FULL STEAM AHEAD: TIPS AND TRAPS IN DRAFTING AND ENFORCING BOILERPLATE CLAUSES

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‡ To some extent, this paper may reflect the differing viewpoints of the authors, taking into account their personal experiences and practices. Different portions of this paper have been written by each of the authors; however, they have attempted to present a consolidated paper, which in some cases may not necessarily reflect their personal opinions. Each author accordingly may not agree with all statements in this paper.
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I. INTRODUCTION

The significance of boilerplate language in franchise agreements is often overlooked. Parties preoccupied with the substantive, deal-specific provisions sometimes treat an agreement's boilerplate provisions like formulaic afterthoughts; they are often considered to be provisions which, by dint of precedent, take care of themselves. However, counsel for the franchisor and the franchisee should pay careful attention to boilerplate clauses, for they can have far ranging consequences and even determine the outcome of disputes.

Some boilerplate clauses are intended to manage and minimize litigation risks, and a sizable body of case law has developed in this area. Some provisions provide for managing disputes, including in particular forum selection and choice of law clauses. Others, such as those dealing with waivers, limitations, and disclaimers, clarify the nature and extent of the parties' rights under an agreement. Still others are used to limit the damages resulting from any ensuing litigation or dispute resolution process.\(^1\)

The use of boilerplate can help enhance predictability in the interpretation of agreements. For boilerplate to achieve this, it must be carefully adapted to reflect the actual understanding between the parties. When used effectively, boilerplate can greatly narrow the issues and decrease the cost of litigation when a disagreement between the franchisor and franchisee arises.\(^2\) In some cases, properly adapted boilerplate provisions can even forestall litigation altogether.

However, when boilerplate provisions are included in franchise agreements without adequate forethought, unintended consequences can result. Consideration should be given to relevant statutes and case law when drafting boilerplate provisions to ensure their effectiveness. Similarly, when disputes arise, the failure to consider possible attacks on the enforceability of such standard clauses may prove to be unfortunate. Indeed, in some cases, a review of relevant statutory and case law authority may provide unexpected support for defeating enforcement of such clauses.

II. MANAGING DISPUTES: FORUM SELECTION AND CHOICE OF LAW

A. Forum Selection Clauses

A forum selection clause, often called a venue clause, designates the court or location where a dispute is to be resolved. A forum selection clause can be either mandatory (i.e., exclusive), meaning that any dispute must be adjudicated in that, and only in that, court or location, or permissive, meaning that, although the parties agree that the dispute may be resolved in a particular forum, the forum selected is not the exclusive court or location where the dispute must be resolved.

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\(^2\) The Amended FTC Rule, 16 C.F.R. 437, like its predecessors, does not address substantive aspects of the franchisor relationship that had been advocated by some franchisees, such as mandatory arbitration, jury trial waivers, forum selection and choice of law.
Originally, forum selection clauses were viewed as being "against public policy" and were generally deemed unenforceable. However, in 1973, that view changed when the United States Supreme Court held in *M/S Bremen v. Zapata Off-Shore Co.*\(^3\) that contractual forum selection clauses are prima facie valid and enforceable unless enforcement would be unreasonable under the circumstances involved.

Generally, for the sake of convenience, franchisors select their home state as the forum for dispute resolution. But in selecting a forum, franchisors should consider such factors as the case load in that court, the applicable rules of court, the temperament of the judges, how the jury pool is selected, the general composition of the jurors, and whether juries in that state tend to award high or low damages. It is also worthwhile to consider whether a federal court would be preferable over a state court. Too often, franchisors automatically select their home state without considering these and other important factors.

1. **Scope of the Clause**

   In drafting a forum selection clause, it is important to define precisely what issues will require resort to (or, if a permissive clause, will be permitted to be brought in) the designated court (or arbitration locale). A clause that refers to any legal action or proceeding "arising out of or relating to this Agreement" might be interpreted more narrowly than one that refers to any legal action or proceeding "arising out of or relating to this Agreement or the relationship between the parties." Similarly, a clause that refers to "all actions to enforce this agreement" might limit the scope of the forum selection provision to actions for performance or breach of the contract.\(^4\) Perhaps the broadest clause available would be one that refers to "any action against the other."

   In addition to focusing on the scope of the claims encompassed by a forum selection clause, consideration should be given to establishing the scope of the persons encompassed by such clauses. If the franchisor or franchisee is a corporation, for example, should the officers (if suing or sued individually), affiliates, owners, directors, etc. be bound by the venue clause (and/or by other procedural clauses in the agreement)? If so, consideration should be given to including a general provision seeking to bind these persons and entities to the provisions of the agreement. However, in doing so, consideration should be given to whether these others should be bound by the other provisions – e.g., would they want to give up their right to a jury trial; if there is an arbitration clause, would they want to give up their right to litigate (and the protections of appeal rights)?

   Similar concerns arise in the drafting of guarantees. If the guarantees fail to include a forum selection clause (or fail to incorporate the relevant provisions of the franchise agreement by reference), a guarantor may argue that it is not bound by the forum chosen in the franchise agreement. In *Ramada Franchise Systems, Inc. v. Cusack Development*

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\(^3\) 407 U.S. 1 (1972).

\(^4\) See Jacobson v. Mailboxes Etc., U.S.A., Inc., 646 N.E.2d 741, 745 (Mass. 1995) (interpreting a forum provision "for all actions enforcing this agreement" as applicable only to actions for performance or breach of contract, not for fraud in the inducement).
Inc., for example, Ramada brought suit against Cusack Development, its franchisee, for breach of the parties' license agreement. Also named as a defendant was Michael Cusack, a principal of Cusack Development who, to induce Ramada to execute the license agreement, guaranteed the performance of Cusack Development's obligations. While the license agreement contained a forum selection clause and a consent to personal jurisdiction in the selected forum, the guarantee did not. The court held that, given the absence of these provisions in the guarantee, there was no basis in that state for the exercise of personal jurisdiction over the guarantor. All claims against the guarantor accordingly were dismissed.

It is, of course, very important to use words that indicate whether the clause is mandatory or permissive. For example, using words such as "shall," "only" and "exclusively" signals a mandatory requirement that litigation or arbitration be filed in the designated venue, while using the word "may" indicates a permissive clause.

Another drafting issue to keep in mind, though less significant, relates to the verb used. A forum selection clause that says that a party must "file" an action in a specific court could be interpreted (though perhaps incorrectly) as requiring only that the case be first "filed" in that venue without precluding the filing party from then seeking to transfer it to another forum. While this may be a hyper-technical reading of the words (and it may be difficult for a plaintiff to move to transfer), it is best to avoid this situation by using a different phrase such as "shall be filed and litigated in" the designated venue.

**PRACTICE POINTERS**

**FORUM SELECTION – GENERAL**

- Consider the specific words used to define the scope of the forum selection clause. Should it cover all actions relating to "the Agreement," "the relationship," "enforcing this Agreement," or a combination of these?

- Consider which persons or entities should be encompassed by the forum selection clause. Consider including a forum selection clause, or incorporate it by reference, in guarantee agreements.

- Focus on whether the forum selection clause should be mandatory ("shall," "only," "exclusively") or permissive ("may").

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6 See, e.g., Nina Moss v. Curves Int'l, Inc., Bus. Franchise Guide (CCH) ¶13,638 (S.D. Fla. 2007) (the use of the term "shall" along with the specifically chosen term "venue" supported the determination that the forum selection clause was mandatory and a finding that the clause was mandatory was further warranted due to the use of the phrase "exclusive"); T Brad Braman v. The Quizno's Franchise Co., LLC, Bus. Franchise Guide (CCH) ¶13,830 (N.D. Ohio 2008) (by virtue of the parties' use of the term "exclusive," the forum selection clause was explicitly mandatory, not permissive). For a recent article discussing forum selection clauses, see Bryan P. Couch, Are Franchisees Subject to Personal Jurisdiction in the Franchisor's Home State? 28(3) FRANCHISE L.J. 150 (Winter 2009).
(2) **State v. Federal Court**

A forum selection clause can express a preference for federal or state court, if that is desired. Because most forum selection clauses select a venue in the district or state where the franchisor is based, unless the matter involves a federal question the franchisor generally cannot remove the case from the state court to the federal court.7 Therefore, forum selection clauses may specify that, "if federal court jurisdiction is available" for the matter, it must be filed in the federal court.

One interesting case construed the word "of" in the forum selection clause as indicating that exclusive jurisdiction would be in the state court of a particular state. In *American Soda, LLP v. U.S. Filter Wastewater Group, Inc.*, 8 American Soda filed a breach of contract action against U.S. Filter in state court in Colorado. U.S. Filter removed the case to federal court in Colorado and American Soda moved to remand the case on the ground that U.S. Filter had waived its right to remove by a mandatory forum selection clause in the parties' contract. The clause provided that "the Courts of the State of Colorado/Arbitrator shall be the exclusive forum for the resolution of any disputes . . . ." The Court of Appeals for the Tenth Circuit held that the phrase "Courts of the State of Colorado" referred only to the state courts in Colorado because the federal court was not a court "of the State of Colorado but rather a court of the United States of America."9 Therefore, the court concluded, U.S. Filter had waived its right to remove and the case could only proceed in the state court.

Similarly, in *Alliance Health Group, LLC v. Bridging Health Options, Inc.*,10 the Court of Appeals for the Fifth Circuit was asked to address the issue of whether a venue clause stating that "any litigation related hereto shall occur in Harrison County, Mississippi" allowed for the case to be filed in the federal court in that county. After analyzing several other cases with similar language, the court concluded that while a federal court is not a court "of" the county, if the federal court is located "in" the county, as that was the language of the clause at issue, the action could be brought there. The court even distinguished cases where the federal court "district" encompassed the county identified in the venue clause and cases, as the one before it, where the federal court was actually "in" that county.11

As these cases illustrate, the precise words chosen can make the difference between whether a case is litigated in state court or federal court and whether the parties have waived the right to remove the case to federal court.

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7 See 28 U.S.C. § 1441(b) (defendant in a diversity case cannot remove case to federal court if defendant is a resident of that state).
8 428 F.3d 921 (10th Cir. 2005).
9 Id. at 926.
10 553 F.3d 397 (5th Cir. 2008).
11 Id. at 400.
PRACTICE POINTERS
FORUM SELECTION – STATE OR FEDERAL COURT?

- Consider whether the forum selection clause should express a preference for federal court or state court.
- Avoid inadvertently waiving the right to remove an action to federal court. Courts “of” a state do not include the federal courts “in” that state.

(3) Drafting in Case the Franchisor Moves

As noted above, for convenience, forum selection clauses drafted by franchisors typically designate a venue near where the franchisor is based. Yet, with the increase over the last few years of acquisitions of franchisors, it is not uncommon for the headquarters of a franchisor to be moved to another state. To accommodate this trend, forum selection clauses should be drafted so that venue will be near where the franchisor is based at the time the legal action is filed.

Although that language was not present in the venue clause involved, at least one court has interpreted a venue clause as requiring that the action be filed where the franchisor was based at the time the action was filed. In ABC Rental Systems, Inc. v. Colortyme, Inc.,\textsuperscript{12} the franchisor entered into franchise agreements with the plaintiff franchisees between 1988 and 1990. The agreements provided, among other things, that “any action brought by either party against the other in any court, whether federal or state, shall be brought within the State of Texas in the judicial district in which Franchisor has its principal place of business . . . .” In the late 1980s and early 1990s, at the time of the execution of the agreements, the franchisor’s principal place of business was in Henderson County, Texas, a county within the jurisdiction of the Eastern District of Texas. However, by 1995, when the franchisees had commenced suit in the Eastern District of Texas, the franchisor had moved its principal place of business to Dallas, Texas (in the Northern District of Texas). Addressing the franchisor’s motion to transfer venue from the Eastern to the Northern District of Texas, the court concluded that the phrase “principal place of business,” as employed in the forum selection clause, meant the franchisor’s principal place of business at the time suit is brought:

The raison d’etre of forum selection clauses is to minimize the disruption of litigation when defendant/franchisors become involved with franchisees throughout the country. It is entirely appropriate for a company which does business in many jurisdictions to use a forum selection clause in its contracts to limit the venues in which it can be sued. With this in mind, certainly it was the intent of the parties who signed the Agreements that any litigation arising out of the Agreements would occur in Defendants’ principal place of business at the time suit is filed.\textsuperscript{13}

\textsuperscript{12} 893 F. Supp. 636 (E.D. Tex. 1995), Barry Heller, one of the co-authors, was counsel of record in this case.
\textsuperscript{13} Id. at 639.
Franchisors should not depend upon other courts to follow the reasoning of the ABC court. If their desire is to preserve the convenience of having litigation or arbitration near their headquarters, they should draft the forum venue clause to require that the case be litigated/arbitrated “where Franchisor’s principal place of business is located at the time the action is filed.”

**PRACTICE POINTER**

**FORUM SELECTION – FRANCHISOR MOVES**

- If the franchisor wants to increase the likelihood that litigation will be near its headquarters even if the company is acquired or its headquarters is moved, it should draft the forum selection clause to include a phrase like “where Franchisor’s principal place of business is located at the time the action is filed.”

(4) **Required Relationship**

Can a franchisor designate in a forum selection clause a particular venue for litigation or arbitration even if that venue bears no relationship to the parties, the agreement or the transaction involved? The answer is generally “no,” but it depends.

Generally, to enforce a forum selection clause, there must be some nexus between the location selected and the parties, the agreement or the transaction. However, statutes in some states authorize selection of that state in certain cases for venue purposes, even though there is no connection between that state and the parties, the agreement or the transaction. For example, the State of New York had adopted section 5-1402 of the New York General Obligations Law, which reads as follows:

Choice of forum. 1. Notwithstanding any act which limits or affects the right of a person to maintain an action or proceeding, including, but not limited to, paragraph (b) of section thirteen hundred fourteen of the business corporation law and subdivision two of section two hundred-b of the banking law, any person may maintain an action or proceeding against a foreign corporation, non-resident, or foreign state where the action or proceeding arises out of or relates to any contract, agreement or undertaking for which a choice of New York law has been made in whole or in part pursuant to section 5-1401 and which (a) is a contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate, not less than one million dollars, and (b) which contains a provision or provisions whereby such foreign corporation or non-resident agrees to submit to the jurisdiction of the courts of this state.

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14 For a discussion of cases on both sides of the issue concerning enforceability of such clauses, see Peter R. Silverman and James H. O'Doherty, *Float Like A Butterfly, Sting Like A Bee: The Lure of Floating Forum Selection Clauses*, 27(2) FRANCHISE L.J. 119 (Fall 2007).

15 Burger King Corp. v. Midland Mgmt., L.L.C., Bus. Franchise Guide (CCH) ¶12,332 (S.D. Fla. 2002) (the choice of Florida law was reasonable because the franchise agreements became effective upon the franchisor’s execution in Florida, the franchisor was headquartered in Miami, Florida, and all major decisions regarding the agreements were made in Florida).
Because of the familiarity of the New York courts with commercial issues, some franchisors, such as Hilton Hotels, have for years included a New York venue clause in their franchise agreements, even though neither Hilton nor the franchisee may be based in New York.

Canadian courts have also tended to give considerable regard to the relationship between the parties and the selected jurisdiction. In 1279022 Ontario Ltd. v. Posen,\(^\text{16}\) it was found that a court can choose to disregard a forum selection clause if it finds that the plaintiffs can show a real and substantial connection to the jurisdiction in which they have chosen to bring an action. Such a clause is by no means conclusive of the jurisdiction in which litigation must be brought.

In Clayton Systems 2001 Ltd. v. Quizno’s Canada Corp.,\(^\text{17}\) the court held that the party that desires a forum different from that provided for by the forum selection clause of the franchise agreement has the burden of establishing a strong reason for the change of venue. In this case, the court found that the jurisdiction clause – which stated that Colorado would be the sole venue for disputes – would not determine the venue. Given that the agreement was between two British Columbia companies and was negotiated, drafted and signed in British Columbia, that almost all of the assets transferred were in British Columbia, that the defendant’s only known assets were in Canada, and that there was a trial underway in British Columbia already, the court was satisfied that a British Columbia court was the appropriate venue for the proceedings.

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**PRACTICE POINTER**

**FORUM SELECTION – NEXUS**

- Absent an applicable statute, select a state for venue purposes that has a nexus to the agreement, the transaction or the parties.

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(5) **Enforceability**

(a) **Federal Court/State Court**

As noted above, in the federal courts, forum selection clauses are generally enforceable, absent fraud, duress or enforcement being unreasonable, as would be the case if a party were denied its day in court.\(^\text{18}\) However, if a party were to move to transfer a case from one court to the court designated in the forum selection clause, the forum selection clause would be given significant weight, but it would be only one factor in the calculus of whether, pursuant to considerations of *forum non conveniens*, the case should be transferred.\(^\text{19}\)

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\(^{19}\) See Stewart Org., Inc. v. Ricoh Corp., 487 U.S. 22 (1988) (forum selection clause is an important factor to be weighed with other factors in the court’s analysis of transfer issue).
The laws in the state courts differ amongst themselves but generally do accord significant weight to forum selection clauses absent a clause in a given instance causing an unreasonable result.\textsuperscript{20}

(b) State Franchise Statutes and Case Law

Several states have included in their franchise statutes or statutes of general applicability a provision that, in one form or another, voids a clause in a franchise agreement that requires a franchisee based in that state from being required to litigate in another state.\textsuperscript{21} These provisions do not mean that a franchisor cannot file an action against a franchisee in a state other than the one where the franchisee is based. It merely means that, in asserting a right to bring that suit or in resisting an attempt to transfer the case from that court, the franchisor cannot rely upon the forum selection clause as it is voided by the statute. Even so, the franchisor can argue that the factors relevant to \textit{forum non-conveniens} still justify its filing of that case in that court.

A few states have adopted a similar approach voiding forum selection clauses in franchise agreements by judicial decision, rather than by statute. For example, in \textit{Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.},\textsuperscript{22} the New Jersey Supreme Court held that forum selection clauses in franchise agreements are presumptively invalid. However, other decisions have limited the scope of that ruling. In \textit{Cadapult Graphic Systems, Inc. v. Tektronix, Inc.},\textsuperscript{23} the plaintiff, a New Jersey-based printer, entered into an agreement with the defendant, an Oregon-based supplier, to sell the defendant's products. The parties' agreement contained an Oregon forum selection clause. The plaintiff filed suit in New Jersey. The suit did not include any claims under the New Jersey Franchise Practices Act. The plaintiff argued that the forum selection clause was invalid under the \textit{Kubis} case. In response, the court found that the state policy set forth in \textit{Kubis} was not implicated because there was no New Jersey Franchise Practices Act claim. According to the court, \textit{Kubis} applies only where a franchisee seeks relief against a franchisor that is alleged to have violated the New Jersey Franchise Practices Act. The court thus enforced the forum selection clause and granted the defendant's motion to transfer the case to Oregon.\textsuperscript{24}

\textsuperscript{20} See High Life Sales Co. v. Brown-Forman Corp., Bus. Franchise Guide (CCH) ¶9,945 (Mo. Super. Ct. 1992) (a forum selection clause purporting to prevent Missouri courts from exercising jurisdiction is no longer considered void per se as contrary to state public policy; a forum selection clause should be enforced unless it is unfair or unreasonable to do so); O'Brien Eng'g Co., Inc. v. Cont'l Machines, Inc., Bus. Franchise Guide (CCH) ¶11,638 (Ala. Super. Ct. 1999) (forum-selection clauses are not against the public policy of Alabama and should be enforced unless to do so would be unfair or unreasonable under the circumstances).

\textsuperscript{21} Some of these franchise statutes by their language extend to clauses of this type even in arbitration provisions. See, e.g., Mich. Comp. Laws §445.1527(f); and Cal. Bus. & Prof. Code § 31512. However, it is questionable whether such a provision would be enforceable with respect to arbitration as it may be pre-empted by the Federal Arbitration Act.

\textsuperscript{22} 680 A.2d 618 (N.J. 1996).

\textsuperscript{23} 98 F. Supp. 2d 560 (D. N.J. 2000).

\textsuperscript{24} See also Park Inn Int'l, LLC v. Mody Enterprises, Inc., 2000 WL 913702 (D. N.J. 2000) (\textit{Kubis} does not apply to out-of-state franchisee which cannot assert NJFPA claim).
The public policy concerns in a state may also significantly impact the enforceability of a forum selection provision. For example, in Jones v. GNC Franchising, Inc.,\textsuperscript{25} a California franchisee brought suit against GNC in California. GNC moved to dismiss or transfer venue based on the Pennsylvania forum selection clause in the parties' franchise agreement. The motion was denied and the forum selection clause was held unenforceable because it contravened the strong public policy of California, contained in the California Franchise Relations Act, to protect California franchisees from being forced to litigate franchise-related disputes outside of the state.

The Arthur Wishart Act (Franchise Disclosure)\textsuperscript{26} (the "Ontario Act") and the Alberta Franchises Act\textsuperscript{27} (the "Alberta Act") provide that any provision in a franchise agreement restricting the application of the law of that province or restricting jurisdiction or venue to any forum outside that province is void with respect to a claim otherwise enforceable under these Acts. The Alberta Act also states that the law of Alberta applies to franchise agreements.\textsuperscript{28} In the recent Alberta decision of Bad Ass Coffee Co. of Hawaii v. Bad Ass Enterprises Inc.,\textsuperscript{29} the Court recognized and enforced a Utah arbitral award against the franchisee that had been confirmed by a Utah court. This case supports the view that the language "with respect to a claim otherwise enforceable under this Act" denotes that such a statutory provision only applies to claims under the Act such as a claim for breach of the duty of fair dealing. It could therefore be concluded that clauses that are not covered by the provincial franchise legislation are not rendered void by these statutory provisions. Since enforcing the Utah award did not depend on the Alberta Act, the claim to enforce the award was upheld.

(c) In the Arbitration v. Litigation Context

The Federal Arbitration Act (the "FAA") requires that agreements to arbitrate should be enforced as written. Section 2 of the FAA provides that arbitration agreements subject to the Act "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."\textsuperscript{30} Based on this, it has been held that a state, by statute or judicial decision, cannot interfere with the right of the parties to agree to the location where an arbitration will be held.\textsuperscript{31} However, not all courts have reached the same result.\textsuperscript{32}

\textsuperscript{25} 211 F.3d 495 (9th Cir. 2000).
\textsuperscript{26} S.O. 2000, c. 3 at s. 10.
\textsuperscript{27} R.S.A. 2000, c. F-23 at s. 17.
\textsuperscript{28} R.S.A. 2000, c. F-23 at s. 16.
\textsuperscript{30} 9 U.S.C. § 2.
\textsuperscript{32} See Florence Bolter v. Harris Research, Inc., 104 Cal. Rptr. 2d 888 (Cal. App. 4 Dist. 2001) (place and manner terms of arbitration provision of franchise agreement found unconscionable and remedy
B. Choice of Law Clauses

(1) Scope

The specific words used in a choice of law provision can often make a difference as to which law will actually be applied by a court, and this can at times impact the outcome of the case.

A choice of law clause referring to “the Agreement” may be viewed as narrower than one referring to “the relationship.” In Valley Juice Ltd., Inc. v. Evian Waters of France, Inc., 33 for example, a spring water distributor asserted a variety of tort and contract claims against Evian, its supplier. Noting that the parties’ agreement specified that it was “to be governed by the laws of the State of New York,” the court held that New York law applied to the plaintiff’s contract claims. 34 The court also held, however, that the choice of law clause did not necessarily dictate the law applicable to the plaintiff’s tort claims, including its claim under the Massachusetts Unfair Trade Practices Act (“MUTPA”). Addressing which law applied to that claim, the court first noted another case which had dismissed a MUTPA claim because the parties’ agreement called for the application of California law and because the claim was, in essence, a re-framed contract claim. The clause at issue in that case, however, was far broader than the one before the court — which merely stated that the “agreement” was to be governed by New York law — in that it specified that the “rights and obligations of the parties . . . shall be governed by and construed in accordance with the laws of the State of California.” According to the court, this distinction mandated a different result:

[A]n agreement which “does not state that the rights of the parties are to be governed by [non-Massachusetts] law but only that the agreement is to be governed and construed by [non-Massachusetts] law . . . does not purport to bar the application of [MUTPA] to the parties’ dealings in Massachusetts.” 35

Similarly, if the choice of law provision states that “the agreement will be construed and interpreted according to the law of the state of X”, a court may decide not to apply the

under state civil code allowed court the discretion to strike provisions of agreement requiring arbitration of disputes with California franchisees to take place in Utah).

33 87 F.3d 604 (2d Cir. 1996).
34 Id. at 607.
chosen law to a tort claim. As the court observed in *America’s Favorite Chicken Co. v. Cajun Enterprises, Inc.*:  

> The choice of law clause in the franchise agreements provides that the “Franchise Agreement[s]” shall be interpreted and construed under the laws of the state of Louisiana, which shall prevail in the event of any conflict of laws." On its face, the choice of law clause is restricted to the interpretation or construction of the franchise agreements . . . Since the [California Franchise Investment Law] claims do not implicate the interpretation or construction of the franchise agreements, they are not governed by the narrow choice of law clause present here."

Thus, if drafters desire the chosen law to be applied to contract and tort claims, broader language should be used.

**PRACTICE POINTER**  
**CHOICE OF LAW – SCOPE**

- Consider the specific words used to define the scope of the choice of law clause. Should it cover issues relating to “the Agreement,” “the relationship,” etc.? Should it apply only to “construing and interpreting” the Agreement or should it also “govern” the Agreement and relationship?

(2) **Required Relationship**

In determining whether a choice of law provision will be upheld, courts will often examine whether the chosen state has a logical connection with the dispute before it. In *LaGuardia Associates v. Holiday Hospitality Franchising, Inc.*  

> the franchisor terminated the franchise for failing to pay amounts owed under the parties’ franchise agreements. The franchisor was a Delaware corporation based in Georgia, the franchisee was based in New York, and the franchise agreements contained a choice of law provision providing that the agreements were to be “governed by Tennessee law.” Tennessee was the home of the franchisor at the time the franchise agreements were executed, but the franchisor had since moved to Georgia. The franchisee sued the franchisor in New York, seeking to bar the franchisor from terminating the franchise agreements.

In determining which state’s law to apply, the court stated that it is the general policy of New York to enforce a choice of law clause in a contract. However, absent a controlling statute, New York courts will not enforce a contractual choice of law clause if the state selected does not have a reasonable relationship to the economic activity. The court found that “[t]he parties have failed to identify a sufficient ‘reasonable relationship’ between the franchise and Tennessee to warrant application of the Agreements’ Tennessee choice of law clauses.” As the court noted:

> The fact that Tennessee once had a “reasonable relationship” to the Agreements is not sufficient to justify applying Tennessee law to the current dispute. The “reasonable relationship” of the chosen state to the

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36 *Bus. Franchise Guide (CCH) ¶11,297 (5th Cir. 1997).*
37 *Id. at 30,122* (emphasis added).
38 *92 F. Supp. 2d 119 (E.D. N.Y. 2000).*
agreement must exist at the time of the contract dispute, and not merely at some point in the past. At present, it cannot be said that Tennessee has any interest in, or relationship to, the Agreements or the franchise relationships they establish. The Tennessee choice-of-law provision in the Agreements are thus unenforceable under New York choice-of-law rules.\textsuperscript{36}

The court also pointed out that its conclusion was buttressed by the fact that the franchisor prepared the franchise agreements. It found that there would be no hardship on the franchisor by declining to apply Tennessee law when the franchisor, which authored the choice of law clause in an effort to avail itself of the fruits of Tennessee law, "has through its own actions eliminated the necessary relationship between the franchise arrangements and Tennessee."\textsuperscript{40} The court applied New York law, and thus, the franchisor's selection of the law of its then-home state in the choice of law provision resulted in the non-enforcement of the choice of law provision.

Not all states require that there be a “nexus” between the state law chosen and the facts involved for the choice of law clause to be enforceable. Similar to the New York statute discussed above regarding venue clauses, New York has enacted a statute which allows parties in certain cases to agree to be governed by New York law even if New York bears no relationship to the events or circumstances. Thus, section 5-1401 of the New York General Obligations Law provides as follows:

§ 5-1401. Choice of law.

1. The parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection one of section 1-105 of the uniform commercial code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state. This section shall not apply to any contract, agreement or undertaking (a) for labor or personal services, (b) relating to any transaction for personal, family or household services, or (c) to the extent provided to the contrary in subsection two of section 1-105 of the uniform commercial code.

Accordingly, in selecting a specific state law to apply to a franchise agreement, the parties should select a state that bears a reasonable relationship to the transaction, unless a statute (such as that in New York) provides otherwise.

The language included in one choice of law clause in an attempt to address the “nexus” requirement resulted in different states’ laws applying to different claims in the case. In Grady's American Grill, L.P. v. Reilly,\textsuperscript{41} a franchisee brought claims for breach of the parties’ franchise agreements and claims related to a guaranty executed by the franchisee. With respect to the franchise agreements, the parties “agreed contractually to have the franchise agreements governed by the laws of the state in which the franchisor

\textsuperscript{36} Id. at 127-128 (emphasis added).
\textsuperscript{40} Id. at 128.
\textsuperscript{41} Bus. Franchise Guide (CCH) ¶11,853 (S.D. Tex. 2000).
had its principal place of business from time to time."\textsuperscript{42} The court noted that "during the course of events providing the foundation for the claims in this case, [the franchisor's] principal place of business was moved from Vermont to Indiana . . . and then back to Vermont.\textsuperscript{43} Although Vermont was the principal place of business at the time the suit was filed, the alleged breaches occurred at various times throughout the relationship. The court held that "whether an alleged breach was in fact a breach depends on what state's laws governed the contract at the time of the breach. Therefore, the court must consider both Indiana and Vermont law.\textsuperscript{44} Accordingly, selecting the law of the state of the franchisor's principal place of business "from time to time" could result in the law of two different states each applying to different claims if the franchisor moves to another state.

\begin{center}
\textbf{PRACTICE POINTER}
\textbf{CHOICE OF LAW – NEXUS}
\end{center}

- As with forum selection clauses, absent an applicable statute, select a state law to be applicable that has a nexus to the agreement: the transaction or the parties.

\begin{center}
(3) \textit{"Two Bites at the Apple"}
\end{center}

To increase the likelihood that a provision of the franchise agreement will be found enforceable, it is advisable to include a phrase in the choice of law provision stating that if application of the chosen law would render a provision unenforceable, then the parties intend the law where the franchisee is based (or some other law relevant to the transaction) to be applied.\textsuperscript{45} Thus, if the choice of law provision would render, for example, a non-compete covenant unenforceable under the chosen law, a provision of this nature would provide the franchisor with "two bites at the apple" – and increase the likelihood that the non-compete provision would be rendered enforceable.

\begin{center}
\textbf{PRACTICE POINTER}
\textbf{CHOICE OF LAW – EFFECT OF STATE LAW}
\end{center}

- To increase the likelihood of enforcing all provisions of the agreement, draft the choice of law clause so that if the state law selected would render a provision unenforceable, the state law where the franchisee is based would apply.

\begin{center}
(4) \textbf{Carve Out Certain Types of Claims}
\end{center}

While most choice of law clauses select a single state's law for all purposes, there may be circumstances in which it is advisable to select a different state's law for certain types of issues. In the franchise context, probably the most common "carve-out" from the chosen state law is for covenants against competition. For example, if a franchisor is based in California and therefore designates the laws of that state in its choice of law clause in

\textsuperscript{42} Id. at 33,103.
\textsuperscript{43} Id.
\textsuperscript{44} Id.
franchise agreements with franchisees in other states, it should carve out from the clause any post-term covenants as they would (with limited exceptions) be unenforceable under California law.

Similarly, certain states have stricter requirements than most for protection of confidential or trade secret information. Franchisors selecting the law of those states should be careful to carve out those types of issues so that enforcement of the clauses in the franchise agreement dealing with those issues are more likely to be upheld and enforced.

<table>
<thead>
<tr>
<th>PRACTICE POINTER</th>
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<tbody>
<tr>
<td>CHOICE OF LAW – CARVE OUTS</td>
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<tr>
<td>- Carve out from the application of the selected state law any provisions (e.g., covenants) that would be rendered unenforceable by that state law.</td>
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(5) **Substantive Law v. Conflict of Law**

Confusion can result if a choice of law clause merely designates the law of a particular state without making it clear that it is the substantive law of that state which is being selected. The choice of law clause should state that the conflict of law rules of the state selected are not intended to be applied as a result of the choice of law clause. Phrases such as “without giving effect to its conflict of law principles” or references to the “substantive law” or “internal laws” of the state should be included in the clause. The purpose of these phrases is to avoid renvoi, i.e., to make it clear that the state law designated governs only with respect to the substantive law of the state, not the conflict of law rules of that state. Otherwise, the choice of law clause could result in applying the conflict of law principles of the chosen state’s law, only to find that that state’s conflict of law rules leads to the application of the substantive laws of another state.

(6) **Watch Out for State Franchise Statutes**

In broadening the scope of a choice of law clause, franchisors should be careful to avoid adopting the law of a particular state that may contain a franchise statute. In that situation, the clause should provide that no franchise statute, law or regulation of that state is intended to be made applicable to the agreement unless it would otherwise apply. An example can help illustrate this point. The New Jersey Franchise Practices Act applies only to franchisees that have a principal place of business in New Jersey. A franchisee not based in New Jersey may point to a choice of law provision in its franchise agreement selecting New Jersey law and argue (whether correctly or not) that the parties intended the New Jersey Franchise Practices Act to apply to it. If the choice of law provision stated that the parties do not intend any state franchise statute, law or regulation to be made applicable unless it otherwise applies, the franchisor in this example can avoid the application of the New Jersey Franchise Practices Act to franchisees not based in New Jersey (because the Act would not “otherwise be applicable”).

Even without such an exclusionary clause, some courts have reached the same result – but not without substantial time devoted to litigation of the issue. In *Southwestern*
Adjusting Co. v. Underwriters Adjusting Co., a group of plaintiffs asserted that the defendant had violated the common law equivalent of the New Jersey Franchise Practices Act by, among other things, wrongfully terminating their licensing agreements. The claim was premised on the plaintiffs' contention that their agreements were franchises. While the parties' agreements contained a New Jersey choice of law clause, the court dismissed the plaintiffs' wrongful termination claims, noting that the Act "only applies to franchisees located within New Jersey, and [that] all of the . . . plaintiffs are located outside of the State."

A similar result was reached in In re Montgomery Ward Catalog Sales Litigation, which addressed the scope of the Illinois Franchise Disclosure Act ("IFDA"). There, the defendants moved for summary judgment as to plaintiffs' claims under the IFDA, asserting that the pertinent provisions of that Act were not applicable to franchises located outside the State of Illinois. Opposing that motion, the plaintiffs asserted that the parties' contracts expressly provided that they would "be governed in all respects by the laws of Illinois." The district court rejected this assertion, holding that this provision made applicable only those statutes that the Supreme Court of Illinois would apply to the parties' dispute. Concluding that the Illinois court would find that the IFDA "does not have extraterritorial effect" because the statute's language made it clear that the Illinois legislature "intended to protect only the citizens of Illinois" in enacting the statute, the court granted defendants' motion for summary judgment and dismissed plaintiffs' claims under the IFDA.

To avoid any doubt that the selection of a state's law was not intended to invoke a state franchise statute unless that statute would jurisdictionally be applicable by its terms, the choice of law clause should expressly address this issue by stating that the intent of the clause is not to make applicable any "franchise statute, law or regulation of that state that would not otherwise be applicable." In Century Pacific, Inc. v. Hilton Hotels Corp., the court enforced a carve-out provision which provided that "nothing in this [choice of law] section is intended to invoke the application of any franchise, business opportunity, antitrust, implied covenant, unfair competition, fiduciary or any other doctrine of law of the State of New York or any other state which would not otherwise apply absent this [paragraph]." Because the New York Franchise Sales Act would not otherwise have been applicable, the court concluded, based on this carve-out language, that the choice of law clause selecting New York law did not invoke the Act.

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46 Bus. Franchise Guide (CCH) ¶10,040 (D.N.J. 1992). Barry Heller, one of the co-authors, was counsel of record in this case.
47 Id. at 23,356.
49 Id. at 186.
50 Id. at 186-187.
51 Id. at 187.
53 Id. at 37,712.
(7) **Enforceability of Choice of Law Clauses**

A court faced with a choice of law clause will generally begin by assessing enforceability of the clause by referring to the choice of law rules of the forum state. If the lawsuit is filed in a federal district court based upon diversity jurisdiction, the court will apply the choice of law rules of the state where that court is sitting in order to decide whether or not to enforce the choice of law clause. Choice of law provisions are considered presumptively enforceable. However, courts generally, absent an applicable statute providing otherwise, require that a reasonable relationship exist between the events or transaction at issue and the state whose law is chosen.

In deciding whether to enforce a choice of law clause, the forum court will generally refuse to apply the designated state’s law if doing so would violate a significant public policy of the forum state. Similarly, if the court determines that the governing law provision was induced by fraud, it may decline to enforce the clause. Some courts have rejected choice of law provisions if the agreement is viewed as a contract of adhesion, which is particularly the case if the non-drafting party can establish that it was unaware of the choice of law clause.

In determining whether to enforce a choice of law clause, numerous courts apply the Restatement analysis which provides that a court will enforce a choice of law clause unless (1) the designated state has no substantial relationship to the transaction; (2) no other reasonable basis exists to support the choice of that state’s law; or (3) application of that law would contravene a fundamental public policy of the state whose law would otherwise govern based on traditional conflicts of law principles. In considering whether the chosen state has a substantial relationship to the event or transaction under the Restatement approach, courts examine the extent of contacts that exist with the selected jurisdiction. The following contacts are generally considered substantial enough to render the clause enforceable: the place where either party conducts its business; either party’s principal place of business; the place where the contract was entered into, negotiated or to be performed; the location of the property that is the subject of the contract; where events under the contract will take place; and the place of injury.

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55 See *Restatement (Second) of Conflict of Laws*, § 187 (2)(a) and Comment f (1971).
56 See Fairfield Leasing Corp. v. Techni-Graphics, Inc., 607 A.2d 703, 707 (N.J. Super. Ct. Law Div. 1992) (contract invalidated choice of law clause because the court found that the agreement was a contract of adhesion and that the clause was not conspicuous enough due to its small size and location in the text).
57 See *Restatement (Second) of Conflict of Laws*, § 187 (2), (3) (1971).
Various state franchise statutes, while not invalidating choice of law clauses in their entirety, have voided choice of law clauses to the extent that application of the clause would bar a franchisee in that state from the protections of that state’s franchise laws. For example, many jurisdictions contain provisions in their franchise statutes rendering void any provision of a franchise agreement that would require the franchisee to waive compliance with that state’s franchise law.\(^{58}\)

As noted above, some states have enacted statutes concerning the enforceability of choice of law provisions in the absence of any relationship to the underlying events or transaction. New York, Delaware, and California, for example, have adopted legislation that their respective laws may be selected to govern an agreement if the amount in controversy exceeds a certain amount, even when there is no nexus between that state and the contract.\(^{59}\)

Absent statutes such as those in New York, Delaware and California, in selecting the state law to govern the franchise agreement, the franchisor should select a state with a reasonable relationship to the transaction involved. Doing so will increase the likelihood that that choice of law will be honored.

As discussed above in the Form Selection Section (see p. 9), the Ontario and Alberta Acts provide that any provision in a franchise agreement restricting the application of the law of that province is void with respect to a claim otherwise enforceable under these Acts.

### PRACTICE POINTERS

**CHOICE OF LAW – ENFORCEABILITY**

- Courts will generally enforce a choice of law clause unless doing so would violate a significant public policy of the forum state; the clause was included by fraud, or the state whose law is chosen has no substantial relationship to the transaction (absent an applicable statute eliminating the nexus requirement).
- Various state franchise laws prevent the use of choice of law clauses to deny a franchisee the protections afforded the franchisee by its home state’s franchise law.

### III. SHAPING CONTRACTUAL RELATIONSHIPS: WAIVERS, LIMITATIONS CLAUSES, AND DISCLAIMERS

At the outset it is important to note that waivers, limitations, and disclaimers – like other contractual provisions – will not necessarily be enforced in every jurisdiction, no

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\(^{59}\) See N.Y. Gen. Oblig. L. § 5-1401(1) (allows parties to designate New York law as the governing law when the amount in controversy is $250,000 or greater); Del. Code. Ann. § 2708 (permits parties to select Delaware law when the amount at issue is at least $100,000); Cal. Civ. Code § 1646.5 (permits parties to select California law when the amount at issue is at least $250,000).
matter how well drafted they may be. Some states may have statutory prohibitions against certain terms or case law that holds particular provisions to be unenforceable. Therefore it is important to coordinate such provisions with the choice of law and choice of forum provisions of the franchise agreement. As discussed below, courts weigh several factors in determining whether a particular provision is binding on the franchisee. None of the factors alone will necessarily be determinative on the issue, and decisions relating to the enforceability of such provisions can turn not only on the precise wording of the provision but on the facts and the parties as well.

A. Waivers

Waivers are terms agreed to by parties to an agreement whereby one or both relinquish their ability to pursue certain constitutional, statutory, or common law rights. For example, parties can waive their right to a jury trial or their right to bring a class-action lawsuit. As defined by section 84 of the Restatement (Second) of Contracts (1981), a waiver is the "intentional relinquishment of a known right." However, the use of the terms "known" and "intentional" are deceptive. From a legal standpoint, knowledge actually means that the party is, or should be aware of the facts, and proof of intent is not required to enforce a waiver.

The effect of waiver provisions will depend on state law, but, as a general rule, they should be clear and conspicuous and agreed to knowingly, intentionally, and voluntarily. It is also helpful to have certain provisions highlighted and placed near the signature line with a caption heading and set apart in a separate paragraph. Some states do not enforce certain provisions that are not reciprocal, and some courts are more inclined to recognize a waiver when the agreement is between parties of relatively equal bargaining power or between sophisticated business people, particularly if they are represented by counsel or have intentionally elected not to hire counsel.

(1) Waiver of State Statutory Protections for Franchisees

The franchise laws of some states expressly prohibit the enforcement of certain contractual provisions, including, for example, forum selection clauses and provisions which attempt to impair the applicability of the franchise laws of the home state of the franchisee. For example, the Illinois Franchise Disclosure Act invalidates a forum selection clause that requires litigation to be conducted outside the state. Some states enforce a complete prohibition on the franchisee's ability to waive its state statutory rights. In Rutter v. Bx of Tri-Cities,60 the court ignored the franchise agreement's choice of California law, finding that Washington law represented a fundamental policy of that state. Many states, however, will honor a choice of law provision when the chosen state has a substantial relationship to the parties, provided that there is no misrepresentation, duress, undue influence, or mistake and that the chosen state's law does not violate a fundamental policy of the state in which the franchisee is located.

The Illinois law also provides that "[a]ny condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this

Act or any other law of this State is void.\textsuperscript{61} Furthermore, when dealing with certain issues, such as termination and non-renewal, a franchisor must comply with the applicable state statutes that govern the franchise and cannot simply rely on the express terms of its franchise agreement. For example, in Globe Distributors, Inc. v. Adolph Coors Co.,\textsuperscript{62} a New Hampshire beer manufacturer relied on the language in a distributorship agreement, which allowed for termination for non-payment without any demand or notice, to its peril. The distributor was awarded double damages of over $10.2 million, plus attorney’s fees, because the brewer failed to comply with the state statute requiring the brewer to give written notice of an intent to terminate and an opportunity to cure the claimed deficiency.

Similarly, the Ontario Act and the Alberta Act state that any waiver or release by a franchisee of a right or requirement under the Act is void.\textsuperscript{63} However, in 1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC,\textsuperscript{64} the court held that such statutory invalidation does not apply to a release given (with the advice of counsel) by a franchisee in the settlement of a dispute for existing, known breaches of the Ontario Act.

**PRACTICE POINTER**

**DEFAULT AND TERMINATION NOTICES**

- Any of a franchisor’s personnel involved in drafting default, termination, or non-renewal notices should consult legal counsel to be certain that the notices comply with applicable state law requirements beyond what otherwise might be called for in the notice provisions as set forth in the franchise agreement.

(2) **Waiver of Right to Jury Trial**

Federal courts and most states will honor a properly drafted jury trial waiver. However, Georgia is one example of a state that will not do so. The court, in Bank S., N.A. v. Howard,\textsuperscript{65} noted that “pre-litigation contractual waivers of jury trial are not provided for by our Constitution or Code and are not to be enforced in cases tried under the laws of Georgia.” Some states will enforce a jury trial for some types of contracts, but not others. And some will not enforce a jury trial waiver if the parties do not possess equal bargaining power.\textsuperscript{66} In Whirlpool Financial Corp. v. Sevaux,\textsuperscript{67} the court set down a number of factors that require consideration in determining whether a contractual waiver of the right to jury trial was entered into knowingly and voluntarily; namely, the parties’ negotiations concerning the waiver provision, if any, the conspicuousness of the provision, the relative

\textsuperscript{61} 815 ILCS 705/41 (2009).
\textsuperscript{63} S.O. 2000, c. 3 at s. 11; R.S.A. 2000, c. F-23 at s. 18.
\textsuperscript{65} 444 S.E.2d 799, 800 (Ga. 1994).
\textsuperscript{66} See e.g., Drelling v. Peugeot Motors of America, Inc., 539 F. Supp. 402 (D. Colo. 1982) (finding contractual waiver of jury trial unenforceable where the defendants “failed to show that the plaintiffs had any choice other than to accept the contract as written”).
\textsuperscript{67} 866 F. Supp. 1102 (N.D. Ill. 1994).
bargaining power of the parties and whether the waiving party’s counsel had an opportunity to review the agreement.

In *Dunkin’ Donuts Franchised Restaurants, LLC. v. Manassas Donut Incorporated*, the court upheld jury trial and punitive damages waivers by applying a similar standard to each, noting that they were made knowingly and voluntarily. Significantly, the jury trial waiver and the punitive damage waiver were both listed twice, both times set in capital letters and once in bold-faced font. The court also considered that the signatories had read the agreement, that one was an attorney, and that one was an experienced businessperson. The waiver language was broad enough to encompass all disputes, including those raised in the franchisee’s counterclaim that the franchisor acted in bad faith in terminating the franchise agreement.

In *Bonfield v. AAMCO Transmissions, Inc.*, the court noted that, although the Seventh Amendment of the U.S. Constitution guarantees the fundamental right to a jury trial in a civil case, that right – like most constitutional rights – is waivable. While noting that the courts will indulge “every reasonable presumption against waiver,” the court nonetheless upheld the waiver. Significantly, in AAMCO, although the franchisee had an attorney, it elected not to have the attorney review the franchise agreement.

On the other hand, a California case, *Grafton Partners v. Superior Court of Alameda County*, held that a jury trial waiver was unenforceable because it was not authorized by any statute.

Since civil trials are so rarely tried by a jury in Canada, a jury trial waiver clause will not normally be found in a franchise agreement. Accordingly, there is an absence of case law regarding the enforceability of such a clause. *Beaucage v. Grand & Toy Ltd.*, however, is an example of a franchise case where the issue was dealt with on a cursory basis. Here the court looked to section 108 of Ontario Courts of Justice Act in ruling that a jury trial is inappropriate where the relief will be of a declaratory or interim in nature.

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**PRACTICE POINTERS**

**DRAFTING WAIVER PROVISIONS**

- Make the waiver conspicuous. Include caption headings, use bold-faced, capital letters, and/or a larger font size from the rest of the agreement. Do not bury the waiver in the text of another paragraph.

- Include an acknowledgment that the signatories have read and are aware of the waiver to show that they signed it voluntarily and knowingly.

- Consider having a space for the signatories to initial the waiver clauses.

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68 Bus. Franchise Guide (CCH) ¶13,794.
69 Bus. Franchise Guide (CCH) ¶9,740.
70 Bus. Franchise Guide (CCH) 13,125.
72 R.S.O. 1990, c. C.43.
Consider drafting the agreement in "Plain English."

- Make waivers mutual.

- Encourage signatories to obtain legal advice and include information about franchisee's counsel or franchisee's desire not to use counsel in the files. Include a provision in the franchise agreement urging the franchisee to seek advice of counsel.

- Draft waiver provisions so that they are broad enough to encompass all disputes of whatever kind or nature, whether arising out of or relating to the negotiation, performance or breach of the franchise agreement or any other agreement or otherwise, as well as any counterclaims.

- If a waiver is intended to apply to ancillary agreements, use the same waiver language in each agreement.

- Determine if the provision will be enforceable in view of the applicable choice of law and forum selection provisions.

(3) **Class Action Waivers**

Class action waivers have come under increased scrutiny in the last few years as consumers have challenged such clauses as being unconscionable and therefore unenforceable. This approach has been followed by at least one court in considering the issue in a franchise context.

California has been at the forefront of this trend. In 2002, in a case called Szetela v. Discover Bank,\(^73\) the California Court of Appeals found that a class action arbitration waiver clause was unenforceable in that it was procedurally and substantively unconscionable. In 2005, in Discover Bank v. Superior Court,\(^74\) the California Supreme Court held that under California law, the class action waiver was unenforceable. It concluded that the FAA did not pre-empt its decision because the concept of unconscionability on which the Discover Bank decision was based applied to all contracts, generally, not just to arbitration agreements.\(^75\) In reaching its decision that the waiver was unconscionable, the court emphasized that the clause was in a contract of adhesion and involved a bill stuffer that purportedly added the class action waiver in the parties' bank account agreements.

Although franchise agreements are substantially different from the type of bank contracts and consumer claims involved in Discover Bank, the California Court of Appeals applied the unconscionability rationale in that case to a class action waiver in a franchise agreement in Independent Association of Mailbox Center Owners, Inc. v. Superior Court.\(^76\) The appellate court held that the trial court erred in not finding unenforceable the ban on class action arbitration in one of the versions of the franchise agreements at issue. (The

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\(^{73}\) 118 Cal. Rptr. 2d 863 (Cal. Ct. App. 2002).

\(^{74}\) 30 Cal. Rptr. 3d 76 (Cal. 2005).

\(^{75}\) Id. at 89.

\(^{76}\) 34 Cal. Rptr. 3d 662 (Cal. Ct. App. 2005). Barry Heller, one of the co-authors, was counsel of record in this case.
other versions involved did not contain a class action waiver.) The court reasoned that some franchise agreements resemble in some respects consumer contracts and that a franchise agreement, like a consumer contract, can in some circumstances be a contract of adhesion. Based on this, the court struck down the class action waiver as unconscionable.

While not in a franchise context, earlier this year, the Court of Appeals for the Second Circuit held that a class action arbitration waiver clause in a credit card agreement was unenforceable. The court made a point of stating that it was not deciding whether class action waiver provisions are void or enforceable per se but, rather, whether the particular waiver contained in the contract between the parties was enforceable.\textsuperscript{77} The primary basis for its conclusion was that it would be cost-prohibitive for the plaintiff merchants to bring individual actions against American Express given the maximum amount of damage each could recover.\textsuperscript{78} The court was particularly concerned that the class action waiver would “effectively preclude any action seeking to vindicate the statutory rights asserted by the plaintiffs.”\textsuperscript{79}

Whether other courts will follow the lead of the California and New York courts, and whether they will extend this reasoning to franchise agreements (as the California court did in the \textit{Mailboxes} case) remains to be seen. Because the risks to a franchisor are greater if a class action waiver is not enforced in an arbitration context, as compared to a litigation context, franchisors which require arbitration and include a class action waiver clause might consider an additional provision: The arbitration clause might include a provision providing that, if the class action waiver is found to be unenforceable, the arbitration clause shall not apply to the dispute and the dispute shall be resolved in court.

Recent Canadian cases have addressed the issue of the enforceability of class action waivers in franchise agreements. In \textit{2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.},\textsuperscript{80} the court found that a contract that precludes class proceedings interferes with the administration of justice as such an agreement denies the opportunity to make the best use of judicial resources and denies the public the access to justice and behavioural modification provided by class proceedings. There may be instances, however, where contracting parties may be able by contract to shape the contours of a class proceeding in whole or in part. Therefore, contracting out clauses are neither categorically enforceable nor categorically unenforceable and their enforcement will be determined in the context of a certification motion. The preferred approach is for a contracting out clause to be read down so that it is just a strong factor in determining whether a class proceeding is the preferable procedure. It was also held by the Ontario Court of Appeal in \textit{Smith Estate v. National Money Mart Company},\textsuperscript{81} that a clause which requires disputes to be resolved by arbitration and prohibiting joinder or consolidation of claims is not enforceable where the

\textsuperscript{77} \textit{In re Am. Express Merchants' Litig. v. American Express Travel Related Servs. Co.}, No. 06-1871-cv, slip op. at 7 (2d Cir. Jan. 30, 2009).

\textsuperscript{78} \textit{Id.} at 20.

\textsuperscript{79} \textit{Id.} at 7.


\textsuperscript{81} [2008] O.J. No. 4237 (C.A.).
effect would be to deny the plaintiffs a remedy because it would not be economically feasible for them to arbitrate the claim individually.

PRACTICE POINTERS
CLASS ACTION WAIVERS

- Include a class action waiver clause in franchise agreements but bear in mind that certain courts will not enforce them.

- If you include a class action waiver in an arbitration context, and want to avoid having a class action in arbitration, consider also including a provision stating that, if the waiver is found to not be enforceable, the matter should be litigated in court and not arbitrated.

(4) Non-Waiver Provisions

Franchisors and franchisees frequently do not act on breaches by the other side, creating concerns that the failure to enforce a provision could give rise to a claim of waiver. Non-waiver provisions, which are typically included in franchise agreements and most other commercial contracts, are intended to address such concerns. For example, in Dunkin’ Donuts, Inc. v. Northern Queens Bakery, Inc., the court recognized that acceptance of a franchise fee did not constitute a waiver of any breach of contract claim pursuant to the terms of the franchise agreement, and in Burger King Corp. v. Lee, the court held a non-waiver provision to be enforceable under the circumstances, noting that “the Agreement states that the failure of [franchisor] to exercise any right or option it has under the Agreement shall not constitute a waiver of its right to require exact and strict compliance with the terms of the Agreement.”

B. Contractual Limitations

(1) Contractual Limitations for the Time to Bring an Action

Many franchisors include a provision in their franchise agreements that require the franchisee to assert its claim or file suit within a specified period, which may be significantly shorter than what would otherwise be permissible under the applicable statute of limitations. The failure of a party to bring the action within the appropriate time period can be devastating to the party seeking relief, so it is particularly important for counsel of any party seeking to pursue a claim to pay heed to agreed upon time limitations. As with other provisions discussed in these materials, the effect of time limitation provisions is subject to applicable state law. In most cases, the courts will enforce the provision if it is reasonable, i.e., if the party has sufficient time to investigate and file a claim.

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84 See Han v. Mobil Oil Corp., 73 F.3d 872 (9th Cir. 1995) (contractual limitation period requiring a plaintiff to commence an action within twelve months following the event giving rise to a claim is a reasonable limitation that generally manifests no undue advantage and no unfairness); Dennehy v. Cousins Subs Sys., 2003 U.S. Dist. LEXIS 6943 (D. Minn. Apr. 21, 2003) (holding that, under Wisconsin law, parties can, by contract, agree upon a limitations period provided the franchisor
In analyzing the threshold question of whether or not to include such a provision, a number of other questions should be considered. Should it be unilateral or mutual? What is a reasonable period of time for bringing an action? When does the provision start to run? What is the scope of claims covered by the limitation? Should the provision apply to counterclaims, cross-claims, third party claims, and claims or defenses in the nature of set off or recoupment? Should certain claims be excluded? Does the chosen forum and law in the agreement permit such a limitation? Does the state’s statute of limitations provide for a longer time period than the one selected?85

Defenses to contractual limitation provisions include equitable tolling, equitable estoppel based on blameless ignorance, culpable action by the defendant, the existence of a close and important relationship, active concealment, or the presence of a continuing wrong.86

Each Canadian province has a Limitations Act which specifies the limitations period for bringing an action. In Ontario87, a party has two years from discovering the events giving rise to a cause of action to commence an action, with an ultimate limitation period for most cases of fifteen years. The Ontario and Alberta88 Limitations Acts provide that, in general, these periods cannot be waived by way of contract; however, there are several limited exceptions.

| PRACTICE POINTERS
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<th>CONTRACTUAL WAIVERS OF STATUTE OF LIMITATIONS</th>
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<tr>
<td>• Provide for a reasonable period of time asserting claims.</td>
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<tr>
<td>• State that claims are barred, rather than waived, in order to best position oneself against an argument that the state franchise act voids any provisions that are viewed as a waiver of a franchisee’s rights.</td>
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<tr>
<td>• Determine if the provision will be enforceable in view of the applicable choice of law and forum selection provisions.</td>
</tr>
<tr>
<td>• If an arbitration provision is included in the franchise agreement, craft the limitation period so that it also applies to arbitration proceedings.</td>
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proves (1) that the action was covered by the terms of the contractual limitations period and (2) the limitations period is reasonable).

85 For a more extensive discussion of these considerations as well as other issues relating to limitation periods, see Sandy T. Tucker, Contractual Limitations of Action Periods in Franchise Agreements, 24(1) FRANCHISE L.J. 18 et. seq. (Summer 2004) and Scott G. McLester, Sandy T. Tucker, and William Killion, Statutory and Contract Limitations of Action in Franchising, IFA 36th Annual Legal Symposium, Tab 19 (2003). The sample provision under "Limitations for Time to Bring an Action" in the Appendix was taken from those articles.
86 Id. at 21.
87 S.O. 2002, c. 24, Sch. B.
C. Disclaimers and No Reliance Provisions

(1) Merger/Integration/"Entire Agreement" Clauses and Disclaimers

Arguably merger/integration (or "entire agreement") and disclaimer clauses are the most common boilerplate clauses. Merger/integration clauses state, essentially, that the document in which the clause is found sets forth the entire agreement between the parties thereto and that all prior agreements and representations made by and between the parties are merged (or integrated) into that document, and that it supersedes and terminates all previous agreements between the parties. Disclaimers are statements intending to specify or limit the scope of rights and obligations with respect to a contractual relationship.

A typical merger/integration clause will often state that there are no collateral agreements or understandings, written or oral, affecting the agreement at hand and, further, that the agreement may be altered or modified only by a written amendment executed with the same formality as the agreement itself.

With a merger/integration clause, the parties accede to a modified form of the common law rule disallowing parol evidence of prior representations in the face of a written agreement, one that adds a broader interpretation with the effect that the rule against parol evidence operates to prevent a party to a lawsuit from introducing extrinsic evidence of negotiations that occurred before or while a written agreement was being reduced to its final written form.\(^{89}\) While some courts will apply the rule to disallow only evidence of negotiations that \emph{contradicts} a term of the written contract, a merger/integration clause will typically operate to disallow evidence of negotiation of \emph{anything} that might have been but was not included in the contract.

In the franchise context, disclaimers are often expanded to include "no reliance" language whereby the franchisee acknowledges certain activities. For example, a franchisee might acknowledge that it has conducted its own due diligence or that it is not relying upon representations of the franchisor that are not specifically included in the franchise document. Some disclaimers are included within the body of a franchise agreement and are highlighted in some fashion, such as being set in all capital letters or bold-faced font. Other disclaimers are contained on separate documents such as questionnaires that require a franchisee to affirmatively indicate whether it has received certain representations and/or that it is not relying on any representations not contained in the agreement.

The purpose of a merger/integration clause is to have the contracting parties acknowledge that, if an obligation or agreement is not included in the written contract document, then it is not part of the contract even if there were discussions, negotiations, or representations about it. Indeed, when the negotiations are completed by the execution of the contract, the transaction, so far as it rests on the contract, is merged in the writing.\(^{90}\) Disclaimers serve the purpose of requiring a franchisee to affirmatively deny receipt of or reliance on representations regarding the franchise opportunity. Merger/integration clauses

\(^{89}\) See \textit{Restatement (Second) of Contracts} § 215 (1981).

and disclaimers can also preclude fraudulent inducement claims and can save the franchisor the time and expense of litigating whether a franchisee relied on any representations not contained in the franchise agreement (or franchise disclosure document) in its decision to purchase a franchise.

(a) Enforceability

In determining the enforceability of merger/integration clauses and disclaimers, courts will usually consider all the circumstances in which the representations were made, as well as the express terms of the clause(s), to ascertain if the boilerplate clause is factually false. When material extrinsic evidence shows that outside agreements were in fact relied upon, parol testimony may be given effect rather than allowing boilerplate provisions to vitiate the true understanding of the parties.\textsuperscript{91}

With respect to claims for fraudulent inducement, different jurisdictions take different approaches. Some jurisdictions will allow the use of merger/integration clauses and disclaimers to defeat all claims of fraudulent inducement. Other jurisdictions will dismiss claims where there are merger/integration clauses and the disclaimers disclaim the specific representation purportedly relied on.

Depending on the particular state laws, merger/integration clauses and disclaimers can provide protection to the franchisor, a compelling argument to a judge, or a powerful tool in challenging the reasonableness of a franchisee's reliance. They can also prove valuable to a franchisor, as was the case in \textit{Lady of America Franchise Corp. v. Malone}.\textsuperscript{92} where the court found that the comprehensive and unambiguous disclaimer and non-reliance clause barred the franchisee from admitting evidence of fraud in the inducement because the franchisee could not show detrimental reliance on the alleged misrepresentations.

However, there are also instances where merger/integration and disclaimer clauses were found to be unenforceable.

In \textit{Westerfield v. Quizno's Franchise Co.},\textsuperscript{93} the court, on a motion to dismiss the plaintiffs' fraud claims, found that the express disclaimers and non-reliance clauses in the franchisor's Uniform Franchise Offering Circular and franchise agreement undermined the franchisees' fraud claims based on misrepresentations and failure to disclose material information. The court pointed out that "[p]rospective franchisees were advised 'to seek professional assistance, to have professionals review the documents and to consult with other franchisees regarding the risks associated with the purchase of the franchise . . . .'" However, in a subsequent ruling on a motion for reconsideration, the court noted that it had erred in concluding that the disclaimers and non-reliance clauses contained in Quizno's Uniform Franchise Offering Circular and franchise agreement precluded the plaintiffs' fraud

\textsuperscript{92} Bus. Franchise Guide (CCH) ¶13,562.
\textsuperscript{93} Bus. Franchise Guide (CCH) ¶13,794.
claims as a matter of law. Rather, Wisconsin law suggests that more than contract language is needed to defeat a claim of fraud.\footnote{Bus. Franchise Guide (CCH) ¶13,887.}

In \textit{Randall v. Lady of America Franchise Corp.}, a provision contained in a franchise agreement that purported to preclude the franchisee from asserting that it had relied on prior representations in executing the agreement was not enforced. The court denied the franchisor's motion to dismiss based on this merger/integration clause, noting that, if a party alleges that a contract was procured by fraud or misrepresentation as to a material fact, then an integration clause will not make the contract incontestable, and oral representations may be introduced into evidence to establish fraud.\footnote{See Randall v. Lady of America Franchise Corp., 2005 WL 2709641 (D. Minn.).}

In \textit{A.J. Temple, Inc. v. Union Carbide Marble Care Inc.},\footnote{A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care Inc., 162 Misc.2d 941 (N.Y. Sup. 1994), aff'd 214 A.D. 2d 473 (1st Dep't 1995), mod. 87 N.Y. 2d 574 (1996).} the court held that the merger and waiver clauses in a franchise agreement did not bar a franchisee's fraud claims against its franchisor under the New York Franchise Sales Act. The plaintiff franchisee asserted that the defendant franchisor had made a series of misrepresentations to the plaintiff to induce it to enter into the franchise agreement which was the subject of the action. The defendant moved to dismiss citing the merger and waiver clause in the franchise agreement. The court rejected the anti-waiver protections of the New York Franchise Sales Act and held that enforcement of the merger and waiver clauses in the subject franchise agreement would impermissibly permit the defendants to get around the anti-fraud provisions of the New York Franchise Sales Act by contracting out of such liability.

In \textit{RadioShack Corporation v. Comsmart, Inc.},\footnote{222 S.W.3d 256 (Ky. Ct. App. 2007).} the court found that evidence of fraudulent misrepresentations made by representatives of the franchisor to induce the franchisee to enter into a franchise agreement were admissible under Kentucky law to show that the agreement had been procured by fraud. The court did not follow the decision in \textit{Papa John's v. Dynamic Pizza, Inc.},\footnote{317 F. Supp. 2d 740 (W.D. Ky. 2004).} in which the federal district court, applying Kentucky law, had held that an integration clause was an absolute bar to a claim of fraud in the inducement, because Kentucky authority is, in fact, to the contrary. The Kentucky court held that, because fraud in the inducement sounds in tort rather than in contract, parol evidence is admissible.

See also \textit{Burgo v. Lady of America Franchise Corporation},\footnote{Bus. Franchise Guide (CCH) ¶13,430 (C.D. Cal. 2006). Julianne Lusthaus is a member of the firm that represented the franchisees in this action.} where the United States District Court for the Central District of California denied the franchisor’s motion to dismiss the franchisees’ claims for common-law fraud and violation of the California Franchise Investment Law (CFIL). The court determined that the anti-waiver provisions of the CFIL rendered the merger and integration clauses and disclaimers void.
In Canada, courts have held entire agreement clauses to be enforceable, but they have made distinctions with regard to certain circumstances. In *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.*, 100 the Supreme Court of Canada held that a broadly drafted exclusionary clause, to the effect that there are no representations except as expressly stated in the franchise agreement, will generally protect a franchisor from claims based upon pre-contractual negligent misrepresentations or an oral collateral warranty. An exception to this rule may be where the franchisee is unsophisticated and has not had the benefit of independent legal advice.

In *Zippy Print Enterprises Ltd. v. Pawlik*, 101 however, the British Columbia Court of Appeal distinguished situations where a material representation is made on behalf of the franchisor. Justice Lambert stated that “[a] general exclusionary clause will not override a specific representation on a point of substance which was intended to induce the making of the agreement unless the intended effect of the exclusion clause can be shown to have been brought home to the party to whom the representation was made by being specifically drawn to the attention of that party, or by being specifically acknowledged by that party, or in some other way.”

The Ontario Court of Appeal further developed this point in the leading franchise law case of *Shelanu Inc. v. Print Three Franchising Corp.* 102 The court held that if a conflict arises between the intention of the parties as inferred from the totality of the evidence on the one hand and the meaning of the contract on the other, intention should win. Enforcing an exclusion clause that is contrary to the reasonable expectation and understanding of the parties in these circumstances would not be fair or reasonable.

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<td><strong>IMPROVING ENFORCEABILITY OF MERGER/INTEGRATION CLAUSES AND DISCLAIMERS</strong></td>
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<tr>
<td>• To improve the enforceability of merger/integration clauses and disclaimers, they should be negotiated and drafted to address specifically the subject matter about which potential claims of fraud might be made.</td>
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<td>• If a claim sounds in fraud rather than in contract, the merger/integration clause may not bar evidence regarding misrepresentations made.</td>
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<tr>
<td>• If the claim sounds in contract and the merger/integration clause is factually false, such as where a franchisee simultaneously executes multiple agreements with the franchisor in addition to the franchise agreement, a court may not enforce the clause.</td>
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(2) Recent Developments

(a) The Amended FTC Rule

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100 [1982], 1 S.C.R. 726 (S.C.C.).
102 (2003), 64 O.R. (3d) 533 (C.A.).
The Amended FTC Rule now prohibits franchisors from disclaiming any representations in their Franchise Disclosure Document. Franchisor counsel should be sure to modify typical integration provisions previously included in franchise agreements to ensure that they do not purport to disclaim, or require a prospective franchisee to waive, reliance on any representation in the Franchise Disclosure Document or any exhibits to the FDD. The revision must be included in the body of the Franchise Agreement itself. The Franchise Rule Compliance Guide notes that this “includes the use of integration clauses that purport to disclaim liability for statements authorized by franchisors in their disclosure documents. This prohibition is intended to prevent fraud by ensuring the accuracy of information contained in disclosure documents. It is not intended to ban all uses of integration clauses. By its terms, the prohibition is limited to waivers or disclaimers pertaining to statements made in the disclosure document and its exhibits or attachments.”

(b) Anti-Waiver Provisions of Franchise Statute Invalidate Separate and Distinct Questionnaire Executed at Franchise Closing

In a very important case for franchisees in New York, Emfore v. Blimpie Associates, the Appellate Division, First Department of the Supreme Court of the State of New York modified the trial court’s order and allowed the plaintiff franchisee to proceed with its claims that the defendant franchisor had violated sections 683 (disclosure requirements) and 687 (fraud) of the New York State Franchise Sales Act by providing false and misleading earnings statements to the plaintiff. The Appellate Court ruled that under the Franchise Act there is no difference between contract clauses in the franchise agreement proper and separate questionnaires or other documents containing disclaimers or waivers that the franchisor requires the franchisee to sign, and therefore both are invalid under the Franchise Act.

In Emfore, the plaintiff corporate franchisee alleged that it was induced to execute a franchise agreement with the defendant franchisor by a series of fraudulent representations made by representatives of the franchisor. Among other things, the defendants allegedly misrepresented the sales levels of existing Blimpie stores and the sales levels that the plaintiff could expect to reach in its operation of a Blimpie store.

The defendants moved for summary judgment based on the existence of not just a merger/integration clause in the franchise agreement, but in particular a separate “questionnaire” completed by the franchisee at the closing of the franchise purchase and sale purporting to indicate that no representations had been made to the franchisee that were not included in the agreement.

The trial court granted the defendants’ motion for summary judgment dismissing the complaint and denied the plaintiff’s cross-motion for summary judgment dismissing certain affirmative defenses. The Appellate Division, First Department, however, unanimously

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103 16 C.F.R. 437.
modified, on the law, the trial court’s decision, reinstated the plaintiff’s causes of action which are based on the defendants’ alleged violations of the New York Franchise Act and dismissed the defendants’ respective affirmative defenses that relied upon release and waiver clauses and disclaimers. The court determined that the disclaimers contained on a questionnaire, initialed by the officer of the plaintiff, violated the provisions in the law that any condition, stipulation, or provision purporting to bind any person acquiring any franchise to a waiver of compliance with any provision of the Act shall be void, and that a franchisor may not require a franchisee to assent to a release, assignment, novation, waiver, or estoppel that would relieve a franchisor from any duty or liability under the law. While the plaintiff franchisee’s common law claims of fraud were defeated by the merger/integration clause and questionnaire, the statutory claims survived. The Appellate Division subsequently denied the defendants’ motion for re-argument or modification of its decision and order.

(3) **Disclaimers Relating to Right of Control**

Numerous vicarious liability suits have been brought against franchisors seeking recovery for an act or omission of a franchisee. In instances where franchisees have caused damage to third parties, the third parties have brought suit against the franchisee and the franchisor based on the doctrine of *respondeat superior*. Generally, this doctrine provides that a master (meaning the franchisor) is liable for the acts of the servants and agents (meaning the franchisee). The analysis focuses on control, considering whether a franchisor had the right to control the conduct of the franchisee which injured the third party. 106

For this reason, it is good practice to include a disclaimer of control of the franchisee’s day-to-day operations in a franchise agreement to limit the franchisor’s risk of vicarious liability. Such a disclaimer played a role in the favorable outcome obtained by the franchisor in *Jones v. Filer, Inc.* 107 In that case, a Midas franchisee improperly performed a brake job, which resulted in an accident that killed a person. A negligence action was brought against the franchisee and the franchisor. The franchisor argued it could not be liable because it did not have the right to control individual brake jobs, citing the following terms in the franchise agreement:

This Agreement does not in any way create the relationship of principal and agent between Midas and Franchisee, and in no circumstances shall Franchisee be considered an agent of Midas. Franchisee shall not act or attempt to act, or represent himself, directly, or by implication, as an agent of Midas or in any manner assume or create or attempt to assume or create any obligation on behalf of or in the name of Midas, nor shall Franchisee act or represent himself as an affiliate of any other authorized Midas Franchisee.

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106 See 62B Am Jur 2d Private Franchise Contracts § 298 (2008) ("A franchisor may be held vicariously liable for the tortious conduct of its franchisee only if the franchisor has control or a right of control over the daily operation of the specific aspect of the franchisee’s business that is alleged to have caused the harm.").

The court found the agreement did not completely control the issue, but it did consider it as a factor in its decision to dismiss the claims against the franchisor.

(4) **Disclaimer of Fiduciary Relationship**

Generally, commercial parties negotiating at arm’s length do not become fiduciaries of each other upon entering a contract, and courts have generally found that no fiduciary relationship exists between a franchisor and a franchisee, except under unusual circumstances.\(^{108}\)

Despite the reluctance of courts to treat the franchise relationship as a fiduciary one, it is advisable to include a disclaimer. For example, the following disclaimer was considered by a court in *Broussard v. Meineke Disc. Muffler Shops* when determining that the franchisor did not owe any fiduciary duty to the franchisee: “[T]his Agreement constitutes and contains the entire agreement and understanding of the parties with respect to the subject matter hereof. There are no representations, undertakings, agreements, terms, or conditions not contained or referred to herein.” The court found that the disclaimer emphasized that the franchise relationship was governed solely by the contract and discouraged “the imposition of extra-contractual obligations based upon the welter of conflicting oral statements and representations that plaintiffs introduced at trial.”\(^{109}\) Noting that Florida courts had yet to address the issue of whether a fiduciary relationship exists in the franchise context, the court in *Burger King Corp. v. Kellog*\(^{110}\) gave weight to the use of a disclaimer in dismissing a claim of breach of fiduciary relationship.

In *Jim Ltd. v. Mister Donut of Canada Ltd.*,\(^{111}\) the Supreme Court of Canada confirmed that the relationship between a franchisor and a franchisee would not normally be characterized as a fiduciary one. The Ontario Act has helped define the franchising relationship by stating that every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement.\(^{112}\) In *Shelanu*,\(^{113}\) the Ontario Court of Appeal stated that a duty of good faith and fair dealing allows a party to act in its own self-interest, while having regard to the legitimate interests of the other party. This can be contrasted with the “fiduciary” standard whereby one party acts solely in the interests of the other party.

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**PRACTICE POINTER**

**FIDUCIARY DUTY**

- Even though courts will not generally find a fiduciary duty in a franchise relationship, it is still advisable to expressly disclaim any such relationship and to obtain an acknowledgment that the franchisee and franchisor are dealing at arm’s length.

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\(^{109}\) 155 F.3d 331 (4th Cir. 1998).

\(^{110}\) Bus. Franchise Guide (CCH) ¶9,730 (Fla. 1990).


\(^{112}\) S.O. 2000, c. 3 at s. 3(1).

\(^{113}\) (2003), 64 O.R. (3d) 533 (C.A.).
(5) Financial Performance Disclaimers

The use of Financial Performance Representations (formerly referred to as "Earnings Claims") in Franchise Disclosure Documents is not mandatory, but they are becoming more common. Nevertheless, some franchisors still avoid making them for fear that they could serve as a fertile basis for claims of misrepresentation and ensuing litigation. In an effort to lessen the risk of claims of misrepresentation, franchisors are likely to include additional disclaimers, warnings, and caveats in Item 19 of the FDD and, where appropriate, in the body of the franchise agreement. Although not typically classified as "boilerplate," such disclaimers address some of the concerns that traditional waivers and disclaimers are intended to address. Examples of financial performance disclaimers include the following:

- Actual results may vary from location to location, and you are likely to achieve results that are different from the results stated in this Item 19.
- Actual results vary from area to area and market to market and we cannot estimate or project financial results for any particular operation.
- You are responsible for developing your own business plan and should consult with your own professional advisors.
- A statement of historical sales will not necessarily correspond to future results because of factors such as inflation, deflation, and other variables.\(^{114}\)
- Other than the preceding financial performance representation, [name of franchisor] does not make any financial performance representations. We also do not authorize our employees or representatives to make any such representations either orally or in writing. If you are purchasing an existing outlet, however, we may provide you with the actual records of that outlet. If you receive any other financial performance information or projections of your future income, you should report it to the franchisor's management by contacting [name, address, and telephone number], the Federal Trade Commission, and the appropriate state regulatory agencies.\(^{115}\)

In Canada, courts will again focus on the intention of the parties. In the recent case of *TDL Group Ltd. v. Zabco Holdings Inc.*\(^{116}\), it was held that in claims for negligent misrepresentation a court will give considerable regard to a clause in which the franchisor disclaims the making of, and the franchisee acknowledges that it has not received or relied upon, any warranty or guaranty as to potential revenues or profits.

\(^{114}\) Adapted from Rupert Barkoff, Brian Schnell, and Andrew Scott, *How to Prepare, Read, and Use a Financial Performance Representation*, chapter 3 in HERSHMAN & MAZERO, FINANCIAL PERFORMANCE REPRESENTATIONS, THE NEW AND UPDATED EARNINGS CLAIM (Stuart Hershman and Joyce Mazero eds. ABA Forum Committee on Franchising 2008), p. 87.

IV. USING BOILERPLATE TO MANAGE DAMAGES AND FEES

A. Contract Clauses Limiting Damages

Many franchise agreements contain a clause, or a set of clauses, whereby the parties agree to limit the types of damages each party may recover if it is successful in litigation or arbitration. A clause may preclude a party (usually the franchisee) from recovering one type of damages, such as punitive damages. Or, it may preclude a party (usually the franchisee) from recovering multiple types of damages. For example, a limitation of damages term may state that “the franchisor shall not have any liability to the franchisee for any lost profits or consequential damages for any claim arising under or concerning this agreement.” The following are the most common types of damages generally available to contracting parties:

**Actual/Compensatory/General Damages**

Actual (or “compensatory” or “general”) damages are those damages that flow naturally from a breach of a contract. Actual damages are those that are most readily and accurately measured and sufficiently predictable at the time of contracting such that the parties are deemed to have contemplated them.\(^{117}\) Actual damages are intended to compensate a party for its definite losses; actual damages should put an injured party in the position it occupied before the injury.\(^{118}\) For example, a franchisee’s actual damages might be lost sales when the franchisor has encroached on the franchisee’s territory; the difference in profits for a period when the franchisor failed to provide the franchisee adequate support; and the investment made by a franchisee who was fraudulently induced to execute a franchise agreement. A franchisor’s actual damages might be past royalties due and owing; termination damages (such as the costs to de-identify a location); and rent paid under a guaranty of a franchisee’s lease.

**Consequential/Special Damages**

The consequential (or “special”) damages of one contracting party do not flow directly from the acts or omissions of the other party. Rather, they arise as a less direct consequence of such acts or omissions.\(^{119}\) These damages are a real but not necessary result of the injury complained of; they are the ancillary costs to a wronged party to a transaction.\(^{120}\) To be recoverable, consequential damages must have been foreseeable by the parties and must have been proximately caused by the breach of contract at issue. Consequential damages are foreseeable if they were actually communicated to or known by the breaching party, or were matters of which the breaching party should have been aware, at the time of contracting.\(^{121}\) For example, the consequential damages of a franchisee fraudulently induced to enter into a franchise agreement might include the franchisee’s lost salary if he or she left his or her then-current employment in order to open

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\(^{117}\) See In re Magna Cum Latte, 2008 WL 2047937 (Bkrtcy. S.D. Tex.).

\(^{118}\) 25 C.J.S. Damages § 3 (2009).

\(^{119}\) 25 C.J.S. Damages § 3 (2009).

\(^{120}\) Byron E. Fox & Bruce F. Schaeffer, Franchise Regulation and Damages §§7.02-8.02 (Thomas Long & Peter Reap eds., CCH 2009).

\(^{121}\) See In re Magna Cum Latte.
a franchise. Or a franchisor might have consequential damages resulting from having to market and sell a franchise to a replacement franchisee.

**Exemplary/Punitive Damages**

Exemplary damages make an example of a wrongdoer or punish him (and are therefore also called “punitive” damages). Typically, exemplary damages are not assessed against a party that merely breaches a contract. Exemplary damages are awarded to a non-breaching party over and above what will compensate that party for its loss when the wrong done to it was aggravated by circumstances of malice or willful or wanton misconduct. For example, exemplary damages in a franchise context might be awarded when a franchisor specifically targets a franchisee for removal from the franchise system, and takes actions to “destroy” the franchisee. Or a franchisee may be liable for exemplary damages where it uses the franchisor’s trademark in a way that is intentionally designed to damage the franchise system.

**Liquidated Damages**

Liquidated damages (addressed in greater detail below) refer to a certain sum of money (or a formula to calculate an amount of money) that the contracting parties expressly agree to as the amount of damages to be recovered by either party for a (particular) breach of the agreement.

The reason for including a clause purporting to limit contractual damages in the event of a breach is, of course, to protect oneself from having to pay the other side much or anything. Even if a limitation of damages provision proves to be unenforceable, it may dissuade a franchisee from pursuing what otherwise may be a valid claim because of concern that he or she may not be able to recover adequate damages to justify the costs of dispute resolution. The specter of the clause may affect whether claims are asserted, what claims are asserted and/or damages sought by the other party as well as its negotiating position.

(1) **Enforceability**

When clauses limiting the right to recover certain damages are enforced, it is typically because the law recognizes that competent parties are free to make their own agreements and allocate their own risks. Generally speaking, absent statutory prohibition, a contract clause that purports to limit a party’s right to damages will be enforced unless it is unconscionable. Black’s Law Dictionary defines “conscionable” as “conforming with good conscience; just and reasonable.” As noted in *Stanley A. Klopp*,

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125 Id.
126 The important case of Nagraampa v. MailCoups, 469 F.3d 1257 (9th Cir. 2006) provides an instructive discussion of unconscionability in the context of franchise agreements.
Inc. v. John Deere Co., among commercial parties there is usually a presumption of conscionability in contracts. Unconscionability can be procedural or substantive or both. Procedural unconscionability concerns the negotiation of the contract and whether there was overreaching by one party with an unfairly superior bargaining position—such as might arguably be found in the franchisor–franchisee setting. Procedural unconscionability might also be characterized as an “absence of meaningful choice with respect to the provision.” Substantive unconscionability is a characteristic of a contract term so one-sided as to oppress or unfairly surprise an innocent party.

In Klopp v. John Deere Co., which dealt with a dealer agreement that contained an express limitation of damages, the court defined “unconscionability” as “the lack of meaningful choice coupled with a contract term which is so one-sided as to be oppressive.” The court found that the limitation of liability for lost profits was not “one-sided,” but that it protected both the manufacturer and the dealer in the event a new agreement was not reached. The court also rejected the claim that the term was invalid because it was not negotiated, stating, “[m]ere unequal bargaining power between contracting parties does not render their contracts unconscionable.” The court recognized that the limitation did not exculpate the defendant of all damages, but only limited the type of damages, i.e., lost profits, that could be recovered.

In Trans-Spec Truck Service v. Caterpillar, Inc., the court, similar to the court in Klopp v. John Deere Co., rejected plaintiff’s claims that the limitation of liability left it without a minimum, adequate remedy. It found that, because the limitation of liability, by its own terms, only applied to negligence and consequential damages, the plaintiff had an adequate remedy to obtain direct damages through statutory claims and, consequently, the limitation of liability was not unconscionable. Thus, courts may likely determine that a clause precluding recovery of all types of damages is unconscionable as such limitation or waiver would deprive the plaintiff of a minimum remedy.

Other cases where damage limitation clauses were enforced include Adams v. John Deere Co., where the court found that a provision of a farm equipment dealership agreement prohibiting recovery of lost profits resulting from dealership termination was held to be not unconscionable. The terminated dealer was an experienced businessperson who had entered into dealership agreements containing the same “no lost profits” clause for more than 20 years, but claimed to have failed to read the agreement at issue carefully enough to be aware of the clause. His claims that the dealership agreement was a contract of adhesion with “one-sided” clauses were unavailing, especially since the particular clause in question limited the liability of both parties for termination damages.

127 510 F. Supp. 807, 810 (E.D. Pa. 1981) ("A number of courts have recognized that, although it is possible, rarely will a commercial contract or term be found to be unconscionable.").
129 Id.
Similarly, in CogniTest Corp. v. Riverside Publishing Co., a limitation on remedies provision contained in an exclusive distribution contract between a computer software manufacturer and a distributor was upheld. There, the clause precluded the manufacturer from recovering lost profits for the distributor's alleged breach of contract. The provision, which explicitly prohibited recovery of lost profits or consequential damages, was valid under Illinois law because it was not alleged to be unconscionable and because a liquidated damages clause provided an adequate remedy.

Other courts have found damage limitation clauses to be unconscionable. For instance, in Bolter v. Superior Court of Orange County (Harris Research, Inc.), the court found unconscionable a clause prohibiting an arbitration award of punitive or exemplary damages and unenforceable under California law. The court found that requiring carpet cleaning services franchisees to close their businesses for days on end in order to arbitrate their claims but at the same time preventing them from obtaining exemplary relief was patently unfair. And, the court in G&R Moojestic Treats, Inc. v. Maggiemoo's held that, under Maryland law, a provision purporting to limit a franchisee's remedies and to preclude an award of punitive damages against the franchisor was unenforceable. The court found that because the franchisee was fraudulently induced to enter into the franchise agreement, it would not be precluded from seeking punitive damages.

(2) Statutory Concerns

Enforceability of clauses limiting recovery of certain types of damages may be affected by state statutes which may provide for certain types of damages notwithstanding efforts to waive them. For example, South Dakota and Washington provide that franchisees can seek punitive damages for failure to comply with registration and disclosure laws.

In addition, some franchise statutes make it unlawful for a franchisor to require a franchisee to waive any of its rights under the statute or to relieve the franchisor of any liability imposed by that franchise law. Those statutes generally provide a franchisee with the right to recover its damages if the franchisor violates the statute. Such anti-waiver provisions may provide support for a claim that a contract clause purporting to restrict a franchisee's right to recover certain damages, constitutes an unlawful waiver under the franchise statute.

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PRACTICE POINTERS

IMPROVING ENFORCEABILITY OF DAMAGES LIMITATIONS.

- A clause which precludes recovery of all damages in the event of a breach of the...
agreement may not be enforceable.

- A provision that is clear and precise with respect to what damages are being limited, as well as having the limitation apply to both parties may be more likely to be enforced.

- Negotiation of clauses that purport to limit damages – with evidence or a statement of such negotiation – may increase the likelihood that such clauses will be deemed to be not unconscionable and therefore enforced.

- A provision limiting damages should be made conspicuous in the contract document, and there should be evidence that the provision was actually read by the party against whom it is to operate, perhaps by means of the party initialling the clause.

B. Liquidated Damages Clauses

Some franchise agreements contain a liquidated damages clause (sometimes referred to as a "stipulated damages" clause). Such clauses contemplate an amount agreed to by the parties at the time they enter into the contract as an estimate of the actual damages or a basis for calculating damages that are likely to flow from a contractual breach. Courts will often enforce a liquidated damages clause provided the amount agreed upon is not unconscionable or against public policy. The law recognizes that contracting parties may choose to agree as to the amount of damages to be paid upon breach rather than leaving that amount to the calculation of a court or jury.\(^\text{137}\) Indeed, one of the purposes of such clauses is to allow the parties to avoid the time and effort required to prove damages. However, a liquidated damages clause is only effective where the sum agreed upon is designed to compensate the non-breaching party for the other party's failure to perform and actual damages are likely to be uncertain or not easily proven.\(^\text{138}\)

A liquidated damages clause functions well when damages contemplated would include items such as goodwill or lost profits, as these are particularly difficult to quantify.\(^\text{139}\) Such a clause can provide for either a specific dollar amount to represent compensation for a breach or a formula for determining a compensatory amount, in either case fixing in advance with certainty the damages to be recovered by the non-breaching party. It is important to decide whether the clause should state that the liquidated damages are the sole and absolute remedy. While a franchisor may not want to limit its rights to pursue additional remedies, a franchisee may want to ensure that the liquidated damages will be the sole remedy with respect to any monetary damages arising out of a premature termination of the franchise agreement.

An obvious reason for including a liquidated damages clause is the potential benefit of a substantial savings in time and effort to prove one's damages arising from a breach of the agreement. It must be borne in mind, however, that where a party challenges a liquidated damages clause as a penalty the parties will incur costs in connection with litigating the enforceability of the clause. As a result, the time and effort saved in not having

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\(^\text{137}\) Truck Rent-A-Center, Inc. v. Puritan Farms 2\textsuperscript{nd} Inc., 41 N.Y.2d 420 (1977).


to prove one’s damages might nonetheless be spent litigating the reasonableness of the clause. Of course, if a court holds a liquidated damages clause to be unenforceable, the non-breaching party is still able to recover its actual damages – which, in some cases, might be greater than the amount contemplated by the clause.

(1) **Enforceability**

Liquidated damages clauses are generally enforced if (1) at the time the contract was entered into, the anticipated damages in the event of a breach were incapable of, or very difficult to accurately determine; and (2) the amount of the damages specified in the liquidated damages clause is not disproportionate to the damage reasonably anticipated for the breach.\(^{140}\)

To be enforced, a liquidated damages clause must not be a penalty or an attempt to compel compliance with the contract’s terms. The amount required to be paid cannot be grossly disproportionate to the amount of actual damages. An amount clearly disproportionate to real damages would be punitive and could reasonably be determined to be designed to compel performance by fear of economic devastation.\(^{141}\) Relevant to the inquiry into whether one side is seeking to exact a penalty are the sophistication of the parties; whether both sides were represented by counsel; and whether the clause was negotiated.\(^{142}\) Courts are more likely to find both that a liquidated damages clause contemplates a reasonable estimate of damages and that the actual damages were incapable or very difficult to calculate accurately when the parties have negotiated the clause at issue.\(^{143}\)

However, requiring that a stipulated amount be reasonable begs the questions, reasonable “as compared to what” and “determined as of when”?\(^{144}\) Typically, courts enforce a liquidated damages clause if the amount contemplated by the clause as damages is reasonable when compared to the harm that the parties anticipated would result from a breach at the time they entered into the contract.\(^{145}\) In fact, most courts will

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\(^{143}\) See Ramada v. Homewood, Bus. Franchise Guide (CCH) ¶13,545 (N.D. Ill. 2007) (applying New Jersey law; finding that the parties had “comparative bargaining power” based at least in part on the fact that the clause was negotiated).

\(^{144}\) 24 WILLISTON ON CONTRACTS §65:17 (4th ed. 2008).

look to the agreement as of the date of its making, rather than the date of its breach, to determine if a liquidated damages clause is reasonable and therefore enforceable.\(^{146}\)

Yet at least one court has required a liquidated damages clause to be reasonable both prospectively and retrospectively.\(^{147}\) Whichever approach a court takes, however, the court will generally enforce liquidated damages provisions if actual damages are uncertain or difficult to determine at the time the contract is formed.\(^{148}\)

(2) **Who Bears the Burden?**

More than one jurisdiction has determined that the party challenging the enforceability of a liquidated damages clause bears the burden of demonstrating that the clause is really a penalty and therefore should not be enforced.\(^{149}\) In *Century 21 v. Heritage*, the magistrate judge found that the liquidated damages clause at issue was enforceable and recommended that the court award the amount contained in that clause. The court noted that in New Jersey a liquidated damages clause contained in a commercial contract will be deemed *presumptively* reasonable when the contracting parties are sophisticated businesspersons.

In Canada, liquidated damages clauses also frequently appear in franchise agreements, particularly for hotel franchises on account of these agreements not containing non-competition covenants. Such clauses have not been addressed by Canadian courts in the franchise context.

(3) **What About Interest on the Liquidated Amount?**

Some courts have awarded interest on the liquidated damages amount even when the parties' agreement — in the clause itself or elsewhere — does not provide for interest. In those cases, the courts applied local substantive law, and when that law provided for prejudgment interest, interest on the liquidated damages amount was awarded.\(^{150}\)

(4) **Hotel Cases**

Liquidated damages clauses are regularly found in the hotel industry and courts have routinely upheld such clauses. In one case, a liquidated damages clause based on lost profits for a two-year period was found to be reasonable (hotel franchisors have argued successfully that it takes approximately two years to find a replacement franchisee).\(^{151}\) In another, a liquidated damages provision based on three times the royalty and marketing fees payable to the franchisor for the 12 months of a hotel's operation immediately


\(^{151}\) See, e.g., *Majestic Towers*, 488 F. Supp. 2d 953.
preceding the date of termination was ruled enforceable.\textsuperscript{152} In a third case, a liquidated damages provision requiring the franchisee to pay the franchisor $100,000 was valid and enforceable under New York law; there was no indication that $100,000 was an unreasonable estimate of the franchisor's probable damages.\textsuperscript{153}

However, in a recent case involving a hotel franchise, the court held that the liquidated damages provision operated as an unenforceable penalty under Tennessee law because it allowed the franchisor to “round up” to the next whole year when calculating the reservation fee damages owed even though the franchisee abandoned mid-year.\textsuperscript{154} In that case, the franchisee abandoned the hotel with six years and four months remaining on the franchise agreement. Under the liquidated damages clause, the franchisor was entitled to recover its reservation fee damages as though there were seven years remaining at the time of abandonment. The court found the provision to be a penalty. It noted that, unless the contract was terminated on the precise anniversary date of the agreement, the franchisor would be entitled to collect more reservation fees than it would have otherwise been entitled to if the contract had been performed. Importantly to the court, this fact would have been readily apparent to the franchisor at the time the contract was formed.\textsuperscript{155}

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**PRACTICE POINTERS**

**IMPROVING ENFORCEABILITY OF LIQUIDATED DAMAGES CLAUSES**

- Include an affirmative recitation that damages are being liquidated specifically because the parties acknowledge that they are difficult to estimate; that the amount (or formula) contemplated represents the parties’ best estimate; and that the amount is not a penalty.

- As with clauses purporting to limit damages generally, a negotiated liquidated damages clause is more likely to be enforced than one forced upon the other party.

- Use of accepted industry standards as foundation for calculation of the liquidated damages amount or the formula by which it will be calculated upon breach will increase the likelihood of enforcement of the clause.

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\textsuperscript{152} Country Inns & Suites by Carlson, Inc. v. Interstate Properties, LLC and William Abruzzino, 2008 WL 2782683 (M.D. Fla.).


\textsuperscript{154} Guesthouse Int'l Franchise Systems, Inc. v. British Am. Properties MacArthur Inn, LLC, Thomas Noons and Edwin Leslie, Bus. Franchise Guide (CCH) ¶14,065 (M.D. Tenn. 2009). On a subsequent motion for reconsideration, the court clarified that the subject liquidated damages clause was not, as a whole, unenforceable. Rather, the part of the provision which provided for “rounding up” when determining the reservation fee was unenforceable. Guesthouse Int'l, 2009 WL 792570 (M.D. Tenn. 2009).

\textsuperscript{155} The court in Guesthouse International determined that calculating damages in that case was a matter of simple math and that the calculation for reservation fees should consist of the “annualized” (or pro-rata) reservation fee for the first year multiplied by the 6+years that remained on the Agreement, arriving at the precise amount of damages.
C. Attorney's Fees

The general rule of law known as the "American rule" is that attorney's fees, ordinary expenses and burdens of litigation are not allowed to the successful party absent a contractual or statutory exception. This rule is generally followed throughout the country.

Many franchise agreements contain a provision providing for the recovery of attorney's fees in litigation and arbitration. Such clauses typically provide for the recovery of reasonable attorney's fees and costs by the prevailing party. Questions arise, however, regarding just what fees and what costs are recoverable and what it means to be the prevailing party. In addition, many states have statutes which affect the ability of a prevailing party to recover attorney's fees notwithstanding the non-existence or particular language of an attorney's fees clause. As discussed below, some statutes provide for recovery of reasonable attorney's fees for a breach of contract; some statutes make reciprocal one-sided attorney's fees clauses and other statutes provide for recovery of attorney's fees in connection with a violation of that statute.

A contract clause providing for the recovery of attorney's fees by the prevailing party ostensibly will make it worthwhile – or even simply possible – for an injured party to pursue claims for its damages, inasmuch as access to the courts is expensive, and sometimes prohibitively so. The rationale behind such a contractual provision is to ensure that the winner actually walks away from a dispute with more money than he or she must pay counsel.

In reality, though, and especially when an attorney's fees provision is one-sided, it is often intended to frighten the unprotected party (often the franchisee) away from litigation. The franchisee may have valid claims but may barely be able to cover its own attorney's fees and expenses let alone risk a determination that it is ultimately required to pay the franchisor's legal expenses, which can be, and often are, substantial.

(1) Reasonable Fees

Many franchise contracts and statutes provide for the recovery of reasonable attorney's fees. In determining what constitutes reasonable fees, the federal courts have applied the so-called "lodestar" method of determining attorney's fees. Under that approach, a court multiplies the "reasonable" number of hours expended by each attorney of counsel to the party performing work in connection with the case by a "reasonable" hourly rate for that attorney and then adds each attorney's reasonable fees for a total reasonable fee. The court then adjusts the total fee amount based on other considerations in order to achieve a wholly reasonable fee under the circumstances. As set forth in *Hensley v. Eckerhart*, there are 12 factors derived directly from the American Bar Association Code of Professional Responsibility which a federal court applying the lodestar

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method should use in determining the reasonableness of an award of attorney’s fees. These factors are as follows:

(i) The time and labor required.
(ii) The novelty and difficulty of the questions.
(iii) The skill requisite to perform the legal service properly.
(iv) The preclusion of employment by the attorney due to acceptance of the case.
(v) The customary fee.
(vi) Whether the fee is fixed or contingent.
(vii) Time limitations imposed by the client or the circumstances.
(viii) The amount involved and the results obtained.
(ix) The experience, reputation, and ability of the attorneys.
(x) The “undesirability” of the case.
(xi) The nature and length of the professional relationship with the client.
(xii) Awards in similar cases.

*Bores, et. al. v. Domino’s Pizza*\(^{160}\) provides a detailed example of the application of the lodestar method for determining a prevailing party’s reasonable attorney’s fees award. In that case, the United States District Court for the District of Minnesota was called upon to determine the amount of attorney’s fees and costs to be awarded to Domino’s, the plaintiffs’ franchisor, which had obtained a judgment dismissing the claims asserted by multiple franchisees. The parties’ franchise agreements stated:

> If any legal or equitable action is commenced, either to challenge, interpret or to secure or protect our rights under or to enforce the terms of this Agreement, in addition to any judgment entered in our favor, [Domino’s] shall be entitled to recover such reasonable attorney’s fees as [Domino’s] may have incurred together with costs and expenses of litigation.

Domino’s sought to recover just under $1.1 million in attorney’s fees for 2,200 hours of work, plus approximately $200,000 in costs. As the franchise agreements provided for recovery of “reasonable” fees, the court applied the lodestar analysis and ultimately awarded Domino’s the amount of $450,000 in attorney’s fees and costs.

Many states, including Oklahoma, Washington, Maryland and Wisconsin,\(^{161}\) apply the lodestar approach to determine reasonable attorney’s fees, with appropriate adjustments to that figure based on case-specific factors. Such factors may include

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\(^{160}\) 2008 WL 4755834 (D. Minn. 2008).

consideration of the factors set forth in that state’s rules of professional conduct which are generally similar to the factors identified in Hensley.\textsuperscript{162}

(2) **Prevailing Party**

Assuming the enforceability of a contractual provision allowing for the recovery of attorney’s fees to the prevailing party in a resolved dispute, who is the prevailing party? Certainly, there are cases when it is clear: When the plaintiff is awarded an affirmative judgment, for example or when the defendant persuades the court to dismiss the complaint. But many cases are more complicated.

In *CK DFW Partners LTD v. City Kitchens, Inc.*,\textsuperscript{163} the court, applying California law, had to determine whether a franchisor was entitled to recover attorney’s fees in an action commenced in Texas by a Texan franchisee notwithstanding a California forum selection clause. The court dismissed the action without prejudice, holding the forum selection clause valid. The franchisor then sought attorney’s fees in connection with its motion pursuant to a clause in the franchise agreement which provided for the recovery of attorney’s fees by a prevailing party. The court determined that the franchisor had not "prevailed." A party who is merely successful in enforcing a contractual forum selection clause — but has not yet obtained “greater relief” on the merits — is not a prevailing party, according to the United States District Court for the Northern District of Texas.

The California Supreme Court has stated that, in deciding whether there is a "party prevailing on the contract," the trial court should compare the relief awarded on the contract claims with the parties’ demands on the same claims and their litigation objectives as disclosed by the pleadings, trial briefs, opening statements, and similar sources. Further, the prevailing party determination is to be made only upon final resolution of the contract claims and only by a comparison of the extent to which each party has succeeded and failed to succeed in its contentions.\textsuperscript{164}

(3) **Other Statutory Considerations**

(a) **Absent a Contract Clause, a Relevant Statute May Provide for Attorney’s Fees for Breach of Contract**

Some state statutes may provide for the recovery of attorney’s fees by a party that prevails on a breach of contract claim even if the contract does not contain a clause entitling either party to attorney’s fees. For example, both Texas and Arizona provide for the recovery of attorney’s fees by the “prevailing party” in actions arising out of a contract.\textsuperscript{165} Idaho similarly provides for the recovery of attorney’s fees absent an express contractual provision for recovery of fees where the claim arises out of a contract relating to the purchase or sale of goods, wares, merchandise, services, or out of any commercial transaction (defined to mean all transactions except transactions for personal or household

\textsuperscript{163} 541 F. Supp. 2d 839 (N.D. Tex., 2008).
\textsuperscript{164} Hsu v. Abbara, 9 Cal. 4th 863, 876 (1995).
\textsuperscript{165} Texas Statutes and Codes, Civil Practice & Remedies Code § 38.001; Arizona’s Revised Statutes § 12-341.01.
purposes).\textsuperscript{166} Thus, a party may have the right to recover attorney's fees in connection with a breach of the franchise agreement even absent a clause in the agreement.

(b) One-Sided Clauses

Some franchisors include an attorney's fees clause which is limited so as to only provide the franchisor with the right to recover attorney's fees. Franchisors should take note, however, that several states have enacted statutes that make reciprocal a one-sided contract clause relating to attorney's fees and which may apply in a dispute concerning a franchise agreement. For instance, California, Montana, Florida and Oregon\textsuperscript{167} all have statutes which govern the recovery of attorney's fees in connection with contract disputes under each state's laws, and provide that even if a contract clause provides only one party with the right to recover attorney's fees, the other party will nonetheless be entitled, as a matter of law, to recover attorney's fees if it is deemed the "prevailing party" in the action.

(c) Franchise Statutes

Notwithstanding contractual provisions and the presence or absence of statutes that make one-sided attorney's fees provisions reciprocal, many state franchise statutes (i.e., disclosure statutes, relationship statutes, and/or unfair trade practices statutes/"Little FTC Acts") provide for the recovery of attorney's fees by a franchisee that prevails on a claim under that statute. States with such statutes include Florida, Hawaii, Illinois, Indiana, Iowa, Maine, and New York.\textsuperscript{168}

In Canada, successful litigants are typically awarded legal costs, albeit not on a complete indemnity scale. Each province's Rules of Civil Procedure deal with the awarding and fixing of costs. As a result, lawyers' fees are not typically addressed in franchise agreements.

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\textbf{PRACTICE POINTERS} \\
\textbf{IMPROVING ENFORCEABILITY OF ATTORNEY’S FEES CLAUSES} \\
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\item A party seeking to recover attorney's fees must be sure to have counsel keep detailed billing records, clearly identifiable as related to the matter at hand, to avoid any doubt in the mind of the judge or arbitrator regarding the propriety of the bills. Time records should clearly indicate which lawyer worked on which aspects (claims/defenses) of the matter, for how long, and at what rates.
\item Consider the likely venue for the litigation when deciding whether to include a one-sided attorney's fee clause.
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\textsuperscript{166} Idaho Code § 12-120
\textsuperscript{167} CAL. CIV. CODE § 1717 (West 2009); MONT. CODE ANN. § 28-3-704 (2009); FLA. STAT. ANN. § 57.105 (West 2009); OR. REV. STAT. § 20.096 (2009).
\textsuperscript{168} FLA. STAT. ANN. § 817.416 (West 2009); HAW. REV. STAT. § 482E-9 (2009); ILL. REV. STAT. ch. 815, para. 705/26 (2009); IND. CODE ANN. § 23-2-2.5-28 (West 2009); IOWA CODE ANN. § 551A.8 (West 2009); ME. REV. STAT. ANN. tit. 32, § 4700 (West 2009); N.Y. GEN. BUS. LAW § 691 (McKinney 2009).
APPENDIX
SAMPLE BOILERPLATE CLAUSES

CAVEAT: The examples in this Appendix have been adapted from actual cases and franchise agreements and are intended to provide guidance to assist the attorney in crafting their own provisions. As with any sample provision, “one size does not fit all” and there is no assurance that these provisions will be enforceable in any particular jurisdiction. Users are cautioned against lifting a provision in its entirety without making appropriate modifications for their particular situation.

STATUTORY/REGULATORY SAVINGS CLAUSE

If any valid applicable law or regulation, in effect at the time this Agreement is executed, of a governmental authority having jurisdiction over this Agreement limits our rights of rescission or termination or require longer notice periods than set forth herein, this Agreement shall be deemed amended to conform to the minimum notice periods or restrictions upon rescission or termination required by such laws or regulations. The provisions of this Agreement which conflict with the applicable law shall, only to the extent not in accordance with applicable law, be ineffective, and in their stead, we shall comply with applicable law respecting each of said matters. We shall not, however, be precluded from contesting the validity, enforceability, or applicability of such laws or regulations in any action relating to this Agreement or to its rescission or termination.

WAIVER OF RIGHT TO JURY TRIAL\(^\text{169}\)

Jury Trial Waived. Franchisee and Franchisor hereby agree that they shall and hereby do waive trial by jury in any action, proceeding or counterclaim, whether at law or at equity, brought by either of them, or in any matter whatsoever which arises out of or is connected in any way with this Agreement or its performance.

NON-WAIVER

No waiver of any condition or covenant in this Agreement, or failure to exercise a right or remedy by Franchisor or Franchisee, shall be considered to imply or constitute a further waiver by Franchisor or Franchisee of the same or any other condition, covenant, right, or remedy.

WAIVER OF DAMAGES

Franchisee hereby waives, to the fullest extent permitted by law, any right to or claim for any punitive, exemplary, incidental, indirect, special, consequential or other damages (including, without limitation, loss of profits) against Franchisor, its affiliates, and the officers, directors, shareholders, partners, members, agents, representatives, independent contractors, servants and employees of each of them, in their corporate and individual capacities, arising out of any cause whatsoever (whether that cause is based on contract,

negligence, strict liability, other tort or otherwise) and agrees that in the event of a dispute, Franchisee is limited to the recovery of any actual damages sustained by it.

LIMITATIONS FOR THE TIME TO BRING A COURT ACTION

Any claim arising out of or relating to the franchise agreement, the relationship between the parties, the franchisor's operation of the system, and the franchisee's operation of the franchise unit will be barred unless filed before the expiration of the earlier of (1) the time period for bringing an action under any applicable state or federal statute of limitations; (2) one year after the date upon which a party discovered, or should have discovered, the facts giving rise to an alleged claim; or (3) two years after the first act or omission giving rise to an alleged claim. Claims of the franchisor attributable to the underreporting of sales, claims of the parties for indemnification, and claims of the franchisor related to its rights under any of the marks shall be subject only to the applicable state or federal statute of limitations.\textsuperscript{170}

MERGER/INTEGRATION CLAUSE COMPLIANT WITH AMENDED FTC RULE

Entire Agreement. This Agreement, including all Exhibits attached, constitutes the entire, full and complete agreement between you and us concerning the subject matter of this Agreement, and supersedes any and all prior agreements; provided that nothing in this or any related agreement is intended to disclaim the representations we made in the Franchise Disclosure Document that was furnished to you in connection with the offer to grant you a franchise. No amendment to this Agreement is binding unless executed in writing by both parties.

GENERAL DISCLAIMERS

YOU HAVE BEEN ADVISED TO MAKE AN INDEPENDENT INVESTIGATION OF OUR OPERATIONS AND TO OBTAIN INDEPENDENT PROFESSIONAL ADVICE REGARDING THIS FRANCHISE. IF YOU HAVE NOT OBTAINED SUCH ADVICE YOU HAVE KNOWLINGLY AND WILLINGLY ELECTED NOT TO DO SO.

WE MAKE NO EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS THAT YOU WILL ACHIEVE ANY DEGREES OF SUCCESS IN THE OPERATION OF THE FRANCHISE. YOU UNDERSTAND THAT YOU MAY SUSTAIN LOSSES AS A RESULT OF THE OPERATION OR THE CLOSING OF THE BUSINESS.

YOU UNDERSTAND THAT THE BUSINESS VENTURE CONTEMPLATED BY THIS AGREEMENT INVOLVES A HIGH DEGREE OF FINANCIAL RISK AND DEPENDS TO A LARGE DEGREE ON YOUR SKILLS, ABILITIES, INITIATIVE, AND HARD WORK, AND OTHER FACTORS, SOME OF WHICH ARE WITHIN AND SOME OR WHICH ARE BEYOND YOUR CONTROL, INCLUDING BUT NOT LIMITED TO, MARKET AND OTHER ECONOMIC CONDITIONS, YOUR FINANCIAL CONDITIONS AND COMPETITION.

YOU HAVE READ THIS AGREEMENT IN ITS ENTIRETY, HAVE BEEN THOROUGHLY ADVISED WITH REGARD TO THE TERMS AND CONDITIONS OF THIS AGREEMENT BY COUNSEL OR OTHER ADVISOR(S) OF YOUR CHOICE, HAVE HAD AMPLE

OPPORTUNITY TO INVESTIGATE ALL REPRESENTATIONS MADE BY OR ON BEHALF OF US AND HAVE HAD AMPLE OPPORTUNITY TO CONSULT WITH OUR CURRENT AND FORMER FRANCHISEES IN ORDER TO MAKE YOUR OWN INDEPENDENT INVESTIGATION OF THE FRANCHISE.

YOU UNDERSTAND AND AGREE THAT WE HAVE NO OBLIGATION TO ACCEPT YOUR APPLICATION AND MAY REFUSE TO GRANT A FRANCHISE FOR ANY REASON, OR NO REASON, WITHOUT DISCLOSING THE BASIS FOR ITS DECISION. YOU ACKNOWLEDGE THAT UNLESS AND UNTIL WE SIGN THIS FRANCHISE AGREEMENT, THE FRANCHISE HAS NOT BEEN GRANTED, YOU ARE NOT A FRANCHISEE OF OURS AND YOU MAY NOT RELY UPON BECOMING A FRANCHISEE OF OURS.

DISCLAIMER OF FIDUCIARY RELATIONSHIP

FRANCHISEE is an independent contractor, and is not an agent, partner, joint venturer, or employee of FRANCHISOR, and no fiduciary relationship between the parties exists.

DISCLAIMER OF FINANCIAL PERFORMANCE REPRESENTATIONS\footnote{See FDD Guidelines for mandatory language required for Item 19 if no financial performance representations are given.} \footnote{Under the Amended FTC Rule, the presentation of cost or expense data alone is not a financial performance representation. Nevertheless, a presentation of cost data, coupled with additional sales or earnings figures, from which prospective franchisees could readily calculate average net profits, is a financial performance representation, and does trigger the Item 19 disclosure obligation. In any event, under some circumstances it may be advisable to include appropriate disclaimers with cost and expense figures, even if standing alone, in order to avoid the risk of exposure to claims for violations of state anti-fraud laws or common law.}

YOU HAVE NOT RECEIVED ANY REPRESENTATIONS OF YOUR POTENTIAL SALES, INCOME, PROFIT OR LOSS OR ANY REPRESENTATION OTHER THAN THOSE CONTAINED IN THIS AGREEMENT AND OUR FRANCHISE DISCLOSURE DOCUMENT, FROM US OR ANYONE ACTING ON OUR BEHALF.

FRANCHISEE ACKNOWLEDGES THAT IT HAS NOT RECEIVED FROM THE COMPANY (OR ANYONE ACTING OR PURPORTING TO ACT ON BEHALF OF THE COMPANY) ANY ORAL OR WRITTEN INFORMATION CONCERNING THE POTENTIAL SALES, COSTS, INCOME OR PROFITS [OR ACTUAL AND HISTORIC SALES, INCOME, OR COST FIGURES] THAT MAY BE DERIVED OR POTENTIALLY DERIVED FROM FRANCHISEE’S STORE.

FRANCHISEE ACKNOWLEDGES AND AGREES THAT THE ACTUAL RESULTS OF FRANCHISEE’S STORE MAY VARY FROM OTHER LOCATIONS. THE COMPANY EXPRESSLY DISCLAIMS ANY WARRANTY, REPRESENTATION OR GUARANTEE REGARDING THE ECONOMIC SUCCESS, IF ANY, OF FRANCHISEE’S STORE. FRANCHISEE FURTHER ACKNOWLEDGES AND AGREES THAT ANY SUCH FRANCHISE AND THE ECONOMIC RESULTS THEREOF ARE ENTIRELY SPECULATIVE IN NATURE. FRANCHISEE ACKNOWLEDGES THAT IT HAS NOT RELIED IN ANY MANNER ON ANY WARRANTIES, REPRESENTATIONS AND/OR
GUARANTEES REGARDING THE PROFITABILITY OR OTHER RESULTS OF OPERATION OF FRANCHISEE'S STORE, NO SUCH WARRANTIES, REPRESENTATIONS OR GUARANTEES HAVING BEEN MADE BY THE COMPANY OR ANYONE ON BEHALF OF THE COMPANY.

CHOICE OF LAW

This Agreement takes effect upon its acceptance and execution by Franchisor, and the Agreement and the relationship arising out of, or relating to, the Agreement shall be [interpreted and construed/governed] [under/by] the laws of the State of __, which laws shall prevail in the event of any conflict of law (without regard to, and without giving effect to, the application of the choice-of-law rules of that state); provided, however, that if any provision of this Agreement would not be enforceable under the laws of the State of __ and the franchise business is located outside of that state, then that provision shall be [interpreted and construed/governed] by and under the laws of the state in which the franchise business is located. Nothing in this Section __ is intended by the parties to make applicable any franchise, business opportunity, antitrust, unfair competition, fiduciary or other similar law, rule, or regulation of any state which would not otherwise be applicable.

CHOICE OF VENUE

The parties agree that any action against the other shall be filed and litigated, whether in federal or state court, only within such state and in the judicial district in which Franchisor has its principal place of business at the time of the action. The parties agree that this Section __ shall not be construed as preventing either party from removing an action from state to federal court; provided, however, that venue shall be as set forth above. The parties hereby waive all questions of personal jurisdiction and venue for the purpose of carrying out this provision.

CLASS ACTION WAIVER

Any action shall be conducted on an individual basis, and not as part of a consolidated, common, representative, joint, group, or class action.

LIQUIDATED DAMAGES

The parties recognize the difficulty of ascertaining damages to the Franchisor resulting from premature termination of this Agreement before its expiration. For this reason, the Franchisor and Franchisee have provided for liquidated damages, representing the Franchisor's and the Franchisee's best estimate as to the damages arising from the circumstances in which they are provided and which are only damages for the future profits lost to the Franchisor due to the termination of this Agreement before its expiration, and not a penalty or as damages for breaching this Agreement, or in lieu of any other payment or remedy.

If, at any time, this Agreement is terminated by the Franchisor for cause, then the Franchisee agrees to pay the Franchisor, within ten (10) days of termination, an amount equal to the actual number of months remaining in the term of this Agreement, times the monthly average amount of the Royalty, Brand Fund Contribution and other fees owed by the Franchisee under the relevant sections of this Agreement for the twelve (12) month period prior to termination (or the entire term prior to termination if less than twelve (12)
months) based on the Franchisee's actual Gross Revenues, and reduced by a discount of eight percent (8%) to produce the present value of the Franchisor's lost profits.

These damages are in addition to any monies due to Franchisor for past due payments or any other actual or consequential damages.

ATTORNEY'S FEES

[One-sided:] Franchisor will be entitled to recover from the Franchisee attorney's fees, expert's fees, court costs, arbitrator fees, mediator fees, and all other expenses of litigation, arbitration, and/or mediation, if Franchisor prevails in any action instituted against Franchisee to secure or protect the Franchisor's rights under this Agreement or any and all related agreements, or to enforce the terms of this Agreement or any and all related agreements, or in any action commenced or joined in by the Franchisee against the Franchisor.

[Reciprocal:] If any action or arbitration is commenced concerning this Agreement, any related agreement, or the Franchise, the party that substantially prevails in that action or arbitration will be entitled to a judgment against the other for the cost of the action or arbitration, including reasonable attorney's fees.