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Hospitality Law

Franchise Termination: Taking the Offensive



Mr. Peter Ripin

By Peter Ripin, Partner, Davidoff & Malito LLP

Consider this scenario. You invest large amounts of your hard earned cash, time and energy in building your hotel franchise into a successful business and then you're hit with a notice of termination from your franchisor which you think is unjust and want to fight. What's your best strategy? In almost all cases, you're better off not sitting back and waiting for the inevitable trademark infringement lawsuit to be brought against you. Instead, take the bull by the horns and go on the offensive: sue the franchisor to prevent the termination of your franchise.

There are several advantages to this strategy. First and foremost is that by striking first and immediately moving for a preliminary injunction to prevent termination of your franchise, you may be able to focus the court's attention on your strongest argument, i.e., that without an injunction you will be irreparably injured by losing your business, forfeiting your investment, and having your franchise canceled. The other major advantage is that a potentially long and costly litigation may be short-circuited since many wrongful termination cases are resolved after the preliminary injunction determination. Although this decision can be "reversed" after a trial on the merits, oftentimes a court's "first" impression is also its "last" impression and, since the losing party may feel that the court has already made up its mind, many cases settle at this point.

The standard which a court applies in deciding whether to grant a preliminary injunction requires that a franchisee demonstrate (a) irreparable injury in the absence of an injunction which is defined as injury which cannot be adequately compensated by money damages, and (b) either (1) a likelihood of success on the merits of your claim or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly in your favor. Fortunately, there is a large body of case law which holds that irreparable harm can generally be assumed where a franchisor is attempting to terminate an exclusive franchise arrangement on short notice. Indeed, in one case where a hotel franchisee sued Holiday Hospitality Franchising, Inc. to prevent the termination of its franchise, the court stated:

By the nature of the exclusive arrangement, the franchisee's business operation depends upon the economic relationship established by the franchise agreement. The franchise relationship is the lifeline of the franchisee's business; the franchisee's investment of capital, time and effort in promoting the franchisor's goods or services -- to the general exclusion of competing goods and services -- would be irreparably lost upon termination. Money damages cannot make the franchisee in such situations whole.^[1]

Similarly, other courts have recognized that even if a franchisee ultimately prevails on the merits of its lawsuit, it may simply be too late -- that the loss of customers and goodwill resulting from even a "temporary" shutdown of the franchisee's business is not recoverable and cannot be adequately compensated by money damages.^[2]

In addition to demonstrating irreparable injury, a franchisee must also raise at least a potentially meritorious claim that the franchisor wrongfully terminated the franchise. In many cases, a franchisee will argue that the franchisor violated the agreement's implied covenant of good faith and fair dealing by terminating the franchise based upon a wrongful pretext. For example, a franchisee may contend that a franchisor has fabricated a "default" as a pretext to get rid of a successful franchisee so that it may acquire its business without paying for it or simply "replace" the existing franchisee with a new franchisee more to the franchisor's liking. It is important to note, however, that if a franchisor has legitimate reasons to justify termination of the franchise such as a failure to pay franchise fees or royalties, a court may not be swayed by the fact that the franchisor's termination was motivated by an improper pretext.

Finally, the court must "balance the equities" and decide whether the franchisee has presented a sufficiently compelling case for judicial intervention. Thus, a franchisee should argue that preserving the franchise for a brief period so that the case may be resolved at a trial on the merits is a far more equitable result than compelling the immediate termination of the franchise which may result in the loss of an entire business and numerous jobs.

In short, when it comes to preventing termination of your franchise, a franchisee is well advised to consult with counsel before simply abandoning ship.

[1] See LaGuardia Associates v. Holiday Hospitality Franchising, Inc., 92 F. Supp.2d 119, 130-31 (E.D.N.Y. 2000).

[2] See Lepore v. New York News Inc., 365 F.Supp. 1387, 1389 (S.D.N.Y. 1973) (court held that franchisees would suffer irreparable injury by having their franchise terminated because "They will have lost their business and their customers and should they eventually succeed on the merits of this case, it may be impossible to reestablish the businesses as going concerns. Such a victory would, indeed, be pyrrhic").

Peter M. Ripin is a partner with Davidoff & Malito LLP in New York City where he practices in the areas of business litigation and dispute resolution. Mr. Ripin has represented numerous institutions and individuals in the hospitality industry including hotels in connection with disputes concerning website domain name piracy and the Anti-Cybersquatting Piracy Act, timeshare developers and managers in disputes arising out of joint ventures, restaurant franchisees in connection with actions seeking to terminate their franchise agreements and large catering halls involving significant business disputes. Mr. Ripin was formerly associated with Kelley Drye & Warren and Shea & Gould and is a cum laude graduate of Columbia University and Georgetown University Law Center. He may be reached at (212) 557-7200 and pmr@dmlegal.com

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