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Don’t Feel Bad for Protecting Your Franchise and Trademark Rights

FOLEY & LARDNER LLP
Article By
[Jason B. Binford]
[Lisa Hemphill]
[Foley & Lardner LLP]
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All franchisors understand that there are risks and pitfalls when entering into a franchise agreement. Both the franchisor and the franchisee want the franchisee to do well and be successful. As a franchisor, you want your franchisee to succeed so that others may invest in your franchise, which would help you grow your global footprint. In the real world, however, **sometimes franchisees do not perform as expected**. The franchisee can default on the franchise agreement, file for bankruptcy, or just have a bad year. Like any bad relationship, although it hurts, an exit strategy is sometimes required.

If a **franchisee defaults or breaches the franchise agreement**, the franchisor must take action to **protect its brand**, as the brand symbolizes the goodwill of the franchise and is its most valuable asset. Failure to police the brand and allow a terminated franchisee to continue to use the brand can significantly weaken the brand and value of the franchise license. This often leads to the franchisor filing a motion for a preliminary injunction to stop a franchisee from continuing to operate its business and infringe the franchisor’s trademarks. The elements of such a preliminary injunction were analyzed in an opinion recently published by the U.S. District Court for the Eastern District of Michigan involving **Little Caesar Enterprises, Inc. and LC Trademarks, Inc.** (collectively, “LCT”), the owner of the

LITTLE CAESARS trademarks, *Little Caesar Enterprises, Inc. v. Miramar Quick Service Restaurant Corporation*, 2:18-cv-10767 (E.D. Mich. July 16, 2019).

Ultimately, the court issued a preliminary injunction enjoining the franchisees from continuing to operate as Little Caesars' franchises and continuing to use the LITTLE CAESARS trademarks. The case provides a number of helpful reminders on how to effectively terminate a franchise relationship.

Background of the Little Caesars' Case:

Brothers Khalid and Abdel Drihmi (hereinafter "Defendants") owned four Little Caesars franchises in Connecticut and Massachusetts. They owned the franchises through two companies, one of which was Miramar Quick Service Restaurant Corporation. After many critical violations to the franchise agreement, LCT sent two letters to Defendants with the subject "Notice of Default and Notice of Franchise Agreement Termination." The franchisees failed to cure the violations and committed further violations, including failing to comply with federal tax laws, report gross sales, and pay royalty and advertising fees. LTC then filed a motion for a preliminary injunction to enjoin Defendants from operating in violation of the franchise agreements and committing trademark infringement. LCT argued that it ran the risk of losing its goodwill in its brand should customers be dissatisfied with their experience at the franchisees' restaurants.

In contrast, the franchisees asserted that a preliminary injunction would cause Defendants to suffer substantial financial harm. Specifically, the Defendants asserted that they "decided to invest their life savings and that of their family in this business in the pursuit of the American dream" and that an injunction would destroy their business. The court stated that it did not take such consideration lightly, but found that the harm at issue arose "from the Defendants' conduct in violating the terms of the franchise agreement more than it [did] from the issuance of [a] preliminary injunction."

As to the public interest question, the court specifically noted the generally recognized public interest in holding parties to their agreements, as cited by other courts including *S. Glazer's Distrib. Of Ohio, LLC v. Great Lakes Brewing Co.*, 860 F3d 844, 853-54 (6th Cir. 2017). Here, the court found that plaintiffs adduced significant evidence that Defendants breached and continued to breach the franchise agreements. Therefore, the court held that LCT would suffer substantial reputational harm should Defendants continue to operate their unauthorized Little Caesars franchises. Accordingly, the court held, the public interest is best served by guarding against the operation of unlicensed franchisees. *R-J-L Foods, Inc.,* 796 F.Supp. at 1036.

For franchisors, this is an important point. Even where an injunction may end the business of an otherwise sympathetic franchisee, a court may still issue the injunction if the franchisee's conduct caused the harm and also based on the public policy of holding parties to the terms of their agreements.

The franchisees in the case chose to defend against the preliminary injunction in the district court rather than seek protection in bankruptcy court. However, the facts of the case present another learning opportunity for franchisors if the franchisees had, in fact, filed bankruptcy. The court makes clear that LCT effectively terminated the franchisees' agreement and the fight between the parties related to the post-termination issue of the franchisees continuing to use LCT's trademarks. The fact that the termination had effectively occurred is very significant with respect to bankruptcy. A franchise agreement – and the related rights and obligations – is one of the most significant assets in any franchisee Chapter 11 (i.e., reorganization) bankruptcy filing. However, the agreement only becomes an asset of the franchisee's bankruptcy estate if the franchisee files bankruptcy *before* the agreement is terminated. It is well accepted under the law that bankruptcy cannot "resurrect" a terminated franchise agreement. That likely explains why Chapter 11 bankruptcy was not at issue in the LCT case. The franchisees could have filed Chapter 11 bankruptcy post-termination, but there would be little practical reason to do so because the most important asset required for reorganization – the franchise agreement – would not have been part of the bankruptcy case. The practical lesson for franchisors is that if a franchisee is teetering on the edge of insolvency, the franchisor should consider expeditiously terminating the franchise agreement in order to prevent such agreement from becoming an asset of the bankruptcy estate in any franchisee Chapter 11 bankruptcy filing.