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Message from the Chair

By Will K. Woods, Baker & McKenzie, LLP

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As I write this column, spring has begun and very hopeful signs of the end of the pandemic are emerging each day. With the ongoing vaccination efforts across the country, we can all look forward to a return to brighter times and more normalized routines sooner rather than later.

The Forum planning committee is deep into preparation for our return to an in-person annual Forum meeting in Atlanta on October 13–15, 2021. We have a terrific lineup of intensive programs, plenaries, and workshops that our speakers are already hard at work on. And, of course, our signature social and networking events will be even more special this year after a long, two-year hiatus. More information about this year's Forum meeting is coming soon, but mark your calendars now and plan to join all of your friends and colleagues as we reconnect in October!

Throughout my (now many!) years in Forum leadership, I have come to learn that a foundational element of the Forum on Franchising's success is that we consistently seek out, in both formal and informal ways, input from our membership (including former Forum leaders) on what the Forum is doing right and areas in which the organization can be improved, and, as appropriate, we act on that input. One of the ways in which we gather feedback from Forum membership is our Membership Survey, which we conduct every five years (this is different from the annual Forum Meeting Survey, which is conducted after the Forum meeting each year). The Membership Survey provides current and future Forum leadership with valuable information and insight directly from our members that help shape strategic planning decisions, including resource allocation, going forward.

Our last Membership Survey was conducted in 2016, so the time has come for a new Membership Survey. You will soon receive an email with a link to the 2021 Membership Survey. With the assistance of a marketing consultant, the format and many of the questions in the survey were streamlined and modernized in 2016, so it is a very easy questionnaire to complete. *Once you receive the link, please complete the survey right away.* It is important that we hear from as many of you as possible.

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When "Shall" Is Not Mandatory—Scrutinizing Forum Selection Clauses

By Frank Sciremammano and Alicia Goedde, Lathrop GPM LLP

Forum selection clauses are ubiquitous in franchise agreements. They are contractual provisions in which parties agree to litigate their disputes in specified state or federal courts. There are generally two types of forum selection clauses—mandatory and permissive—and though the distinction between the two often turns merely on a word or two, which category a particular clause falls into is critical in determining the outcome of a forum dispute. *See* John M. Doroghazi and David J. Norman, *What's Left to Litigate about Forum Selection Clauses?* Atlantic Marine *Turns Four*, 36 F.L.J. 591-593 (Spring 2017).

Mandatory forum selection clauses require all litigation to be conducted in a specified forum. A forum selection clause is mandatory if it clearly indicates, through generally obligatory language demonstrating the parties' exclusive commitment, that jurisdiction is proper only in the named forum. Permissive forum selection clauses, on the other hand, allow but do not require litigation in a specified forum. Permissive forum selection clauses are often described as "consent to jurisdiction" clauses, and they do not prohibit litigation elsewhere.

Take the following examples: (i) a franchisee sues a franchisor in a jurisdiction that is not specified in the franchise agreement's forum selection clause, and the franchisor seeks to transfer the case to the specified jurisdiction; and (ii) a franchisor sues a franchisee in the jurisdiction specified in the franchise agreement's forum selection clause, but the franchisee seeks to transfer the case to a more convenient jurisdiction. In these instances, whether the forum selection clause is mandatory or permissive will dictate the level of deference a court gives to it—with significantly more deference given to mandatory provisions. The more deference given, the more predictability over forum selection clause enforcement for franchisors with franchisees located nationwide. Likewise, the more deference, the more predictability for a franchisee performing due diligence on a franchise system, giving the prospective franchisee a reasonable expectation of where any litigation will take place. Perhaps most importantly, a properly crafted mandatory forum selection clause will reduce the risk of having to engage in an expensive upfront battle regarding proper venue prior to a court addressing the merits of the lawsuit.

The Supreme Court has held that *mandatory* forum selection clauses will be enforced unless "extraordinary circumstances unrelated to the convenience of the parties clearly disfavor[s]" enforcement. *Atl. Marine Const. Co. v. U.S. Dist. Court for W. Dist. of Texas*, 571 U.S. 49 (2013). Thus, the nonenforcement of valid mandatory forum selection clauses has become rare. Courts, on the other hand, are unlikely to give such deferential treatment to *permissive* forum selection clauses. Instead, in a dispute over a forum, courts typically view the existence of a permissive forum selection clause as merely one of many factors, giving more weight to the traditional forum nonconveniens analysis, which includes factors such as the plaintiff's choice of forum, the convenience of the parties, and the needs of the case. As such, litigation over forum selection clauses typically turns on a determination of whether the clause is, in fact, mandatory, which, in turn, may require an analytical dive into the parties' word choice.

Often, forum-selection clauses are relatively clear. For example, in *ARCpoint Fin. Grp., LLC v. Blue Eyed Bull Inv. Corp. (BEBIC)*, No. 6:18-cv-00235-AMQ, 2018 WL 2971205 (D.S.C. June 13, 2018), a federal court in South Carolina held the following forum selection clause was mandatory and denied a franchisee's motion to transfer the case to a more convenient forum:

> Any action brought by either party, . . . shall be brought in the appropriate state or federal court located in or serving Greenville County, South Carolina. The parties waive all questions of personal jurisdiction or venue for the purposes of carrying out this provision. . . . This exclusive choice of jurisdiction

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> and venue provision shall not restrict the ability of the parties to confirm or enforce judgements or arbitration awards in any appropriate jurisdiction.

Id., 2018 WL 2971205, at *5. In holding the forum selection clause was mandatory, the court reasoned that the clause, by its own terms, provided "the exclusive choice of jurisdiction and venue" and that all claims, except those covered by arbitration, "shall be brought in the appropriate state or federal court located in or serving Greenville County, South Carolina." *Id.*

In contrast, in *Carl's Jr. Restaurants LLC v. 6Points Food Services Ltd., et al.*, No. CV 15-9827-CHK (ASx), 2016 WL 3671116 (C.D. Cal. July 7, 2016), a federal court in California held a forum selection clause was permissive and granted a franchisee's motion to dismiss in favor of a Canadian forum. There, the forum selection clause stated:

> . . . [Franchisor] may file suit in the federal or state court located in the jurisdiction where its principal offices are located at the time suit is filed or in the federal or provincial court located in the jurisdiction where [Franchisee] resides or does business or where the Development Territory or any Franchised Restaurant is or was located or where the claim arose. [Franchisee] consents to the personal jurisdiction of those courts over [Franchisee] and to venue in those courts. . . .

Id., 2016 WL 3671116, at *2. The court held the forum selection clause was permissive, not mandatory, because it used a permissive verb—the franchisor "*may* file suit" in the specified forums—and did not state the franchisor "'must' or 'shall' file suit in one of those places." *Id.*, 2016 WL 3671116, at *4 (emphasis in original). The court further reasoned the fact that the franchisee could "potentially" be called to litigate in California "says nothing about whether the forum-selection clause *mandates* litigation in particular courts." *Id.* (emphasis in original).

But not all forum selection clauses are so clear. Take, for example, the following language:

> . . . Franchise Owner consents and agrees that the following courts shall have personal jurisdiction over it in all lawsuits relating to or arising out of this Agreement or the parties' relationship and hereby waives any defense Franchise Owner may have of lack of personal jurisdiction in any such lawsuits filed in these courts: (A) all courts within the state court system of [Michigan] and (B) all courts of the United States of America sitting within [Michigan], including, but not limited to, all the United States District Courts sitting within [Michigan].
>
> . . . Franchise Owner consents and agrees that venue shall be proper in any of the following courts in all lawsuits relating to or arising out of this Agreement or the parties' relationship and hereby waives any defense it may have of improper venue in any such lawsuits filed in these courts: the state court of the county where the Franchisor has its principal place of business (presently, Oakland County); and the United States District Court for the Eastern District of Michigan, Southern Division.

At first glance, the foregoing appears mandatory. The clause clearly states, "venue shall be proper" in certain courts, and the named courts "shall have personal jurisdiction over [the parties] in all lawsuits relating to or arising out of" the franchise agreement. However, a federal court in Connecticut held that clause was permissive because it merely conferred jurisdiction in the named forums and did not contain "specific language of exclusion" indicating jurisdiction elsewhere was prohibited. *MAK Mktg., Inc. v. Kalapos*, 620 F. Supp. 2d 295, 301-02 (D. Conn. 2009). Accordingly, the Michigan-based franchisor was forced to litigate the lawsuit in Connecticut rather than Michigan.

Similarly, in *Utah Pizza Serv., Inc. v. Heigel*, 784 F. Supp. 835 (D. Utah 1992), the franchise agreement's seemingly mandatory forum selection clause provided: "[t]he parties agree that in the event of litigation between them, Franchise Owner stipulates that the courts of the State of Michigan shall have personal jurisdiction over its person, that it shall submit to such personal jurisdiction, and that venue is proper in Michigan." *Id.* at 837. However, the court held it was permissive because "the plain language of the clause reveals that it was intended to give [the franchisor] the right to bring suit in Michigan" but "nothing in the provision indicates an intent to prohibit litigation elsewhere." *Id.*

To further complicate things, similarly worded—though, perhaps, not perfectly clear—provisions may be interpreted differently by

different courts. Take, for example, decisions in the cases of *Get in Shape Franchise, Inc. v. Caldwell*, No. CV 15-13118-NMG, 2016 WL 11002219 (D. Mass. Feb. 18, 2016) and *Thompson v. Founders Grp. Int'l, Inc.*, 886 P.2d 904 (Kan. 1994). In *Get in Shape*, the franchise agreement's forum selection clause stated: "except to the extent governed by the U.S. Trademark [A]ct of 1946 (Lanham Act, 15 U.S.C. Section 1051, et seq.) or the U.S. Arbitration Act, this Agreement shall be governed by the laws of the State of Massachusetts, and venue shall lie in Norfolk County, Massachusetts." *Get in Shape*, 2016 WL 11002219, at *2. The court held that was mandatory language because "the use of the word 'shall' reflects an intent to designate" the named forum "as the exclusive forum for disputes arising under the franchise agreement." *Id.* at *5.

The forum selection clause in *Thompson* was nearly identical to that in *Get in Shape Franchise, Inc.* but for the insertion of the word "properly" between "shall" and "lie." *Thompson*, 886 P.2d at 906. The franchise agreement's forum selection clause stated:

> The parties to this Agreement agree that jurisdiction and venue of any action brought pursuant to this Agreement, to enforce the terms thereof or otherwise with respect to the relationships between the parties created or extended pursuant hereto, shall properly lie in the Circuit Court of the Thirteenth Judicial Circuit of the United States District Court for the Middle District of Florida, Tampa Division.

Id. at 906. The Kansas Court of Appeals held the clause was permissive because it did not prevent the franchisee from bringing an action in Kansas. The court specifically observed, "obviously, 'shall' indicates a mandatory intent, but the word must be taken in context."

The material distinction between "venue shall be proper," "venue is proper," and "venue . . . shall properly lie in" (all held to be permissive) on one hand; and "venue shall lie in" (held to be mandatory) on the other hand, is not obvious, but highly significant in litigation. *See* Doroghazi & Norman, *supra*, at 593–95. Franchise practitioners should closely examine the specific language in their forum selection clauses early in the drafting process and endeavor to resolve any ambiguity. Parties can indicate a mandatory intent by including exclusionary or obligatory language, such as the forum coupled with terms and phrases like "exclusive," "must and will," "must be," "shall be," "shall lie," "sole," "only," and "renouncing any other jurisdiction." *See ARCpoint Fin. Grp., LLC*, 2018 WL 2971205, at *5; *Get in Shape Franchise, Inc.*, 2016 WL 11002219, at *2; *see also Bent v. Zounds Hearing Franchising, LLC*, No. 15 CIV. 6555 (PAE), 2015 WL 7721838, at *5 (S.D.N.Y. Nov. 30, 2015) (clause was mandatory because it provided that all actions "must be initiated and litigated" in Arizona); *Xiao Wei Yang Catering Linkage in Inner Mongolia Co., LTD. v. Inner Mongolia Xiao Wei Yang USA, Inc.*, 150 F. Supp. 3d 71, 77 (D. Mass. 2015) (clause was mandatory because it provided that "in the event of dispute, and arbitration or litigation is needed, the location shall be the place of registration of the Overseas Management Company."); *ServiceMaster of Fairfax, Inc. v. ServiceMaster Residential/Commerical Servs., L.P.*, No. CV PX 16-02589, 2017 WL 3023342, at *4 (D. Md. July 17, 2017) (clause was "clearly [] mandatory" because it provided that "*all* litigation . . . *must and will* be venued *exclusively* in Memphis, Tennessee") (emphasis in original); *Pomerantz v. Int'l Hotel Co., LLC*, 359 F. Supp. 3d 570, 576 (N.D. Ill. 2019) (clause was mandatory because it provided that the parties agreed to "submit to the jurisdiction" of the courts and tribunals of the City of Cancun, "thereby renouncing any other jurisdiction that may correspond to them by reason of present or future domicile").

If a forum selection clause can be construed as a mere consent to jurisdiction or waiver of forum nonconveniens, or merely uses the language "consents," "agrees," "submits," or "proper," without other exclusionary language, it will likely be construed as permissive. *See Carl's Jr. Restaurants LLC*, 2016 WL 3671116, at *2; *MAK Mktg., Inc.*, 620 F. Supp. 2d at 301–02; *Utah Pizza Serv., Inc.*, 784 F. Supp. at 837; *Thompson*, 886 P.2d at 906. A carefully drafted forum selection clause will effectuate the parties' true intent and save significant resources by preventing litigation over ancillary procedural issues.■

I See Ghosts: The Rise of Delivery-Only Kitchens

By Tony Marks, Bryan Cave Leighton Paisner LLP

In 2018, the investment bank UBS predicted that the global online food ordering could grow to $365 billion in 2030, up from $35 billion in 2018. In June 2020, UBS reported that GrubHub increased the number of restaurants on its platform by 133 percent in 2020, after increasing 51 percent in 2019. DoorDash was up 30 percent in 2020 and, again according to UBS, the growth of Postmates and UberEats was steadier in 2020.

What Is a Ghost Kitchen?

Online food ordering platforms and delivery apps have dramatically expanded the food delivery market. Initially, the resulting demand for delivery has resulted in traditional restaurants struggling to simultaneously meet the additional delivery demand and maintain the quality of service and food for their in-dining room patrons.

Also referred to as dark kitchens, delivery kitchens, shadow kitchens, or commissary kitchens, there are a variety of types of ghost kitchens. The simplest ghost kitchens piggyback off existing kitchens to offer new cuisines or concepts available exclusively on delivery apps. A fast-growing version of the ghost kitchen is a kitchen located within a commercial or industrial space, outfitted with multiple kitchen units, and each operated by different food service operators. The kitchens developed within commercial or industrial properties typically include basic kitchen equipment and allow for customization for particular uses. Each individual kitchen can support one or more delivery concept. Central corridors and runners facilitate picking the packaged meals for placement in a central location where delivery drivers pick up the packaged foods—typically a driver for one of the online food ordering platforms.

Another typical format for ghost kitchens is the commissary kitchen, which is a large commercial kitchen where several brands may operate from within the same kitchen. The ghost kitchen operator (the landlord) may also provide or require their kitchen operators to use proprietary software. In some instances, facilities allow for customer pick-up, and in almost no instances are dining areas available to customers.

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Who Uses Ghost Kitchens?

Users of ghost kitchens run the gamut in the food service sector, from caterers to virtual restaurants. When ghost kitchen facilities launched, they were attractive to traditional restaurant operators who needed to relieve pressure on their full-service kitchens and to lower costs on the food produced for delivery, resulting in potentially improved margins. As the number of ghost kitchen facilities has increased, this model has become attractive to both franchised and non-franchised restaurants to expand their delivery footprint. This model is especially attractive to brands with good brand recognition but a limited number of physical locations. Suddenly those brands can leverage their brand equity and expand their reach by using a ghost kitchen to produce food for delivery outside of the geographic area served by their retail facilities.

Restaurateurs also see the ghost kitchen as an opportunity to launch new brands and test concepts and new recipes. A ghost kitchen may allow multiple delivery-only brands to operate from a single space. Additional opportunities exist for restaurant operators who have underutilized kitchens or kitchens that serve a restaurant that operates two day-parts (i.e., a restaurant that serves two of the three breakfast, lunch, and dinner day-parts). For example, such a breakfast and lunch day-part operator may see value and increasing bottom-line profit by operating a delivery-only dinner ghost kitchen. Many restaurants can do this with minimal to no additional investment in kitchen equipment. Likewise, it may be easy for a Chinese food restaurant to broaden its offerings by producing a ghost kitchen menu of Asian-inspired noodle dishes, beyond its usual menu, with the staff, equipment, and ingredients that it regularly maintains.

New brands can also pursue opportunities to develop and operate only through online delivery platforms. Often referred to as "virtual restaurants," these ghost kitchens allow operators to pivot quickly to new menus, new branding or marketing, or develop new concepts in their entirety.

In the current COVID-19 world, restauranteurs and landlords are adapting their available resources for use in operating ghost kitchens. Landlords

with unused restaurant kitchens recruit talented restauranteurs to use the kitchens as delivery-only venues, including in hotels. Online food ordering platforms, with mountains of data regarding the ordering habits of their customers, are also entering the fray by partnering with chefs and operators to operate commissary kitchens and virtual restaurants. Likewise, wholesale food vendors are developing programs to help operators start their own ghost kitchens.

Opportunities and Operational Considerations for Franchising

Restaurant franchisors have begun to embrace the full spectrum of ghost kitchen opportunities. Many have begun utilizing ghost kitchen facilities to expand into new markets or fill service gaps in delivery areas by adding franchisees to operate only ghost kitchens or by offering existing traditional franchisees opportunities to operate ghost kitchens, whether from their existing kitchen space or additional sites. Some franchisors even offer opportunities to existing franchisees to expand to ghost kitchens for other brands that the franchisor owns or with whom the franchisor has established a strategic relationship. Virtual restaurant operators and creators have begun developing their brands, recipes, operating procedures, marketing techniques, and other procedures so that franchised operators can replicate their virtual restaurant concepts.

The ghost kitchen reduces or eliminates several major cost factors of a traditional restaurant, including rent for a desirable location and sizable dining room and labor costs, due to the elimination of the front-of-the-house operations. Although the barriers are low to launch a restaurant from a ghost kitchen, the ghost kitchen still requires visibility. This is the case whether the restaurant has a physical restaurant presence in the area that the ghost kitchen serves or exists solely as a virtual restaurant on online food ordering platforms. Operators should expect to devote greater resources to marketing, pay-per-click advertising, sponsored ads, and other measures required to keep their brands visible on the online food ordering platforms and search engines. Placement on the online platform's carousel will be paramount to success for a purely virtual restaurant. Ghost kitchens offer significant savings compared to traditional restaurants with respect to real estate and labor costs. However, delivery platforms' fees, delivery platforms' influence (if not control) over menu prices, and other charges can have a material impact on restaurant margins. As the platforms get more ubiquitous and competitive and governments step in to cap fees, restaurant operators may gain some strength in negotiating rates.

Restaurants that adopt ghost kitchen food preparation modalities will also need to adapt their concepts to the cooking environment. Operators can optimize most ghost kitchens for functionality and speed of food preparation. They should also consider the scope of the menu offering for delivery and managing food waste. Additionally, the delivery region for online food ordering platforms may differ from those typically used by their full-service restaurant counterparts, including territorial exclusivity given to franchisees. Ghost kitchen operators should also evaluate the packaging used and how the items will travel, especially if delivery platforms have multiple deliveries in one vehicle. For example, operators should consider food safety (e.g., using tamper-evident labels and seals and maintenance of temperatures) as well as how packaging affects the food product (e.g., will hot food steam fried food or wilt lettuce).

Additional Implications for Franchising

With opportunity come challenges. Franchisors looking to use ghost kitchens must consider the necessary operational and legal changes to a typical restaurant franchise offering.

Operationally, franchisors must consider modifications of the menu and systems to facilitate service in either a shared kitchen space or a smaller kitchen that focuses on cooking and packaging orders in a manner that preserves optimal quality for delivery to the driver or pick-up customer. This may include changes to recipes, offerings, cooking methods, kitchen staffing, workflow, packaging, and technology. For example, if an operator adds the ghost kitchen to an existing restaurant, franchisors should consider whether the ghost kitchen will use the restaurant's point of sale system and whether that system can segregate the sales between the two brands.

Below is a list of material legal considerations and changes to typical franchise agreements and disclosure documents for franchising ghost kitchens:

- Territorial Rights: Franchisors must consider the territorial rights granted to existing franchisees and those granted to ghost kitchen operators. For example, a typical franchise agreement may prohibit a franchisor itself or another franchisee from operating a franchised business in the territory granted in such a franchise agreement. These typical

prohibitions may preclude a franchisor from setting up or authorizing a ghost kitchen location in a franchisee's territory. Franchisors should also review franchise agreements to determine if the availability of the brand on the online delivery platforms or the delivery by the drivers using those services will breach existing franchise agreements. Franchisors should carefully consider the implied covenant of fair dealing and general principles of law when evaluating encroachment issues.

Franchisors and franchisees typically cannot control the delivery area served by the online food ordering and delivery platforms. Thus, a franchisee evaluating either a traditional or ghost kitchen opportunity should consider the impact, if any, of delivery offerings by other ghost kitchens and traditional restaurants in its anticipated trade area.

- Computation of Royalty and other fees based on sales: Typically, franchisors calculate royalties and other fees charged based on sales and the amount of "cash in the till" with limited deductions. Because of the flow of funds when franchisees use online ordering platforms, agreements should clearly state whether the royalties and other fees paid to the franchisor include or exclude fees charged by the online ordering platforms. Further, franchisors typically receive royalties without deduction for the costs of doing business. Franchisors and franchisees should consider whether the economics of a franchise that relies on high price online food ordering and delivery platforms work when franchisees pay royalties on the gross sales before any platform fee deductions.
- Term and Renewals: Frequently the term of the lease or occupancy agreement with a ghost kitchen facility is shorter than the average restaurant lease. Franchisors will need to consider whether the franchise agreement terms and renewals offered for ghost kitchens will be different than for traditional units. If the franchise term for a ghost kitchen is shorter than the traditional franchise, franchisees should consider negotiating reductions to initial and renewal fees.
- Ghost Kitchen Added to Existing Franchised Business: For a ghost kitchen added to a traditional franchised restaurant, franchisors and franchisees should consider whether the term of the ghost kitchen franchise should be co-terminus with the main franchised business. Alternatively, the parties should consider whether one of the two formats can operate effectively in the absence of the other format. In addition, franchisors may seek to include cross-default provisions, and franchisees should consider the risk that such provisions pose to their existing franchised businesses.
- Required Technology: A ghost kitchen facility operator may offer or encourage the use of different technology platforms than are used in the traditional business. Franchisors should consider modifying existing point of sale and kitchen management systems for the ghost kitchen format. Franchisors may also permit the use of the operator's technology. Similarly, franchisees should investigate whether the franchisor has optimized any required technology platform for the ghost kitchen format.
- Marketing Fund: Franchisors should consider how they will use marketing fund contributions by franchisees operating ghost kitchens and traditional franchises. Will the franchisor comingle funds? Will it adapt marketing for both the retail setting and the ghost kitchen setting? Will it proportionally use the marketing fund for retail and ghost kitchens to the extent that there are differences in the offerings? Franchisors should ensure that any decisions as to the use of advertising funds contributed by ghost kitchen franchisees align with the requirements for advertising fund management in existing franchise agreements.
- Multiple Brands: Often a single ghost kitchen can produce food for multiple franchised or independent restaurants. Platform franchisors (i.e., those that franchise multiple brands) may also see an opportunity to franchise more than one of the platform's brands for a single franchisee to operate at an existing restaurant or in a separate ghost kitchen facility. Franchisors that permit franchisees to operate multiple brands, and franchisees that will operate multiple brands must consider the scope of in-term non-compete covenants in their franchise agreements. For example, a franchisor of a pizza restaurant concept should consider whether it would be willing to agree to let a ghost kitchen franchisee simultaneously operate another unrelated pizza business out of the same kitchen. A franchisee that will operate multiple brands must consider whether the in-term

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Exclusive Remedy Provisions in Franchise Statutes: An Unsettled History of Interpretation

By Filemon Carrillo and Allard Chu, Mulcahy LLP

Franchise litigation often begins with shotgun-style pleadings featuring claims for statutory violations and various theories of liability under common law. Mounting a defense to these complaints entails analyzing every pleaded theory, including its elements, remedies, and defenses, such as applicable limitations periods. While the same set of facts may apply to multiple claims, the viability of each claim may differ. As a result, a franchisor's motion to dismiss may dispose of some legal claims but leave others intact, potentially resulting in a Pyrrhic victory and protracted litigation. For the franchisee plaintiff in this scenario, however, the strategy to pursue every viable claim is more likely to result in claims that survive initial motion practice.

In a common scenario, a franchisee plaintiff will assert a claim for a violation of statutory antifraud provisions or of registration or disclosure laws. The franchisee will also assert common law claims for breach of contract, fraud, and negligence, among others, based on the same violations of the franchise statutes. Further still, creative franchisee counsel will leverage "unfair trade" or consumer protection statutes to assert additional theories of liability and expand the menu of potential remedies.

The good news for those defending these overlapping claims, and a hurdle of which plaintiffs' counsel should be aware, is that there may be a statutory basis to narrow the scope of a complaint effectively and efficiently early on in litigation. Some franchise statutes contain preemption language that may narrow the scope of a suit from the outset or even dispose of the suit altogether. However, the proper interpretation of the preemption language is not necessarily settled in case law. This article discusses common preemption provisions in franchise statutes, the provisions' unsettled history of judicial interpretation, and brief arguments in favor of and against interpreting the provisions to create broad preemptive powers.

Franchise Statute Preemption Provisions

Some but not all franchise regulatory schemes include preemption or exclusive remedy provisions. For example, the California Franchise Investment Law (the "CFIL") provides:

> Except as explicitly provided in this chapter, no civil liability in favor of any private party shall arise against any person by implication from or as a result of the violation of any provision of this law or any rule or order hereunder. Nothing in this chapter shall limit any liability which may exist by virtue of any other statute or under common law if this law were not in effect.

Cal. Corp. Code § 31306. Other jurisdictions include a virtually identical limitation. *See, e.g.*, Mich. Comp. Laws Ann. § 445.1534; N.Y. Gen. Bus. Law § 691.

This article shall refer to the first sentence of CFIL § 31306 as the exclusive remedy provision and the second sentence as the savings clause. On the one hand, the exclusive remedy provision provides that civil liability is limited to that which is created by the franchise statute. On the other hand, the savings clause preserves liability that would exist under any other statute or under the common law if the CFIL "were not in effect." Judicial efforts to reconcile these seemingly contradictory provisions have resulted in divergent outcomes. Below are a few examples of courts confronting these provisions.

An Unsettled History of Interpretation

Samica Enterprises, LLC v. Mail Boxes Etc. USA, Inc., *637 F. Supp. 2d 712 (C.D. Cal. 2008)*

In *Samica*, a group of UPS Store franchisees filed suit against the franchisor and affiliated entities. They alleged that the franchisor "duped" them into investing in the franchises, which were allegedly

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unviable economically. *Samica*, 637 F. Supp. 2d at 715. In addition to pursuing claims for violations of the CFIL, the franchisees asserted common law fraud and misrepresentation claims based on the same acts and omissions that formed the basis for the CFIL claims. The franchisor moved for summary judgment, arguing, in part, that the CFIL's exclusive remedy provision preempted the common law claims.

The Central District of California agreed with the franchisor, finding that the CFIL preempted allegations of common law fraud that are based on the same facts that constitute CFIL violations, while this was not the case for claims independent of CFIL violations. The *Samica* court concluded that the exclusive remedy provision "bars claims that may otherwise be brought under the CFIL—*i.e.*, those claims alleging misrepresentations and omissions covered by" the CFIL's provisions. *Id.* at 722. Because the basis for the franchisees' claims were alleged misrepresentations covered by the CFIL, the exclusive remedy provision precluded their common law claims. *See also Pinkberry Ventures, Inc. v. Penninsular Group, LLC*, 13-CV-02146 & 13-CV-02662, 2013 WL 12145606, at *2 (C.D. Cal. Dec. 17, 2013) ("It appears clear from the CFIL that common law claims that could be brought as CFIL claims are displaced and therefore barred by Cal. Corp. Code § 31306." (citing *Samica*)); *Flip Flop Shops Franchise Co., LLC v. Neb*, 16-CV-7259, 2017 WL 2903183, at *8 n.7 (C.D. Cal. Mar. 14, 2017) ("Under Section 31306 of the CFIL, claims alleging misrepresentations that fall within the scope of Section 31300 and 31301 can only be brought under the CFIL, and any other claims of fraud based on such violations are preempted." (also citing *Samica*)).

Andersen v. Griswold Int'l, LLC, *No. 14-cv-02560, 2014 WL 12694138 (N.D. Cal. Dec. 16, 2014)*

The *Andersen* court disagreed with the holding in *Samica*. In *Andersen*, franchisees sued their franchisor for misrepresentations it allegedly made when marketing to potential franchisees. The franchisees asserted claims for violations of the CFIL as well as common law fraud and misrepresentation, among others. The franchisor filed a motion to dismiss, arguing in part that the exclusive remedy provision preempted the common law fraud claims, citing *Samica*.

The franchisees challenged the *Samica* court's reasoning, arguing that the savings clause allows plaintiffs to bring viable claims independent of the CFIL. The Northern District of California agreed with the franchisees, finding that the "plain language of the statute preserves preexisting common law and statutes enacted before the CFIL that would apply if it had not been enacted." *Andersen*, 2014 WL 12694138, at *5.

Both *Samica* and *Andersen* involved claims for common law fraud that the franchisees argued were viable independent of the CFIL. The *Samica* court held that if a claim is viable under the CFIL, then the CFIL preempts all other claims concerning the same facts. On the other hand, the *Andersen* court allowed the common law theory to go forward by citing the CFIL's savings clause. Without an obvious way to reconcile *Samica* with *Andersen*, the preemption issue under the CFIL remains an open question. As seen below, this disagreement is not unique to California's statute.

Toyz, Inc. v. Wireless Toyz, Inc., *799 F. Supp. 2d 737 (E.D. Mich. 2011)*

In *Toyz, Inc.*, a group of franchisees sued the franchisor and affiliated companies for violations of the Michigan Franchise Investment Law (the "MFIL"), alleging that the defendants made material misrepresentations. The franchisees asserted common law fraud claims predicated on the same misrepresentations. The defendants moved to dismiss, arguing in part that the MFIL preempted the common law claims. Like the CFIL, the MFIL contains an exclusive remedy provision with a savings clause. The Eastern District of Michigan denied dismissal premised on preemption.

Subsequently, the defendants filed a motion for rehearing on the issue of preemption. In support of their arguments, defendants submitted a then-recent ruling issued by Michigan's Oakland County Circuit Court—the state's trial court—in *R & B Commc'nss, Inc. v. Wireless Toyz Franchise, LLC* ("R & B"), No. 2010-113623-CK. Just two months prior to the Eastern District of Michigan's order denying dismissal, the R & B court held, based in part on *Samica*, that the MFIL preempts common law misrepresentation and omission, rescission, and concert of action claims.

The Eastern District of Michigan disagreed with the circuit court. It held that the "plain language of the statute does not limit any other cause of action brought under common law" and, thus, the MFIL did not preempt the common law claims.

In jurisdictions with exclusive remedy provisions like that in the CFIL, whether these preempt common law fraud claims depends on a court's interpretation of the savings clause.

The plain language of the savings clause suggests that common law claims remain viable even with the exclusive remedy provision. But, is this interpretation at odds with the policy underlying franchise statutes and their shortened statutes of limitations?

A Brief Argument in Favor of *Samica* and Franchise Statute Supremacy

Franchise statutes typically impose broad regulations on franchise transactions. Many require strict compliance with presale procedures and impose a harsh consequence for any violation, including liability for damages and even automatic rescission. Moreover, these regulatory schemes may impose liability on the officers and principals of a franchisor. In so doing, legislatures are expanding protections for franchisees that may be duped into a franchise system based on misrepresentations.

These remedies have a limit, typically in the form of a statute of limitations shorter than that applied to common law fraud claims. The argument in favor of a *Samica* interpretation is that such shorter statutory periods, where applicable, must be respected. Otherwise, franchisees may sit on their claims. If the franchised business is a success, then there is no business purpose for bringing suit. If the franchised business fails, the franchisee can file suit and seek rescission and damages. The intent of the franchise statute was to amplify protections for franchisees, not grant them two bites from the same apple.

In passing these provisions, the legislature determined the proper remedies and limited availability of those remedies to the statutory period applicable to franchise statutes. Such a comprehensive regulatory scheme displaces the common law. As a policy matter, the savings clause should not eviscerate the limitations period or limitation of remedies in the franchise statute.

A Brief Argument in Favor of *Andersen* and Saving Common Law Claims

The argument in favor of an *Andersen* interpretation is that the savings clause preserves preexisting common law claims by its plain terms. Reading the statute to preempt claims that fall squarely into the language of the savings clause renders it meaningless. An interpretation favoring preemption violates the canons of statutory interpretation favoring a construction that gives effect to a statute's plain, unambiguous language and gives all terms meaning. Liability for common law fraud may exist independent of a franchise statute and, therefore, franchise statutes should not preempt such claims.

It is also important to point out the differences between claims for misrepresentation under a franchise statute and the common law. The statute of limitations is certainly one of them, but to single it out as the distinguishing factor ignores potential substantive differences. The requisite elements for fraud, for example, may differ between a franchise statute and the common law. Consequently, the factual showing required of the plaintiff may differ based on the claim, even if there is significant overlap. The remedies available may also differ. The savings clause makes clear that while the statute provides an exclusive scope of claims and remedy for any statutory violation, the statute does not alter the claims or remedies that are otherwise available under other statutes or the common law.

The Takeaway

Counsel must examine the viability of alternative theories of liability in a franchise dispute. Where statutory language like that discussed in this article is in play, preemption is not guaranteed. From a franchisor's perspective, keeping a dispute within the confines of franchise statutes and regulations prevents exposure to remedies that may not be available under them. In addition, it prevents franchisees from circumventing the statute of limitations by asserting common law claims whose statutory periods extend beyond the limitations period in franchise statutes. On the other hand, franchisee counsel should not assume that franchise statutes preempt common law claims where the basis for liability overlaps and should assert both statutory and common law claims if the facts support them. In light of the case law on both sides, counsel on both sides of a franchise dispute should not overlook the scope of the exclusive remedy provision and savings clauses in franchise statutes.■

Advance Your Case by Analyzing Metadata: E-Discovery Practice Techniques for Solo & Small Firms

By Xiaoyin Cao, Carmen Caruso Law Firm

Nearly 15 years have passed since the 2006 amendments to the Federal Rules of Civil Procedure ("Rules") introduced a new category of discoverable information—electronically stored information ("ESI"). Although not addressed directly in the Rules, many courts have held that if a requesting party asks upfront, it can seek metadata—data about data—subject to the same general rules of discovery applicable to other "documents." *See Aguilar v. Immigration and Customs Enforcement Div. of U.S. Dept. of Homeland Sec.*, 255 F.R.D. 350, 355 (S.D.N.Y. 2008) ("Metadata is not addressed directly in the Federal Rules of Civil Procedure but is subject to the general rules of discovery. Metadata thus is discoverable if it is relevant to the claim or defense of any party and is not privileged."); *see also AtHome Care, Inc. v. The Evangelical Lutheran Good Samaritan Soc'y*, No. 1:12-cv-053-BLW, 2013 WL 1819691 (D. Idaho Apr. 30, 2013) (granting plaintiff's motion to compel documents, ordering the defendant to identify and produce metadata for the documents); *Williams v. Sprint/United Mgmt. Co.*, 230 F.R.D. 640, 652 (D. Kan. 2005) ("when a party is ordered to produce electronic documents as they are maintained in the ordinary course of business, the producing party should produce the electronic documents with their metadata intact. . . ."). Metadata is important because it is "electronically-stored evidence that describes the 'history, tracking, or management of an electronic document,'" including "hidden text, formatting codes, formulae, and other information associated" with an electronic document. *Aguilar*, 255 F.R.D. at 354 (internal citations omitted).

A common misconception is that electronic discovery ("e-discovery") is nothing other than using software to make productions by electronically redacting and Bates-stamping documents. As information technology advances, the boundary between administrative tasks and legal analysis blurs. Law firms can use e-discovery software either in a lower capacity (such as Bates-stamping) or in a higher capacity (such as data analysis or analytics). Litigators do not need to be information technology experts to use e-discovery tools to gain value in litigation. Litigators in solo or small firms face the challenge of engaging in e-discovery against opponents who may have greater resources, but this challenge is far from insurmountable.

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Document Collection Stage: Always Collect the Metadata

At the start of a case, lawyers will obtain documents from their clients and begin formulating discovery requests to the opposing parties. They should do so with the goal of collecting ESI with metadata intact.

Collection from Clients

When collecting documents from clients, always obtain "native" format instead of printouts. Native format contains embedded information—the metadata. For example, an email in native format (e.g., .msg) will contain many important categories (called "fields") of metadata, such as date, sender, recipient, and subject. Most (if not all) e-discovery software gives users the ability to sort the files chronologically based on the date that a person sent an email or created a file. After the initial client interview, it is essential to sort the client's documents chronologically to understand and verify the client's story, build the case, and spot any unfavorable documents.

For example, a franchisee client who believes she was misled into signing a franchise agreement may not identify every statement or disclosure made to her (or might be ignoring other communications that contradict her claim). By sorting the emails between the client and the franchisor chronologically, the story of the case begins to emerge, and it becomes easier for the franchisee attorney to analyze all representations and disclosures using the date of the execution of the franchise agreement as a reference point.

Representation of franchisors poses additional challenges, as responsive documents typically are from multiple people (the "Custodians"). To counter a franchisee's fraudulent inducement claim, the franchisor's legal team may collect several sets of documents from Custodians: The director of franchise sales, the president, and a sales representative might have exchanged emails with the franchisee prior to the execution of the franchise agreement; the

regional manager and several field consultants might have documents for a bad performer argument; three employees in the legal department might have had exchanges with the franchisee which lead to the execution of a general release. By sorting all documents chronologically from multiple Custodians, the case becomes less fragmented, which saves time and leads to a clearer picture of the facts.

Obtaining native format emails is simple. Many law firms use email applications such as Outlook and Mail App on Mac to log in to their email accounts (as opposed to an internet browser). In most of these applications, the legal team can perform a keyword search, select all emails populated from the search (or, without doing any keyword search, select all emails from X date to Y date), and drag and drop them into the computer's hard drive. This method captures the native files with complete metadata. To avoid a client's self-selection of the documents and therefore avoid spoliation, lawyers should engage opposing counsel early on to agree on parameters such as Custodians and search terms. A paralegal (and sometimes an outside vendor) should participate and supervise the collection process and keep a clear record of the search criteria.

Document Requests to Opposing Parties

As frequently quoted by courts, "if a party wants metadata, it should 'Ask for it. Up front.'" Adam J. Levitt & Scott J. Farrell, *Taming the Metadata Beast*, N.Y.L.J., May 16, 2008, at 4. Courts have generally only ordered the production of metadata when a party requests it in the initial document request and the producing party has not yet produced the documents in any form. *Aguilar*, 255 F.R.D. at 357; *see also In re Porsche Cars N. Am., Inc., Plastic Coolant Prods. Litig.*, 279 F.R.D. 447, 449 n.5 (S.D. Ohio 2012) ("If the requesting party does not specify a form, therefore, the producing party is within its right to produce the ESI in static image form (TIFF or PDF) with no metadata.").

Lawyers should request metadata when serving document requests. Some metadata fields, such as sender, recipient, date, time, author, last modified, and file extension are less controversial. Typically, the requesting party attaches a schedule specifying the production format and all fields of metadata to a document request. Lawyers should not consider the production of metadata an unreasonable burden if the producing party uses e-discovery software. In addition, using metadata makes both parties' work more efficient, as discussed below. Therefore, the parties should agree on metadata production through a good faith meet and confer.

To use metadata effectively, it is helpful to understand how e-discovery software works. Typical e-discovery software can produce documents in a four-folder structure containing four parallel tracks of information for the same document: image, native, text, and data.

- The image folder will contain static images (TIFF or PDF) of the documents with no metadata. These are the documents with redactions and Bates numbers used in deposition and trial. The filename of each image file will be the first page Bates number of that document.
- The native folder will contain documents in native form. Typically, parties only produce native form when the image form does not provide all the information, such as for spreadsheets and video recordings. The file name of the native file will also be the Bates number of that document.
- The text folder will contain a .txt file of all text extracted from the documents. The file name of each .txt file will be the same as that of the image file for the same document.
- The data folder will contain a metadata "loadfile" for the documents produced. Typical e-discovery software can produce and load metadata file in .dat, .opt, .lfp, or .csv format.

Lawyers with limited resources who cannot load the metadata loadfile into e-discovery software should request the metadata loadfile in .csv format, which the legal team can read with Microsoft Excel. Once opened, the loadfile does not differ from a spreadsheet containing all requested metadata fields for each document. Lawyers can use this .csv file as a catalog of the documents received by sorting and searching this spreadsheet. However, in comparison with using e-discovery software, lawyers' ability to use the metadata is substantially limited in Microsoft Excel. In addition, because the parties' agreement normally dictates the exchange of metadata, lawyers will likely have trouble obtaining metadata from the opposing party if they cannot reciprocate.

Document Review Stage: Non-linear Review Approach

"Linear review" is a traditional approach to reviewing documents where the review team looks at one document after another, normally in chronological order, until the review team has reviewed the entire data set. Linear review usually takes a substantial amount of time and is largely repetitive. It often requires multiple reviewers to divide the work by time period of

the documents, which creates problems for collaboration and fragmented information, since one reviewer will not have a full picture of any issue. In addition, linear review requires the reviewers to keep track of all issues simultaneously, which creates additional difficulties.

The advance of information technology introduces a non-linear or problem-solving approach. The goal of the non-linear review approach is to find the most relevant documents for an issue or to answer a specific question. After talking to a client and reviewing a few key documents, a lawyer begins to develop a legal theory. Using the non-linear review approach, the lawyer provides targeted questions to the review team relevant to the legal theory, and the review team looks for documents to answer these questions. The non-linear review approach is a dynamic process that requires the lawyer and the review team to communicate and adjust the search throughout the review process. As the review team gets deeper into the document review, it may discover documents that completely undercut the initial legal theory. The legal team and reviewers should consult periodically so they can adjust the questions they want to answer about their case. Similarly, as the lawyer learns more, the lawyer may change the legal theory or add more questions for the review team to answer. Using this method, the review team is a more active participant in the case analysis process.

Legal research in Westlaw and LexisNexis uses non-linear review. Starting the document review process with non-linear review by first reviewing the most relevant documents issue by issue allows the reviewers to have a full picture of an issue and a better understanding of the case. Reviewers can then use linear review to make sure they did not miss key documents. Using "and," "or," and "not" is the Boolean search method in Westlaw and LexisNexis. Most, if not all, e-discovery software programs enable users to do Boolean searches not only in the text of the documents but also in the metadata fields.

This example explains the advantages of metadata searches:

> Client Rick is a HugeBurger franchisee who recently built and opened ten new HugeBurger restaurants. Rick used ConstructionComp, which was a mandatory vendor of HugeBurger. However, since the opening, Rick experienced various problems, including water leakage, faulty electrical wiring, and cracked walls. Upon investigation, Rick concluded that HugeBurger received undisclosed rebates from ConstructionComp.

During the lawsuit, Rick's lawyer requested (1) all communications between HugeBurger and ConstructionComp; and (2) all accounting and financial records showing any rebates or money HugeBurger received due to Rick's purchase of ConstructionComp's services. HugeBurger produced 30,000 pages of documents. Counsel's staff loaded the documents into its e-discovery software and used Boolean search methods to help answer critical questions:

1. What did HugeBurger and ConstructionComp discuss without Client Rick's knowledge? A text search of "HugeBurger" and "ConstructionComp" would not be effective. The search would locate all documents where someone from HugeBurger mentioned ConstructionComp when ConstructionComp did not participate in the conversation. The search would also yield all emails that Rick was involved in, as his company exchanged countless emails with ConstructionComp and HugeBurger regarding the construction service agreement and the construction work.

   Instead, staff conducted a metadata search. In the metadata file "email domain all" (which means email domains "from," "to," "cc," and "bcc"), the legal team entered the search criteria: "@hugeburger.com" AND "@constructioncomp.com" BUT NOT "@rickcompany.com." Using those search criteria, the e-discovery software found 100 emails where a conversation involved someone from HugeBurger and ConstructionComp, but no one from Rick's company.
2. How much did HugeBurger receive from ConstructionComp due to Rick's purchase? Accounting or number-related documents are usually Excel spreadsheet files (e.g., .xlsx). If ConstructionComp emailed HugeBurger any documents showing a rebate, or if HugeBurger had any internal accounting documents, they might be in Excel spreadsheets. Rather than review 30,000 documents to find them, the legal team searched ".xlsx" in the "file extension" field to quickly locate all accounting documents and then further refined searches with other criteria.

When Lawyers Choose Not to Load the Metadata to E-Discovery Software

If lawyers do not use e-discovery software to load productions, they are greatly limiting their ability to effectively use metadata. However, if a law firm's current practice is to not request or use metadata at all,

counsel can still gain advantages by reviewing the metadata loadfile in Microsoft Excel.

When opening a loadfile in Microsoft Excel, the names of metadata fields produced are in the first row (such as Bates, email subject, data, and time), followed by the "values" of each document produced. Use those as column headings by clicking "Freeze First Row" in the "View" tab and then selecting and clicking "Filter" in the "Data" tab.

Then, use the "Sort" function to sort the entries in ascending or descending order based on any column. It is especially helpful to sort the "date" column ascending (select "expand the selection" so the sorting will expand to other columns), which will provide a "timeline." The legal team can then read the "subject" and "file name," which will often provide an idea about the content of the document. Next, the legal team can locate the actual documents in the other folders based on the Bates number.

To further help pinpoint documents, use the "Filter" function. To find the documents that are likely accounting records, go to the "file extension" column and filter by selecting only the Excel spreadsheet files. To find out what HugeBurger and ConstructionComp discussed without Rick's knowledge, filter by selecting all @hugeburger.com domain in the "from" column, plus filter by selecting all @constructioncomp domain in the "to" column, plus filter by unselecting all @rickcompany.com domain in the "to," "cc," and "bcc" columns. However, this combination will leave out all emails from @constructioncomp to @hugeburger.com without @rickcompany.com and may not be as accurate as when using e-discovery software.

Conclusion

The search techniques used above are a few examples of asking a question and then designing the most effective approach to answer that question using available technologies. There are infinite possibilities once the legal team understands how metadata works.

Some e-discovery software programs have started to incorporate various methods to assist litigators by using analytics, data visualization, and artificial intelligence. Whether it is a major brand or independent e-discovery software, Boolean search, natural language search, artificial intelligence-enhanced search, or Microsoft Excel, the fundamentals involved in document review and analysis will not change. It is up to litigators to use these tools to work effectively in order to enhance their clients' chances of success in litigation.

Those who are interested in a template for a Form of Production and Load File Specifications to attach to document requests may contact the author at xcao@cdcaruso.com.■

I See Ghosts: The Rise of Delivery-Only Kitchens

Continued from page 8

non-compete, co-branding provisions and the confidentiality provisions allow the operation of multiple brands.

- FDD Considerations: When offering ghost kitchen franchises for an existing franchise brand, franchisors should consider, among other things: Items 5 and 6 (with respect to fees charged and their computation); Item 7 (with respect to the cost to start the business); Item 8 (with respect to required goods or services); Item 11 (with respect to the franchisor's obligations, training, variants in the advertising funds); Item 12 (with respect to territorial rights and other brands); Item 16 (with respect to limitations on what the franchisee may sell); Item 17 (with respect to term and other variations); Item 19 (if a disclosure is provided); and Item 20 (with system outlets in operation).

Given the rise of these types of restaurants, some see ghost kitchens leading the way for the industry and reimagining what a restaurant can be. While others may be less sanguine about ghost kitchens, it is clearly a new mode to bring food to customers and can be another option in the portfolio for restaurateurs to move forward.■

Subchapter V Bankruptcy Is Available for Franchise Companies

By Craig R. Tractenberg, John R. Gotaskie, Jr., and Keith C. Owens, Fox Rothschild LLP

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Whether your client is a franchisor or a franchisee, franchise attorneys should know about the availability of Subchapter V of title 11 of the United States Code (the "Bankruptcy Code"). As many attorneys are aware, filing Chapter 11 bankruptcy is often very expensive. However, Subchapter V provides a workable solution for the typical small business bankruptcy.

A Subchapter V bankruptcy is tailor-made for small franchisors and franchisees. It contemplates a Chapter 11-type result by requiring the small business bankruptcy debtor to file a Chapter 11 plan of reorganization within 90 days of the bankruptcy, thereby avoiding the administrative headaches and expense of a traditional Chapter 11 bankruptcy filing. The process is analogous to a Chapter 13 plan in that a trustee makes disbursements from the debtor's disposable income during a three- to five-year period in order to make payments to creditors under the plan and to assist with the reorganization. Subchapter V can be a powerful business solution for small franchisee and franchisor business debtors that eliminates the time, expense, and yes, some of the stigma, of a typical Chapter 11 filing.

History of Subchapter V Bankruptcy

In August 2019, Congress passed the Small Business Reorganization Act of 2019 ("SBRA"), which created Subchapter V of Chapter 11 of the Bankruptcy Code (11 U.S.C. §§ 1181–1195). Subchapter V became effective on February 19, 2020. Initially, Subchapter V was available for debtors with no more than $2,725,625 in aggregate secured and unsecured, non-contingent, and liquidated debt, which made Subchapter V an option for only the smallest of companies. Due to Subchapter V's low cap on secured and unsecured debt, very few businesses were able to take advantage of Subchapter V. However, in response to the COVID-19 pandemic, the CARES Act expanded Subchapter V eligibility for a period of one year (unless Congress further extended this deadline) by increasing the cap to $7,500,000. The CARES Act set a sunset date for this increased cap on March 27, 2021, after which the eligibility debt ceiling would return to $2,725,625. However, in March 2021, Congress extended this deadline for an additional year.

The primary objective of SBRA is to enable small businesses to emerge successfully from bankruptcy with a court-approved plan of reorganization. The debtor must file the plan of reorganization not later than 90 days after a bankruptcy filing, absent circumstances beyond a debtor's control. The benefits offered to businesses that file Chapter 11 bankruptcies, including a debtor's ability to right-size its balance sheet, reduce liabilities, reject or restructure burdensome leases and executory contracts, renegotiate funded debt, and sell its assets are now available for smaller companies without having to incur the costs associated with larger Chapter 11 filings.

In addition, the SBRA offers small business franchisees and franchisor owners the opportunity to retain their ownership interest in the reorganized company. This is beneficial when compared to non-small business Chapter 11 cases, which generally result in the cancelation of equity (unless equity holders provide new value to fund a Chapter 11 plan of reorganization or the Chapter 11 plan provides for payment in full to all unsecured creditors). The SBRA is also favorable for debtors that seek to reorganize when compared to Chapter 7, receivership proceedings, or assignments for the benefit of creditors, which are tools for liquidating a company.

What Makes a Subchapter V Bankruptcy Novel?

Chapter 11 Debtor as Exclusive Plan Proponent

Unlike Section 1121 of the Bankruptcy Code applicable in non-SBRA cases, which allows any party-in-interest to file a Chapter 11 plan once the debtor's "exclusivity period" has expired, the SBRA only authorizes the small business debtor to

file a Chapter 11 plan of reorganization. This prevents third parties from attempting to purchase the franchise business in a bankruptcy sale over the objection of the debtor.

Streamlined Process to File and Confirm Chapter 11 Plan

The SBRA imposes the following truncated timeline to file a Chapter 11 plan of reorganization, significantly reducing administrative expenses in bankruptcy and thereby increasing the chances of a successful reorganization:

- Not later than 60 days after the bankruptcy filing, the bankruptcy court will hold a status conference "to further the expeditious and economical resolution of a case under this subchapter."
- Not later than 14 days before the status conference, the debtor's bankruptcy counsel is required to file a report that details the steps the company and its advisors have taken to attain a consensual plan of reorganization.
- Unless the debtor requests an extension related to circumstances outside of its control, the debtor must file its Chapter 11 plan of reorganization not later than 90 days after the bankruptcy case is filed.
- Once the debtor completes all payments according to the plan, the reorganized debtor will receive a discharge from all of its pre-confirmation debts.

Chapter 11 Plan Requirements

The Chapter 11 plan of reorganization in Subchapter V must provide the following:

- All projected disposable income of the debtor within a three- to five-year period (i.e., three years "or such longer period not to exceed 5 years as the court may fix"), beginning on the date that the first payment is due under the plan, will be applied to make payments under the plan; or
- The value of property to be distributed under the three- to five-year plan, beginning on the date on which the first distribution is due, is not less than the projected disposable income of the debtor.

Continued Ownership and Management

The Chapter 11 plan in Subchapter V may permit the owners of the small business debtor to retain their stake in the reorganized debtor, as long as the plan does not discriminate unfairly and is "fair and equitable," with respect to each class of claims and interests.

- A debtor may satisfy the fair and equitable requirement in one of the following ways:
  - The debtor's advisors must identify the debtor's "disposable income," and the plan of reorganization must explain how the debtor plans to distribute the disposable income to the standing trustee during a three- to five-year period in order to make payments to creditors under the plan; or
  - The plan may require the debtor to distribute some or all of its property to the standing trustee for the benefit of its creditors, provided that such property "is not less than the projected disposable income of the debtor" during the three- to five-year period.
- The debtor's management will continue to operate the business unless removed for fraud, dishonesty, incompetence, or gross mismanagement.

Plan Modifications

The reorganized debtor may modify the Subchapter V Chapter 11 plan upon a showing of changed circumstances, after notice and a hearing.

Appointment of a "Standing Trustee"

Unlike a typical Chapter 11 case, and more like a Chapter 13 wage earner's case, a "standing trustee" remains throughout the payment period set forth in a confirmed Chapter 11 plan. The standing trustee will account for all of the property received by the debtor, examine and object to the allowance of claims, review the debtor's financial condition and business operations, report fraud or misconduct, appear at hearings, prepare a final report and account, help facilitate a plan of reorganization, distribute property in accordance with a confirmed plan, and ensure a debtor's compliance with the confirmed plan.

The standing trustee can oppose the discharge of debt if there are grounds for it, examine proof of claims, attend the first meeting of creditors and status conferences, and act as a mediator and assist in the formulation of a Subchapter V Plan.

As the standing trustee will be responsible for payment compliance under franchise contracts, this will eliminate collection activity and provide periodic financial reporting without additional expense to the creditors.

No Official Committee of Unsecured Creditors

There is no official committee of unsecured creditors unless the bankruptcy court, upon a showing of cause, orders otherwise. This reduces the administrative burden on the small franchisee or franchisor business debtor of having to pay fees and expenses of committee professionals.

Employment of Estate Professionals

The Bankruptcy Code prevents small business debtors from employing professional persons such as accountants and lawyers if they hold a pre-petition claim against the bankruptcy estate and are not willing to waive that pre-petition claim. Subchapter V vitiates that rule, however, because the SBRA provides that small business debtors may employ such professionals if the debtor owes an individual professional less than $10,000 prior to the date of the bankruptcy filing.

No United States Trustee Fees

Subchapter V exempts small business debtors from paying United States trustee fees, which are fees based on a company's disbursements, further reducing the costs of administration.

Mortgage Modifications for Guarantors

The small business debtor can seek to modify a mortgage against a principal residence if the debtor did not use the mortgage loan primarily to acquire the residence. The SBRA will make it harder for creditors to take away a business owner's residence pledged as collateral to support the business. This provision may provide flexibility to franchisees who have pledged their residence for purchase money loans for the franchised business or have guaranteed business obligations secured by a recorded mortgage.

Unique Protections for Creditors

The new "disposable income" requirement may mandate a minimum payment to creditors higher than what Chapter 11 otherwise mandates. Some of the normal Chapter 11 requirements—such as monthly operating reports, special debtor in possession bank accounts, and supervision by special trustees—provide protection to creditors and other parties-in-interest, such as guarantors.

The Future of Subchapter V in Franchising

Many anticipate an uptick in bankruptcy filings after government pandemic relief aid like the CARES Act funding and its forgiveness period expire. Because Subchapter V provides a needed remedy for small business debtors and individuals concerned with the administrative burdens and expenses of a Chapter 11 filing, franchisees and emerging franchisors may want to use this tool to their advantage.

Franchisors should plan now to have a preset protocol for dealing with their franchisees who file Subchapter V due to the compressed deadlines. Franchisors can also suggest or aid struggling franchisees with Subchapter V to maintain their franchise during these uncharted times. Franchisees should be aware, however, that any bankruptcy filing is likely an event of default under their franchise agreements, and franchisors may not be inclined to provide such support.

For franchisees and emerging franchisors, Subchapter V may be a prescription to save their business from the economic consequences of the pandemic. There are also mortgage modification provisions that will help guarantors of business debts to save their homes.

Few cases have been filed to date, but franchise attorneys should anticipate that Subchapter V will be a powerful vehicle for the revitalization of franchisees and franchisors alike. ■

Message from the Chair

Continued from page 1

Spring is the season during which the Forum Nominating Committee is convened to do the important work of nominating Governing Committee members. The members of the 2021 Nominating Committee are as follows:

- Eric H. Karp (Chair of the Nominating Committee) - Witmer Karp Warner & Ryan
- Ron Gardner - Dady & Gardner PA
- David Gurnick - Lewitt Hackman
- Van Thiet Lam - Regal Nail Salon and Spa, LLC
- Ann MacDonald - Schiff Hardin, LLP

This year's Nominating Committee will recommend candidates for four Member-at-Large positions on the Governing Committee, all with terms beginning August 2022, when current Governing Committee members Julie Lusthaus, K Whitner, Beata Krakus and Rob Lauer complete their terms.

An election to fill these positions will take place at the Forum's Annual Business Meeting, which will be held in conjunction with the 44th Annual Forum on Franchising. This meeting will take place on Thursday or Friday, October 14 or 15, 2021, at the Hilton Atlanta in Atlanta, Georgia.

Forum members wishing to recommend candidates to fill these positions should convey their comments by email to Eric Karp no later than *Friday, May 21, 2021*. Eric's email address is ekarp@wkwrlaw.com.

The Governing Committee and I are here to serve you, so I encourage you to contact me with any questions, comments, or suggestions about the Forum at will.woods@bakermckenzie.com or 214-978-3022.■

Message from the Editor-in-Chief

By Erin C. Johnsen, Garner, Ginsburg & Johnsen, P.A.

Spring is here (even in Minnesota), and, with it, we are happy to bring you fresh content on a number of important considerations for franchise lawyers. In this issue, our authors examine: how small differences in language can dictate whether forum selection clauses are mandatory or permissive; the rising popularity of ghost kitchens and their implications for franchising; how courts have differed in interpreting preemption or exclusive remedy provisions in franchise statutes; how small firms can use e-discovery techniques to improve their practices; and why Subchapter V bankruptcy may be a good option for some small franchisors and franchisees.

By the time this issue hits your desks, I should be on maternity leave, as I am writing this note exactly one month before my due date. Many thanks to our associate editors for keeping the publication on track during this time. Special thanks to Justin Sallis, who will be filling in temporarily as the main point person for *The Franchise Lawyer* and to Keri McWilliams, who will be working with Justin to make sure our summer issue gets to you on schedule. If you have questions relating to *The Franchise Lawyer* between the months of June and August 2021, please direct them to Justin Sallis at justin.sallis@lathropgpm.com.■

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