

Are You Sure You Considered Every Contingency When Drafting the Franchise Agreement?

A LITIGATOR'S
PERSPECTIVE

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Every once in a while, a case comes along to remind us that franchise agreements often last for very long periods of time. This fact means—for better and for worse—that drafters of franchise agreements need to consider their provisions from every angle, including the fact that the franchisor might someday wish to exit the franchise model of business. A recent case decided by the U.S. District Court for the District of Maryland is such a case. See *Jos. A. Bank Clothiers, Inc. v. J.A.B.-Columbia, Inc.*, 2017 WL 6406805 (D. Md. Dec. 15, 2017).

The *Jos. A. Bank Clothiers* case involved a single dispute respecting renewal rights of three different franchise agreements, all involving Jos. A. Bank (“JAB”) stores located in the Columbia, South Carolina area. The franchisees received their first franchise agreement in August of 2005 for a single store in Columbia. Then, in October 2009 and April 2010, JAB and the franchisees agreed to open two additional stores under two new franchise agreements. Each of the franchise agreements was set to expire on the expiration date of the first agreement, which was August 31, 2015. All three franchise locations were the subject of the lawsuit.

In 2014, while the three Columbia franchises were in continuous operation, JAB was acquired by a competitor. JAB at that point decided to exit the franchising business, and instead concentrate on corporate-owned retail store operations.

The language of the franchise agreements, at first blush, seemed relatively straightforward. For example, in Section 2.01 of the Agreements JAB granted the franchisees, “[t]he right ... to sell the Products at the store and use the System in connection therewith, for a period starting on the date of the Agreement and expiring on August 31, 2015 (the ‘Term’).” Consequently, the franchise agreements would expire on August 31, 2015, absent renewal.

The Dispute Over Renewal Rights

The main dispute between the parties centered on Section 16 of the franchise agreement governing renewal rights. Section 16.01 stated, “Franchisee has the right, subject to the conditions contained this Section 16, to buy a successor franchise for the Store on the terms and conditions of Franchisor’s then current form of franchise agreement[.]” Section 16.03 went on to say that, “[i]f Franchisee has the right to buy a successor franchise in accordance with Section 16.01 ... then Franchisor and Franchisee ... will execute the form of franchise agreement ... which Franchisor then customarily uses, or most recently used, in granting franchise rights[.]”

The dispute centered around the terms found in Section 16.03. First, what does it mean to buy “a” successor franchise? Second, what does the “then current form” of agreement mean? And third, which agreements do the phrases “then customarily uses” and “most recently used” refer to? Unfortunately, none of these essential terms were defined within the franchise agreement.

The parties filed cross motions for summary judgment. Under applicable Maryland law, as in most states, the interpretation of a contract is ordinarily a question of law for the court. Moreover, the court noted that, when interpreting written contracts, Maryland law requires objective contract interpretation; that is, clear and unambiguous contractual language will be enforced. Furthermore, under the objective view of contract interpretation, a written contract is ambiguous only if, when read by a reasonably prudent person, it is susceptible to more than one meaning.

The parties did not dispute that, because the franchisees met the conditions set forth in Section 16.01 of the franchise agreement, they were entitled to purchase a successor franchise. The question before the court was the terms upon which any successor franchise could be purchased.



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Perpetual Franchise?

The court began its analysis by looking at the arguments presented by both parties regarding the term of any agreement for a successor franchise. Pointing to the word “a” successor franchise, the franchisor argued that the franchisees would be entitled to a single renewal. The franchisees, on the other hand, argued that it was entitled to perpetual rolling renewals on the exact same terms as the initial franchise agreement—because each new agreement would provide for “a” successor franchise in Section 16.01. The franchisees argued that the only way JAB could change the franchise agreement would be to restart its franchising program and repeatedly sell new franchise rights to new franchisees on a new franchise agreement without any rights to a successor franchise.

The court rejected both parties’ arguments. It disposed of JAB’s argument by pointing out that the term “a” doesn’t necessarily mean a single time event. For example, someone could have the right to “a” lunch break. But such phrasing doesn’t mean that, during the entire time the person is employed, they could only receive one lunch break. Instead, it means they receive one lunch break every day.

On the flip side, the Court also rejected the franchisees’ argument, because it found that the contract was unambiguously clear that they were not entitled to unlimited rolling renewals. Rather, the court concluded that the franchise agreement provided for the purchase of a successor franchise—nothing more and nothing less. Because rolling renewals were not automatically contemplated by the plain language of the franchise agreement, the court concluded that the agreement simply does not require them.

The court went further, however. Going beyond the four corners of the parties’ franchise agreement, the court—even though it didn’t have to (and perhaps wrongly, as in this author’s opinion it could have decided the perpetual renewal question based solely upon the language of the Agreement)—reviewed evidence presented to it and decided that rolling renewals were not a universal practice at JAB, despite the franchisees’ assertions to the contrary. Therefore, the court concluded that, if the franchisees were correct that they were entitled to a successor franchise agreement which itself contains a renewal provision, it was emphatically not because of JAB’s alleged—and non-existent, at least according to the court—historical practice of rolling renewals.

Inherent Ambiguity as to Term and Form

The court next found the franchise agreement to be ambiguous as to the term and form of any successor agreement because of the three different ways such an agreement was described in the original agreement; that is, (a) JAB’s “then current form” of franchise agreement; (b) the form of the franchise agreement that JAB “then customarily uses”; and, (c) the form of franchise agreement which JAB “most recently used.” In evaluating each of these three options, the court found them to be wanting because none of them fit precisely. Consequently, because the agreement was ambiguous on the question of term and form of any successor agreement, the court analyzed what would be the proper form of a new franchise agreement between JAB and franchisees.

The court rejected use of the form of franchisee agreement from JAB’s most recent renewal because that renewal was merely a renewal and payment by check. The court decided that was not a truly “new” franchise agreement.

Next, the court decided that the natural reading of the language of the franchise agreement respecting the “then current form” must be either the form which the Franchisor most often or most customarily uses to grant franchises, or in the absence of such custom, the then current form must be the form that Franchisor currently uses. Unfortunately for JAB, because JAB was trying to exit the franchise business, the court concluded there wasn’t a “customary” or “current” form.

Consequently, the court concluded that a reasonable person could read “customarily uses” or “most recently used” and come to at least two different conclusions on the facts presented. Accordingly, the franchise agreement was found to be ambiguous under Maryland law.

Finding no answer in the franchise agreement respecting the proper form of a renewal agreement, the court next examined whether or not the franchise agreement allowed JAB to alter the form of the old franchise agreement for the successor agreement. Here, JAB pointed to Section 16.03 of the Agreement, which provided that successor franchise agreements “may contain provisions, including royalty fees, materially different from those” originally contained in the franchise agreement. JAB argued that this clause allowed it to present changes in any renewal agreement.

The franchisees disagreed. The franchisees argued that although JAB could present the franchisees with a form that was materially different, JAB could not deviate from whatever was its then current form, preventing JAB from creating any specific clauses that would be materially different from the original agreement. Once again, the Court found that reasonable people could disagree and found the agreement to be ambiguous on this point.

Use of Extrinsic Evidence

Because the court found the contract to be ambiguous and subject to two differing interpretations, the court concluded that extrinsic evidence had to be examined with respect to the Agreement. Nonetheless, the court looked at a very narrow aspect of the Agreement.

Specifically, the court stated that it would only consider evidence of what the parties meant when they used the phrases: “the then current form” and “the form of franchise agreement . . . which Franchisor customarily uses, or most recently used, in granting franchise rights.” Both sides pointed to evidence that tended to support their conclusions with respect to their interpretation of the Agreement.

The franchisees presented evidence in the form of a letter written in 2014—nine years after the first of their franchises were established in 2005—by the former CEO of JAB indicating that the then current form of franchise agreement implied no limitation on renewals. The court, however, discounted this testimony because the former CEO was now serving as a consultant for the franchisees. On JAB’s side, there was no evidence created contemporaneously with the drafting of the original franchise agreement in 2005. Nevertheless, there was an email from 2009 when the second franchise had been granted to the franchisees. In 2009, the former general counsel of JAB stated in an email that all agreements will expire with the expiration or earlier termination of the Columbia Agreement. According to JAB, this email meant that all the parties were aware prior to the establishment of the second and third franchises that all of the franchise agreements would end after one renewal.

The court was flummoxed and found that the extrinsic evidence presented simply did not resolve the ambiguity. Therefore, the court denied summary judgment to all parties and did not decide as a matter of law which form would be the proper one to use for a renewal. The court further directed that a

reasonable jury would have to analyze the evidence presented and come to a final conclusion.

Lessons? Oh Yes

The lessons of this decision are many. The biggest one is that drafters of franchise agreements must think years ahead when drafting franchise agreements. Franchisors and franchisees need to think not just about the immediate situation that they find themselves in, or even the situation they’ll find themselves in at the time of franchise renewal. They need to examine what might happen down the road and be flexible and account for future situations.

Here, JAB was no longer committed to franchising as it was attempting to exit the franchising portion of its retail business so it could focus on corporate stores. As we all know in these changing days of retail environments, that’s not necessarily an unusual event, and it could be common for many retailers in the future.

At the same time, the franchisees clearly believed on some level that they had bargained for a perpetual, automatically renewing franchise agreement. It is clear that the law in most states, as it was in Maryland, is that contracts, including franchise agreements, are not automatically and perpetually renewable without specific language in the agreement. Accordingly, if the franchisees wanted to obtain such a perpetually renewing agreement from the very beginning, it was incumbent upon them to negotiate clear and unambiguous language providing for such renewals. That said, and on that same issue, if JAB wanted to limit renewal to a single occurrence, it could have drafted a much clearer agreement providing for “one” or “a single” renewal as opposed to simply saying “a” renewal.

This last point is the point that probably is the most important lesson from this case. General language that the parties believe to say one thing clearly at the beginning of a relationship may become ambiguous when applied to different facts after a relationship has evolved. Consequently, precise choices with regard to words, especially around numerosity, the form and term of renewal, and other types of issues that are subject to ambiguous interpretation, must necessarily and absolutely be considered at the outset of a franchise agreement, because you never know then what you will know later on. Think of it as your present self saving your future self from agony—and if that’s not enough motivation, think of the legal fees you’re saving. ☐