First-step analysis: franchise disputes in USA (New York)

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Dispute resolution

Common disputes

What issues are typically the subject of disputes between franchisors and franchisees in your state?

The most common disputes arising out of a franchise purchase in the state of New York pertain to FDD disclosure and registration issues, and pre-contract misrepresentations and/or omissions that the franchisee relied upon in entering into the agreement. Accordingly, franchisees often assert claims under Section 683 of the New York Franchise Sales Act for a franchisor's failure to make proper disclosures in its FDD and under Section 687 for pre-contractual misrepresentations and/or omissions made by the franchisor.

Franchisees will often also assert claims under the common law for negligent misrepresentation and fraud if the franchisor made pre-contract misrepresentations or omissions. If the franchisor fails to give any ongoing support and training that may be required under the contract, the franchisee may assert claims for breach of contract, and breach of the implied covenant of good faith and fair dealing. However, these common law claims are often more difficult to establish and the potential recovery is not as great, especially since there is no statutory right to attorney's fees and court costs.

Franchisors often assert claims against wayward franchisees for breach of contract. Such claims typically arise if the franchisee fails to pay its royalties or deviates from the system's operations standards. To the extent such defaults are not cured and the franchisor then terminates the franchise agreement, a franchisor may seek damages or an injunction for trademark violations under the Lanham Act, if the franchisee does not promptly de-identify; and seek to enforce a non-compete provision.

Venue and governing law

What legal and practical considerations should be borne in mind when choosing a litigation venue and governing law for franchising disputes arising in your state?

The franchisor and its counsel will likely have an in-depth understanding of the local state law and will value the comforts of franchisor's home turf and the convenience of having its witnesses nearby and available for a trial or arbitration. So, as a practical matter, the franchisor usually chooses to apply the law of its home state to the franchise agreement, and to litigate any franchise disputes in a venue near its corporate headquarters. Often there is a carve-out in the contract permitting the franchisor to sue the franchisee in its home state for claims relating to enforcement of a non-compete provision or the franchisor's post-termination trademark rights.

If either the franchisor or franchisee is based in the state of New York, the New York Franchise Sales Act will apply regardless of any governing law provision in the franchise agreement that may provide for the law of another state. In fact, New York requires an addendum or rider to the franchise agreement, which states, in part, that the choice of law provision does not constitute a waiver of the parties' rights under the NYFSA. Notwithstanding the NYFSA's anti-waiver provision, a venue provision that designates a forum outside of New York can be enforceable.

Document retention

What document retention considerations and policies are pertinent for parties to franchise-related litigation in your state?

Once a party reasonably anticipates litigation, it must suspend any routine deletion processes for its electronic data (e.g., the purging of emails) and implement a litigation hold that will preserve all potentially relevant documents in their hard copy or electronic form. It is not enough for a company to direct its employees to initiate a litigation hold; counsel must oversee the process (with the technical assistance of competent IT professionals) to ensure that the litigation hold is being put into place as it should be.

There is no bright line rule as to when a party can be said to have first "reasonably anticipated litigation," but, in the franchise context, the issuance of a demand letter, a default notice, and/or a termination notice may be a triggering event giving rise to the duty to preserve.

In franchise disputes—unless the franchisee has been terminated—the parties continue to have an ongoing business relationship and, so the preservation of documents is complicated by the fact that the franchisor may have control or access over certain of the franchisee's documents. For example, the franchisee's business emails may be on the franchisor's server, and the franchisee's POS may offer the franchisor a direct feed to the franchisee's business information. In that respect, the franchisor has a distinct advantage.

Remedies

What remedies are available and commonly awarded in franchise-related litigation?

As a franchisee-friendly statute, the NYFSA gives aggrieved franchisees powerful statutory claims. If a franchisee succeeds in suing under the NYFSA, it can recover damages or, if the franchisor's violation(s) are found to have been willful and material, it may be entitled to rescission (a restoration of the status quo ante). Additionally, a franchisee can recover 6% interest from the date of purchase, attorney's fees, and court costs. It is significant, given the typical disparity in the financial resources of the franchisor and franchisee, that only the franchisee has a statutory right to recover its attorney fees if it prevails.

Franchisors may recover damages for breach of contract and, importantly, if the franchisee wrongfully terminates the franchise agreement prior to expiration of the term, the franchisor may be entitled to recover lost future profits (including the lost royalties stream for the duration of the franchise term). Franchisors will often aggressively seek an injunction and damages for any post-termination failures to de-identify and abide by the terms of any non-compete agreement.

Alternative dispute resolution

Is alternative dispute resolution (ADR) commonly used for franchising disputes in your state? What considerations should be borne in mind when opting for ADR?

The dispute resolution provision in most franchise agreements provides that the parties must submit their dispute to arbitration and, sometimes it also requires, as a condition precedent, that the parties first mediate. Arbitration is often the preferred forum for franchisors who may want to resolve their franchise disputes in the

more private confines of an arbitration than in open court. In theory, if not in practice, arbitration is a more cost effective and expeditious process than litigation in court would be for the parties.

If the franchisor opts for arbitration in its dispute resolution provision, it should consider whether to expressly require that claims against the principals, officers and employees of the franchisor be brought in the same arbitration forum. It is particularly important in New York since the NYFSA grants franchisees a cause of action against, not just the franchisor, but also the franchisor's control persons and any employees who materially aided in the statutory violation. NYFSA Section 691(3).

Before the prevailing party can enforce an arbitration award in New York, a petition to confirm the arbitration award must be filed in New York state court within one year of issuance of the award. CPLR Section 7510. Then, the judgment confirming the award must be filed and entered in the office of the county clerk.

Some arbitration provisions call for a three-arbitrator panel, which can increase the costs of an arbitration significantly. Discovery may be limited and the rules of evidence are "relaxed." Further, the ability to appeal a decision is virtually non-existent. Despite these factors, arbitration remains an extremely popular means of resolving franchise disputes in the state of New York.

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