



Lessons Learned

A continuing column drawing lessons for franchise systems from franchise litigation and other sources.

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Forum Selection Clauses – Sometimes Enforced; Sometimes Not

In a Franchisor/Franchisee dispute, the location where a lawsuit is heard (assuming arbitration is not the chosen method to resolve the dispute), can be critical to the outcome, not only because local juries may have sympathy with their own state's residents, but because additional costs can make prosecution or defense of a case in a remote location more difficult. (Note that this is a different question than what state's laws apply; a franchise agreement might specify the laws of X state to apply, and for the dispute to be heard in Y state, and a court may uphold that provision.)

Well-drafted franchise agreements almost always contain a forum selection clause, ideally (from the Franchisor's perspective) specifying the state in which the Franchisor's then-current headquarters are located. but are those clauses actually enforceable?

Well, sometimes yes and sometimes no, as demonstrated by two recent cases.

In Ramada Worldwide v. Bellmark Sarasota Airport, a case decided by a federal court in New Jersey, the judge determined that a "balancing of the relevant factors" required that the forum selection clause in a franchise agreement (specifying New Jersey as the location for litigation) be ignored and litigation take place in Florida, the residence of the Franchisee.

Aside from the fact that all of the relevant acts related to the dispute took place in Florida, and that the franchised location was in Florida, most of both sides' witness were located there and litigation in New Jersey would have been inconvenient for the Franchisee, which had limited financial resources.

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However, the court also focused on another factor, which apparently was critical: The Franchise Agreement failed to provide that New Jersey was the exclusive location for any litigation and, in fact, stated that the choice of New Jersey was non-exclusive, allowing the court to focus on the question of relative convenience of the parties. In addition, the choice-of-law provision in the franchise agreement was not emphasized.

Therefore, one of the lessons of this case is the enforceability of the choice-of-law provision is enhanced when it is made exclusive and noticeable in the franchise agreement, something done in the current Holmes & Lofstrom Model Franchise Agreement.

DVDPlay, Inc. v. DVD 123 LLC, a Florida state case came out the opposite way, enforcing the choice-of-law clause in an agreement between a California Franchisor and a Florida Franchisee, holding that the choice of California as the appropriate forum was both valid and survived the Franchisor's termination of the franchise agreement based on the Franchisee's alleged breach. Interestingly, this conclusion was reached by a Florida court, notwithstanding the fact that the Franchisee was a Florida resident, demonstrating that at least some courts will ignore that factor.

Enforcement of Non-Competition Clause

A further case (RescuecomCorp. v. Matthews), coming out of a Federal trial court in New York, provides a good example of the business factors which a court found convincing in enforcing the non-competitions clauses in a franchise agreement.

Here the franchise agreement had been terminated by the Franchisor and the Franchisee thereafter operated a competitive business (computer sales and services) from the same location which it had been using as a Franchisee, in direct competition with remaining Franchisees in the system and successfully taking away at least five of the Franchisor's former customers.

In issuing a preliminary injunction against the Franchisee, the court noted that the customers diverted to the Franchisee had a prior business relationship with the Franchisor and that to the degree the diversion benefited the former Franchisee, the Franchisor was disabled from transferring those customer relationships to other Franchisees in the system.

Lessons Learned

Perhaps the lesson to be learned from this case is that a clear explanation of the business realities surrounding violation of a non-competition commitment can be highly convincing to a judge or arbitrator and that concentration on those realities, when supported by the right facts, can be crucial to enforcement of the agreement.

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