



Lessons Learned

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

By: David E. Holmes, a founding partner of Holmes & Lofstrom, LLP

Franchise Agreement “Boilerplate” Defeats Fraud Claim

Many businesspeople report that “their eyes glaze over” when they reach the last third of their Franchise Agreements: the portion with the “legal boilerplate” and after the business essentials of the relationship (payments, service and support, marketing fund, etc.) have already been covered.

As it turns out, those parts of the Franchise Agreement can be the most crucial if a dispute develops between the Franchisor and the Franchisee. An excellent example of just how important those provisions are recently arose in a Georgia case (Holiday Hospitality Franchising v. Mitsubishi), involving a claim by a Franchisee that the Franchisor had made false statements and material omissions during negotiations for the franchise. In that case, the boilerplate operated to completely deflect the Franchisee’s claims.

In summary, the court upheld the “merger and integration” clauses of the Franchise Agreement; those providing that the Franchise Agreement itself contains all of the parties’ representations and agreements, and prohibiting reference to any discussions’ promises or otherwise which were not included in the written Franchise Agreement itself.

As a result of that holding, the “liquidated damages” clause in the Franchise Agreement was enforced. (In general, a liquidated damages clause limits the damages payable by either party to an agreement, generally should limit each party similarly and is enforceable in many states under various circumstances and limitations.)

Here, the liquidated damages clause provided for 3 years income to the Franchisor in the event of early termination by the Franchisee. The court concluded that this amount of damages was “heavy” but not unreasonable in light

☐ Northern California Office

4251 S. Higuera St., Suite 401 · San Luis Obispo, CA 93401
Phone: 805.547.0697 · Fax: 805.547.0716



☐ Southern California Office

6621 E. Pacific Coast Hwy., Suite 250 · Long Beach, CA 90803
Phone: 562.596.0116 · Fax: 562.596.0416

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of a ten year franchise term, and reasonably related to the effect of the Franchisor no longer having a Franchisee in the market. On that basis, damages were assessed against the Franchisee.

One lesson to be taken from this case is to consider the use of properly drafted liquidated damages clauses in Franchise Agreements. They may prove to be of significant assistance in litigation, although they can also raise some issues in various contexts.

David Holmes has practiced domestic and international franchise law for more than 30 years. David earned his undergraduate and law degrees from the University of Southern California. He specializes in franchise law, including structuring franchise systems, drafting registration documents, legal compliance, litigation management and negotiations. He also serves as an expert witness on franchising matters in both federal and state courts and has taught graduate level business law courses at California State University, Long Beach. He contributes to the publications and committees of the International Franchise Association, American Bar Association and California State Bar.