Can a Choice of Forum Clause Force a Franchisee to Litigate In the Franchisor's Home State?

BY MITCHELL J. KASSOFF

A franchisee who has a grievance against his franchisor is not likely to want to pursue litigation in a distant forum, and thus may turn to a state court in his home state. The franchisor typically removes the case to federal court,[1] and then, invoking the forum selection clause in the typical franchise agreement, seeks to transfer the case to the federal court in the franchisor's home state.

Although it is well settled that parties to a contract may voluntarily agree to a choice of forum in the event they engage in litigation, when the parties are from different states the question becomes whether the forum selection clause was voluntarily negotiated.

In franchise disputes, typically involving a franchisee from one state and a franchisor from another, the key issue becomes whether the forum selection clause can be enforced. The franchisee may also raise other issues in an attempt to defeat a transfer motion. This article assesses the issues and arguments that the franchisee may raise to defeat a motion to transfer the case to federal court in the franchisor's home state.

Franchise Agreement Terms

Before a franchisor grants a franchise, the franchisee is required to execute a franchise agreement provided by the franchisor. The agreement is usually presented on a take-it-or-leave-it basis and is not subject to negotiation. When litigation ensues, the franchisee is thus likely to allege that the forum selection clause was, effectively, an improper contract of adhesion.

The argument for that position typically cites the franchisor's superior financial resources and superior bargaining ability. This franchisee's affidavit is not likely to be disputed by the franchisor, opening the way for the franchisee to argue that the adhesive nature of the document provides a foundation for invalidating the franchisor's attempt to enforce the forum selection clause.

McNally Wellman Co. v. New York State Electric & Gas Corp.[2] holds that the court must first inquire "into any inequities of bargaining power when the parties drafted the contract, a factor NYSEG cannot argue existed here. Further, an assessment of unconscionability 'generally requires a showing that the contract was both procedurally and substantively unconscionable when made – *i.e.*, some showing of an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.'"[3]

The franchisee may claim that, in addition to the breach of the franchise agreement, the franchisee has other causes of action such as fraud, lost opportunities and violation of the antitrust laws. Even if the court were to decide that the forum selection clause should be enforced, the franchisee's typical argument contends, the issue would be moot because these causes of action that go beyond breach of a franchise agreement are not subject to the selection clause. This reasoning then supports an argument that the case should continue in the franchisee's home state because these other counts of the complaint are inextricably woven with the allegation that the franchisor has committed a breach of contract.

In *Jones v. GNC Franchising, Inc.*,[4] the U.S. Court of Appeals held that a franchisor's forum selection clause was not enforceable. The relative financial burdens of litigating and the location of relevant witnesses favored California, where the franchisee was located. This would be the same in a situation in which the only con-

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nection between the franchisor's home state and the lawsuit is the location of the franchisor.

Weight to Franchisee's Choice

In *Goff v. AAMCO Automatic Transmissions, Inc.*,[5] a U.S. District Court, quoting the Comment to the Proposed Official Draft of the Restatement Second, Conflict of Laws, stated that:

> "A choice of law provision, like other contractual provisions, will not be given effect if the consent of one of the parties to its inclusion in the contract was secured by misrepresentation, duress, undue influence, or mistake. A factor which the forum may consider is whether the choice of law provision is contained in an 'adhesion' contract, namely one that is drafted unilaterally by the dominant party and then presented on a 'take-it-or-leave-it' basis to the weaker party who has no real opportunity to bargain about its terms."

The pleadings of the complaint and the affidavits of the franchisee need to show this to be the situation in the franchisee's case. At the very least, the franchisee's strategy would be to argue that litigation must continue in the chosen venue to allow the franchisee to prove these allegations.

In *Choice Hotels International, Inc. v. Madison Three, Inc.*,[6] a U.S. District Court denied the motion for a transfer of venue to a federal court in another state. The court held:

> To a large extent, then, there has been no substantial showing by [franchisors] that a transfer under the circumstances of this case would do anything other than shift the greater burden and inconvenience of trial from [franchisors] to [franchisee], which is not a proper purpose of a transfer of venue. I note that a [franchisee's] choice of forum is entitled to a degree of deference, although "the weight given to this factor should be commensurate with the degree it impacts the policy behind section 1404(a), that is to make trial 'easy, expeditious and inexpensive.'"

In *Quality Inns International, Inc. v. Patel*,[7] a U.S. District Court held:

> The motion to transfer imposes upon the moving party the burden of establishing that the case should be transferred and it is important that the franchisee's choice of forum be accorded grave weight. The court must assess three factors in determining whether the motion to transfer will be granted; (1) the convenience of the parties; (2) the convenience of witnesses; and (3) the interest of justice.
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> Put simply, "[W]here a transfer would merely shift the inconvenience from one party to the other or where after balancing all the factors, the equities lean but slightly in favor of the movant, the franchisee's choice of forum should not be disturbed."

Thus, when the parties, activities and witnesses can be shown to be concentrated in the franchisee's state, the franchisee is then in a position to argue that the current court is the proper forum.

In *Call Carl, Inc. v. BP Oil Corp.*,[8] a U.S. District Court held:

> Therefore, even if a corporation is not found or doing business in a jurisdiction, it is subject to venue in an antitrust suit if it is transacting business there.
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> This provision has received considerable attention in the courts, which have generally construed it as providing [franchisee] with a wide choice of forum, regardless of harm to the [franchisor] corporations sued under the Act. The leading case on the section 12 venue provisions, *United States v. Scophony Corp.*, 333 U.S. 795, 92 L. Ed. 1091, 68 S. Ct. 855 (1948), characterizes judicial construction of the Act as follows: "[The Supreme Court in *Eastman*] relieved persons injured through corporate violations of the antitrust laws from the 'often insuperable obstacle' of resorting to distant forums for redress of wrongs done in the places of their business or residence. A foreign corporation no longer could come to a district, perpetrate there the injuries outlawed, and then by retreating or even without retreating to its headquarters defeat or delay the retribution due."

Franchisor's Action

The franchisee also needs to argue that the falsity of the information in the franchisor's Uniform Franchise Offering Circular (UFOC) and the franchisor's knowledge thereof are issues to be addressed during discovery. When a major part of the franchisee's case is based on fraudulent conduct, the argument becomes that the case is not subject to a forum selection clause for two reasons: acceptance of the clause was the result of the very fraud at issue, and the franchisor perpetrated the fraud in the franchisee's state *prior* to the existence of the contract. When this argument can be made convincingly, the franchisee is then well positioned to insist that a transfer of the case to a federal court in another state is appropriate.

The court also needs to be informed that the case involves the sale of a franchise by a franchisor. The Federal Trade Commission rule on franchising[9] ("FTC Rule"), states that:

> In connection with the advertising, offering, licensing, contracting, sale, or other promotion in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, of any franchise, or any relationship which is represented either orally or in writing to be a franchise, it is an unfair or deceptive act or practice within the meaning of section 5 of that Act for any franchisor or franchise broker:
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> * * *
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> (b) To make any oral, written, or visual representation to a prospective franchisee which states a specific level of potential sales, income, gross or net profit for that

> prospective franchisee, or which states other facts which suggest such a specific level, unless:
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> (1) At the time such representation is made, such representation is relevant to the geographic market in which the franchise is to be located;
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> (2) At the time such representation is made, a reasonable basis exists for such representation and the franchisor has in its possession material which constitutes a reasonable basis for such representation, and such material is made available to any prospective franchisee and to the Commission or its staff upon reasonable demand.

Therefore, the franchisee's argument becomes that the franchisor must show that it complied with the requirements of the FTC Rule. This is an issue that requires discovery and that is not subject to the terms of the franchise agreement.

The franchisor's response may be that there is no private cause of action pursuant to the FTC Rule, which is quite correct. The franchisee needs to be able to respond that this allegation is not being made so that the franchisee can sue for the violation of the FTC Rule. The reason that the franchisee is providing this information to the court is to show that by failing to follow the requirements of the FTC Rule, the franchisor committed fraud in providing the information in the UFOC, which does not allow the franchisor the use of the forum selection clause.

The argument becomes that . . . the franchisor perpetrated the fraud in the franchisee's state prior to the existence of the contract.

The franchisee must argue further that if the franchisor makes the claim that the statement or omission must have been misleading at the time it was made, then the franchisor's motion must be denied because discovery is required to determine whether the statement was false when it was made.

Antitrust Issues

The franchisee may also try to argue that the terms of the franchise agreement violate state and federal antitrust laws. The franchisee's position is likely to cite the importance of the antitrust laws and remind the court that the U.S. Supreme Court, in *United States v. Topco Associates, Inc.*,[10] stated:

> Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete – to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster.

The franchisee's position becomes that the market and products are clear and unambiguous – the market is simply the franchisee's territory and the products and services are those the franchisor provides. Based on the holdings in the cases cited, the franchisee can then take the position that he must have his day in court to prove the charges in the complaint. The franchisee also argues that the litigation must continue in this court so that discovery can commence in order for more specific information to be obtained.

The franchisee's complaint also needs to deal with monetary damages resulting from the franchisor's violation of the antitrust laws. The argument becomes that the franchisor's statements in response to these allegations raise questions of fact to be resolved at trial.

Private antitrust actions, such as this, are the only means by which injured individuals or businesses can recover their damages under the antitrust laws. For this reason, the U.S. Supreme Court and Congress have long recognized the importance of such actions.[11]

In regard to the pleading of an antitrust claim, as held in *Nagler v. Admiral Corp.*,[12] an antitrust complaint need not spell out detailed facts, and need only satisfy the liberal notice pleading requirements of Federal Rule of Civil Procedure 8(a).[13] The courts have gone so far as to say that an antitrust complaint need only furnish "the slightest clue as to what conduct by the [franchisors] is claimed to constitute 'an illegal contract combination and conspiracy,'"[14] and have taken the position that dismissal of an antitrust claim is appropriate only if it is "wholly frivolous."[15]

In *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*,[16] the U.S. Supreme Court held that:

> The trial court dismissed its suit not because Walker failed to allege the relevant market, the dominance of the patented device therein, and the injurious consequences to Walker of the patent's enforcement, but rather on the ground that the United States alone may "annul or set aside" a patent for fraud in procurement. The trial court has not analyzed any economic data. Indeed, no such proof has yet been offered because of the disposition below. In view of these considerations, as well as the novelty of the claim asserted and the paucity of guidelines available in the decided cases, this deficiency cannot be deemed crucial. Fairness requires that on remand Walker have the opportunity to make its [Sherman Act] § 2 claims more specific, to prove the alleged fraud, and to establish the necessary elements of the asserted § 2 violation.

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Thus, the franchisee can be in a position to argue that these antitrust violations must be tried in this court at this time.

Conclusion

The franchisee in a suit against a franchisor is likely to argue that even if the court were to accept the franchisor's argument that an alleged breach of contract should be subject to the choice of forum provision in a contract, the forum selection provision should not apply to the other counts in the complaint. In the interests of judicial economy, therefore, the matter is then portrayed as one that should proceed in one forum, the franchisee's home state. The franchisee is further likely to argue that the franchisor's motion to dismiss or stay the franchisee's lawsuit should be denied so that discovery can proceed and allow the parties to obtain information uniquely available in the franchisee's home state.

The final result regarding any dispute on the venue of the litigation is likely to be quite fact specific.

1. 28 U.S.C. §§ 1441, 1446.
2. 63 F.3d 1188, 1198 (2d Cir. 1995).
3. *Id.* at 1198 (citation omitted) (quoting *Gillman v. Chase Manhattan*, 73 N.Y.2d 1, 537 N.Y.S.2d 787 (1988); *see Am. Dredging Co. v. Plaza Petroleum*, 799 F. Supp. 1335, 1339 (E.D.N.Y. 1992), *vacated in part*, 845 F. Supp. 91 (E.D.N.Y. 1993).
4. 211 F.3d 495 (9th Cir. 2000).
5. 313 F. Supp. 667, 670 (D. Md. 1970).
6. 23 F. Supp. 2d 617, 622 (D. Md. 1998) (citations omitted) (quoting *Laughlin v. Edwards Bus. Machs.*, 155 F.R.D. 543, 545 (W.D. Va. 1994).
7. 1988 U.S. Dist. LEXIS 14342, *2, *4 ((D. Md. Dec. 8, 1988) (citations omitted) (quoting *Derry Fin. N.V. v. Christiana Cos., Inc.*, 555 F. Supp. 1043, 1046 (D. Del. 1983).
8. 391 F. Supp. 367, 370–71 (D. Md. 1975) (citations omitted), *aff'd in part, rev'd in part on other grounds*, 554 F.2d 623 (4th Cir. 1977).
9. 16 C.F.R. § 436.1.
10. 405 U.S. 596, 610 (1972) (citations omitted).
11. *Hanover Shoe v. United Shoe Mach. Corp.*, 392 U.S. 481, 494 (1968); *Perma Life Mufflers v. Int'l Parts Corp.*, 392 U.S. 134, 139 (1968); *Zenith Radio Corp. v. Hazeltine Research*, 395 U.S. 100, 131 (1969); *Minnesota Mining & Mfg. Co. v. N.J. Wood Finishing Co.*, 381 U.S. 311, 318 (1965); *Kelco Disposal, Inc. v. Browning-Ferris Indus. of Vermont, Inc.*, 845 F.2d 404, 411 (2d Cir. 1988), *aff'd*, 492 U.S. 257 (1989); *Monarch Life Ins. Co. v. Loval Protective Life Ins. Co.*, 326 F.2d 841, 845 (2d Cir. 1963), *cert. denied*, 376 U.S. 952 (1964).
12. 248 F.2d 319 (2d Cir. 1957).
13. *Accord Barr v. Dramatists Guild, Inc.*, 573 F. Supp. 555, 559 (S.D.N.Y. 1983) ("[a] franchisee is not required to provide detailed allegations"); *Broadcast Music, Inc. v. Hearst/ABC Viacom Entm't Servs. Inc.*, 746 F. Supp. 320, 326 (S.D.N.Y. 1990) ("[a]ntitrust allegations, however, are governed by the 'short and plain statement' requirement of Rule 8(a)"); *Newburger, Loeb & Co. v. Gross*, 365 F. Supp. 1364, 1367–68 (S.D.N.Y. 1973) ("skeletal" allegations survive a motion to dismiss).
14. *Klebanow v. N.Y. Produce Exch.*, 344 F.2d 294, 299 (2d Cir. 1965).
15. *Radovich v. NFL*, 352 U.S. 445, 453 (1957); *see United States v. Employing Plasterers Ass'n*, 347 U.S. 186, 189 (1954); *Three Crown Ltd. P'ship v. Caxton Corp.*, 817 F. Supp 1033, 1047 (S.D.N.Y. 1993).
16. 382 U.S. 172, 178 (1965).