

Summer 2013, Vol. 3 No. 3

Just the Facts on Franchise Litigation

An Interview with Carmen D. Caruso

How did you choose to practice in franchise law? Is there anything that or anyone who drew you into this area?

As a young lawyer who started in a great litigation boutique, I represented McDonald's Corp. in a series of cases in Illinois, California, New York, and New Jersey. Through that particular client, I was fortunate to meet some of the most knowledgeable people in franchising and to see up close the things that can make a system great. Later on, when I went out on my own, the experience was invaluable in attracting clients; it remains invaluable today.

What is your favorite part of practicing in franchise law?

I concentrate in franchise litigation. From an academic standpoint, franchising is a lawyer's dream. The cases involve an interplay of contract and statutory interpretation, antitrust and intellectual-property issues lurking in the background, and the possibility of very serious fraud claims arising under common law, state franchising laws, state "Little FTC Acts," and even Racketeer Influenced and Corrupt Organizations Act claims under federal law. But more importantly, franchising attracts dynamic entrepreneurial individuals. They are fun clients that often become good friends. The cases often turn on questions of intent or credibility, all the things that make cross-examination fun.

You also have the opportunity to help clients design and build their franchise systems, to negotiate deals, and to counsel franchise clients on the full range of issues that would affect any business. It is a great area to do a mix of litigation and transactional work if that is your preference.

Last but not least, franchise lawyers probably see more of the world than most. If you're dealing with a national brand or an international one, the next case might arise anywhere.

Name and describe one case that anyone who practices in franchise law should know.

Dayan v. McDonald's Corp., 125 Ill. App.3d 972 (Ill. App. Ct. 1984). My old partners tried this case while I was in law school. The McDonald's franchisee in Paris, France, challenged the decision made by McDonald's to terminate his franchise for failing to meet quality, service, and cleanliness (QSC) requirements. The appellate decision, which came after a 65-day trial, remains frequently cited today whenever a franchisor seeks to terminate a franchisee or whenever a franchisee tries to establish that its franchisor is acting in bad faith.

Aside from making law, the trial was high drama. The turning point came on the cross-examination of a witness who had presented some photographs of the franchisee's restaurants as alleged proof that the restaurants met all of the QSC standards. What the franchisee and his

lawyers forgot was that in the Northern Hemisphere, trees grow their leaves in the spring and shed leaves in the fall. When the cross-examiner directed the witness's attention to the trees in front of the restaurants as depicted in his photographs, it was apparent to everyone in the courtroom that the photographs being offered as proof of QSC compliance were not taken in the time of year that had been claimed. The franchisee's evidence had been faked.

Describe a case on which you have worked that involved a lot of the key issues in franchise law.

Interim Health Care of Northern Illinois Inc. v. Interim Health Care Inc., 225 F.3d 876 (7th Cir. 2000), stands out, as we had to go to the U.S. Court of Appeals for the Seventh Circuit to get a summary judgment reversed. The franchisor terminated its franchisee for non-payment of royalties, but this happened only after the franchisor had pursued a strategy of deliberately siphoning the franchisee's customers (home-health-care patients) to a competing company-owned office. Building on the doctrine of good faith and fair dealing, which had been applied in the franchising area in *Dayan v. McDonald's*, the court of appeals recognized that even if a franchisor has "good cause" for termination under the state franchising act (and not paying royalties is surely good cause), the franchisee still can bring a damages claim based on the franchisor's lack of "good faith" in the period in which it was establishing good cause for termination. Thus, the franchisee can seek damages for wrongful termination even when good cause was present.

What is a common mistake people make when practicing franchise law?

Unfortunately, we have seen numerous cases in which a general business lawyer or even a sophisticated intellectual-property law firm is sued for malpractice when the lawyers attempt to represent their client in selling franchises without becoming familiar with Federal Trade Commission regulations on franchise sales and specific statutory regulations on franchise sales in numerous states.

A related error is not recognizing that a business arrangement is actually a franchise even though the parties tried to label it as something else, such as a license agreement, a joint venture, a dealership, or an agency. General business lawyers most commonly make this mistake when they set up the arrangement, but sometimes lawyers for a dealer or licensee facing termination also might fail to grasp that their clients will have much stronger rights if they can succeed in establishing the existence of a franchise.

The consequences for not knowing about the franchise laws but trying to franchise anyway can be catastrophic.

What advice would you give to junior attorneys in franchise law? Are there any key skills that new lawyers should develop to excel in franchise law?

Become involved in the ABA Forum on Franchising for the substantive law in addition to staying active in the Section of Litigation. The forum offers an excellent "Fundamentals" course that really should be mandatory for anyone entering the field.

Also, there is tremendous benefit for young franchise advocates to interact with transactional colleagues and franchise business people as it obviously helps in litigation to understand the business issues that are driving the clients' actions. The forum as well as industry trade groups are great places to learn and network.

What trends have you seen in franchise law over the last several years?

Because of cases like *Interim Health Care* and similar cases in which the courts have recognized that franchisees may have implied legal rights under their franchise agreements that cannot be cavalierly disregarded, franchisors have redoubled their efforts to include strict contract language that is designed to negate the franchisee's legal rights in every way that franchisors can imagine. This is a very disturbing trend that often amounts to an attempt by the unscrupulous to grant themselves a license to commit fraud. Sometimes the fraud is present at some of the world's largest brands, as we recently established at trial against a major oil company that franchised its gas stations.

What do you do to stay abreast of emerging issues in franchise law? Are there any specific practice publications or web resources that are particularly helpful?

The ABA Forum on Franchising covers the waterfront in franchise law. The publications are great. But it's even better is to attend the live forum, and still better is to get involved in writing and speaking.

What changes do you expect to see in franchise law over the next five years?

I expect to see backlash in the courts against franchise agreements that are so one-sided that they would tip over if not propped up with the dubious premise that these adhesion contracts were freely negotiated by businesspersons of equal standing. Also, I think we can expect greater recognition of independent franchisee associations having standing to sue to challenge unfair franchisor practices that damage the entire system and all of its stakeholders. Lastly, there will be even more internationalization of franchising and a consequent increase in international arbitration or cross-border litigation.

If you weren't practicing in franchise law, in which area of law would you like to practice and why?

I see parallels between a franchisee or a dealer facing termination and essentially the loss of everything for which she or he has worked and a criminal defendant facing prosecution. Both sets of litigants face uphill odds and need very good trial lawyers. I did criminal defense as a young lawyer to get trial experience and remain very interested in making sure that every accused person receives the full protection of the Bill of Rights in every case.

There is another parallel between franchise litigation and civil-rights litigation, and these two areas intersect at 42 U.S.C. § 1981, when franchisees or dealers complain that they were mistreated on account of race. I have been privileged to represent minority franchisees in these fights, and there clearly remains a need for greater enforcement of section 1981 to make the benefits of the free market available to all.

Keywords: franchise litigation, young lawyer, *Dayan v. McDonald's Corp.*, ABA Forum on Franchising

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