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Fox Rothschild Podcast

Featuring Partner John Gotaskie

We are talking today with John Gotaskie on the Fox Rothschild Podcast about franchise agreements and how quickly they can become out of date. John is a partner and litigator with Fox Rothschild in Pittsburgh. He represents clients in diverse legal matters, including franchising and complex commercial litigation as well as creditor's rights and social media matters. John, good morning.

John Gotaskie: Good morning. Thank you. Good to be here.

***Question:** John, you and Elle Gerhards of the firm's Warrington, Pennsylvania office recently co-authored a post for the firm's Franchise Law Blog about the importance of reviewing franchise agreements from time to time to make sure they're not dangerously out of date.*

John Gotaskie: Thanks for noticing, Mark. It's always important to dust off the old agreement on a regular basis and revise it as necessary to account for a variety of potential updates to the law and the facts of your franchise system, hopefully in the process, if not eliminating, at least reducing potential unexpected risks.

***Question:** Can you provide our listeners with some examples?*

John Gotaskie: Sure. You want to account for new legal decisions, statutory or rule changes or other updates in the federal or state franchise guidance. Or, there might have been changes in how your franchise system operates or practices that you want to document. Finally you should evaluate changes within your segment of the franchise industry or the general business climate, and consider whether your documents need to address those things as well.

If your legal department or outside counsel has not taken a good look at your franchise agreement in a while, then perhaps this is the time for them to do so. I'm always surprised to see some surprising and arguably outdated provisions when I'm reviewing an older franchise agreement.

***Question:** Such as...?*

John Gotaskie: Such as language starting with "if the franchisee is an individual..." Despite the proliferation of lawsuits where disgruntled franchisees attempt to have themselves misclassified as employees, there are still franchise systems who do not require franchises be owned through entities. Forming an LLC or corporation today is a pretty simple, inexpensive and relatively



straightforward process. In most cases, the upside to requiring franchisees to operate through entities outweighs the costs of the procedure and/or benefits of not doing so.

Question: What about liquidated damages?

John Gotaskie: That's a good point that you and I have discussed before. I often see language about "Unenforceable Liquidated Damages and/or Restrictive Covenants Provisions." Unenforceable liquidated damages provisions usually fail to connect the amount of liquidated damages to any real prospect of losses on the part of the franchisor. In many jurisdictions, such a provision is simply unlikely to be upheld if challenged in court. The same is true for onerous noncompetition or nonsolicitation provisions. It just makes no sense to me to maintain provisions in an agreement that have little or no likelihood of being enforced. Instead, it would be better to revise your agreement using enforceable provisions.

Question: Are you seeing anything regarding operations procedures?

John Gotaskie: Most definitely. I have noticed franchise agreements that contain overly rigid and specific compliance guidelines. And I understand why this happens. You're addressing a specific situation. For example, I've seen overly detailed requirements regarding insurance or verbose descriptions of certain internal quality control processes. The franchise agreement should always provide franchisors, and really their franchisees, the flexibility to alter processes or certain requirements through amendments to the operations manual. And we all know that the franchisees have to follow the operations manual, so that's a more flexible way of dealing with the situation.

At the same time, and conversely, it isn't enough anymore for an insurance clause to simply say something like "the franchisor must be an additional insured on the policy of the franchisee," and maybe a couple of policy limit requirements. You need to make sure that the needed coverages are required, purchased and then make sure there is follow through to ensure that the franchisee has done what you've asked.

Question: Are there more?

John Gotaskie: Oh sure. I see very complex ways of calculating asset purchase prices, for example one I saw recently was when a franchise agreement granted the franchisor the right to purchase the franchisee's assets when the agreement was terminated or it expired. Do you really want to fight over the value at that point? Do you want to hire an appraiser? Do you want to disagree with the franchisee on the appraisal, which you will, and then drag out the process longer by allowing the franchisee then to hire its own appraiser and using the average value? I see all these kinds of concepts and even more complicated things in franchise agreements and I wonder why? Maybe consider a simple 30 day right to purchase the franchise assets in cash for book value (cost less depreciation) and that might be something that makes sense in most cases.



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Question: Is vicarious liability one too?

John Gotaskie: Indeed. Just like the insurance, there are big issues with vicarious liability, including the fact that more and more, there are situations where clauses have oversight of employee decisions that properly belong to the franchisee, and I'm talking about things including but not limited to hiring, firing and/or scheduling of the franchisee's employees. Get those provisions out of your agreement before a lawyer (or worse, a regulator or a court) seizes upon them to argue that the franchisor is the true employer of the franchisees' employees.

Question: What about operations manuals?

John Gotaskie: We talked a little bit earlier about how operations manuals should be flexible. Overbroad language in operations manuals is yet another area to review because for example, often an agreement has a clause that says the franchisee must comply with "each and every" provision of the operations manual or similar document of your system. Now of course you probably want some clause like this, we understand. Certain things have to be enforced. But have you reviewed your operations manual then to ensure that you've scrubbed and eliminated things which might subject the franchisor to liability? If you haven't, now is the time to do that as well. Alternatively, the clause can be rewritten to ensure only the absolutely essential portions of the ops manual are included in each and every requirement.

Narrator: Well thank you, John. Listeners, to confidentially discuss whether your franchisor documents should be reviewed for potential updates, please contact John at 412.394.5528 or at jgotaskie – that's J-G-O-T-A-S-K-I-E – at foxrothschild.com.

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