subject for another article.

These questions and others we leave to our intrepid editor, Brother Karp, who will doubtlessly enlist others to opine upon them, hopefully, without creating liability for anyone in the process.

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Switch-Hitting Franchise Lawyers: Representing Both Franchisees and Franchisors
By Gary R. Duvall

Dorsey & Whitney LLP

Abe Lincoln was reputedly faced with the following ethical dilemma. He had two cases on the same day before the same judge in which he was taking opposite positions on

interpretation of the relevant law. After his final arguments in the afternoon case, the judge asked him, "Mr. Lincoln, how can you argue now a position contrary to that you took in the case that I already decided this morning?" Abe scratched his beard and replied, "Your honor, this morning I was wrong."

This article analyzes this ethical and business dilemma in the context of franchise law. Specifically, when may and when should a franchise lawyer decide to either represent franchisees or franchisors, or both?

I. When Not to Switch-Hit

A. Litigation; ABA Model CPC 1.7 Comment 24. There are clearly times when representing both franchisees and franchisors will result in "issue conflicts," especially if one might potentially argue differing sides of the same issue in front of the same court or on appeal. The ABA Model Code of Professional Conduct Rule 1.7 bars concurrent conflicts of interest, where "the representation of one client will be directly adverse to another client," or where "the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer." Generally, this Rule is not interpreted as barring an attorney from representing parties with antagonistic positions on legal issues, so called "positional" or "issue" conflicts, except in connection with litigation. Comment 24 to CPC 1.7 states, as to litigation issue conflicts (like those faced by Mr. Lincoln):

"[24] Ordinarily a lawyer may take inconsistent legal positions in different tribunals at different times on behalf of different clients. The mere fact that advocating a legal position on behalf of one client might create precedent adverse to the interests of a client represented by the lawyer in an unrelated matter does not create a conflict of interest. A conflict of interest exists, however, if there is a significant risk that a lawyer's action on behalf of one client will materially limit the lawyer's effectiveness in representing another client in a different case; for example, when a decision favoring one client will create a precedent likely to seriously weaken the position taken on behalf of the other client. Factors relevant in determining whether the clients need to be advised of the risk include: where the cases are pending, whether the issue is substantive or procedural, the temporal relationship between the matters, the significance of the issue to the immediate and long-term interests of the clients involved and the clients' reasonable expectations in retaining the lawyer. . . . "

For franchise litigators, trying to anticipate the potential issue conflicts and apply these factors (and others that may vary with state ethics rules) may not be practical.

B. Some Legislative and Policy Issues. For client-relations reasons, one should not lobby on behalf of franchisors regarding legislation clearly against the interests of franchisee clients, and vice versa. For example, franchise relationship legislation generally favors franchisees and is generally opposed by franchisors. Gray areas arise with respect to legislation that some franchisees oppose and others do not, and vice versa. And on some issues, franchisor and franchisee interests are generally aligned (*e.g.*, minimum wage, menu labeling, and association health care insurance).

Should a lawyer who represents both franchisees and franchisors be an active member of the IFA Legal-Legislative Committee or the AAFD Board? My view on this has evolved ("evolved" is gentler than saying I was wrong before). The IFA legislative agenda 20 years ago was almost entirely pro-franchisor and focused on opposing franchisee-oriented legislation. During that time, for example, I recall one franchisor having changed lawyers after discovering that lawyer's franchisee-oriented positions on pending legislation. With the addition of franchisee members to the IFA about a decade ago, the legislative agenda of the IFA is now broader and more evenly balanced. I believe that it is more common now that IFA member firms represent franchisees at least some of the time, and at least on non-franchise law issues (e.g., tax, estate planning, real estate, etc.).

- **C. Expert Witness.** A franchise lawyer who hopes some day to be hired as an expert witness should assume that writings, whether in trade press, blogs, listserve, social media, litigation, or otherwise, can and will be used in that matter to attempt to contradict the expert testimony. One needs to take care to only agree to testify on issues that one has not written or testified on in an inconsistent manner. Of course, this is a concern whether one represents franchisees, franchisors, or both. However, the chance of being tripped up is greater when one represents both.
- **D. Marketing and Writing.** If one has a successful franchisor or franchisee practice, especially one with a strong litigation component, why risk upsetting clients and prospects by representing the other side? Focusing on fewer markets is generally good for marketing results. One can also be much freer in writing and speaking engagements. One can impress clients and prospects as being a passionate advocate for one "side." By consistently taking one side on difficult issues, one does not have to constantly balance or qualify one's views. I know of one in-house counsel for a hotel franchisor who has stated orally that the company prefers that its franchisor counsel do not represent franchisees, but that this preference is not strictly enforced, and that exceptions would be considered.

- A. Most Non-litigation Work. With respect to non-litigation practice, there are no potential problems with "issue conflicts" and fewer potential business and marketing issues. (Of course, one must avoid actual conflict situations that might arise in representing a franchisor and its franchisees or franchisee association without consent. Those direct conflicts and related issues of client confidences are beyond the scope of this article.) A franchisor business lawyer might develop a service for helping prospective franchisees evaluate and negotiate franchise offerings, focusing on key contractual and compliance issues often missed by non-franchise specialists. The balance that the franchisor lawyer brings to the franchisee negotiation results in the parties focusing on key issues, rather than wasting time with unreasonable or trivial demands. The lawyer who represents both sides will also become a better advisor and draftsperson for franchisors, having seen key issues from many sides resolved in many ways in many documents and markets. I strongly recommend disclosing the fact and nature of one's franchisee and franchisor work in advance to new franchise clients (regardless of whether they are franchisors or franchisees) to avoid unpleasant surprises in case the client objects.
- **B. Franchisee Association Work.** One can represent franchisors and also develop an expertise in franchise association representation on non-litigation issues, and the related interesting and technical areas of advertising and purchasing cooperative formation and governance. One might choose to disclose up front that if litigation arises, a referral to a franchisee litigation firm may be made.
- **C.** Litigation of Non-Franchise Issues and Settled Matters. One can help franchisees in negotiation, mediation, arbitration and litigation matters not involving franchise law issues, or just involving settled issues. For example, a franchisor-oriented lawyer can probably handle franchise litigation for a franchisee when there has been blatant non-compliance with the franchise disclosure and registration laws if liability and remedies are clear. And a franchisee-oriented lawyer can probably handle an issue of failure to follow a clause in the franchise agreement that aids both franchisees and franchisors (e.g., violation by a single franchisee of an in-term non-compete and theft of trade secrets to start a competing company).
- **D. Marketing.** The flip side of the marketing advantage of focusing on one side is that one occasionally gets excellent opportunities to handle the other side, often from referrals without any marketing effort. In my more than 20 years of franchise practice, my franchisee and franchisor clients have universally reacted favorably to my representing both sides in non-litigation matters.

If I were a franchisor or franchisee, for non-litigation work and other situations described above, I would generally try to hire a seasoned lawyer who has handled all sides of the issues. But that is just me.

Gary R. Duvall is a shareholder with Dorsey & Whitney LLP and Head of its Franchise and Distribution practice.

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The Servicemembers Civil Relief Act: A Safety Quilt for Franchisees Called to Duty

By Cheryl L. Mullin and Maral Kilejian

Mullin Law, PC

Since the Civil War, Congress has recognized that soldiers and sailors who provide active military service to their country frequently are unable to fulfill financial obligations which they assumed pre-service to the same extent that they could as civilians. As a result, over the past 140 years, Congress has enacted various statutes which suspended or limited the pre-service financial or legal obligations of soldiers and sailors who are serving in the military, to ensure that they could devote their full energies and attention to the important national responsibilities they have undertaken.

Laws enacted during the Civil War declared a complete moratorium on suits brought against soldiers during wartime, and provided for the mandatory stay of all civil suits while the soldier was away at war. The Soldiers and Sailors Civil Relief Act of 1918 (which expired by its own terms at the conclusion of World War I) provided, among other things, discretionary powers to the court to stay civil proceedings where equity demanded it. The Soldiers and Sailors Civil Relief Act of 1940 ("SSCRA") provided similar protections. Based on the 1918 legislation, the 1940 Act provided for stays in civil proceedings, interest rate reduction, protection against double taxation, and other types of relief.

After the end of the Cold War, the U.S. began to reduce its active and reserve forces and, since then, has increasingly relied on military reservists and the National Guard for overseas missions (in fact, before 1989, military reservists and the National Guard were to be used only in the event of an all out conflict with the former Soviet Union). During the First Gulf War, 265,000 reservists and 85,000 Guard members were mobilized, although most served in support roles. Recognizing this shift and the effect extended deployment could have on reservists at home, representatives from the Judge Advocate Generals began meeting with staffers from the House Committee on Veterans' Affairs to identify and propose changes to the SSCRA. The result, in 1992, was a draft restatement of the SSCRA.

By the late 1990s, the military began including National Guard units in its war plans for combat readiness. A division of the Texas Guard was assigned to Bosnia to assume peace keeping duties in March 2000—which was the first time since the Korean Conflict that a Guard Division commanded an overseas operation. Since then, the Pentagon implemented plans to have Guard units be combat ready in 150 days. Consequently, in December 2002, the SSCRA was extended to members of the National Guard during certain period of active duty.

After the March 2003 invasion of Iraq and the extended deployments that followed, Congress renewed its interest in this legislation and, in late 2003, Congress passed the Servicemembers Civil Relief Act, which clarified and modernized the SSCRA to reflect military as well as economic and social changes. Further amendments were passed in 2004, and several bills proposing additional amendments have been introduced to Congress.

Hundreds of the thousands of civilians currently are mobilized each year to support our national defense. Most of these civilian/soldiers leave behind jobs protected by the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"), which prohibits hiring discrimination based on military service, provides post-military reemployment rights, and protects employees from being disadvantaged in their civilian careers because of their military service. For franchisees and other business owners who temporarily step out on civilian life to answer our country's call, the SCRA provides a patchwork of protections.

The SCRA protects all servicemembers called to active duty and its proscriptions apply to all contracts to which they are a party. The most well known provision of the SCRA (and its predecessor, the SSCRA) requires that a plaintiff notify the court, via affidavit, of a defendant's military status before default judgment may be granted. Once notified of a defendant's active military status, the SCRA requires a court to appoint

counsel on the defendant's behalf. The actual function of court-appointed counsel is not entirely clear. Some courts have likened the role to a guardian *ad litem* or as an attorney *ad litem*. It has been suggested that counsel's primary responsibility is to obtain a mandatory stay of proceedings (*i.e.*, the SCRA provides for a 90-day mandatory stay if requested by the servicemember or deemed appropriate by the court) while attempting to locate the absent defendant.

SCRA protections, however, do much more than protect absent servicemembers against the entry of default judgment. Other provisions of the law prohibit a party from terminating an installment contract with a servicemember, or repossessing property that is the subject of an installment contract with a servicemember, without a court order. "Installment contract," for purposes of the SCRA, means a contract for "the purchase of real property or personal property; or the lease or bailment of such property). While the definition may not include franchise agreements *per se*, provisions of a franchise agreement relating to the lease of commercial real estate or the sale or lease of equipment are subject to the law's proscriptions, as are ancillary agreements, such as real estate subleases, equipment leases and finance agreements.

The SCRA also declares invalid any sale, foreclosure, or seizure of property for breach of an obligation secured by real or personal property without a court order. This includes exercise of self help remedies under a security agreement or the security provisions of a franchise agreement. It prohibits taking a servicemember's personal assets to satisfy a trade or business-related debt, and imposes a 6% cap on the amount of interest that may be charged on any obligation. The SCRA also tolls applicable statutes of limitations during the period of a servicemember's military service (and, for purposes of determining the "period of military service," no distinction is made between temporary service and career service).

The first military reservist (to this authors' knowledge) to invoke the protections of the SCRA in the franchise context was Lt. Col. Stewart Cathey who, with his wife, had formed a corporation to operate two EXXON® gasoline station and convenience store businesses. To construct the businesses, they sought financing from First Republic Bank. Their corporation signed the loan documents, but the obligation was secured by personal guarantees by Cathey and his wife and a second mortgage on their homes.

In May 1996, Cathey was ordered to active duty in Bosnia. Before leaving, Cathey advised the bank that he intended to invoke his rights under the Soldiers' and Sailors' Relief Act (SSRA), including the imposition of a maximum interest rate on the loan of 6%. He delivered a copy of his military orders to the bank. Despite assurances that his rights would be protected, the bank continued to charge the full amount of interest.

When Cathey returned home, he discovered that the stores had suffered serious financial setbacks because of his absence. He demanded from the bank a cash refund of the wrongfully charged excess interest, which was needed as working capital to reopen the stores for business and return them to profitability. Instead, the bank proceeded to seize and sell both of the Catheys' EXXON® stores. Cathey sued the bank, alleging violations of the SSCRA. The bank moved for summary judgment asserting that the Catheys were not the real parties in interest—their corporation was, and that because the SSCRA protects "person[s] in the military services," such protection did not extend to their corporation. The Court was not persuaded. In a July 6, 2001, unpublished opinion, the Court stated:

In an effort to spin silk from a cow's ear, the Bank suggests that the plaintiffs are not the real parties in interest; rather, that their corporation is. Yet, it is the plaintiffs' home which was put up as collateral for the loans and it is plaintiffs' home upon which foreclosure proceedings were instituted. It is plaintiffs who signed the notes and it is plaintiffs who . . . guaranteed the loans. It is the plaintiffs whose labor and expertise was required to operate the corporation profitably so that its obligations could be met. To suggest that they are not the real parties in interest is simply ludicrous.

Shortly thereafter, the case settled for \$2.1 million.

In *Batie v. Subway Real Estate Corp.*, a case initiated by our firm and currently pending in the Texas District Court, plaintiff Leon Batie alleges that the franchisor's real estate affiliate violated the SCRA by terminating the real estate subleases for his two SUBWAY® stores without a court order while Batie was on active military service in Afghanistan supporting *Operation Enduring Freedom*. Several weeks after the sublease terminations, while Batie was still in Afghanistan, Subway Real Estate Corp. caused the locks to be changed at both store locations. Almost three months after the terminations, Subway Real Estate Corp. through its counsel, initiated forcible entry and detainer actions and obtained judgments for possession from the justice courts. Batie challenges the terminations based on SCRA violations, and asserts that he would have cured the deficiency had he been notified through proper channels. In ancillary bill of review proceedings, Batie challenges the validity of the justice court orders for lack of jurisdiction and violation of his Due Process rights. The district court case is listed for trial in January 2010.

Although the SCRA's proscriptions are clear, the statute itself is silent with respect to available remedies. Various sections of the SCRA provide penalties for violations of the afforded protections. The SCRA does not, however, specifically state who may apply for relief, nor does it specifically provide for a private right of action for violations. Most courts considering the issue have determined that the SCRA provides a private right of action, however, not always on the first round. In *Batie v. Subway Real Estate Corp.*, initiated in the U. S. District Court for the Northern District of Texas (which lawsuit ultimately was dismissed on jurisdictional grounds, precipitating the refiling in state court), the court initially held that no private right of action existed, but reversed itself on a motion for reconsideration. The U.S. District Court for the Eastern District of Michigan in *Hurley v. Deutsche Bank*, after finding that no private right of action existed on a motion for summary judgment and again on a motion for reconsideration, relying in part on our arguments in *Batie v. Subway Real Estate Corp.*, completely reversed itself on a motion for certification and further held that the SCRA permits an award of punitive damages for its violation.

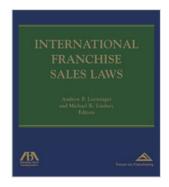
Franchisors that offer financing or that lease commercial real estate or equipment to their franchisees need to be thoroughly familiar with the SCRA as it may apply to franchisees called to active military service. Although certainly not required, a franchisor should know the military status of its franchisees and, for franchisees in the military reserves, a deployment protocol should be adopted.

Such protocol may include placing a conspicuous notation in the file that the franchisee is on active military duty and a reminder that SCRA protections may apply. The parties should agree in advance on any change of notice procedures, and the franchise file should include a notation that important communications may be sent through the Red Cross, using the franchisee's social security number, so that the franchisee is guaranteed to receive them.

As part of the mobilization process, the franchisee is likely to grant someone power of attorney to care for the businesses. What powers does this person have? Power to receive default notices? Accept service of process? Defend terminations? Sell or transfer the businesses? Should the franchisor or someone else have a right or obligation to step in and manage or sell the business if certain events occur? What terms and procedures should apply to the management or sale? Are the appropriate powers of attorney in place to accomplish the objective? Is there a business succession or estate plan in place as it relates to the franchised business?

Although some may argue that a franchise agreement is a contract that should be honored and strictly enforced, the reality is that our country relies increasingly on the efforts of our military reservists and, for this reason, the law affords them special protections. It is the franchisor's obligation to know and follow the law – and by knowing the law and understanding the challenges faced by our civilian soldiers, a franchisor can

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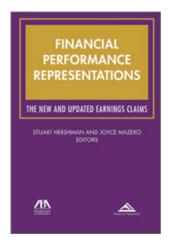
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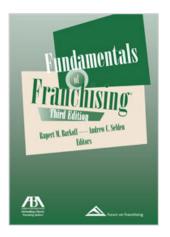
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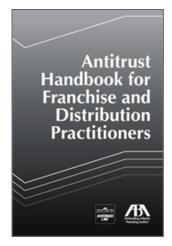
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