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Articles

Collaborative Law: A Different Approach for Solving Franchise Disputes

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For the past 17 years, I have been a trial lawyer representing franchisees in disputes with their franchisors. The vast majority of those cases have involved groups of failed franchisees in systems in distress or collapsing. Those cases have given me the opportunity to obtain internal documents from several large franchisors which detail the manner in which relations with the franchisees have deteriorated over time. In most of those cases, the benefit of hindsight has allowed us to identify points in time in which much earlier intervention could have salvaged the franchise relationship and given the franchise system the ability to stabilize. In this article, I discuss the value of trust in the franchise relationship, analyze how implicit expectations set the stage for conflict, review how disputes are often addressed, and recommend an alternative approach for solving franchise disputes.

Understanding Franchise Disputes

A franchise dispute is more than simply a commercial dispute. It is a hybrid based upon the deep emotional investment made by the franchisees. The typical franchisee is an individual excited about starting their own business. When the prospective franchisee approaches a franchisor, the relationship begins with the franchisor selling the benefits of its system to the prospect. Many times, the impression given to prospective franchisees is that they will be part of a "team." The franchisor may even refer to the franchisees as "partners." The old adage is that the franchisee "will be in business for themselves, not by themselves." These representations are very enticing to a prospect looking to open their own business. Over the course of the sales process, prospects must trust that the franchisor will stand behind them once they sign the franchise agreement and begin operation. After all, there is no test drive available.

The relationship between the franchisor and franchisee is analogous to a marriage. Each party has needs within the relationship which can only be met by the other. Like marriage, the success of the franchise relationship depends upon mutual trust. The franchisor must trust that the franchisee will operate within its system, and the franchisee must trust that the franchisor will give the franchisee support and guidance to help achieve success. The trust between the parties is crucial to the success of the relationship, even more than the terms of the written franchise agreement. Like marriage, once that trust is broken, it can be difficult, if not impossible, to recover. It is at that stage that franchisees will seek out legal representation. The crucial difference between marriage and a franchise is that a marriage does not have a set term. If the trust is broken, the marriage relationship can be dissolved. Franchisees do not have that ability.

Franchisees have general expectations of their franchisor in any system. Generally, those expectations can be categorized as explicit and implicit. The explicit expectations are based upon the terms of the franchise agreement. Franchisees expect a proven system with tools and processes which lead to profitability and sustainability of the system. Those expectations include franchisee support to improve franchisee operations and marketing programs which drive brand awareness. The implicit expectations are based on the franchise relationship itself. Franchisees expect that leadership of the franchisor will be trustworthy and visionary as to the challenges and opportunities within the system. Franchisees expect the franchisor to be concerned with the success of the franchisees and open to new ideas from the franchisees about the direction of the system. Franchisees expect their franchisor to respect them. The implicit expectations are based on the trust the franchisee places in the franchisor at the time the franchisee signs the franchise agreement.

When a franchisee approaches me about their struggles with a franchisor, most, if not all, of their initial complaints center around the implicit expectations. After listening to their concerns, I have to advise them that many of their complaints are not actionable. Rather, I have to redirect them to the explicit expectations based on the written franchise agreement. If litigation ensues, it will be based on a breach by the franchisor of the explicit terms of the franchise agreement. However, to the franchisee, the issue remains the failure of the franchisor to meet their implicit expectations. Traditional commercial litigation will never be able to address or resolve that issue.

Most franchise litigation occurs because the franchisee believes that the franchisor has abandoned the franchisee and is not providing any leadership, support, or alternatives. The franchisee remembers the beginning of the relationship when the franchisor promised to be there to help when the franchisee experienced any rough spots. When that does not happen, the trust built at the beginning of the relationship is broken. To the franchisee, the terms of the franchise agreement are not their concern. The franchisee simply believes the franchisor is wrong and is ready to take action.

It is also important to consider the franchisor's perspective. The franchisor may feel like the franchisee is being unreasonable. There are no guarantees of success in any franchise agreement. The franchisor many times believes that the franchisee is failing to take any responsibility for the difficulties which have arisen. If the franchisee lashes out against the franchisor on social media or through discussions with other franchisees within the system, it further complicates the dispute. The franchisor may feel the need to address what it perceives to be an attack on its system through communication with other franchisees in the system or through its own social media posts. In extreme cases, the franchisor may even sue the franchisee for defamation. Once again, the dispute becomes much more than a simple commercial dispute.

Like a divorce case, many extraneous variables impact the ultimate direction taken by the parties in these disputes. The parties look at the honeymoon stage of the relationship and wonder where things went wrong. One or both of the parties may set out on a litigation campaign to inflict as much pain as possible on the other for breach of the trust that once formed the basis of the relationship. The result is contentious litigation which can be very costly in money and time and can be emotionally draining.

The legal system views franchise cases as commercial disputes involving parties with equal bargaining position. The reality is that the franchisor controls the terms of the franchise agreement and also controls the process by which it grants new franchises. When issues arise, the franchisor dictates the manner in which disputes are heard. If the franchisor chooses, it can bully and threaten a franchisee into compliance because of the risk of financial ruin. A single franchisee is obviously not in a position to inflict the same pain on the franchisor. Attorneys for franchisors and franchisees know the reality of the franchise relationship and the imbalance of power in the relationship. Current dispute resolution procedures which have become standard in commercial disputes, do not consider the imbalance of power nor do those procedures consider the trust issues present in every franchise dispute.

Dispute Resolution Procedures

Most franchise agreements set out dispute resolution in detail. For example, I represented over 70 former franchisees of a large women's-only fitness franchise. Those franchise agreements had a three-step dispute resolution process. The first step was an informal process which required the franchisee to submit a written document setting out in detail the dispute. Franchisor would then respond within thirty days. In our experience, the informal process resulted in no resolution with any franchisee. The second step in the process was mediation through the American Arbitration Association (AAA). Under that process, the franchisee was required to file a formal demand for mediation and pay a filing fee. The parties then would choose a mediator from a list provided by AAA. Once the mediator was chosen, a date for mediation was set which required each franchisee to travel to the town where the franchisor maintained its principal place of business. The AAA mediation process can be complex, so it is not advisable for a franchisee to participate without legal representation. Only if mediation is not successful, can the franchisee proceed with formal litigation. Any lawsuit is required to be filed in the franchisor's backyard. As that franchise collapsed, they changed the franchise agreement to require arbitration and eliminated the possibility of filing an action in court. The arbitration process is extremely costly compared to litigation in court.

If a survey were conducted of franchisees, my hypothesis would be that the vast majority of them skimmed over the dispute resolution procedures in the franchise agreement before signing. That has certainly been my experience with my own clients over the years. Most do not have an experienced franchise attorney review the agreement prior to signing. Franchisees are excited about getting into business and have every intention of being the best franchisee in the system. The possibility of litigation with the franchisor is rarely considered. When things start to go bad, the franchisee seeks legal counsel and discovers that they have to jump through hoops to have their case heard.

In reality, the dispute resolution procedures in most franchise agreements are not designed to resolve any disputes. Rather, the procedures are intended to place such time and monetary burdens on franchisees to discourage the franchisees from going through the process. In effect, the dispute resolution procedure can be a shield to immunize the franchisor from any liability. For example, I represented dozens of franchisees of a commercial cleaning system. The franchisees were mostly from the lower socioeconomic population who paid anywhere from $2,000 to $10,000 for their franchises. During our investigation we developed evidence that the franchisor was churning cleaning accounts and that the franchisor failed to give the franchisees an adequate number of cleaning accounts as required by the franchise agreements. Each franchise agreement required individual arbitration. However, the costs of each arbitration would be at least $5,000 excluding attorneys' fees. We filed suit in federal court arguing that the arbitration clause was unconscionable due to the costs of arbitration. The federal court of appeals disagreed which basically meant that franchisor would never have to answer for its conduct.

Based on that result, one may question why the franchisor would do anything different. However, the proliferation of social media, specifically social media concentrating on franchising, has given franchisees an outlet not available 5 or 10 years ago. In our commercial cleaning franchise

case, the ability of the franchisees to get their story heard resulted in the collapse of what had been a multi-state system with hundreds of franchisees. While adverse publicity may not cause a system to fail, it can cause the franchisor difficulty in selling new franchises because potential franchisees will see negative information online as they conduct their due diligence. It can also cause internal friction with the existing franchisees if they are experiencing similar difficulties. The point is that even if the dispute resolution procedures are used to keep franchisees from proceeding with litigation or arbitration, the dispute can still result in significant costs to the franchisor.

A Different Approach: Collaborative Law

At the time I was licensed in 1992, mediation was becoming more widely accepted, but only after all discovery had been completed and the case was ready for trial. The myth was that the parties could only make informed decisions after full development of the facts. Thankfully, the past 30 years has seen an evolution in alternative dispute resolution with more of an emphasis on earlier intervention. Over the past several years, a process known as collaborative law has developed within the domestic relations arena. One aspect of collaborative law is involving trained mediators early in a divorce or child custody dispute. The parties may be sent to mediation by a court or through a mediation agency contracted by the state child support enforcement agency. Many times, the parties are not represented by counsel. The goal is to address the contentious issues early in the process which can ultimately lead to a settlement. The key to the success in collaborative law is that the mediators are trained to recognize that there is often an imbalance of power and significant trust issues which must be recognized and acknowledged. In the end, the goal is to help both parties feel empowered and in a position to have meaningful discussions toward the resolution of the dispute. Breaking through the cognitive barriers to resolution early in the process is crucial.

What if we viewed franchise disputes not under the lens of commercial litigation, but more like a domestic relations case? What if we put the concentration of resolution of these disputes more on the restoration of trust between the parties rather than on the battling over the written terms of the franchise agreement? What would be required and what would the process look like?

I think a process which would allow the parties to have discussions before attorneys are engaged can be helpful. Attorneys are trained in an adversarial process and, unfortunately, that mindset is not always compatible with making the best business decisions. In the fitness franchise system discussed above, the franchise agreement provided for informal dispute resolution. However, that dispute resolution involved direct communication between the parties who are not adequately trained in dispute resolution. It is like a divorce case in which the spouses try to talk directly to each other to resolve their differences. For the most part, it is not effective because one or both of the spouses is unable to separate trust or emotional issues from the practical considerations of property division or child custody issues. That cognitive interference leads the parties down a path of trying to prove their positions. That same dynamic is prevalent in informal dispute resolution in the franchise context. Not only does that dynamic make it hard to resolve disputes, many times, it leaves the parties more entrenched in their positions. There is no resolution of the dispute, and formal litigation becomes more likely.

In the case of a franchise dispute, the parties should be looking at the informal resolution process as a powerful tool to address disputes rather than just a prerequisite to litigation. If the franchisor and franchisee would take the opportunity to listen and understand what the other is saying, they may see that the dispute is more about a lack of trust. Mediations in the collaborative law context concentrate on "active" listening. Active listening is where one party makes a conscious effort to hear not only the words that the other party is saying but, more importantly, the complete message being communicated. The goal is to remove distractions caused by forming counterarguments while the other party is still speaking. It is a simple concept but not easy to implement.

In addition to my legal training, I am also trained as a mediator. Lately, I have been trying to incorporate these concepts in my mediation practice in all different types of cases, including cases involving unrepresented parties and cases in which the parties have attorneys. The results have been encouraging. At the beginning of the process, I have the parties commit to actively listening to the other party without interruption. That commitment immediately balances the power of the parties. Once the parties have given their initial statements, I then have them tell me what they heard from the other party. In every case, the parties have recognized that there are issues they had not considered before actually listening to the other. In most cases, the parties have more of an appreciation of the emotional conflicts of the other. Getting those issues on the table at the beginning makes the rest of the process more productive.

In franchise disputes, the parties rarely get to that point even if the case goes all the way through formal litigation. As a result, the parties miss a golden opportunity. Franchisors should look at early dispute resolution as a means to improve its system, including franchisee relations. Franchisees should look at early dispute resolution as a way to understand the struggles of the franchisor and the difficulties involved in operation of a franchise system. Even if there is no settlement at this early stage, it can lead to fewer personal attacks in litigation which harm both parties. In the end, each party should be able to feel that the process was fair and that their views were considered.

Conclusion

There will always be disputes between franchisors and franchisees. Many of those disputes will end up in litigation. However, if the franchise industry would take a slightly different approach, some of those disputes could be resolved early and the trust between the parties could be restored. Franchise disputes have become highly contentious with the goal to destroy the opposition. The "win at all cost" mentality in franchise cases is damaging to fran-

chising as a whole. All stakeholders in franchising should take a step back and realize the huge costs to the industry and look at alternative approaches. Any successful alternative must recognize and confront the implicit expectations of the parties that have largely been ignored in franchise disputes. A realization that those expectations are present and must be addressed is not only beneficial to the dispute at issue, but it can also benefit the system by giving the franchisor and its franchisees a deeper appreciation of underlying trust issues which may be straining their relationship. A collaborative approach to resolving challenges facing a system does not require a large capital investment but can have enormous return in stabilizing the system and improving the franchisor/franchisee relationship.

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