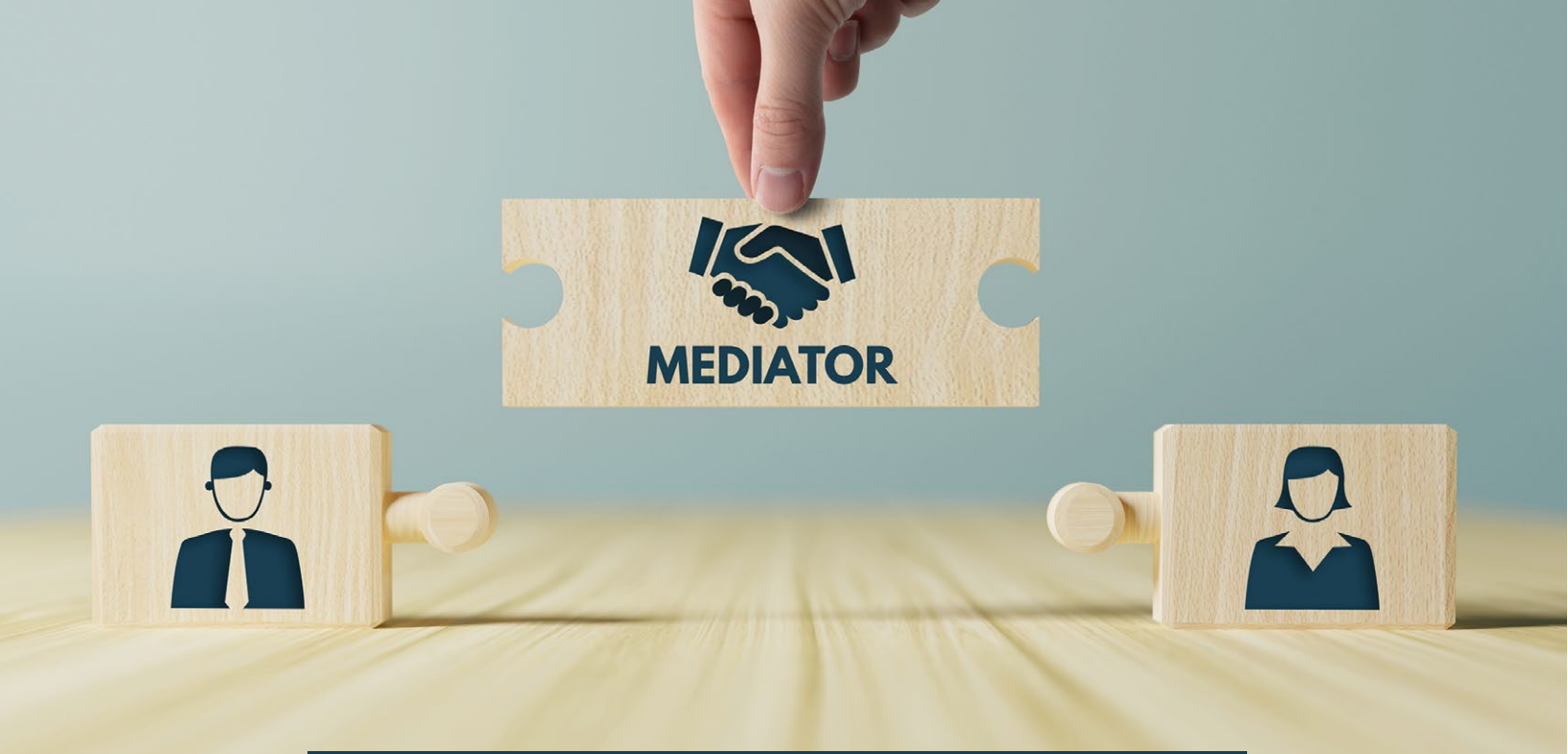


## KNOW YOUR FRANCHISE AGREEMENT:

# Step One to Resolving a Dispute

In the most basic sense, a franchise is a business model wherein a trademark holder licenses the use of its intellectual property, along with its method of business operation, to a licensee for a fee. In that relationship, the owner of the mark is the "franchisor," while the licensee is a "franchisee." The relationship between the two is typically memorialized in a contract known as a franchise agreement. Not all trademark licensing agreements establish a franchisor/franchisee relationship, but those that do must comply with both federal and state law, as applicable.

However, in the franchise relationship, there is an inherent reliance by franchisee and franchisor on one another – the franchisor to control and manage the system as whole, and the franchisee to operate in accordance with the rules and guidelines of the system. Sometimes, this does not work as planned.

The question then is what a franchisee should do when its franchisor violates the franchise agreement? In determining the legal rights and obligations of the respective parties, the first place to look is, of course, the franchise agreement. A well-drafted franchise agreement will contain the appropriate dispute resolution procedures, of which the franchisee should be aware. For example, the agreement should define the procedure of how notice of a default must be given and how much time either party may have to cure that default. For example, Section 15.1 (Termination of Agreement) of the most recent franchise agreement states:

"(1) you and your Owners are in compliance with this Agreement and we materially fail to comply with this Agreement and do not correct such failure within sixty (60) days after written notice of such material failure is delivered to us, you may terminate this Agreement effective thirty (30) days after delivery to us of written notice of termination …"

Short of involving a formal process, however, the parties should first communicate with one another about the perceived default, why it has occurred and how the default can be rectified.

In practice, it is often the best option for all involved if the franchisor and franchisee can work together to resolve any disagreements that may arise. Generally, cooperation and communication can be the path of least resistance. More, determining how to deal with the default can be a crucial consideration because not only will the relationship between the franchisor and franchisee be affected, but also, communication can help avoid undue business disruptions – or worse, damage to your network or the brand.

*by Justin Klein*

Moreover, an informal resolution achieved through open, productive communication can keep costs down for everyone involved. For example, a franchisor may learn of some of the struggles a particular franchisee is facing or even identify a larger systemic problem that if approached correctly, can benefit not only that franchisee, but the system at large.

If open communication does not resolve the problem, the parties must follow the procedure outlined in the franchise agreement. Typically, the first step is to issue a Notice of Default, which will set forth the breaching conduct and the time in which the franchisor may cure the defect (i.e., 60 days). Often, "formalizing" the process is sufficient to resolve the issue.

However, if the franchisor fails to

act timely, or at all, what can be done? Certainly, issuing a termination notice is a last resort for a franchisee – who, likely wants to continue to operate the business. Indeed, once a Notice of Termination is issued, the franchise agreement will typically set forth post-termination obligations on the franchisee, such as ceasing operations, returning operations manuals and other branded materials and removing all signage ("debranding"), non-compete provisions, final accountings and other measures designed to protect the franchise system. The reality of this is enough to encourage, if not force, compliance.

In practice, an attempt to terminate a franchise before the franchise agreement expires may well lead to a legal dispute. Therefore, it is critical to know the limitations imposed by the franchise agreement on the parties' respective remedies. Typically, a franchise agreement may include a covenant to use a chosen, alternative dispute method to litigation, like mediation or arbitration, and set forth a roadmap the parties mutually agree to follow. So, if a Notice of Default falls flat, what is the next best option? Mediation.

Mandatory mediation provisions now appear in most every franchise agreement. Most mediation provisions are carefully crafted to maximize the parties' understanding of the roadmap to and during mediation. As a result, mediation has become more and more utilized in franchise disputes – for obvious reasons.

Mediation is an "informal" meeting of the parties with a third-party neutral party that is hired to help the two sides work through a dispute. Mediation can help limit costs, time and the public exposure that litigation may invite. Also, mediation is confidential by its nature, permitting the parties to speak more openly and freely than they might if they are trying to work through a dispute on their own. Section 19.9 of the most recent Planet Fitness® franchise agreement includes a mandatory mediation provision as follows (in part):

"(1) Mediation. Except as provided in Article 19.9(3), prior to filing any demand for arbitration, the parties agree to mediate any dispute, controversy or claim between and among the parties and any of our or your Affiliates, officers, directors, shareholders, members, guarantors, employees or owners arising under, out of, in connection with or in relation to this Agreement, any Lease for your BUSINESS, any loan or other finance arrangement between us or our Affiliates and you, the parties' relationship, your BUSINESS, or any System standard in accordance with the following procedures:"

This section explains how mediation must be initiated. For example, the party seeking mediation of a dispute must provide a written notice of its request headed "Notification of Dispute." The Notification of Dispute must identify: the facts surrounding the dispute; the amount of damages, if any; and the nature of any other relief, as applicable. Except for disputes relating to Termination (Section 15), the responding party must respond to the Notification of Dispute within 20 days. The mediation provision has a built-in "informal," "good faith" obligation on the parties to attempt to resolve the dispute short of hiring a third-party mediator. If, after 20 days, that cannot be achieved, the parties, unless otherwise agreed to, will submit their dispute to the American Arbitration Association (AAA) for administration of the mediation.

The AAA is an independent organization that assists in the administration of mediation and arbitration matters both in the United States and internationally. The AAA has specific rules and fees governing mediations.

In short, the process is a simple one. The parties work to mutually agree on a third-party neutral, called a mediator, who will assist the parties in trying to resolve their dispute. If the parties cannot agree on a mediator, the AAA will propose several options from their expansive list of qualified mediators from which the parties must, according to the franchise agreement, "jointly select." This is often done through a rank and strike process. Once a mediator is selected, there is typically a preliminary conference (by phone) to discuss the particulars of the matter. And, then a mediation session, which all parties must attend (in person, usually) is scheduled.

Avoiding conflicts is critical to the success of any franchise operation. Indeed, it can be a major distraction to not only the franchisee's business, but also to the franchisor's as well as the overall operations of a franchise system. Unfortunately, many times it is unavoidable. As such, it is important to be aware of the process to resolve these conflicts while incurring as little interruption or interference as possible. Open dialogue and communication is paramount to ensure this result. However, when all else fails, it is not only imperative to know and follow the proper procedure to mediation, but doing so may very well lead to a successful resolution and avoidance of what could be debilitating litigation or arbitration.

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