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# FRANCHISEE ASSOCIATIONS: FRIEND OR FOE?


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## Introduction

Traditional contract law dictates that the day to day relationship between two parties to an agreement is governed by the writing. While this is true, in franchising the greater impact often comes from the unique culture of each franchise system. That culture will dictate the extent to which franchisor management will treat its franchisees as stakeholders and collaborators in the development and advancement of the franchise system and the brand, or whether they will be treated as children were treated in an earlier era, who were expected to be seen and not heard.[1]

In nearly every franchise system, the form of the franchise agreement, the choice of products and services to be offered, the advertising and marketing used to promote those products and services, the branding which will be associated with them, and many other aspects of the system, have traditionally been determined by the franchisor so that the franchisor can protect its brand. It is no less true that the manner in which a franchisor engages with its franchisees can also play a large part in determining whether an independent franchise association becomes an ally or a foe of the franchisor.

## I. Independent Franchisee Association Formation and Structure

### A. Type of Entity

The typical independent franchisee association entity is a state-based nonprofit corporation. This provides the limited liability features of incorporation and also satisfies one of the requirements for inclusion in Item 20 of the Franchisor's disclosure document as an independent franchisee association, which requires that the association be "…incorporated or otherwise organized under state law…". 16. C.F.R. §436.5(t)(8)(ii).

### B. State of Formation

Choosing the state of formation is based on two factors.

First, if the independent franchisee association will have a permanent principal office, consideration should be given to the state in which that office is located, so that the entity will not need to qualify to operate in more than one state. A permanent principal office is often a professional management company that acts as the back office for the association, performing such tasks as dues collection and billing, meeting planning, website administration and communication with franchisee members.

Second, consideration should be given to the level of state corporate income tax. As noted below, the Association will be a taxable entity.

[1] See www.http://idioms.thefreedictionary.com/children (last visited on March 21, 2016)

## C. Taxation

It is axiomatic that while all tax exempt entities are not for profit organizations, not all nonprofit corporations are tax exempt. In 1979, United States Supreme Court decided by a 6 to 3 vote, that a single brand franchise association is not entitled to a tax-exempt status. See *National Muffler Dealers Association v. United States*, 440 U. S. 472 (1979). The court held that because the association limited its membership to franchisees of their franchisor, they were not entitled to the "business league" exemption under section 501(c)(6) of the Internal Revenue Code. The definition of "business league", under the statute and applicable regulations, is an entity substantially equivalent to a chamber of commerce or board of trade, the activities of which should necessarily be directed to the improvement of one or more lines of business. The Supreme Court determined that franchisees of a single brand do not constitute a line of business, because the purpose of the exemption is not to aid one group in competition with another within the same industry. Accordingly, the association's quest for a refund of income taxes paid was defeated.

## D. Name of the Association

The choice of name for the association may involve a balancing of the right of the franchisor under the Lanham Act and under the franchise agreement to control the use of its trademarks and service marks, and the need and desire of the independent franchisee association to have a name which is accurately descriptive of its membership.

The reaction of franchisors to the use of their trademarks in the name of the independent franchisee association has varied as greatly as their overall reaction to the creation of the association itself. Some franchisors have willingly granted permission for the use of their names and sometimes even their logo by the association in its name, in its written materials and on its website.

Absent that consent, many franchise associations will choose a name that is descriptive of the association, but does not convey that it has been created or sponsored by the Franchisor. An example would be "The Independent Association of XYZ Franchisees, Inc." This takes advantage of the fair use doctrine.[2]

In the Servpro system, the franchisor brought a civil action in 1994 against the franchisee association for the use of the "Servpro" name but not the logo in the name of the association. The association had been incorporated as "National Servpro Franchisee Association, Inc." After the filing of cross motions for summary judgment by the franchisor and the association, the matter was settled with the association agreeing to change its name to "NSFA, Inc." to which it could append the tag line: "An Independent Association of Servpro Franchisees."

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[2] Section 33(b)(4) of Lanham Act, 15 U.S.C. § 1115(b)(4)). See also, Patt, *Not All Is (Fair) Use in Trademarks and Copyrights*, INTABulletin, International Trademark Association, Vol. 67, No. 18, September 15, 2012.

## E. Eligibility for Membership

In order to maintain its independence, to allow for private internal deliberations, and to preserve the attorney-client privilege with respect to communications between the association and its counsel, it is typical for franchisee associations to limit membership to independently owned franchised locations.

An example of such a membership provision is as follows:

> Membership in the Association is open to all franchised locations of the Franchisor, except (a) those owned or controlled by the Franchisor or by any shareholder, employee, officer, director, subsidiary, or parent of the Franchisor or any of its or their affiliates, or (b) any person related by blood or marriage to a shareholder, employee, officer or director of the Franchisor or any of its affiliates.

Some franchisee associations create multiple categories of membership, some of which are open to those who are not franchisees. The special categories can include branded locations owned by the franchisor or an affiliate, as well as vendors who sell goods or services to franchisees. These categories of membership generally do not include voting rights.

## F. Officers and Directors

As with any organization, responsibility for overall management of the franchisee association will rest with its Board of Directors. In deciding upon the structure of the board, consideration is most often given to ensuring a fair geographic balance, so that each area of the country where there are franchisees has some form of representation.

In addition, in systems where there is a wide range of the number of units owned, consideration may be given to having classes of directors based on the volume of business or number of units owned or both. This ensures a balance of large and small operators, as their interests may vary to some degree.

The bylaws of the association will nearly always specify that the directors are elected by the members, often with staggered terms, in order to assure continuity. Officers can either be elected directly by the members or by the board.

## G. Bylaws

Among the most important issues to be decided when creating the bylaws of an independent franchisee association, is the dues structure. Mature and well managed franchisee associations have three sources of revenue: dues, trade shows and conventions, and advertising supported publications.

The dues structure may also be dependent upon the average number of units owned by a franchisee in the system. The association will want to incentivize the largest owners to be members and to pay dues based on the number of locations that they operate. On the other hand, if the number of votes accorded to each franchisee is based upon the dues they pay or the number of franchised units they own, or both, owners of smaller operations may be feel disenfranchised.

Other issues related to the bylaws and general corporate governance to be determined include a mission statement defining the nature of corporate purposes, the number of directors, how long officers and directors will serve, quorum requirements for votes of the membership and of the board, the date and location of the annual meeting, procedures for the removal of officers and directors, votes necessary to amend the bylaws, and insurance and indemnification

### H. <u>Meeting Frequency</u>

Almost all independent franchise associations have an annual meeting of members, sometimes held simultaneously with a convention or trade show. Some independent franchisee associations will hold meetings before, during or after a franchisor sponsored convention or meeting. Many associations have at least a quarterly meeting of the Board of Directors held in person, and many others hold telephone conference call meetings on a monthly or quarterly basis. The frequency of meetings can depend on what issues are facing the franchise system at any particular time, whether stemming from relationships issues with the franchisor or from external regulatory or competitive challenges.

### I. <u>Franchisor Participation in Meetings</u>

Open communication is an essential element of the relationship between the franchisor and its franchisees. Thus, the most successful franchise systems feature frequent interaction between franchisor management and the independent association. There are a number of associations in which representatives of the franchisor have a standing invitation to address the membership and the board. These presentations can include not only issues involving the relationship between the franchisor and franchisee, but also information regarding such issues as the supply chain, consumer surveys, information regarding the performance of competitors, as well as plans for advertising, marketing and promotions. Some write articles for advertising supported franchisee association publications.

For example, the CEO and other senior executives of the franchisor of Hardee's and Carl's Jr. regularly meet with the Board of Directors of the Independent Hardee's Franchisee Association, Inc. These meetings provide an opportunity to discuss matters of mutual concern, including advertising and marketing strategies and plans, initiatives to deal with evolving consumer preferences, the status of commodities markets related to the price of beef and pork, and committees of franchisor and franchisee representatives dealing with restaurant design. There is also an open-ended question and answer session. Thus, all system initiatives have been thoroughly vetted and discussed well before they are implemented in the field.

These meetings and communications allow for a free exchange of ideas, for franchisor management to discuss issues of common interest, to enlist franchisee leadership support for system changes, and other initiatives, and to reduce the possibility of mistrust or suspicion on the part of franchisees.

### J. Franchisee Seat on Franchisor's Board Of Directors

There are a limited number of franchise systems, to the knowledge of the authors, that have invited a franchisee to sit on the Board of Directors of the franchisor. From a relationship point of view, this can be a very positive development because it gives the board of the franchisor an opportunity to have input from an exemplary franchisee, who has likely made a substantial investment in the franchise system and in the brand.

At the same time, a seat on the board of the franchisor raises a number of issues, including the fact that such franchisee has a fiduciary obligation to the franchisor, but may also be a member of the independent franchisee association or even a board member, creating dual and possibly conflicting duties and responsibilities. The confidentiality obligations attached to membership on the board of the franchisor may prevent the franchisee from sharing with his or her fellow franchisees issues which could be of great concern and interest to the franchisee association and its constituent members. For example, suppose that a franchisee member of the board of directors of the franchisor learns of some circumstance or development, whether internal or external to the franchise system, that would have a material effect on the franchisee community, but is bound by that fiduciary duty or a confidentiality agreement, or both, not to disclose to the franchisee association. This could include the possibility of a sale or merger of the franchisor, the acquisition of a competing franchise system, a recapitalization or refinancing of the franchisor, impending material changes in the renewal franchise agreement, system changes that would require substantial capital expenditures, regulatory initiatives or inquiries, or any other sensitive matter, any one of which could have a material impact on franchisees.

In addition, both the franchisor and the franchisee association must take special care to ensure that attorney-client privileged communications are protected from disclosure. This may mean that both for the franchisor board and the franchisee association board, the franchisee that sits on both may be excluded from communications were counsel for either entity is present.

## II. Franchisee Association Role in Litigation

a. Funding/Supporting Franchisees' Litigation Against Franchisor.

Everyone in the franchise community knows that franchise litigation or arbitration is expensive and that fact generally serves as the single greatest deterrent when it comes to bringing franchise disputes to a third party. Based on size and resources, franchisors can often spend small or individual franchisees into the ground. For many smaller franchisees the cost is so high that the alternative, which is usually to accept the status quo or some other deal offered by the franchisor, is the only financially viable option available to them.

One solution pursued by established franchisee associations is to agree to subsidize, or even fully cover, the cost of litigating a franchisee's claims. The concept is rather simple – a larger number of franchisees pool funds, either by authorizing the use of franchisee association dollars or by funding a litigation trust, to create a war chest to be used by an individual franchisee to engage in combat with the franchisor and its counsel. Such an approach has two potential effects. First, with adequate funding in hand, the franchisor may be convinced that a negotiated and less expensive settlement alternative is preferable to a prolonged and expensive legal battle. Second, and only if the first option fails, at least the franchisee can be more confident that it will have sufficient funds to mount, and potentially win, a strong case.

As with most complicated scenarios in life, the devil is often in the details. A number of issues must be addressed before the association can make a determination regarding the propriety of funding an individual franchisee's case. First, the governing board must determine that the issues at stake in the particular case affect the association's members sufficiently to justify utilizing association resources. Second, the members must be convinced that it is worth it to spend association dollars, or to pool funds, to fund someone else's fight. In the latter case, a litigation trust is often created and managed by an independent third party to ensure funds are collected and spent appropriately. Third, the terms of the expenditure (including spending limits and approval of counsel handling the case), allocation of the proceeds generated by any victory, determining who bears (and must pay for) the risk associated with losing the case (and potentially paying a large judgment and the franchisor's attorneys fees), the extent to which the association will be involved in settlement negotiations, and under what circumstances it can withdraw funding must all be agreed upon in advance of commencing the suit. Because counsel for the association likely has a conflict of interest in such a scenario, the litigating franchisee should hire its own counsel to prosecute or defend the case, subject only to the approval of the franchisee association.

One final issue to consider for the prospective litigant in such a scenario is the potential waiver of the attorney client privilege. Prior to making a decision to financially back the litigation, the executive committee of the association will need to be fully apprised of the facts, claims, legal issues, and risks associated with the specific case. This process will likely entail detailed discussions, and perhaps extensive document review, by the committee or its counsel. In most cases, these discussions will not be subject to the attorney client privilege, even if counsel is present. As a result, the petitioning franchisee should be informed in writing of the likelihood of waiving the privilege and then sign a formal document waiving the privilege before the association can undertake a meaningful examination of the case. This very process may result in adverse effects on both the specific case and the broader interests of the franchisee members of the association, so even the initial consideration of the opportunity must be handled with care by the franchisee association.

b. Standing to sue the Franchisor

Prior to commencing a lawsuit directly against the franchisor on behalf of a group of franchisees or the entire franchise system, a franchisee association must first determine that it has standing to bring such a suit. The question of an association's standing generally requires satisfactorily addressing three factors:

1). Do the members of the association have sufficient standing to sue in their own individual names?:

2) Are the matters at issue directly connected to the association's role in protecting the economic interests and legal rights of its members?; and

3) Can the association adequately represent the interests of the members in the litigation, or do the claims require the actual participation of specific aggrieved parties?

As a general rule, and in consideration of the three factors outlined above, franchise associations are most often found to have sufficient standing when they seek prospective relief on behalf of their members. This type of relief can come in the form of declaratory relief relating to specific rights under the terms of the franchise agreement or the law. Franchisee associations have also been effective in obtaining injunctive relief which precludes the franchisor from taking some form of action against individual franchisees or the entire system.

When assessing standing and the propriety of the association bringing claims on behalf of the entire system, it is generally important that the franchise agreement used by the system contain identical or substantially similar language with respect to the specific issues in the case. If the franchise agreement has evolved over time in its treatment of a specific topic, it becomes more difficult for the association to reasonably claim that it can represent all of the members adequately. This can serve as the basis for a challenge to standing by the franchisor, which will often assert that the claims in the case are actually individualized, making the presence of individual plaintiffs essential and driving up the cost of the proceeding. However, it is important to note that there is no legal requirement of unanimity, and courts have generally recognized franchisee association standing under such scenarios as long as the association's actions were properly authorized by its board of directors.

Unless the case involves a federal claim of some sort, it is important to remember that association standing cases will likely be tried in state courts. It is nearly impossible to rely on diversity of citizenship to establish federal jurisdiction in a franchisee association case when the association is seeking compensation or other relief for its individual members (as opposed to the association itself) because the association is deemed to be a "citizen" of every state in which its members are citizens. As a result, federal diversity jurisdiction is defeated in every case in which at least one franchisee is a citizen from the same state in which the franchisor is based.

c. Class Action and Consolidated Actions

A third way for an association to assist its members in litigation is to coordinate a class action or lead the effort to consolidate multiple franchisee cases against the franchisor. It is important to note that most modern franchise agreements expressly prohibit class actions or consolidated actions by franchisees, making this approach more challenging than other options for franchisee associations. In addition, as the Meineke litigation established in the late 1990s, it is critical that the association and counsel for the various franchisees carefully analyze the composition of proposed "classes" to ensure that each proposed class can adequately represent the members of that class prior to the commencement of the suit. It is also essential that the parties pursuing a class action be prepared for the complexities and expense associated with the procedural warfare that naturally follows such a process-heavy approach to resolving a franchise dispute.

## III. <u>Franchise Association Anti-Trust Restrictions</u>

Before analyzing the anti-trust implications related to franchisee associations, it is important to recall the elements of a potential anti-trust claim. As a general rule, anti-trust law is designed to keep competitors from engaging in behavior that is deemed to be anti-competitive from a consumer perspective. Anti-competitive behavior can include conduct that causes consumers to pay higher prices, has the effect of restricting the choices of consumers, or results in consumers paying more or receiving less. In the end, anti-trust law is aimed at protecting the interests of consumers, not protecting competitors from each other.

Anti-competitive conduct is evaluated in two distinct categories. The first is conduct that, by its very nature, is deemed to be anti-competitive. This type of conduct is considered *per se* illegal, and if the conduct is proven the anti-trust violation is established even if the aggrieved party cannot prove actual anti-competitive effect. The following types of conduct by franchisees or their association could be considered *per se* violations of the law:

a. Market Allocation

Franchisees are considered "horizontal" competitors of each other. This provides them with certain cover from anti-trust law (as described above). However, if franchisees, either through their own actions or under the direction of a franchisee association, were to divide territories or customers among themselves, then such conduct could be deemed adverse to the interests of consumers and therefore a *per se* violation of anti-trust laws. In fact, any concerted activity by the association to restrict consumer choice or impact consumer pricing would likely be subject to scrutiny by regulatory authorities or consumer advocates.

b. Price Fixing

It is axiomatic that franchisees may not set prices in concert with each other. Should the franchisee association choose to take an active role in directing or even requiring that franchisees set and maintain certain specific prices, it too could be seen to be part of an illegal conspiracy and guilty of a *per se* violation of the anti-trust rules. It is also important to remember that an actual agreement to fix prices is not always necessary to establish a *per se* violation of anti-trust law. In fact, the mere act of sharing cost and profit data has been known to subject parties to prosecution for price-fixing in cases in which the sharing of such information is likely to impact the pricing decisions of entities that otherwise compete with each other.

c. Boycotts (Against Franchisor; Suppliers; Other Franchisees)

Sometimes franchisees find themselves in the position to exert economic leverage over the franchisor or a particular supplier. This leverage may legally be exerted through arms-length negotiation or by pitting suppliers (including the franchisor) against each other in a competitive bidding process. But in a case in which franchisees, or the association, agree among themselves that they conduct an outright boycott against the franchisor or a supplier, such conduct could be deemed to be a *per se* violation of the law.

In addition to conduct which amounts to a *per se* violation of the anti-trust laws, certain other conduct may be deemed illegal based on the totality of the circumstances. This conduct is analyzed in a complex legal formula known as the “Rule of Reason.” At its most basic level, the Rule of Reason seeks to determine whether the pro-competitive effects of certain conducts are outweighed the anti-competitive effects. By their very nature, Rule of Reason claims are much more difficult to prove. Consequently, regulators and anti-trust plaintiffs are far less likely to bring such claims. However, it possible for franchisee associations to run afoul of this type of anti-trust restriction. For example, should the association refuse to admit or otherwise choose to boycott an unpopular franchisee, the aggrieved franchisee could claim that it was put at a competitive disadvantage as the result of the association’s activity and bring an anti-trust claim against the association using a Rule of Reason analysis. Similarly, imposing specific membership criteria that has the effect of keeping some franchisees out of the organization, as well as admission and expulsion practices may all subject a franchisee association to Rule of Reason claims at some point. Finally, it is also important that the association leave to the franchisor (which is vertical competitor and therefore permitted to coordinate the activities of its franchisees) to direct collaborative efforts regarding methods of distribution or terms and conditions of the sale of products to franchisees or the consuming public.

## IV. Franchisee Association Activities

### A. Communication and Collaboration Regarding System Changes

Friction generated by system change can be the most challenging issue for any franchise system.[3] While every business must adapt to evolving consumer preferences, regulatory challenges and other issues, unilateral, top-down, silo-based decision-making by a franchisor has a high likelihood of generating conflict and even litigation. Only by including franchisees in the process of deciding whether to make a change, and if so, what the change will be, can the franchisor substantially reduce the likelihood of conflict.

The authors are aware of one franchise system were the franchisor has come to believe, with the full support of a joint committee of franchisor representatives and franchisees, that the design of the kitchen in this restaurant system is acting as a limit on the volume of food that can be produced, consistent with safety and efficiency standards. To that end, the franchisor and the franchisee association have been collaborating on the design, with full transparency to the franchisees. Proposed redesigns of the kitchen have been tested in a variety of franchised locations with the results shared, including extensive videos taken of employees implementing various design changes. Regular presentations have been made to the board of the franchisee association. The result, not yet finalized, will be a kitchen design which has been thoroughly tested and vetted with the full participation of the franchise community. Thus, likelihood of resistance, despite the fact that substantial capital expenditures will be required, has been reduced to as close to zero as possible.

The benefits of this kind of collaboration are not theoretical. *In Re Sizzler Restaurants International, Inc*., BFG ¶11,408 (US Bankruptcy Court, C.D. California (1998)) illustrates this point. Sizzler had franchised, operated or joint ventured approximately 600 locations. It terminated the franchise agreements of the defendant and the defendant asserted a number of counterclaims, including violation of the implied covenant of good faith and fair dealing regarding the marketing for the restaurants.

Each restaurant had both a buffet court and a grill, each with different results. The franchisor decided that it would reorient its marketing emphasis away from the buffet court and more towards the grill. Rather than implementing this change on its own, Franchisor wisely chose to consult with the trustees of the National Sizzler Franchisee Association, sharing with the association marketing studies which supported the change. Following its review, the association issued a written report supporting the change, stating that the buffet court had higher food costs and lower average checks and a high share of customer counts. The court stated that the implied covenant of good

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[3] For example, see *Bores v. Domino's Pizza, LLC*, 530 F.3d 671 (8th Cir. 2008)(dispute between franchisor and franchisee over the mandate to install new computer equipment and software) and *Loehr v. Hot N' Now*, U.S. District Court, S.D. Florida. Case No. 95-6253-CIV-GONZALEZ (dispute over substantial change in the menu offerings for this restaurant chain implemented following its purchase by PepsiCo)

faith and fair dealing requires a party vested with discretion to do so reasonably, with proper motive and not arbitrarily, capriciously or a manner inconsistent with the reasonable expectations of the parties. In the end, the court observed that Sizzler had good cause to make the change, in no small measure because the franchisee association was consulted and agreed.

The lesson for franchisors is that if you engage in a collaborative process that is illustrated by the Sizzler decision, you may be inoculated from a claim based on the implied covenant of good faith and fair dealing.

### B. Advertising and Marketing

As noted above, one of the areas in which franchisees seek input is on the use and application of advertising funds contributed by franchisees as a percentage of their gross revenue.

### C. Mentoring and Training

While the training function is primarily the role of the Franchisor, it is not unusual for franchisee association meetings to include presentations by experienced in prominent franchisees on best practices in a wide range of areas. In most franchise systems, there are a group of what is sometimes referred to as natural leaders; franchisees who are respected by their peers, as well as by the franchisor as competent and compliant operators of their franchise businesses. Independent franchisee associations often enlist these franchisees to impart their knowledge, wisdom and experience to their fellow franchisees.

### D. Human Resources, Wage and Hour and Labor Law Support

In light of the joint employer initiatives of the National Labor Relations Board, the United States Department of Labor as well as private litigants, there has been discussion between some franchisee associations and franchisor counsel about how they might act in concert. One national franchisor has recently accepted a proposal from its independent franchisee association to pay substantially the entire cost of retaining a prominent national employment and labor relations law firm to provide seminars to franchisees, articles in the franchisee association' publications and FAQs that can be published to the franchisee association's website, all in an effort to elevate compliance and avoid costly litigation and damaging public relations.

### E. Lobbying on Issues of Mutual Concern

Government relations is an arena where issues and concerns of franchisor and franchisee may be identical. Examples of such issues include minimum-wage legislation, or state or federal regulation specific to the industry in which the franchise system operates, such as tip pooling laws and the like. In the experience of one of the authors, lobbying the government agency or legislative body with the joint effort of franchisor and franchisee representatives can be very effective. In addition, working together on issues of mutual concern in this arena could well lead to cooperation and collaboration, and other areas as well.

### F. <u>Trade Shows and Conventions</u>

Conventions and trade shows can be important opportunities for franchisee associations to deliver value to their franchisee constituent members and also to generate revenue to fund its activities. Even in franchise systems where the franchisor controls the supply chain, vendors have come to understand that their true customer is the franchisee. Thus, these vendors are willing to attend conventions and pay sometimes substantial fees to exhibit at trade shows, to address attendees and even to fund outings and activities, such as golf tournaments and the like.

In some systems were franchise associations have trade shows and conventions, it is not unusual for the association to invite one or more members of franchisor management to address the group and answer questions.

### G. <u>Informal Dispute Resolution</u>

Leaders of independent franchisee associations, particularly in mature franchise systems often have a very extensive knowledge of the inner workings of the franchisor and relationships with many members of the management team. In many cases, the institutional knowledge and memory that resides in the franchisee association, can rival that of management, which may have changed many times, particularly in the event of a change in ownership or control. This provides a unique opportunity for a leader of an independent franchisee association to engage in informal dispute resolution, when an issue arises between a franchisee and the franchisor. This is often done behind the scenes, without either side consulting lawyers, in an effort to solve a problem with minimal risk and expenditure.

## V. <u>Franchisor Participation</u>

### A. <u>Franchisor's Involvement in Franchisee Association and Franchisee Advisory Council meetings</u>

Franchisors are, naturally, more involved in franchisee advisory council meetings than franchisee association meetings because franchise advisory councils are typically organized by, and serve at the pleasure of, the franchisor[4]. Franchise advisory councils may meet two to four times a year, and are typically made up of members elected by the franchisees to foster the credibility of the franchise advisory council (although the terms and structure of representation is usually determined by the franchisor, often with

[4] This is not always the case, however. For example, Big O Tires, LLC's predecessor was a purchaser's cooperative originally established to obtain tires for associated tire dealers at favorable prices, and Big O's FAC evolved from its predecessor's dealer board.

representation by geographic region) [5]. Franchise advisory council members are usually reimbursed for their travel and accommodation expenses. Franchisors often create the meeting agenda, keep the franchise advisory council meeting minutes, and handle administrative functions of the franchise advisory council.

Items that may be covered in a franchise advisory council meeting are: franchise development, new products, marketing, IT/POS, training and best practices. The franchise advisory council meeting may include an open discussion with a representative of the franchisor's senior management team, such as a CEO or CFO. Franchisors may be willing to share non-public information about future plans and initiatives at franchise advisory council meetings provided that the franchise advisory council members in attendance sign confidentiality agreements.

Franchisor participation in independent franchisee association meetings, on the other hand, is much more limited, and is only permitted to the extent allowed by the franchise association. Unlike a franchise advisory council, the franchisee association creates the organizational rules that govern the calling of meetings, voting, and how the by-laws are amended. Franchisee associations are self-funded by member dues and, occasionally, from contributions given by suppliers or other advertisers.

Some franchisee associations permit franchisor-owned units to be eligible as members of the franchisee association. This provides financial support to the franchise association in the form of additional dues and allows for greater participation by the franchisor. Other franchisee associations, however, exclude franchisor-owned units from membership altogether, so as to allow the association to conduct its affairs completely confidentially. Some franchisee associations have gone so far as to bar franchise owners from membership if they were former employees of the franchisor[6].

Effective communication is critical to the relationship between a franchisor and its franchise advisory council or franchisee association. Franchise advisory councils and franchisee associations can help evaluate and give advice on system-wide changes, and obtaining the support of the franchise advisory council and franchisee association for a controversial initiative can be invaluable. Some franchisors will even allow the franchise advisory council to review and comment upon annual changes to the Franchise Disclosure Document before they are finalized.

Additionally, the importance of finding quality franchisee candidates to serve on the franchise advisory council or in the leadership of the franchise association cannot be overstated. Serving in either capacity takes a great deal of time and dedication and obtaining candidates who will work, constructively, to improve the franchise system and

[5] One example of a FAC structure consists of a board of 11 franchisees, 5 of which are voted on by the franchisees by region, five that are appointed by the franchisor by region, and an "at large" franchisee appointed by the franchisor.

[6] See, Spandorf and Barkoff, "*Close Encounters: Franchisee Associations and Councils*," 2003 ABA Forum on Franchising.

share a commitment to build the brand must be a top priority of both the franchisor (to the extent possible) and the franchisee association.

### B. Franchisor's Involvement in Franchisee Association's Board of Directors

Occasionally, franchisors are offered voting rights or a position on the franchisee association's board. While this may be viewed as a positive development by the franchisor, by accepting a board or other officer position in a franchisee association, the franchisor's representative will take on fiduciary duties to the franchisee association's members. This becomes problematic because of the conflicts of interest that are certain to arise between the representative's duties to the franchisor and the association.

Franchisor attendance at franchisee association meetings as a guest, however, is not problematic, and may be beneficial to both parties. Allowing the franchisor's senior management to attend portions of franchisee association meetings can help facilitate communication, and foster an understanding of each other's perspectives on a variety of issues.

## VI. Protections for Franchisee Association Members and Leaders

### A. Statutory Freedom of Association

At present, the laws of 12 states formally protect the right of franchisees to freely associate for lawful purposes. These statutes differ slightly from state to state and provide varying prohibitions.

For example, the Michigan statute[7] makes void and unenforceable any provision in a franchise agreement that would prohibit a franchisee from joining a franchisee association.

The statutes in Arkansas[8], California[9], Connecticut[10], Minnesota[11], Nebraska[12] and New Jersey[13] go a step further and prohibit the franchisor from directly or indirectly prohibiting the right of association among franchisees for any lawful purpose.

The California statute specifically provides that a franchisor may not restrict or inhibit the right of franchisees to join a trade association and the Minnesota statute provides that it shall be unfair and inequitable for any person to restrict or inhibit the free association of franchisees.

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[7] Mich. Comp. Laws § 445.1527(a)
[8] Ark. Stat. Ann. § 4-72-206(2)
[9] Cal. Corp. Code § 31,220
[10] Conn. Gen, Stat. Ann. § 42-133l(f)(2)
[11] Minn.R. 2860.440
[12] Neb. Rev. Stat. § 87-406(2)
[13] N.J. Stat. Ann. § 56:10-7(b)

Hawaii[14], Illinois[15] and Washington[16] make it unlawful for a franchisor to restrict or inhibit a franchisee from joining a franchisee association. Specifically, the Hawaii and Washington statutes provide that it shall be an unfair or deceptive act or practice or an unfair method of competition for a franchisor to restrict the right of the franchisees to join a franchisee association and the Illinois statute deems such conduct to be an unfair franchise practice.

Finally, the Iowa[17] and Rhode Island[18] statutes prohibit a franchisor not only from forbidding franchisees associating with other franchisees or participating in an associate but prohibit franchisors from retaliating against a franchisee for its involvement in a franchisee association.

The text of each state law protecting the rights of franchisees to freely associate has been reproduced in the Appendix A to this paper.

A large selection of states also have industry specific statutes that protect automobile dealers, motor fuel dealers and beer and wine distributors' rights of free association. For example, Massachusetts has an automobile dealership statute which prohibits the improper granting of a competitive motor vehicle franchise in the relevant market area previously granted to another franchisee and provides that "…every franchisee shall have the right of free association with other franchisees for any lawful purpose."[19]

## B. <u>FTC Rule Required Disclosure of Franchisee Associations</u>

The Disclosure Requirements and Prohibitions Concerning Franchising (the "New Franchise Rule") was most recently amended, on July 22, 2007 and became effective on July 1, 2008. Among the new disclosures required by the New Franchise Rule was one that required disclosures of trademark specific franchise associations as part of the Item 20 disclosure.[20]

The disclosure requirements regarding associations are divided into two categories of entities. For both categories of entities, the disclosure must include "...the name, address, telephone number, email address and Web address (to the extent known) of each trademark specific franchise organization associated with the franchise system being offered."[21]

[14] Haw. Re. Stat. § 482E-6(2)(A)
[15] Ill. Comp. Stat. Ch. 815, § 704-17
[16] Wash. Rev. Code Ann. § 19.100.180(2)(a)
[17] Iowa. Code Ann. § 537A.10(10)
[18] R.I. Gen. Laws § 19-28.1-16
[19] M.G.L. c. 93B, §4(3)(I) and §10
[20] 16 CFR §436.5(t)(8).
[21] <u>See</u> <u>id.</u>

For those that "…are created, sponsored or endorsed by the franchisor…", Item 20 must disclose the relationship between the organization and the franchisor.[22]

For franchisee organizations that are not so created, sponsored or endorsed, they must be (a) incorporated, or otherwise organized under state law, and (b) request to be included in the franchisor's disclosure document during the next fiscal year. This request must be renewed on an annual basis within 60 days following the close of the franchisor's fiscal year. A franchisor is under no obligation to verify the organization's continued existence but may include the following statement: "the following independent franchisee organizations have asked to be included in this disclosure document".

This provision was the subject of much debate in the nearly decade-long process that led to the adoption of the New Franchise Rule. Some franchisor advocates opined that independent franchise associations should not be disclosed at all, or that if they were disclosed, they should meet some threshold of membership in order to be listed. No such threshold was incorporated into the final version of the New Franchise Rule.

The import of this new disclosure requirement cannot be overstated. To the extent that there was ever any question about the legitimacy of independently organized franchisee associations and their lawful activities, this stamp of approval from the Federal Trade Commission resolved any such doubts.

In the Statement of Basis and Purpose, the Commission made clear its view that speaking to an independent franchisee association is one of many essential elements of pre-investment due diligence available to a prospective franchisee. The Commission stated that "The disclosure of trademark specific franchisee associations-both those sponsored or endorsed by the franchisor and independent franchisee associations-will greatly assist prospective franchisees in their due diligence investigation of the franchise offering, thereby preventing misrepresentations in the offer and sale of franchises."

## C. <u>Cases Alleging Discrimination and Retaliation</u>

Over the years, there have been a number of judicial decisions that deal with the rights and responsibilities of franchisee associations, as well as their members and leaders. When presented with credible evidence of unfair, retaliatory or discriminatory practices against franchisees as a result of their participation in associations of franchisees, dealers or distributors, judges and juries have had little trouble finding franchisors culpable, even in states where no statutory protections exist.

The courts have had little patience with franchisors' bad conduct towards members and leaders of franchisee associations. Juries have had even less patience with unfair, retaliatory and discriminatory practices. This may be due to the blatant and heavy handed conduct of some of these franchisors, which is clearly viewed as a violation of franchisee's rights.

[22] 16 CFR §436.5(t)(8)(i)

The oldest decision concerning franchisees' rights to associate arose in the AAMCO Transmission franchise system. In McAlpine v. AAMCO Automatic Transmissions, Inc., 461 F. Supp. 1232 (1978), a group of twelve (12) franchisees representing substantially all of the franchisees in the Detroit market and who were members of the National AAMCO Dealers Association ("NADA"), broke away from AAMCO in November 1973 to form a competing transmission repair business and operate independently from the franchise system. The franchisor sought, *inter alia*, money damages from the franchisees for destroying the goodwill associated with its rights as franchisor. Although the franchisees were held liable for damages of $412,000, the court endorsed the legitimacy of collective franchisee activities and the responsibility of the damages verdict was shared among the 12 franchisees. The decision is generally regarded as a clear victory for the franchisees.

The franchisor claimed that prior to the termination of their franchise agreements, the franchisees, through NADA, conspired to break away from the AAMCO franchise and devised a plan to start a new business together. The Court drew a parallel between the franchisees' freedom of association and the constitutional right to assemble and stated that "[f]ranchisees, like all persons in the United States, enjoy the right pursuant to the First Amendment of the United States Constitution to assemble, subject only to those exceptions specifically provided for by statute. Although a franchisee cannot combine with a competitor to fix prices, 15 U.S.C. §1, for example, franchisee gatherings, and joint activities which do not violate the law cannot, standing alone, be actionable." The franchisee association meetings, which began as a lawful vehicle to discuss legitimate business concerns, did not rise to the level of a tortious conspiracy, especially in light of the protections afforded by the Michigan Franchise Investment Law and the First Amendment.

In a passage that stands the test of time, the Court stated that "[o]ne of the traditional control mechanisms of a franchisor has been to keep its franchisees disorganized."[23] The Court subsequently held that "[f]ranchisees, by necessity, must have access to the franchise group in order to act together to deal with common problems, whether those problems be the oppressiveness of the franchisor or some less momentous concern."[24]

A 1982 Massachusetts case also dealt with a very clear attack on the legitimacy of collective organization and action by franchisees. Like the franchisees in in McAlpine v. AAMCO, the franchisee in Ricky Smith Pontiac, Inc. v. Subaru of New England, Inc., 14 Mass. App. Ct. 396 (1982), was a Subaru automobile dealer who was accused by the franchisor of engaging in illegal activities in support of a franchisee association. These two cases are parallel in that they both relate to allegations of anti-competitive behavior and involve challenges to the legitimacy of a franchisee association. In Ricky Smith, the dealer had participated in and became the president of the New England Subaru Dealers' Council, Inc., which was created to deal with what the franchisees

[23] McAlpine v. AAMCO Automatic Transmissions, Inc., 461 F. Supp. 1232, 1273 (1978)
[24] Id. at 1273-74.

believed was an unlawful effort to expand the number of dealerships in New England. Members of the association combined their resources to gather information about the franchisor's business practices, to obtain legal advice and to support litigation against the franchisor for claimed violations of automobile dealer protection statutes.

The franchisor alleged that the franchisee association was an illegal conspiracy in restraint of trade, that the franchisees devised to prevent the franchisor from granting additional competitive motor vehicle franchises, and that the Council's members "illegally combined to create de facto horizontal territorial limitations controlled by, and for the benefit of, existing franchisees." The Court found that the Council was an example of the type of association contemplated by M.G.L. c. 93B, §10 and that there was no proof that the Council violated antitrust laws or did anything in restraint of trade. The Court further determined that "an association of automobile dealers handling the same line or make, formed for the purposes of processing mutual grievances against their common franchisor, and safeguarding market areas defined and entrusted to the dealers by state statute, does not violate the antitrust laws absent proof of an illegal combination or evidence that illegal means were used to accomplish otherwise lawful ends."[25]

Not only do Courts directly protect franchisees' rights to associate, they also punish franchisors for intimidating or retaliating against franchisees who are members of franchisee associations in an attempt to deter such behavior from happening again.

The California case, Pepperidge Farm, Inc. v. Mack, Bus. Franchise Guide (CCH) ¶ 9530 (S.D. Cal. 1989), demonstrates the substantial risk a franchisor takes if it attempts to intimidate a franchisee from joining or supporting a franchisee association. In Pepperidge Farm, the judge assessed punitive damages in the amount of $1,000,000 against a franchisor for conduct designed to cause a Pepperidge Farm franchisee severe emotional distress.

The Court found that there was sufficient evidence that the franchisee was terminated as a result of his leadership role in the Pepperidge Owners Association and determined that a jury could have reasonably concluded that the franchisor intentionally inflicted emotional distress on the franchisee by making an example of him in order to deter other franchisees from joining the association. The franchisor's conduct included surveying and photographing the association's members' stores, placing the franchisee's products at the back of store shelves, terminating the franchisee regardless of his performance and prosecuting "an unprecedented and largely groundless breach of contract action" against the franchisee after his termination. The Court felt that the hefty punitive damage award was a sufficient punishment for Pepperidge Farm's actions and would help deter such behavior toward other franchisees in the future.

Another example of unlawful harassment and intimidation of members of a franchisee association can be found in State of New York v. Carvel Corp., 1985 WL 15454. The New York Appeals Court held that Carvel was not entitled to summary

[25] Ricky Smith Pontiac, Inc. v. Subaru of New England, Inc., 14 Mass. App. Ct. 396, 419-20 (1982).

judgment because Carvel may have incurred antitrust liability for allegedly intimidating and harassing its franchisees at a franchisee organization meeting. The attorney general brought an action under the New York Donnelly Act. The defendant franchisor's attorney/director was accused of entering a franchisee meeting place with two other men, demanding permission to address the group, attempting to discover which franchisees organized the meeting and threatening to bring a lawsuit against them. The men the attorney/director brought with him confronted franchisees as they entered the building, warned them that 500 franchises had been lost as a result of their participation in similar activities and that they were risking serious consequences to their businesses by entering the meeting. The tone of one of the men was described as loud, intemperate and intimidating. The Court found that the allegations that the franchisor exercised inordinate control over the franchisees by "invad[ing] and dissent[ing] lawful meetings at which franchisees were attempting to organize support for franchise legislation and by employing fear, threats [and] harassment" were sufficient to state a cause of action.

In Jay Edwards, Inc. v. New England Toyota Distributor, Inc., 708 F.2d 814 (1983), a jury proved that there are serious consequences when a franchisor engages in retaliatory conduct towards a franchisee leader. Here, the First Circuit Court of Appeals affirmed a jury's determination that an automobile dealer had been denied a sufficient number of automobiles by the distributor in retaliation for his activities as president of a franchisee association.

The dealer participated in a presentation of a list of demands to the distributor. Immediately following the presentation, the distributor retaliated by making wrongful accusations of misconduct in sales promotions and knowingly filing a false complaint against the dealer with the state Attorney General. Most significantly, the distributor disregarded its own allocation formula and "shorted" cars to the dealer. The distributor offered the dealer 527 fewer cars than a comparable New Hampshire dealer which had previously received identical allocations, resulting in decreased profits. The distributor was unable to offer any explanation of why it had shorted the dealer but it was clear that it had engaged in action that was arbitrary, in bad faith or unconscionable.

The dealer's claim for lost profits went to the jury, which awarded $1.419 million in damages, exactly the same sum the dealer demanded. On appeal, the First Circuit affirmed the jury verdict but reduced the amount of damages by $950,000.

The lesson for franchisors here is clear: juries have little patience for franchisors that retaliate against franchisees for exercising their rights of free association. In this case, the distributor's retaliatory conduct was especially obvious.

Another and later retaliation case, brought in federal court in Missouri, is Darrell Dunafon v. Taco Bell Corp., Bus. Franchise Guide (CCH) ¶ 10,919 (W.D. Mo. 1996), where a Taco Bell franchisee was also able to demonstrate the consequences of retaliatory conduct.

Franchisees from around the country had banded together to form the International Association of Taco Bell Franchisees, whose mission was to bring issues concerning the franchisee community to the franchisor's attention. The association not only communicated its position on certain issues concerning member franchisees to Taco Bell directly but also discussed their concerns with the media, including the Wall Street Journal and the Restaurant Business Magazine as well as the United States Congress. Taco Bell did not appreciate these activities and openly referred to the association leaders as "renegades and scum."

Taco Bell publicly stated that the leaders of the franchisee association would not be granted expansion rights within the system. As in the Edwards case described above, where the distributor disregarded its own allocation formula and shorted cars to the dealer, Taco Bell changed an established process for expanding franchises specifically in retaliation against one franchisee. The plaintiff franchisee alleged that although Taco Bell had a previously established 3-step process for approving a franchisee's request to establish a new location, Taco Bell, in retaliation against the franchisee, established a $4^{th}$ step to this process because of his "attitude problem", making it more difficult for the franchisee to expand. Even though he had previously been approved for a new location, his request was denied.

The Court denied Taco Bell's Motion to Dismiss and Motion for Partial Summary Judgment, stating that the franchisor's exercise of discretion may have been in bad faith and based on retaliatory motives and that a general issue of material fact existed as to whether Taco Bell tortuously interfered with the franchisee's business.

This case eventually settled after Taco Bell agreed to pay the franchisee $500,000.

Cherick Distributors, Inc. v. Polar Corp., 41 Mass.App.Ct. 125 (1996), another jury case, involved a dealer's unlawful attempt to terminate an unwritten distribution agreement on the eve of a scheduled distributor association meeting. The Polar beverage distributor utilized the theories of breach of implied covenant of good faith and fair dealing, tortious interference with advantageous relationships and violation of the state's unfair and deceptive practices act to win a jury verdict against the manufacturer.

In this case, the president of the distributorship had written a letter to other distributors inviting them to attend a meeting to discuss the possibility of forming an association to negotiate with Polar, the manufacturer. Upon discovering the letter and the scheduled association meeting, Polar terminated its oral agreement with the plaintiff distributor claiming that his letter of credit had expired, but Polar's vice president later admitted that the grounds for termination was a pretext.

The jury found that the sudden termination of the plaintiff's distributorship agreement, which happened to coincide with the planned meeting of Polar distributors, was calculated to put the plaintiff out of business and to discourage other distributors from attending the meeting. This provided ample support for the jury's finding that the four days' notice was unreasonable and that the termination constituted a breach of the covenant of good faith and fair dealing. The unreasonably short notice of termination also supported the jury's finding that Polar tortuously interfered with the plaintiff's advantageous relationships with Polar customers as well as the finding that Polar's conduct amounted to an unfair or deceptive act under M.G.L. c. 93A, which provides treble damages. The Court referred to Polar's "opportunistic timing" as "more than a mere coincidence" and, after correcting a mathematical error, the appellate court affirmed a $225,000 judgment in favor of the distributor.

In Popeyes, Inc. v. Yozo M. Tokita, et al., 1993 WL 386260, a Popeye's Chicken franchisor refused to allow a multi-unit franchisee to transfer the franchise. The franchisee alleged that the refusal to grant consent was due to the franchisor's dislike of the franchisee's ethnicity as well as his activities on behalf of a Popeye's Franchise Association and contended that the franchisor revised store evaluation reports and made derogatory remarks to other franchisees to discourage them from working with him to develop the Western Franchise Association. Although the Court was not inclined to agree with the franchisee's implied covenant claims, it stated that the franchisee offered sufficient evidence of Popeye's hostility toward the franchise association and could present to the jury the question of whether the franchisor had acted reasonably in withholding consent to the sale. Consequently, the Court denied the franchisor's Motion for Summary Judgment on the franchisee's claims based on breach of contract and the implied covenant of good faith and fair dealing.

Oil Express National, Inc. v. John D'Alessandro, et al., Bus. Franchise Guide (CCH) ¶ 11,400 (N.D. Ill. 1998) involved bitter ligation in the federal court of Illinois. The quick oil change franchisor, Oil Express, named the franchisees' attorneys as proposed defendants in the litigation, claiming that the attorneys had induced a group of franchisees to breach their franchise agreements by refusing to pay royalties and advertising fees. The franchisor further alleged that the attorneys had made a demand that it lower its royalty rate from 5% to 1% and this this conduct amounted to extortion.

The Court was called upon to decide whether the claims against the franchisees' attorneys, on the basis on alleged tortious interference with a contract and on antitrust grounds, could be added by way of amendment to the then existing claims. The court denied the franchisor permission to add the claims on the basis that the franchisees had already decided to breach their franchise agreements before they contacted the attorneys. By this time, 25 of 58 franchisees had joined in the alleged boycott.

The court pointed out that the franchisor had already terminated the franchise agreements in question before the royalty reduction demand had been made. Therefore, there was no way any threats had been made against the franchisor. The court also stated that attorneys act under a qualified privilege when advising clients on matters pertaining to contracts which shield them from claims of tortious interference when that advice results in their clients breach of contract. The only way to overcome that qualified privilege is to prove that the attorneys acted with actual malice, which requires proof of their desire to harm the opposing litigant unrelated to the actual interests of the attorneys' client. Since there was no allegation or proof that the attorneys had any independent interest in or relationship to the franchisor, the franchisor's claim failed.

In a 2003 case involving Dunkin Donuts, a federal jury cleared a franchisee of claims of criminal tax fraud and evasion brought by the franchisor as a basis for termination. Dunkin' Donuts Inc. et al. v. H&Z Donuts Inc, et.al., No. 00-12496 (D. Mass. Sept. 22, 2003).[26] The franchisee claimed that he was in good standing with Dunkin until he began supporting franchisees' rights and organized an independent association of Dunkin' Donuts franchisees.

The franchisee initially filed a lawsuit in Florida alleging that Dunkin' Donuts interfered with franchisee association elections and, within three weeks of filing his complaint, the franchisee received the first of three termination notices. The franchisee continued to operate his locations and the franchisor brought a breach of contract action alleging that the franchisee, *inter alia*, engaged in massive tax fraud in violation of the obligation under the franchise agreement to "obey all laws". After only two hours of deliberation, the jury returned a verdict finding that the franchisee did not breach his franchise agreements. The Dunkin' Donuts franchisee had not been charged and was not under investigation by any government agency and a key piece of evidence, an email from the franchisor's general counsel stating that the organization "had devised a long-term strategy in which Dunkin' Donuts 'committed itself to removing [the franchisee] from the Dunkin' Donuts system," revealed the franchisor's retaliatory tactics. This is yet another example of how juries have supported franchisees that faced this kind of discrimination.

Finally, in the most recent case in this area, Bray v. QFO Royalties LLC, 486 F.Supp.2d 1237 (2007), a Colorado federal court granted a motion for preliminary injunction brought by eight Quiznos franchisees. The court found that the franchisees were substantially likely to succeed on their claims that the franchisor terminated their franchise agreements in retaliation for posting a suicide letter of a former franchisee on the internet. Each plaintiff was an officer or member of the Toasted Subs Franchisee Association, Inc. (TSFA), and the court stated that there was "no dispute in this case that Quiznos had the Plaintiffs' franchise rights terminated as a direct result of the TSFA's actions in posting the… suicide letter."

After learning of the franchisee's suicide, the plaintiff franchisees contacted the franchisee's widow, who found her husband's suicide letter on his computer. The letter attributed the suicide to Quiznos and the litigation he and his wife had been engaged in concerning their franchise. The franchisees decided to notify the franchisee association members of the franchisee's death and their intent to establish a memorial fund on the TSFA website for him. As soon as the franchisor learned that the suicide letter was posted online, Quiznos' general counsel directed outside counsel to identify and terminate any franchisee affiliated with the franchisee association.

[26] Mass. Jury Clears Activist Dunkin' Donuts Franchisee On Tax Fraud Claim, Andrews: Franchise & Distribution, October 2003, http://02ae55a.netsolhost.com/files/article6.pdf

The Court determined that the franchisee organization was akin to a non-profit organization whose only mission was to provide an outlet for franchisees to express their frustrations and exchange ideas to further their interests. Quiznos made clear that its actions in terminating TSFA members "were purely punitive" and the court issued the preliminary injunction in order to protect the franchisees' rights while the case was pending.

In sum, although only 12 states formally protect the right of franchisees to freely associate for lawful purposes, courts nationwide are not forgiving of retaliatory conduct and juries are very willing to punish franchisors who engage in these activities. Not one of the cases cited above relied upon a freedom of association statute in reaching its decision, judgment or verdict. Due to the overwhelming support of franchisee associations, a well-counseled franchisor should steer clear of any retaliatory or discriminatory actions related to franchisee associations and their leaders.

The authors did not locate a single freedom of association case involving credible evidence of retaliation or discrimination where the franchisee did not prevail against the franchisor. Out of the 11 cases described above, franchisee rights to associate succeeded 11 times. Two (out of two) cases demonstrated the failure of franchisors' challenges to the legitimacy of franchisee associations, four (out of four) cases exemplify how juries have few qualms, if any, finding franchisors culpable of unlawful discriminatory or retaliatory treatment towards franchisees who participate in franchisee associations, franchisees have won four (out of four) dispositive motions and injunctions and the one time when a franchisor requested to amend its original claim to add claims against the franchisees attorneys, the Court ruled against the franchisor.

Notwithstanding this obvious winning streak, just last year fully 46% of franchisees stated that they had been told that they would be discriminated against as a result of their involvement with franchisee associations, according to the National Survey of Franchisees 2015 published by Franchise Grade.com.[27] Even though case law clearly demonstrates that discrimination and retaliation is unacceptable and unlawful, there are allegations that it continues to be present in some franchise systems. Responsible and informed counsel should discourage these unlawful practices because one thing is clear – this is a losing battle for franchisors.

**CONCLUSION**

In a world where franchising is often described as a three-legged stool comprised of the franchisor, the franchisees and key suppliers, a strong and effective franchisee

[27] "46% of respondents answered Yes to at least one of "My franchisor has indicated that there could be negative consequences to participating in a franchisee association", "My franchisor has indicated that there could be negative consequences to speaking out about problems within the franchise system", or "My franchisor has increased the frequency of inspections or evaluations of my business after I raised questions or spoke out about problems in the system." http://franchisegrade.com/ctw/Nat-Survey-Franchisees-2015.pdf

association that shares a commitment to building the value of the brand can add extra stability in the form of a “fourth leg.” But for this fourth leg to increase the balance of that stool, each leg must be adjusted. And in the end, the level of adjustment made to each leg will determine whether the fourth leg enhances stability or creates imbalance.

So when asked whether a franchisee association is a “friend” or a “foe”, the real question becomes, does it enhance or jeopardize the stability of the franchise system. For each system, the answer is likely different. But it often comes down to how willing the other components of the system are to adjust themselves in order to make room for the new leg.

## APPENDIX A

**Provision prohibiting franchisee from joining franchisee association is void and unenforceable**

Michigan

Each of the following provisions is void and unenforceable if contained in any documents relating to a franchise… A prohibition on the right of a franchisee to join an association of franchisees. Mich. Comp. Laws § 445.1527(a)

**Prohibiting the right of association among franchisees for any lawful purpose is prohibited**

Arkansas

It shall be a violation of this subchapter for any franchisor, through any officer, agent, or employee to… directly or indirectly… prohibit directly or indirectly the right of free association among franchisees for any lawful purpose. Ark. Stat. Ann. § 4-72-206(2)

California

It shall be a violation of this division for any franchisor, directly or indirectly, through any officer, agent or employee, to restrict or inhibit the right of franchisees to join a trade association or to prohibit the right of free association among franchisees for any lawful purposes. Cal. Corp. Code § 31,220

Connecticut

No franchisor, directly or indirectly, through any officer, agent or employee, shall… prohibit, directly or indirectly, the right of free association among franchisees for any lawful purpose. Conn. Gen. Stat. Ann. § 42-133l(f)(2)

Minnesota

It shall be unfair and inequitable for any person to… restrict or inhibit, directly or indirectly, the free association among franchisees for any lawful purchase. Minn. R. 2860.440

Nebraska

It shall be a violation… for any franchisor, directly or indirectly, through any officer, agent or employee, to… prohibit directly or indirectly the right of free association among franchisees for any lawful purpose. Neb. Rev. Stat. § 87-406(2)

New Jersey

It shall be a violation of this act for any franchisor, directly or indirectly, through any officer, agent or employee, to… prohibit directly or indirectly the right of free association among franchisees for any lawful purpose. N.J. Stat. Ann. § 56:10-7(b)

**Restricting or inhibiting franchisee from joining association is unlawful**

Hawaii

It shall be an unfair or deceptive act or practice or an unfair method of competition for a franchisor or subfranchisor to restrict the right of the franchisees to join an association of franchisees. Haw. Re. Stat. § 482E-6(2)(A)

Illinois

It shall be an unfair franchise practice and a violation of this Act for a franchisor to in any way restrict any franchisee from joining or participating in any trade association. Ill. Comp. Stat. Ch. 815, § 705-17

Washington

It shall be an unfair or deceptive act or practice and an unfair method of competition and therefore unlawful and a violation of this chapter for any person to… restrict or inhibit the right of the franchisees to join an association of franchisees. Wash. Rev. Code Ann. § 19.100.180(2)(a)

**Franchisor shall not retaliate against franchisee for involvement in franchisee association**

Iowa

A franchisor shall not restrict a franchisee from associating with other franchisees or from participating in a trade association, and shall not retaliate against a franchisee for engaging in these activities.  Iowa. Code Ann. § 537A.10(10)

Rhode Island

A franchisor shall not restrict a franchisee from associating with other franchisees or from participating in a trade association, or retaliate against a franchisee for engaging in the activities.  R.I. Gen. Laws § 19-28.1-16