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# PROACTIVE STRATEGIES FOR FRANCHISORS FOR LIMITING LITIGATION RISK

**Don Fox**
Firehouse Subs (Former CEO)
Saint Johns, FL

**Chelsea Mikula**
Tucker Ellis LLP
Cleveland, OH

**Michael Seid**
MSA Worldwide LLC
West Hartford, CT

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Don Fox, Former CEO, Firehouse Subs
Chelsea Mikula, Partner Tucker Ellis LLP
Michael Seid, Founder and Managing Director MSA Worldwide LLC

### 1. INTRODUCTION

Franchising has grown to become a cornerstone of the global economy. With growth comes risk and one of those risks is litigation, which is unavoidable.

While franchising continues to grow, fortunately, the trend for litigation in franchising is going in the opposite direction.[1] But in today's increasingly complex regulatory and business environment, litigation risk remains a pressing concern for franchisors. In addition to its financial costs and diversion of management time and resources, litigation can threaten the very success that franchising seeks to achieve.

Whether stemming from claims of joint employment, vicarious liability, disputes with franchisees, operational policies and practices, the actions and inactions of third party sellers, defining what is a franchise, in-term and post-term covenants, mergers and acquisition, disclosure issues, or any other reason, the impact of litigation can be devastating to franchise systems if only for its cost on the franchisor/franchisee relationship and the ability of the system to grow.

While a franchisor cannot ever prevent litigation, there are certain steps that can decrease the likelihood of litigation occurring. Regardless of whether its source arises from inside or outside the franchise system, clarity in the core documents (agreements, operations manuals, training programs and materials, and the like), clear and consistent communications and system practices are essential for winning, should the dispute become unavoidable.

This program will examine methods used by franchisors to avoid internal system litigation and provides actionable guidance on fostering ethical business practices, improving communication and refining franchisee support frameworks. We will also examine some of the frequent claims seen in franchise litigation and provide a summary of cases.

While arguably avoidable, from a litigator's vantage point, it is frequently the work of some transactional lawyers that leaves their clients exposed when litigation arises. The lack of sufficient clarity in drafting and missing elements may be caused by a perception of what a client feels is necessary in marketing their opportunities, the overuse of form

[1] Wentland, Emilee. "New Research Examines Wide Divide in Franchise Lawsuits." New Research Examines Wide Divide in Franchise Lawsuits | Franchise Legal | franchisetimes.com (last visited April 4, 2025).

agreement sections to reduce costs and possibly the additional cost and time required to have litigation counsel review transactional counsel's work in advance of its issuance.

This paper outlines proactive, practical strategies franchisors can adopt to reduce litigation exposure. While a franchisor cannot ever prevent litigation, there are certain steps that can decrease the likelihood. This paper provides actionable guidance on fostering ethical business practices, improving communication protocols, refining franchisee support frameworks, and attempting to ensure key documents stand up to judicial scrutiny. Additionally, it highlights often-overlooked areas where franchisors may unintentionally introduce avoidable risk.

## 2. THE LITIGATION LANDSCAPE FOR FRANCHISORS

Franchise systems face litigation threats on multiple fronts and understanding these risks is crucial for developing effective strategies to mitigate them. Some of the most frequent types of claims are discussed below together with a summary of some key court decisions. It is important to disclaim that the laws and types of available claims and remedies will vary by jurisdiction and the below cases are include as examples but not comprehensive summaries of the necessary outcome of a given issue.

### 2.1 Joint employment claims

Despite the respite currently found under the current administration, joint employment can be one of the most significant litigation risks for franchisors and franchisees. It's important to understand, even under the current definition, joint employment can still arise from blurred lines between franchisor and franchisee employee management and the controls, as well as support and methods of enforcing brand standards used in a franchise system. And while a significant risk, there are absolutely practical steps that can be taken to protect yourself from these types of claims, so understanding the law is key.

Joint employment arises when franchisors exert excessive control over the day-to-day operations of franchisees, leading to liability for employment-related claims. The implications of joint employer status include responsibility for wage and hour violations, discrimination claims, and other employment-related liabilities, as well as claims for negligence and other torts. Understanding the nuances of this relationship is key given the vulnerabilities created between franchisor and franchisee. As one court noted: "The legal aspects of a franchise relationship are intricate, and ideally all parties to the relationship understand the potential legal implications of such an arrangement. As a result of the often-unique franchisor and franchisee relationships (including sub-franchisors), the workplace has become progressively complex, and positioning individuals in the context of employment law requirements and protections is increasingly difficult. One primary distinction is that of an employee from an independent contractor. Designation as an employee or independent contractor determines an individual's entitlement, or lack thereof, to many statutory employment protections.[2]"

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[2] *Mouanda v. Jani-King Int'l*, 653 S.W.3d 65 (2022).

Before analyzing cases on joint employer claims, it's important to understand the regulatory environment. The National Labor Relations Board, effective December 26, 2023[3], attempted to significantly revise the criteria for determining joint employer relationships, which had far reaching consequences for franchisors and franchisees. In essence, it rescinded and replaced the prior rule, and under the proposed criteria, even potential or indirect control (versus direct control in prior rules), could qualify as joint employer status. The U.S. District Court for the Eastern District of Texas, however, invalidated this rule on March 8, 2024, finding it to be overbroad and inconsistent with the common-law definition of employment.[4] The court reinstated the 2020 rule which requires "substantial direct and immediate control."

In terms of litigation, one court highlighted that while franchise agreements often explicitly state that franchisees are independent contractors and not employees of the franchisor, it is the actual conduct of the parties that is crucial in determining joint employment status.[5] The court noted that: "the distinction between employees and independent contractors is often blurred, especially in the realm of franchise agreements. Clearly, a business entity cannot use the labels of 'franchisor' and 'franchisee' to avoid employment law and regulation. Instead how the parties functioned and conducted their businesses must be analyzed and mere reliance on their contract labels is inappropriate."

This same sentiment was echoed by another court, which held that "[w]hether an employer-employee relationship exists"…"should be grounded in 'economic reality rather than technical concepts" and based on "the circumstances of the whole activity" looking at the totality of the circumstances.[6] As the court noted, control is the key factor in determining, under the economic reality analysis, whether an entity or person qualifies as an "employer."

**The key takeaway is the language of the agreement is important, but the conduct of the parties is even more important.**

The court articulated two tests to determine "employer" status: the formal test and the functional test. Under the test for "formal" control, the factfinder weighs four factors to determine the franchisor defendants' employer status: whether they "(1) had the power to hire and fire the employees, (2) supervised and controlled employee work schedules or conditions of employment, (3) determined the rate and method of payment, and (4) maintained employment records." Carter, 735 F.2d at 12. Under the test for "functional" control, the Second Circuit has identified several other pertinent factors: (1) whether the alleged employer's premises and equipment were used for plaintiffs' work; (2) the extent to which plaintiffs performed a discrete line job that was integral to the alleged employer's process of production; (3) the degree to which the alleged employers or their agents

[3] National Labor Relations Board Issues Final Rule to Restore Fair and Efficient Procedures for Union Elections | National Labor Relations Board (last visited April 8, 2025).

[4] Chamber of Com. of United States v. Nat'l Lab. Rels. Bd., 723 F. Supp. 3d 498 (E.D. Tex. 2024).

[5] Mouanda v. Jani-King Int'l, 653 S.W.3d 65 (2022).

[6] Olvera v. Bareburger Grp. LLC, 73 F. Supp. 3d 201, 205 (S.D.N.Y. 2014).

supervised plaintiffs' work; and (4) whether plaintiffs worked exclusively or predominantly for the alleged employers. Olvera v. Bareburger Grp. LLC, 73 F. Supp. 3d 201, 206 (S.D.N.Y. 2014).

**Another key takeaway for joint employment is that the primary focus is "control."**

In other words, does the franchisor control certain actions of the franchisee and the franchisee's employees' manner and means of how the franchisee runs its business or the essential terms and conditions of employment (hiring, firing, discipline, supervision, direction, assignments) regardless of the language of the contract? Understanding the legal landscape and the rules of the game can help franchisors take steps to prevent being found liable for the actions of their franchisee employees.

### 2.2 Vicarious liability

While joint employment describes a relationship where two or more employers (or franchisor and franchisee in this context) share control over an employee, vicarious liability is a broader legal doctrine that can hold one party responsible for the actions or inactions of another. Vicarious liability is often triggered by the franchisor's involvement in day-to-day franchisee operations or customer interactions, making control a key factor, similar to joint employment. This risk arises when franchisees' actions, conducted within the scope of their franchise operations, result in harm to third parties, and potentially exposes the franchisor to liability.

It is important for a franchisor to establish and enforce a level of control, as required by the Lanham Act. A Court of Appeals in California made this important point when it determined that a franchisor must be permitted to retain such controls it feels are necessary to protect its trademark and goodwill without creating an agency relationship with its franchisees.[7] Without this fundamental principle, the franchise system would not work. So balancing the necessary control without increasing liability is a fact intensive analysis. The below cases analyze various factors the courts will look to in evaluating vicarious liability claims, but it is very important to note these are fact specific analyses and the individual facts and circumstances are important, as well as the law of the specific jurisdiction.

Courts have held franchisors liable in cases where they have exerted significant control over franchisee operations, as seen in *Corywell v. Morris*.[8] In that case the Superior Court of Pennsylvania affirmed a jury award holding Domino's Pizza vicariously liable for a motorcycle accident involving a franchisee's delivery driver. The Superior Court held that upon review of the evidence, it was clear that the Franchise Agreement between Robizza and Domino's "left Robizza with practically no discretion on how to conduct the day-to-day operations of its franchise store." The court relied on the fact the operating standards: (1) specified the terms of the store's lease and site plan, with the

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[7] *Cislaw v. Southland Corp.,* 4 Cal.Appl.4th 1284 (1992).

[8] *Coryell v. Morris*, 2025 PA Super 28, 330 A.3d 1270 (2025).

right to order refurbishment, and the operating hours of the store; (2) commanded the use of a specific IBM, Inc. platform for accepting and processing employment applications; (3) forbade the hiring of employees who had tattoos or "unprofessional" body modifications that could not be covered while detailing the colors and style of clothes employees could wear and when they could and could not wear them; (4) specified a list of acceptable computer and server models and processing speeds; (5) obligated the franchisee to maintain records of weekly or monthly sales, bank deposits, cancelled checks, and statements, receipts for food purchased, and counts of types of pizzas sold; (6) outlawed the promotion of free delivery; (7) required the use of an approved type of safe in the store and the deposit therein of anything more than $150 that could be kept in the cash registers; (8) preluded the use of delivery vehicles with "excessive" wear and tear or debris; (9) mandated that the store feature at least three telephones and digital clocks viewable from various areas of the store; (10) banned the presence of gaming machines or any form of literature not related to work; and (11) required employees to deal with complaining customers by "apologiz[ing], giv[ing] them what they want, [and] giv[ing] them something extra."

The court relied on all these factors to conclude that "the Franchise Agreement and 2016 operating standards left Robizza with practically no discretion how to conduct the day-to-day operations of its franchise store." The court contrasted its decision to a case involving Best Western, "where the franchisee paid Best Western a flat fee to use the trademark, contributed to advertising, and was otherwise free to operate the hotel as they saw fit so long as it did not fall below minimum quality standards.[9]" Again, the key focus is on the level of control.

It is important to note that the outcome of every case is dependent on the judge, jury, or state in which the claim is brought (or a combination of all of those). The reason being, a Texas court reached a different decision involving Dominos (albeit on slight different facts).[10] The court stated the fact that Domino's retained the right to terminate the franchise agreement, retained a right to receive evaluations and other reports, had a right to conduct inspections, or required MAC to comply with Domino's procedures and rules was not evidence that Domino's had a right of control. The court held that although Domino's had authority to modify its own rules and regulations, the right to prescribe alterations and deviations was not the type of supervisory control sufficient for imposing a duty on Domino's. It also held the fact that Domino's had set general minimum operational standards did not negate the franchise agreement's independent contractor provision. The court reversed the trial court's judgment and rendered judgment dismissing Reddy's claims against Domino's.

An important point of distinction was seen in *Patterson v. Domino's Pizza, LLC*[11], where the court found that while provisions of a franchise agreement are relevant on the issue of the franchisor's control over the franchisee, for purposes of vicarious liability, they are not the exclusive evidence of the relationship, and consequently, the provisions of

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[9] See *Myszkowski v. Penn Stroud Hotel, Inc.*, 430 Pa. Super. 315, 321, 634 A.2d 622, 626 (1993).

[10] *Domino's Pizza, L.L.C. v. Reddy*, No. 09-14-00058-CV, 2015 WL 1247349, at *1 (Tex. App. Mar. 19, 2015).

[11] 207 Cal. App. 4th 385, 143 Cal. Rptr. 3d 396, 115 Fair Empl. Prac. Cas. (BNA) 524 (2d Dist. 2012).

franchise agreements are not necessarily controlling. This is the same analysis as seen in the joint employer cases above. Instead, the court stated that it looks to the totality of the circumstances to determine who actually exercises the ultimate control.[12]

In another case, the Court of Appeals of Texas emphasized that several factors aid the right of control determination for vicarious liability, including the independent nature of the business, the obligation to furnish tools and materials, and the right to control work progress.[13] The court held the fact "that Pizza Hut sets general minimum operational standards for its franchisees does not establish Pizza Hut has the right to control [the franchisee] in the details of its operations.[14]

Put simply, the Court of Appeals of Georgia stated that mandatory operating standards to ensure uniformity and quality among franchisees do not amount to day to day supervisory control over the franchisee.[15]

In another example, a Tennessee court found that a franchisor did not have sufficient control over day-to-day operations of the franchisee restaurant to establish duty of care on part of the franchisor toward restaurant employees, and thus franchisor could not be held directly liable for injuries restaurant employee sustained when he was physically assaulted by his manager at work. The court found there was no indication that franchisor retained any control over hiring, firing, or discipline of any of restaurant's employees.[16]

**Control over the hiring and firing of franchisee employees is mentioned in almost every case and is a sensitive issue for franchisors to be aware of.**

When it becomes even more difficult are situations where the franchisor learns that a franchisee employee is acting contrary to brand standards, against the interests of the franchisor or franchisee, or even when a franchisee employee is causing harm to customers. In these situations, it is important that the franchisor take some action, but it must be done through the franchisee and their right to manage employees.

Vicarious liability claims are fact intensive inquiries that will vary based on the facts of an individual case. But understanding the general framework is important because recent trends seem to indicate that vicarious liability claims are on the rise as there's been an increase in third-party efforts to find not only vicarious liability under theories of agency and apparent agency, but also direct liability against the franchisor under claims of negligent supervision, training or assumption of duty and similar theories. These theories of direct liability essentially claim that if a franchisor imposes certain requirements that

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[12] *Id.*
[13] *Doe v. Yum! Brands, Inc.,* 639 S.W.3d 214 (2021).
[14] *Id.*
[15] *New Star Realty, Inc. v. Jungang PRI USA, LLC*, 346 Ga. App. 548 (2018).
[16] *Gray v. McDonald's USA, LLC*, 874 F. Supp. 2d 743 (W.D. Tenn. 2012).

result in bodily harm or property damage to the customer or employee, the franchisor is directly liable. It's a complicated but important issue.

There are frequently issues that arise out of the conduct of a franchisor's field staff which may be caused by a lack of training or poor direction or supervision by the franchisor. Where field personnel act in a supervisory capacity or approach, or where they reach decisions contrary to the balance between brand standards and control, claims of joint-employer and vicarious liability will arise. Frequently it is the way in which field staff communicate with franchisees in text messaging and emails, that cause issues because of what is perceived as a friendly relationship instead of a business relationship. The distinction and required discipline in drafting is often overlooked in setting the tone of the field consultants communications.

### 2.3 Franchisee disputes

Disputes between franchisors and franchisees often arise from disagreements over the terms of the franchise agreement, including issues related to territory, fees, operational standards, lack of adequate support, system changes, supply chain and possible issues regarding the disclosure document and recruitment process. The largest area of dispute is centered on non-adherence to the franchise agreement, resulting in claims for breach of contract. Misuse of intellectual property, or disputes regarding termination of a franchisee or disparate treatment of franchisees in default also frequently occur.

For litigation counsel, the challenge is how well the basic elements of the relationship are defined and provided for in the franchise agreement by the transactional lawyer. This can include basic definitions to clarify the terms of the relationship, what it means, what it includes and required under the license, and what is the sole and distinct obligations of the franchisee.

In possibly trying to limit the size of the documents or to make them more marketable for franchisors to recruit franchisees, transactional lawyers frequently forget that franchise agreements also have to pass the test of being clearly understandable by the trier of facts and the less than franchise experienced jurors that frequently make the decisions. Often it is the litigation expert that is engaged in disputes whose sole role is to explain the generally accepted standards in franchising, which would not be necessary if the underlying documents were sufficiently drafted.

When disputes arise, the franchise agreement often provides how they are to be resolved whether it be venue, choice of law, by arbitration, or whether mediation (or some form of alternative dispute resolution) is included in the process. Inadequate or ambiguous contract language can exacerbate these disputes, leading to costly litigation and increased costs in resolving the issue. While it is impossible to discuss all of the types of claims that will arise between a franchisor and franchisee, a few examples are explored below.

As mentioned, the most common disputes are breach of contract disputes. In one case the court held that a jury could find that beverage manufacturer's termination of distributor's exclusive distributorship agreement on four days' notice was unreasonable and constituted a breach of the covenant of good faith and fair dealing.[17] This is juxtaposed to a case where the court found the Franchisor's termination of real estate brokerage services franchises was in good faith because the franchisor provided franchisee with more than 30 days to cure its default, as required by the franchise agreement.[18] If the agreement has a termination provision (which it should) it must be followed in order for a court to enforce it. Deviating from the terms of the agreement when it comes to termination will only result in continued disputes and likely litigation (often time regardless of the severity of the reason for termination).

What needs to be understood in enforcing any provision in the agreement is to remove from the process the emotions that can impact how attempts to enforce the agreement are often undertaken. Enforcement to be effectively argued needs to be disciplined and not emotional in its approach as that is how it needs to be seen later during its evaluation by third parties.

Another example where the language of the franchise agreement is instructive, is paying debts of franchisees.[19] The court found a real estate business franchisor did not obligate itself to pay debts of franchisee, as would render franchisor liable for misappropriation of escrow funds by franchisee's owner; rather, franchisor expressly disclaimed any responsibility for financial loss and legal damages of its franchisees in the franchise agreement. In that case the court found that the franchisor did not control the “time, manner, and method” of the franchisee operation and so the disclaimer in the agreement was enforced. Again, the lesson is the language of the agreement is important but the actions must be consistent.

A case that involved several different issues between a franchisor and franchisee concerned the Dunkin Donuts franchise system.[20] In that case, the franchise agreements required the franchisee to adhere to specific operational standards and included a provision for cross-default, meaning a default in one agreement would trigger defaults in others. Following various defaults, including health violations and failure to pay franchise fees, Dunkin sent termination notices to the franchisee, asserting it could no longer operate the shops. The franchisee contested the termination, claiming Dunkin had committed prior breaches and that the violations were minor. After extensive litigation, Dunkin sought a preliminary injunction to stop the franchisee from using the Dunkin' trademarks and operating their shops. The United States District Court for the Middle District of Florida held in favor of the franchisor, Dunkin. Setting clear operational standards in the agreement and providing a clear termination provision was essential to Dunkin’s success.

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[17] *Cherick Distribs. v. Polar Corp.* (1996), 41 Mass App 125, 669 NE2d 218, review den 423 Mass 1109.

[18] *Century 21 Real Estate LLC v. All Professional Realty, Inc.*, 889 F. Supp. 2d 1198 (E.D. Cal. 2012), stay pending appeal denied, (Nov. 16, 2012) (applying California law, specifically West's Ann.Cal.Bus. & Prof.Code § 20020.)

[19] *New Star Realty, Inc. v. Jungang PRI USA, LLC*, 816 S.E.2d 501 (Ga. Ct. App. 2018).

[20] *Dunkin' Donuts Franchised Restaurants LLC v. D & D Donuts, Inc.*, 566 F. Supp. 2d 1350, 1361 (M.D. Fla. 2008).

A relatively new approach from franchisees against franchisors is breach of fiduciary duty claims. In other words, franchisees suing the franchisor as if the franchisor was a fiduciary.[21] It is not a separate cause of action, but concerns the standard by which the franchisor's performance under the franchise contract is to be judged or by which a determination of whether the franchisor is guilty of negligence or fraud may be made. Its primary objective is to impose on the franchisor the most stringent obligations of full disclosure and fair treatment. Its basic premise is that, because of the franchise company's superior and economically more powerful position, its relationship to the franchisee, like that between a trustee and beneficiary, requires exercise by it of the utmost good faith, integrity, and fidelity.[22]

Courts find that, to establish a fiduciary relationship between franchisor and franchisee, a franchisee would need to prove facts independent of the parties' contracts, and would need to show that confidence was reposed as a result of a position of superiority and influence held by franchiser; it was not enough for franchisee to prove that she placed her trust and confidence in franchisor or his agent, as franchisee also had to introduce substantial evidence that franchisor recognized, accepted, or undertook the duties of a fiduciary, which was that of advising, counseling, and protecting franchisee.[23] However, it is insufficient for a franchisor to merely site to provisions in the agreement just as it is insufficient in other matters for a franchisor to simply rely on an integration clause including in an agreement of other claims. The lesson continues: the language of the agreement is important but is not a slam dunk defense. Good and clear language certainly helps, but always ensure the actions are consistent with the goal the franchisor is trying to accomplish.

In another case, a court found that a letter from a franchisor's vice president of marketing and other statements of franchisor's representatives, which referred to a fiduciary relationship and promised that franchisor would "look out for best interests" of franchisees, were insufficient to create a fiduciary relationship between franchisor and franchisees concerning franchisor's management of advertising fund where the franchise agreement gave franchisor sole discretion to organize advertising programs.[24] But a word of caution that communications between franchisor and franchisee are critical pieces of evidence in litigation to either support or contradict the position of the parties. If a franchisor has good language in the agreement but in communications with the franchisee is stating something different, the conduct of the parties is likely to control.

Regardless, the use of terms like partners or partnership or others that cloud the meaning of a franchisor/franchisee relationship will always be unhelpful and should be avoided.

Given the myriad of issues that can arise between franchisors and franchisees, it is important to keep up with the state of the law and ensure that your franchise agreement

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[21] *Smith v. Ogilvie*, 127 NY 143, 27 NE 807.
[22] *Id.*
[23] *Amoco Oil Co. v. Gomez*, 125 F. Supp. 2d 492 (S.D. Fla. 2000).
[24] *Collins v. Int'l Dairy Queen*, 54 F. Supp. 2d 1351 (M.D. Ga. 1999).

addresses issues that you anticipate may arise because of your industry or prior history of litigation with franchisees.

### 2.4 Inadequate operational practices

Overreach or under-support in field services, training, or policies can expose franchisors to legal claims. These risks include claims of negligence, breach of contract, and failure to comply with regulatory requirements.

If a franchisor fails to provide the requisite support services as stipulated in the franchise agreement, this can be grounds for a lawsuit. For example, one court found that evidence of the franchisor conducting unreasonable inspections and failing to provide requisite support services created a jury question on whether the franchisor breached the franchise agreement.[25]

**One element that often creates confusion is the lack of clear definitions establishing the purpose of the initial and continuing fees in a franchise relationship.[26]**

Clearly communicating the separation of the fees from the support services and defining the purpose of the fees as for the initial and continuing use of the intellectual property , during the term, is a frequent and avoidable discussion in litigation that is avoidable with proper drafting.

Several states also give the franchisee a right of private action to sue the franchisor if the obligations are not being met. For example, the New Jersey Franchise Practices Act states a franchisee can bring an action against its franchisor for any violation of the act to recover damages and, where appropriate, seek injunctive relief.[27] And the Maryland Franchise Law prohibits franchisors from making misleading statements about the support they will provide and requires full disclosure of the extent and cost of training, supervision, and technical assistance.[28] This highlights the importance of not only having clear language in the franchise agreement but also being aware of any specific state requirements that will govern the relationship with the franchisees.

### 2.5 Third-party sellers

A growing area of potential litigation involves third-party franchise sellers, including brokers and franchise sales organizations (FSOs). While often calling themselves consultants and advisors and referring to prospective franchisees as their clients, third party sellers are generally paid a fee by franchisors upon the signing of the franchise or development agreement. Recently California passed legislation requiring third party

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[25] *Discovery Point Franchising, Inc. v. Miller*, 234 Ga.App. 68 (1998).

[26] Introduction to the Franchise Business Model - International Franchise Association (last visited April 15, 2025).

[27] N.J.S.A. 56:10-10.

[28] COMAR 02.02.08.16.

sellers to prepare and deliver a disclosure document because of the growing concern over some of their practices, which is discussed in more detail later.[29]

While brokers are independent sales agents that provide prospects to franchisees for disclosure, FSOs provide disclosure and other procedural steps in making the sale, which historically were provided by the franchisor's employees. Franchisors take the position that third party sellers are not employees of the franchisor but rather independent contractors, and that the franchisor should not be held liable, for the actions or inaction by the third-party sellers, even where they violate franchise disclosure laws and other generally accepted standards. These cases can arise when sales agents make misleading statements to potential franchisees or when franchisors are held responsible for the actions of their agents.

In a recent case, the court found that the actions of an FSO engaged by a franchisor were so faulty as to cost the franchisor much of what it considered its trade secrets and proprietary information.[30] Many of the principals of joint employer and vicarious liability will apply to an analysis of third-party sellers.

### 2.6 Non-compete clauses

Franchise agreements may contain in-term and post-term non-compete clauses that restrict franchisees business activities during the term and from operating a similar business in a certain area for a certain period of time after the franchise agreement ends. The enforceability of these clauses is a front and center issue for 2025. In 2024 we saw substantial legislative and administrative rulemaking activity at both the federal and state levels, and the law on this point continues to evolve.

Generally, the law in most states historically has been that a noncompete covenant is enforceable when it is intended to protect a parties legitimate interests. These can include, but not be limited to, prohibiting conduct needed to protect confidential information or trade secrets, provided that the restrictions are reasonably tailored to the necessary geographic limits and duration.

However, in recent years, multiple states have tightened the enforceability in the employment context and, generally, these state statutes only carve out minimal exceptions for the sale of the business and sometimes highly compensated individuals. Some states have even added criminal penalties for employers including or attempting to enforce a noncompete covenant in violation of the new law. States with recently enacted laws preventing or greatly limiting the enforcement of noncompete covenants include Colorado, Illinois, Maine, Maryland, Minnesota, New Hampshire, Oregon, Rhode Island, Virginia and Washington. Several other states are considering new legislation and some states' courts have greatly reduced the enforceability of noncompete covenants, including California, which added to its statute in 2024.

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[29] Add citation

[30] *Smash Franchise Partners et al v. Kanda Holdings, et al.*, Court of Chancery of the State of Delaware, CA No. 2020-0302-JTL.

The FTC proposed non-compete provisions at the federal level in 2024 that would have greatly limited the enforceability of non-compete agreements. While in the proposed rule the FTC stated that the rule was not intended to cover franchise relationships, it invited comments on whether to include franchises and some suggested during the comment period that the rule should be expanded to cover franchisees. The FTC approved the new rule banning non-competes on April 23 to take effect in 120 days. However, multiple lawsuits to enjoin the rule followed, and a Texas court enjoined the rule by order on Aug. 20 in the case of Ryan, LLC v. Federal Trade Commission[31]. For now, the new rule will not take effect.

Recent cases interpreting the enforceability of non-compete agreements are summarized here. A case from the Court of Appeals of Kansas highlights the importance of proportionality in noncompete agreements. The court found the noncompete provision, which imposed a two-year restriction based on barely three months of employment, to be grossly disproportionate and thus unenforceable[32]. This case underscores the need for franchisors to ensure that the duration and scope of noncompete clauses are reasonable and proportionate to the employment term.

A Court of Appeals of Ohio upheld the enforcement of noncompete and confidentiality provisions in a franchise agreement, emphasizing the potential irreparable harm to the franchisor from the former franchisees' affiliation with a competitor.[33] The court noted that the franchisor's trade secrets and ability to attract new franchisees were at risk, justifying the issuance of a permanent injunction.

Another court, under Massachusetts law, found that a franchisor of a small group of fitness studios for women was likely to succeed on the merits of claims that former franchisee breached franchise agreement, as required for franchisor to be entitled to preliminary injunction, enjoining franchisee from operating allegedly competing fitness studio and from using franchisor's confidential information, where termination provision of franchise agreement required franchisee to cease using franchisor's system and confidential methods and gave franchisor rights to purchase franchisee's inventory, and non-compete clause of agreement prohibited franchisee from being employed by any fitness center, health club, personal training studio, or any other business concept that directly competed with franchisor within eight (8) mile radius of franchisee's former studio's location, for two (2) years following termination of franchise agreement, and franchisee sold inventory to operator of competing fitness studio without obtaining franchisor's approval or giving franchisor opportunity to buy inventory, franchisee registered competing studio with state before terminating franchise agreement, and franchisee began volunteering at competing studio for 40 hours per week as manager.[34]

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[31] *Ryan, LLC v. Fed. Trade Comm'n*, 746 F. Supp. 3d 369 (N.D. Tex. 2024).

[32] *Doan Family Corporation v. Arnberger*, 62 Kan.App.2d 769 (2022).

[33] *Gimex Properties Corp., Inc. v. Reed*, 205 N.E.3d 1 (2022).

[34] *Get In Shape Franchise, Inc. v. TFL Fishers, LLC*, 167 F. Supp. 3d 173 (D. Mass. 2016) (applying Massachusetts law).

Recognizing the limitations possible is the first step in being proactive about how to structure the relationship and avoid litigation risk is the second.

### 2.7 Franchisor privileged to control franchisees' supply contracts

The level of control by franchisors over their supply chain and the income they earn from franchisee purchases is a frequently litigated issue. It is no secret that competition among franchised businesses in many sectors is fierce and that many franchised businesses operate on thin margins, meaning that every dollar spent directly impacts the bottom lines of franchisees and franchisors. Improvements to a franchise system's supply chain represent one of the few opportunities for positive impact to a franchise system's financial returns that do not require increased sales, or even, depending on the strategy chosen by the franchisor, a significant investment of capital. A franchise system with a solid supply chain will usually see significant returns on its investment. Potentials for litigation in this area, however, include the below:

**Unfair Contractual Restraints:** Franchisees may argue that certain control measures imposed by the franchisor are unreasonable or violate antitrust laws.

**Conflicts of Interest:** Franchisees may challenge the franchisor's financial interests in suppliers, arguing that these interests lead to inflated prices or less favorable terms.

**Non-Compliance with Operating Manuals:** Disputes may arise if franchisees fail to comply with the franchisor's operating manuals, particularly if those manuals dictate supply chain practices.

In a case, under Texas law, the court held no tortious interference occurred against a restaurant franchisor's non-exclusive distributor's revocable contracts with franchisees, when franchisor required its franchisees henceforth to make 95% of their purchases of franchisor's branded/proprietary products from specified parties other than distributor; distributor alleged economic duress had been imposed upon franchisees, but franchisor had right to approve suppliers and distributors of its branded products, and thus franchisor's change merely caused distributor to lose what it was always legally vulnerable to losing.[35]

## 3. KEY PROACTIVE STRATEGIES

There are practical steps franchisors can take in trying to avoid litigation that will improve the chances of success, should litigation happen. While each franchise system is unique and must be tailored according to your industry and the rules and regulations that govern it, there are some general guidelines that apply in most situations.

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[35] *Schlotzsky's, Ltd. v. Sterling Purchasing and Nat. Distribution Co., Inc.,* 520 F.3d 393, 86 U.S.P.Q.2d 1138, 2008-1 Trade Cas. (CCH) ¶ 76071 (5th Cir. 2008).

### 3.1 Create a Culture of Ethical Business Decisions

While it was drafted as an aspirational document, the IFA's Code of Ethics makes the point that franchisors should "maintain high standards of honesty, integrity, and fairness in all business dealings.[36]" In our experience, franchise systems thrive when they foster an internal and external culture grounded in integrity and ethical business practices can serve as the foundation for minimizing litigation risk.

It is not enough to have a good faith and fair dealing clause in the franchise agreement requiring both parties to treat each other fairly, honestly, and without engaging in any actions that could disadvantage or harm the other. It is the actions and inactions that go beyond the statement of culture that needs to permeate the franchise system for the provision to have any merit.

Many franchisors in their franchise recruitment criteria, manuals, training and other communications, detail how they want their franchise system to culturally perform. One example of a franchisor that defines its culture well is Hungry Howie.[37]

Hungry Howie's website provides:

> "Research shows consumers prefer to shop with businesses that embrace environmentally and ethically sustainable practices. For entrepreneurs, adopting these values is essential to running a socially responsible business. While laws provide a foundation, leaders within an organization shape a brand's ethical standards. By implementing strong practices, business owners can foster a positive workplace culture and enhance their public image."

Hungry Howie offers provides for nine practices to embrace a culture of ethics: "1) lead by example, 2) consistently enforce policies, 3) reward positive behavior, 4) foster community engagement, 5) show you care, 6) respect everyone, 7) be transparent, 8) invest in ethical marketing, and 9) source products sustainably."[38]

Hungry Howie selects its franchisees with care and does not simply sell franchisors. It has found that if it, as the franchisor, models an ethical culture to the system, franchisees will generally follow suit and also prioritize ethical outcomes over short-term financial wins. Firehouse Subs with its substantial growth and exit value, is an example of a system that grew relatively quickly and, with limited disputes and litigation, largely due to its culture of ethics.

This is important because franchise systems operate on trust. The franchisor sets brand standards and since they are not on the premises on a day-to-day and minute to

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[36] IFA Code of Ethics. International Factoring Association (last visited April 6, 2025).

[37] Hungry Howie "Top 9 Ethical Business Practices all Entrepreneurs Should Embrace." Ethical Business Practices For Entrepreneurs | Hungry Howie's Franchise (last visited April 6, 2025).

[38] *Id.*

minute basis, franchisors must trust that the franchisee will execute their business practices to meet the requirements of the franchisor.

To promote a culture of ethics it is recommended that franchisors discuss with legal advisors adding language to the franchise agreement that emphasizes the importance of ethics in the franchise program, such as the below.

"Franchisee agrees to operate the franchised business in accordance with the highest standards of honesty, integrity, and fair dealing, and to comply with all applicable laws and regulations."

"The Franchisee and the Franchisor agree to refrain from any business practices that are misleading, deceptive, or that could damage the reputation or goodwill of the franchise brand."

"The Franchisee and the Franchisor agree to adhere to the highest standards of honesty, integrity, fair dealing, and ethical conduct in all aspects of their relationship, including but not limited to, the operation of the Franchisee's business, the provision of services, and all communications and interactions."

**Litigation Prevention Payoff:** A franchisor with a culture of integrity is likely to enjoy consistency in their system's operations and sustainable growth from the validation of its franchise network.

### 3.2 Communication: What Works & What Creates Risk

Effective communication is essential for preventing misunderstandings and disputes with franchisees. Franchisors should establish open lines of communication and provide regular updates on operational changes, legal developments, and other relevant issues. By maintaining transparent communication, franchisors can build trust and reduce the likelihood of disputes. Clear, accurate, and consistent communication is one of the franchisor's most powerful tools.

**Discussions allow for Understanding:** There is a tendency for individuals to communicate electronically today via emails and text messages. This can lead to informal communications that are not consistent with brand standards.

Further, written communications frequently are the triggers for the furtherance of disputes as they can never provide for the necessary flexibility that direct verbal communication can achieve. Limiting their use and gaining discipline over how you communicate with the franchise system is essential, including emails and text messages. And communicating with your staff about the importance of communications is key.

When disputes arise, the best approach is usually direct communication by phone, video conferencing (teams, zoom, etc.), or face to face. This is the first step in trying to avoid litigation. Put simply: answer your phone and don't avoid difficult discussions.

Where solutions to continuing the relationship cannot be found through discussions, even when passions are highest in a bad relationship, offering the other party a dignified exit ramp from the relationship is generally a beneficial step to take. Remember that franchise systems are glass houses. Even when other franchisees agree with your position, how you handle disputes with franchisees will be observed by the other franchisees in the system. Helping a franchisee to exit the system with dignity and the equity they have earned in the business will go a long way to creating a beneficial culture in a franchise system.

**Automatic Letters of Default:** If you use them every time a franchisee is a day late with their royalties, just stop. There generally is an underlying issue that may need to be understood by your field consultants when payment issues occur. Let them do their job which includes speaking with the franchisee directly and seeing if a solution can be found. There is always time to send out a notice of default, or a notice in advance of a default latter.

In general, it is good practice that all notices of default or notices in advance of default be reviewed and signed by an officer and not by legal counsel. The signature of legal counsel does not add anything to gaining a solution and instead frequently makes finding a solution more difficult and tends to instead trigger litigation.

**Avoid Ambiguous Language:** Emails, text messages, memos, manuals, and support materials need to avoid language that is not clear. Soft language that does not properly state what you intend the other party to understand, will not be any more understandable and may create barriers to winning your case should litigation arise.

Clarity in your communications is essential:

Use plain language instead of legal jargon and technical terms. Think in terms of how a jury unfamiliar with business and franchising will read and understand the franchise agreement;

Define material terms that are central to the agreement in your franchise agreement. Write with clarity so that you can later prevent disagreements over the meaning of the words. If an example will make the definition better understandable, include one;

Be specific when it comes to obligations, timelines, or other material terms. Each of these items will help limit an argument as to ambiguity in the future. If you include terms like reasonable efforts or best efforts; substantial compliance; reasonable proximity; geographic area; promote the brand; full time and best effort; or other open-ended terms that can have multiple meanings, define what you mean in the agreement.

Don’t rely on an integration clause to prevent franchisee claims of fraud and misrepresentation. Instead, include affirmative language that states that the franchisee is not relying on any representation outside of the agreement and disclosure.

Ensuring that communications are consistent with your brand's culture is incredibly important. Attempts at humor in written communications often do not translate well during litigation.

Be intentional in your language and evaluate whether you are imposing requirements on your franchisees or are you merely making a recommendation and whether the franchisee and eventually the jury will understand the difference.

Do not let tradition keep you from making changes. But first, confirm that your franchise agreement allows for the change and that the brand standards manual clearly defines the change. Understand that even beneficial change can be met with resistance. Create a communication plan on how to convey changes to the system that everyone understands and accepts.

If you intend to have the flexibility you need to manage the business and expect to not treat franchisees in an identical manner, which is a practical consideration in every franchise system, provide for that in the agreement.

If your franchisees staff are licensed professionals, governed by their own professional licenses and insurance, provide for those professional standards in your agreement.

Franchise systems do not provide for 100% of the knowledge or support a franchisee may need for managing and operating their business and franchisees generally need the support and training from outside professionals, colleges or associations. If this is a fact in your system, affirmatively make that statement in your agreement.

There is a meaningful difference between should and must and use terms that have the meaning you want to convey. If you are making a recommendation say it:

- The franchisor recommends...": or "The franchisor suggests..."
- "The following are best practices guidelines for..."
- "The franchisor encourages..."
- "The franchisee may exercise discretion in..."
- "The franchisee is free to..."
- "The franchisee has the option to..."
- "The franchisor understands that local conditions may require..."
- "The franchisor will work with the franchisee to..."

If instead something is a brand standard you intend to measure and enforce make that determination equally clear:

- "The franchisee shall..."
- "The franchisee must..."
- "The franchisee is required to..."
- "The franchisee is obligated to..."
- "The franchisee will comply with..."

- "The franchisee must adhere to..."
- "The franchisee is bound by..."
- "The franchisee is subject to..."
- "These standards are mandatory..."
- "These standards are non-negotiable..."

Don’t be afraid of providing franchisees with sample HR forms. Just be certain that the information on HR recommendations and sample forms include the proper disclaimer language and acknowledgements.

**Third-party sellers:** Before you engage any third party seller, like a broker or an FSO, conduct supported due diligence on their performance. While they can be instrumental in selling or recruiting franchisees, frequently they may also trigger issues that may not be readily apparent.

In 2026 the State of California is scheduled to require a prescribed format of broker disclosure. If you engage a third party seller and there is no state disclosure requirement, you should still require your third party sellers to disclose to all prospective franchisees, at a minimum, their relationship with you and their relationship with the prospective franchisee. Require your third party sellers to provide you with a signed receipt from each prospect they present to you. Language you may consider requiring the third party seller to provide includes:

> “We use the services of one or more franchise brokers, franchise sales organizations, and referral sources to assist us in recruiting franchisees. A franchise broker, franchise sales organization or referral source represents us, not you. We pay this person or organization a fee for when you sign a franchise agreement with us. We strongly recommend that you conduct a supported due diligence examination of our franchise opportunity on your own and to also engage the services of an independent legal advisor. If you have received verbal or other promises that are not included in our franchise agreement, please understand that we may not be obligated to you for those promises, unless they are included in our franchise agreement.”

**Litigation Prevention Payoff:** Minimizing contradictory or careless communications can prevent claims of misrepresentation, fraudulent inducement, or control over franchisee operations.

### 3.3 Provide Franchisee Support Without Overstepping Boundaries

It is important to understand that franchisors provide brand standards that franchisees are independently obligated to meet. The franchise relationship is not intended to give the franchisor day-to-day control over their franchisees owned and managed businesses. By providing support without exerting excessive control, franchisors can reduce the risk of joint employer and vicarious liability claims. Field support and ongoing assistance are core to franchise success - but your management and staff must be trained on how a franchise system is intended to operate and the support you provide must be carefully structured to avoid control issues. Several examples of things that can be done include:

**Clearly define each party's roles and responsibilities:** Whether it is the franchise agreement, brand standards manual, training programs, or other routine communications, make sure you clearly define the franchisor's and franchisee's roles and responsibilities.

**Field Staff Training:** Field consultants are not the managers or supervisors of your franchisees or their personnel. Field consultants need to be trained on how to conduct support visits to your franchisees in a way that avoids giving even the appearance of controls. Areas of specific avoidance include but are not limited to employment matters, local compliance, or other franchisee-specific decisions.

Your field staff should be passionate about helping your franchisees succeed and grow their businesses, but they also need to conduct themselves with an understanding that each franchisee is an independent contractor who has control over its day-to-day operations and that the franchisor and franchisee are not agents of the other.

Make sure your field staff understand that they should not get involved in a franchisee's HR-related matters and provide them with appropriate and ongoing training, guidelines and best practices to enable them to effectively fulfill the key roles they play. There is generally no valid reason that your field staff should ever review any of your franchisee's personnel files. Where you wish to confirm that franchisee's management and staff have any required licensing or other certifications, consider having the franchisee acknowledge that for all of their staff in writing to you on a monthly or other basis.

**Employee handbook and forms:** With the proper disclaimers, and with the required acknowledgement by each of the franchisee's management and staff of who they work for and with a specific acknowledgment that they do not work for the franchisor, you can provide franchisees with sample forms and handbooks.

**Employment decisions:** Do not get involved in essential employment decisions of your franchisees like hiring, firing, disciplining, or setting wages. However, depending on the industry and professional licensing requirements of a franchises management staff, like that found in the massage and medical industries, setting brand standards for background checks, safe professional practice standards and zero tolerance policies are a generally accepted standard in franchising.

**Outward messaging and appearance:** Make sure that the franchisee conspicuously identifies itself and its business as an independent franchisee and business owner in all dealings with clients, customers, suppliers and others. This should include appropriate statements on signage at the business and on vehicles, your website, customer order forms, invoices, business cards and other related items. Franchisees should not include the system's brand in their corporate name or on other documentation.

**Training of franchisees personnel:** Franchisors can and should provide their franchisee with training on how to train and certify their own personnel. While it is appropriate for franchisors to provide to franchisees training materials franchisees can use to train their staff, it is up to the franchisee whether they wish to make modifications to your training material and whether their employees and outside contractors are able to conduct their work to meet the franchisor's brand standards.

**Balance Documentation:** Ensure that a franchisor's brand standards manuals and training materials contain clear disclaimers emphasizing franchisee independence.

State that the franchisor does not have direct or indirect control of – or the right or authority to control – the hiring, firing, disciplining, scheduling, or supervising of the franchisee's employees; the franchisee has exclusive control over such matters;

Provide that the franchisee exclusively has the duty to comply with federal and state labor and employment laws;

State that there is no employer or joint employer relationship between the franchisor and franchisee or between the franchisor and the franchisee's employees;

Recommend that the franchisee obtains independent legal, human resources and risk/insurance advice;

Directly tie operational requirements to the maintenance of product and brand quality;

Eliminate any unnecessary reserved control;

Ensure indemnification and insurance provisions cover labor and employment law violations, and acts and omissions of franchisees and franchisees' employees;

Ensure you as the franchisor are named on the insurance as an additional named insured; and

Require franchisees to carry EPL insurance, and police this requirement.

**Establish formal and informal channels for feedback to the franchisees.** This can include regular site visits that are documented. But it can also include informal meetings and just being available to answer questions and provide support.

**Litigation Prevention Payoff:** Helps mitigate joint employment and vicarious liability claims by emphasizing the franchisor's non-involvement in daily employment decisions.

### 3.4 Understand the Franchise Agreement Is Not a Management Tool

Franchisors must recognize that the franchise agreement is not a management tool but a legal contract that defines the relationship between the parties. Clear and precise language is essential to avoid disputes over the terms of the agreement. Franchisors should work with legal counsel to ensure that the agreement accurately reflects the parties' intentions and complies with applicable laws. This can be achieved in the following ways:

**Avoid Overly Prescriptive Terms:** Avoid including overly detailed operational mandates that could create legal entanglement. The manual should generally be the place that contains those elements of the relationship subject to change.

**Clear Allocation of Responsibilities:** Clearly delineate franchisor vs. franchisee duties, ensuring franchisees retain control over employment, customer service, and vendor relations.

**Regular Legal Review:** Keep franchise agreements updated in response to changes in the regulatory landscape and evolving case law. Periodically engage litigation counsel or appropriate experts to review all system core documents and regularly update all documents and routine communications to avoid vicarious liability, joint employment and other risks.

**Language:** Franchisors are required to impose requirements and system standards to assure uniformity in the franchise system and to protect their intellectual property. To minimize risk, the franchise agreement should expressly declare that any required standards exist to protect the franchisor's interests in the system and the trademarks and not for the purpose of establishing any control or duty to take control over those matters that are reserved to the franchisee. The agreement should include clearly worded definitions.

**Brand Standards/Operations Manual:** The franchisor's brand standards manual should appropriately balance the roles and responsibilities of the franchisor and franchisee. The franchisor's role is to protect, grow, and evolve the brand and system. The franchisee is responsible for the day-to-day operation of the business. The operations manual reinforces the nature and scope of controls, as well as distinguishing the difference between required system standards and recommendations, guidelines and best practices to achieve those standards.

A sample general disclaimer on the first page of the manual, should be included. For example:

- As a franchisee, you alone are responsible not only for following the system, but also for the day-to-day operation of your individual Store. For example, only you are responsible for the control of your employees in the daily operation of the Store, as well as the safety and security of the Store, your employees, and customers. In this Operations Manual, we identify a number of recommendations or suggested practices related to various operational aspects of the Store, which we recommend that you implement at your Store. Our experience is that following the

> recommended or suggested practice will enhance the likelihood that you will be in compliance with system standards relating to the operation of your Store. We also in some instances outline required standards rather than recommendations or suggested practices. In those instances the required standards exist to protect our interests in the system and the trademarks and not for the purpose of establishing any control or duty to take control over those matters that are reserved to you. As outlined in your Franchise Agreement with us, we have established a number of system standards that Store owners must meet. For example, one such system standard is the requirement that owners adhere to all laws related to the operation of the Store. This requirement to adhere to all applicable laws is a key system standard of the system. However, we do not establish specific "steps" or "controls" that an owner must take to meet this system standard. Rather, in this section, we identify a number of recommendations and suggested practices concerning compliance with laws. Please note that compliance with applicable laws and regulations deserves special attention because they clearly are your sole responsibility. We always recommend that you contact your own lawyer to make sure you understand and comply with all laws applicable to your business. No information that we provide to you in these areas shifts any part of this responsibility from you.
>
> We do not provide you with a complete system for operating and managing your business and our system is limited to what is included in our agreement and brand standards manual. Where you need additional information and support, you should seek that from professionals and others of your choice.

**Litigation Prevention Payoff:** Prevents plaintiffs from using the agreement to assert undue franchisor control or overreach.

### 3.5 Watch for What Transactional Lawyers & Business People Overlook

Franchisors should proactively identify and address often overlooked issues that could lead to litigation. This includes staying up to date on changes in the law, such as recent developments in non-compete agreements. By ensuring that documentation educates the court on potential defenses, franchisors can strengthen their position in the event of litigation. Types of provisions that are often overlooked or just glossed over, that can lead to litigation risk, are: renewal provisions, termination clauses, damage clauses, dispute resolution mechanism, post-termination restrictive covenants, integration clauses, fees, and the franchisee's obligations such as operating standards, training requirements, and compliance with the system. Even the most sophisticated legal and business professionals can unintentionally expose the system to litigation. As a result we identify some common issues that are often overlooked by transactional lawyers.

**Third-Party Seller Oversight:** Franchisors must vet and monitor brokers and FSOs to ensure accurate, compliant representations.

**Territory Conflicts: Poorly** defined territory clauses or failure to consider cannibalization risks can lead to disputes.

**Disclosure Compliance:** Ensure all Franchise Disclosure Documents (FDDs) are thorough, up-to-date, and consistently delivered.

**Mandatory arbitration and mediation provisions:** If you are going to include these, ensure that you are willing to abide by the terms and that the process is clearly outlined.

**Choice of venue** – Know the law of the jurisdiction and whether it is favorable or not before agreeing to be bound by a given state's law.

**Litigation Prevention Payoff:** Reduces the likelihood of fraud, breach of contract, and misrepresentation claims.

### 3.6 Ensure System Documentation Can Educate the Court

When litigation is unavoidable, your internal documentation becomes your primary defense. We cannot stress enough the importance of documents if you do in fact end up in trial. Below are a few tips to best prepare yourself should you in fact face litigation.

**Organize and Standardize:** Ensure manuals, policies, franchise agreements, and training materials are consistent and well-maintained. A more critical breakdown is as follows:

Franchise Agreement:

- Clarity and Precision: The agreement should clearly outline the roles, responsibilities, and expectations of both the franchisor and franchisee.
- Legal Compliance: Ensure the agreement adheres to all applicable franchise laws and regulations.
- Independent Contractor Status: A provision stating that the franchisor and franchisee are independent contractors can help protect the franchisor from vicarious liability.

Operations Manual:

- Comprehensive Coverage: The manual should provide detailed instructions on how to run the business, including operational procedures, branding guidelines, and quality control standards, but include the disclaimers discussed above about not controlling day to day operations and the franchisee having the ultimate say in execution.

- Consistency and Updates: Regularly update the manual to reflect changes in the business, regulations, and best practices. Date your changes.
- Training Tool: The manual should serve as a primary tool for initial and ongoing training of franchisees.

Policies and Procedures:

- Standardization: Develop clear and consistent policies and procedures for all aspects of the franchise system.
- Enforcement: Implement mechanisms to ensure that franchisees adhere to the established policies and procedures.

Training:

- Comprehensive Training: Provide adequate training for franchisees, including training on the franchisor's business model, brand standards, and operational requirements.
- Ongoing Support: Offer ongoing support to franchisees to help them navigate challenges and maintain consistency.

Consistency and Enforcement:

- Uniformity: Ensure that all franchisees operate according to the standards outlined in the franchise agreement and operations manual.
- Regular Audits: Conduct regular audits to monitor compliance with franchise standards and address any discrepancies.
- Dispute Resolution: Establish clear procedures for resolving disputes that may arise between the franchisor and franchisee.

**Legal Input on Documentation:** Periodically involve litigation counsel in reviewing system documents to ensure they anticipate potential courtroom scrutiny. The laws are constantly changing and evolving and so regular review is important. And we believe review by a litigator, and not just a transactional lawyer, is critical for litigation avoidance.

**Historical Preservation:** Maintain archives of prior versions of manuals, policies, and agreements to demonstrate good-faith evolution and compliance. Obviously follow your standard document retention policy but in many cases being able to show what your training was years ago is a very helpful defense. In addition showing that you are constantly evolving your practices is a positive fact in front of the trier of fact that you are always looking to improve.

**Litigation Prevention Payoff:** Well-maintained records can swiftly counter allegations and assist judges and juries in understanding the franchisor's appropriate role. A jury seeing something in writing is much more compelling than a witness just testifying to the fact. But keep in mind, words do matter, so be intentional in the words that are used.

### 3.7 Stay Up to Date on Changes in the Law and Market Conditions

The most important advice is to stay up to date on any and all changes in the law and the market. Franchisors should regularly review the franchise terms and update franchise agreements and policies to ensure compliance with the evolving laws and remain competitive. Make sure that they comply with any new changes or updates in franchise or business law to avoid compliance issues in business. A common mistake we see is when a franchisor uses the same franchise agreement for decades without revision. Laws are constantly evolving and so too should your agreements. Also avoid franchise agreements and disclosures that are not specifically tailored to your business and are merely form agreements carried over from other brands and modified for your brand.

## 4. CONCLUSION: BUILDING A LITIGATION-RESILIENT FRANCHISE SYSTEM

Preventing litigation risk is not about avoiding accountability—it's about structuring franchise relationships thoughtfully, ethically, and with an eye toward long-term sustainability. By embedding a culture of ethical decision-making, streamlining communications, refining franchisee support, carefully drafting agreements, maintaining litigation-ready documentation, and staying up to date on changes in the law, franchisors can help safeguard their systems against unnecessary legal threats.

The strategies outlined in this paper are not theoretical—they are practical steps that can be implemented immediately, helping franchisors protect their relationships, reputations, and financial health even in the face of litigation.

## 5. BIOGRAPHIES

Chelsea Mikula is an experienced trial lawyer who represents clients nationwide in all aspects of commercial litigation. Chelsea has taken several cases to verdict at trial and in arbitration. She is often brought onto large trial teams to assist with preparation of witnesses and overall trial strategy. She is also national counsel for a franchise hospitality company defending against claims brought under the TVPRA. She has represented franchisors and franchisees in complicated breach of contract actions and other business-related torts. Chelsea's passion for truly getting to know clients allows her to better understand their businesses and help them solve problems quickly and efficiently. She is a frequent speaker on trial practice and commercial litigation trends.

Michael Seid is the founder and Managing Director of MSA Worldwide ("MSA"), a provider of domestic and international franchise advisory services. During his professional career he has been a senior operations officer, financial executive, consultant or accountant for companies within the franchise, retail, restaurant, personal services, healthcare, hospitality, education and service industries. He has also been both a franchisor and franchisee. The International Franchise Association has published that MSA Worldwide is "the leading strategic and tactical advisory firm in franchising." Michael has consulted both domestically and internationally for companies on the appropriateness of franchising, licensing, and other methods of down-stream distribution of products and services; the design, development and implementation of franchise and licensing systems; and for established franchisors, non-franchisors and other multi-unit operators. MSA Worldwide also provides other professional services including but not limited to manuals; training programs; franchisee recruitment strategies; franchisor expansion strategies; real estate site selection and site development; franchisee advisory councils; franchise relations; joint-employment; crisis management; change strategies; management company relationships; litigation support; and the strategic restructuring of established companies. Michael is a frequent speaker at programs on franchising.

Don Fox is a restaurant industry veteran with 50 years of experience, predominately in the QSR and Fast Casual segments. His first job was scrubbing pots and pans at the dish sink of a local Italian restaurant in NJ. He began his management career in 1976 with Six Flags amusement parks. In 1980, he embarked upon a 23-year career with Burger King Corporation, which included assignments in R&D and field operations. Don joined Firehouse Subs in 2003 as Director of Franchise Compliance, rose to COO in 2005, and became CEO in 2009. Under his leadership, the brand grew to over 1250 restaurants in 45 states, Puerto Rico, and Canada. In December of 2021, Firehouse Subs joined the family at Restaurant Brands International. On April 1, 2023, after 20 years with the brand, he passed the leadership torch to his successor and assumed the role of chairman until his retirement at the close of 2023. He is a published author and frequent speaker.