

Declaratory Judgments: An Under Used Tool To Resolve Franchise Disputes

Imagine your franchisor announces the institution of a new trade dress for your fast food system and issues a directive that every franchisee must invest \$100,000 within the next twelve months to adopt the new look and feel. You do not believe your franchisor has the right to impose the change under your franchise agreement. If you refuse, your franchisor may attempt to terminate your franchise. At risk is your business.

Fortunately, the law gives you another option – one that does not require you to flagrantly refuse a direct order – to petition a court to rule whether or not the franchisor's action is proper before you are potentially in violation of the order, and possibly your contract.

In a franchisee-franchisor relationship in the "County of Clarity," each party has a full understanding of the lengthy and complex agreement which forms the basis of their relationship at the time the franchise agreement ("Agreement[s]") is signed. Disputes as to the meaning of the Agreement, and its various terms and conditions, never arise.

Unfortunately, franchise parties do not live the County of Clarity, but rather in the "Area of Ambiguity." Here, the parties realize the limitations and imperfections of the written word. Conflict arises and each party stands firm in their interpretation of what had been previously "clear" and unambiguous language. Threats are spewed forth like lava from a volcano. Attorneys are summoned.

If the parties must litigate every dispute only after a potential breach occurs, both parties incur a significant risk of damage and forfeiture. Fortunately, the availability of declaratory relief (or declaratory judgments) is available to forestall an irreversible dispute, and possibly even provide a scenario that can repair the relationship.

Prior to the 19th century, United States courts simply would not intervene in the parties relationship, before a material breach of obligation occurred. Suits brought prior to a material breach were declared "not ripe" for judicial resolution, and were summarily dismissed.

Today, courts applying federal and state law, can issue expeditious declaratory judgments, and thereby minimize the deleterious effects of prolonged litigation. For example, in 1921, the California Legislature enacted the Declaratory Relief Act (the "Act"). The purpose of the Act is to empower the court, in the event of an "actual controversy," to "declare" the parties' rights and obligations before the dispute ripens into a full-blown action for, perhaps among

other things, breach of contract.

In a recent case decided in 2002, the California Supreme Court explained:

A declaratory judgment action provides litigants with a quick, efficient means of resolving a disputed issue.... [¶] Unlike coercive relief (such as damages, specific performance, or an injunction) in which a party is ordered by the court to do or to refrain from doing something, a declaratory judgment merely declares the legal relationship



By Mario Herman, Esq.

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between the parties. Under the provisions of the [Declaratory Judgment] Act, a declaratory judgment action may be brought to establish rights once a conflict has arisen, or a party may request declaratory relief as a prophylactic measure before a breach occurs. To further the purpose of providing a rapid means of resolving a dispute or a potential dispute, declaratory actions are given precedence in setting trial dates." *Mycogen Corp. v. Monsanto Co.* (2002) 28 Cal.4th 888, at pp. 897-898.

A party to a contract need only allege facts showing the existence of an actual controversy relating to her rights and duties under the agreement, and request those rights and duties be adjudged by the court. The court may make a binding declaration of these rights or duties, whether or not further relief is or could be claimed at the time.

As a general rule, under each of the state and federal declaratory relief laws, three basic requirements must be met before the court may hear a case and issue an opinion as a declaratory judgment:

1. The case needs to present an actual dispute, not a hypothetical legal question. By requiring an actual dispute, the judiciary is ensuring that any decision issued in the case is the final one, because it was based upon concrete facts and not upon some fanciful situation which may not have presented a complete picture of the controversy.

2. The dispute must be between adversary litigants. A supplier who stands to lose business as a result of a franchisor's designation of a new supplier would not likely have standing, because it has no contract with the franchisor. If the adversary element were absent, there would be no need

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for resolution, and any opinion issued would be merely advisory.

3. The courts require that if a decision is issued in favor of the claimant, there is a substantial likelihood that it would have some effect. If the opposing party could simply ignore the ruling, then the opinion lacks finality and is, in effect, advisory.

Declaratory relief actions can be used effectively in a franchisor-franchisee relationship. For example, a franchisee can petition the Court for guidance as to the enforceability of post-term covenants prior to expiration of the contract, without risking a post-term lawsuit that could result in the loss of the business.

Similarly, if a franchisor uses the operations manual to effectuate a "material" change to the Agreement, declaratory relief can be a tactical tool to challenge the enforceability of the proposed change to the manual, without the bitterness of a full blown litigation.

Both sides can continue to perform under the Agreement during the pendency of the declaratory action, and, because the action is inherently prospective in nature, hopefully

return to normalcy after the judgment is rendered.

Since damages are not available for declaratory judgment actions, the only benefit of such a tool is to guide the parties' rights and potential relationship in the future. If one party continues with the objectionable behavior that led to the declaratory judgment action in the first place, the other party can thereafter sue for damages and have the benefit of the declaratory ruling to dramatically enhance the likelihood of prevailing and obtaining damages in the subsequent action.

Franchisees and franchisor who are unable to resolve their disputes through negotiation or mediation are advised to seek resolution through the equitable vehicle of a declaratory relief action. In this way, they can avoid the financial and psychological impact of protracted litigation.

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AAFD Welcomes New Chapters

Super 8
ServiceMaster
AmericInn
QuikDrop

Slender Lady
Ladies Workout Express
Vino 100

Welcome New Supporting Members

EDR - Electronic Data Resources
Brown & Brown/Benefit Protect
Virchow Krause