

Should a Franchise Holder Be Allowed to Continue Operating While a Termination Suit Is Pending?

BY MITCHELL J. KASSOFF

Should a court issue an injunction ordering a franchisor to allow a franchisee to continue to operate his franchise pending conclusion of trial on charges that a franchise was improperly terminated? The position taken here is that in many cases such relief should be granted.

The primary argument of the franchisee will be that an injunction is necessary to prevent irreparable harm if the injunction is not granted. A secondary argument is that during this process a franchisor will earn money from the franchise fees paid by a franchisee, thereby benefiting from this relationship.

The facts in such cases are usually quite simple. A franchisor will have terminated a franchise due to an alleged breach of the franchise agreement. The franchisee will argue that either (a) the breach of the franchise agreement did not exist or (b) it was *de minimis* and not worthy of the drastic step of terminating a franchise. In some cases, a franchisee will allege that it has been discriminated against.

The franchisee will state that its request is simply that the court order a franchisor to maintain the *status quo ante* while this matter is litigated. The franchisee will continue in that if the injunctions are not granted, monetary damages will not suffice and it will be impossible to put a franchisee back in its former position because it will be impossible to know how much a franchisee would have made or would have sold at their franchises.

The U.S. Supreme Court held that a court must weigh “the relative harms to the parties” when deciding if an injunction should be issued.¹

In a case in the Eastern District of New York,² the plaintiff dealer filed a motion for a preliminary injunction enjoining the defendant distributor from terminating its dealership until the dealer’s suit against the distributor was concluded. The court concluded that the dealer made a sufficient showing of irreparable harm if his business were closed.

In a case in the Southern District of New York,³ plaintiffs brought an order to show cause why the defendant

should not be preliminarily enjoined from terminating their carrier agreements and from committing other acts of harassment. The court held:

If the defendant does in fact terminate the plaintiffs, the plaintiffs will be irreparably harmed. 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.

That the court has the power to issue an injunction when the likelihood that the franchise will be terminated is quite clear. “Many courts have held that defendants who are or may be guilty of anticompetitive practices should not be permitted to terminate franchises, leases or sales contracts when such terminations would effectuate those practices.” This is true even though “the plaintiff had violated the terms of the franchise or sales agreement and had given [the] defendant a contractual basis for termination.”⁴

In a case in the Eastern District of New York,⁵ a franchisee violated its franchise agreement on several occasions. Finally, the franchisor threatened to terminate the franchise agreement. The franchisee filed a complaint in state court seeking a temporary restraining order prohibiting the franchisor from removing the franchisee from the franchisor’s reservation system. The temporary restraining order was granted and the defendant



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removed the case to the Eastern District, where the court held:

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. See *Roso-Lino Beverage Distribs., Inc. v. Coca-Cola Bottling Co.*, 749 F.2d 124, 125–26 (2d Cir. 1984) (per curiam) (“The loss of Roso-Lino’s distributorship, an ongoing business representing many years of effort and the livelihood of its husband and wife owners, constitutes irreparable harm. What plaintiff stands to lose cannot be fully compensated by subsequent money damages.”).⁶

The harm that the plaintiff will suffer if the injunction is not granted must be analyzed together with the balancing of equities between the parties.

In a Northern District of New York case,⁷ the plaintiffs sought a temporary restraining order (TRO) against a franchisor. The plaintiffs alleged various causes of action including violations of the New York Franchise Sales Act, fraudulent inducement to enter into certain asset purchase contracts and franchise agreements, fraud, breach of the implied covenant of good faith and fair dealing, conspiracy, and detrimental reliance. The court granted the plaintiffs’ motion for a TRO, holding that such an order could be granted where the party could establish irreparable harm and that if the restraining order was not granted, there was the likelihood of the franchisee being forced into bankruptcy and suffering irreparable harm, thereby rendering a final judgment useless. The court found that the balance of equities weighed in favor of the plaintiffs and granted the TRO for 10 days or until a hearing and determination of the plaintiffs’ application for a preliminary injunction.

The Southern District of New York⁸ has held that the court

must balance the equities to determine if “the harm which [it] would suffer from the denial of [its] motion is ‘decidedly’ greater than the harm [Cherokee] would suffer if the motion is granted.” *Buffalo Forge Co. v. AMPCO-Pittsburgh Corp.*, 638 F.2d 568, 569 (2d Cir. 1981); see also *Roland Machinery Co. v. Dresser Industries Inc.*, 749 F.2d 380, 386 (7th Cir. 1984) (balance the potential harm to the plaintiff if the injunction is erroneously denied against the potential harm to the defendant if it is erroneously granted).⁹

The harm that the plaintiff will suffer if the injunction is not granted must be analyzed together with the balancing of the equities between the parties. If the court

grants the requested relief, the franchisee will a will cost the defendant virtually nothing to comply; indeed, the defendant will make additional money. Therefore, the harm that will be caused if the relief is not granted is greatly magnified when it is compared with the zero cost to the defendant.

It should also be noted that all factors are not weighted equally. The Fourth Circuit¹⁰ stated:

These factors are not, however, all weighted equally. The “balance of hardships” reached by comparing the relevant harms to the plaintiff and defendant is the most important determination, dictating, for example, how strong a likelihood of success showing the plaintiff must make. See *Rum Creek Coal Sales, Inc. v. Caperton*, 926 F.2d 353, 359 (4th Cir. 1991).¹¹

The Court of Appeals went on to state:

Even if a loss can be compensated by money damages at judgment, however, extraordinary circumstances may give rise to the irreparable harm required for a preliminary injunction. For example, the Seventh Circuit has noted that *even where a harm could be remedied by money damages at judgment, irreparable harm may still exist where the moving party’s business cannot survive absent a preliminary injunction.*¹²

The U.S. District Court in Kansas¹³ held:

Plaintiff claims it will be irreparably harmed in several ways if defendant is allowed to discontinue its monthly supply of PVC compound. First, plaintiff claims that because the Shintech supply contract provides only half of its PVC compound requirements it will not be able to meet customer demands, which are presently very high. Consequently, plaintiff will lose goodwill and will eventually lose its customers to other PVC pipe manufacturers able to meet customer demands. Second, the reduction of compound supply will necessitate plaintiff’s laying off 10–12 employees and curtailing operations from seven days per week to five days per week on April 1, 1988. Third, plaintiff will not be able to operate profitably at less than full capacity, and thus will eventually be forced to cease its manufacturing operations altogether. Numerous cases support the conclusion that loss of customers, loss of goodwill, and threats to a business’ viability can constitute irreparable harm. See *Tri-State Generation*, 805 F.2d 351, 356 (10th Cir. 1986); *Roso-Lino Beverage Distributors, Inc. v. Coca-Cola Bottling Co.*, 749 F.2d 124, 125–26 (2d Cir. 1984); *Otero Savings & Loan Ass’n v. Federal Reserve Bank*, 665 F.2d 275, 278 (10th Cir. 1981); *Federal Leasing, Inc. v. Underwriters at Lloyd’s*, 650 F.2d 495, 500 (4th Cir. 1981); *Valdez v. Applegate*, 616 F.2d 570, 572 (10th Cir. 1980); *John B. Hull, Inc. v. Waterbury Petroleum Products, Inc.*, 588 F.2d

24, 28–29 (2d Cir. 1978), cert. denied, 440 U.S. 960, 99 S. Ct. 1502, 59 L. Ed. 2d 773 (1979); *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197, 1205 (2d Cir. 1970); *Associated Producers Co. v. City of Independence*, 648 F. Supp. 1255, 1258 (W.D. Mo. 1986); *Stanley-Fizer Associates, Inc. v. Sport-Billy Productions Rolf Deyhle*, 608 F. Supp. 1033, 1035 (S.D.N.Y. 1985); *Great Salt Lake Minerals & Chemicals Corp. v. Marsh*, 596 F. Supp. 548, 557 (D. Utah 1984).¹⁴

Strong notice should be taken of the last line of the quote, to wit: “Numerous cases support the conclusion that loss of customers, loss of goodwill, and threats to a business’ viability can constitute irreparable harm.”

The Eighth Circuit Court of Appeals held that “where the status quo is a condition not of rest, but of action, and the condition of rest (in this case the refusal to deliver the seed corn) will cause irreparable harm, a mandatory preliminary injunction is proper.”¹⁵

The Southern District of New York¹⁶ described the necessary elements for an injunction as follows:

To prevail on its claim for a preliminary injunction, [the moving party] must demonstrate a threat of irreparable injury and either (1) a probability of success on the merits, or (2) sufficiently serious questions going to the merits of the claims to make them a fair ground for litigation, and a balance of hardships tipping decidedly in its favor. See, e.g., *Brenntag Int’l Chems. Inc. v. Bank of India*, 175 F.3d 245, 249 (2d Cir. 1999). Although the monetary injury claimed here usually does not constitute irreparable harm because such injury can be estimated and compensated, irreparable harm may exist where “but for the grant of equitable relief, there is a substantial chance that upon final resolution of the action the parties cannot be returned to the positions they previously occupied.” *Id.* (internal cite omitted); *S.E.C. v. Princeton Econ. Int’l, Ltd.*, 73 F. Supp. 2d 420, 425 (S.D.N.Y. 1999) (same).¹⁷

The Second Circuit¹⁸ held:

Unlike a party seeking specific performance, a party that requests a preliminary injunction *must* discuss the merits of the dispute underlying the injunction motion. The requirements for a preliminary injunction are well settled: a party seeking relief must show (a) irreparable harm and (b) either (1) likelihood of success on the merits 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 its favor. *Jackson Dairy, Inc. v. H.P. Hood & Sons*, 596 F.2d 70, 72 (2d Cir. 1979) (per curiam).

The test for specific performance is more flexible. It initially requires proof that (1) a valid contract exists between the parties, (2) the plaintiff has substantially performed its part of the contract, and (3) plaintiff and defendant are each able to continue performing their parts of the agreement. See *Travellers Int’l AG v. Trans World Airlines, Inc.*, 722 F. Supp. 1087, 1104 (S.D.N.Y. 1989). A party seeking relief must show equitable fac-

tors in its favor, for example, the lack of an adequate remedy at law, and must also demonstrate that its risk of injury, if the injunction is denied, is one that after balancing the equities entitles it to relief. *Id.* One of the factors balanced is irreparable harm, a common element under both tests. See *Guinness-Harp Corp. v. Jos. Schlitz Brewing Co.*, 613 F.2d 468, 472 (2d Cir. 1980); see also *Payroll Express Corp. v. Aetna Casualty and Sur. Co.*, 659 F.2d 285, 292 (2d Cir. 1981) (specific performance injunction granted where money damages speculative and court found absence of “offsetting equities militating against a grant of equitable relief”); *Erving v. Virginia Squires Basketball Club*, 468 F.2d 1064, 1067 (2d Cir. 1972) (specific performance injunction upheld based on contract language and showing of irreparable damage).¹⁹

The franchisee will state that the relief requested is in reality seeking specific performance of the contract between the parties, namely the continuation of the contractual relationship among the parties.

There are two tests to determine if a court should grant the injunctive relief requested by a franchisee. They are (a) irreparable injury to the moving party and (b) probable success on the merits of the case or “sufficiently serious questions going to the merits as to make them a fair ground for litigation.” To succeed, the plaintiff “need only make a showing that the probability of . . . prevailing is better than fifty percent.”²⁰

Some courts add an additional two tests (c) a balancing of the equities between the parties and (d) the public good. As shown below, not only are these tests easily passed by the plaintiff, but the balancing of the equities of the parties is clearly in favor of granting the relief because the harm to the plaintiff is potentially very significant while the harm to the defendant is likely to be minimal.

In terms of the public good, the franchisee will argue that society as a whole will be helped because it is in the public interest not to allow a franchisor to have a franchisee work more than six years to build up a business and then take it from him. If a large franchisor is permitted to succeed, it will be encouraged to repeat this behavior in countless other cases.

As Judge Friendly once remarked, “the opportunity for doing equity is considerably better than it will be later on.”²¹ In addition to federal law, the law of New York State also supports the franchisee’s position.

The Second Department²² has held that:

The defendants are clearly attempting to terminate the plaintiffs’ exclusive licensing agreement and, absent a preliminary injunction, there is no assurance that the plaintiffs will be able to stay in business pending trial. Such interference with an ongoing business, particularly one involving a unique product and an exclusive licensing and distribution arrangement, risks irreparable injury and is enjoinable (see, e.g., *Chrysler Realty Corp. v. Urban Investing Corp.*, 100 A.D.2d 921; *Roso-Lino*

Beverage Distributions v. Coca Cola Bottling Co., 749 F.2d 124). In the absence of any proof that Carvel will be harmed by the granting of injunctive relief in order to maintain the status quo, the existence of disputed factual issues should not preclude the remedy (see, *Burmax Co. v. B & S Indus.*, 135 A.D.2d 599; *City Store Gates Mfg. Corp. v. United Steel Prods.*, 79 A.D.2d 671; see also, CPLR 6301; *Blake v. Biscardi*, 52 A.D.2d 834; *Nassau Roofing & Sheet Metal Co. v. Facilities Dev. Corp.*, 70 A.D.2d 1021).²³

In the Third Department,²⁴ a corporation entered into a written contract to provide radiology services to a hospital. The contract provided that either party could terminate the agreement as long as the action taken was not arbitrary or capricious in nature. The hospital terminated the agreement in order to reduce the operating expenses of the radiology department, which had operated at a loss. The corporation sought a preliminary injunction requiring the hospital to reinstate the corporation pending the trial of the underlying breach of contract action. The trial court denied preliminary injunctive relief, but the court reversed. The court held that the moving party had to demonstrate the likelihood of ultimate success on the merits; irreparable injury absent granting of the preliminary injunction; and a balancing of equities. The corporation made a *prima facie* showing that the hospital's action could have been seen as arbitrary or capricious, and disruption of the corporation's practice would have resulted in the loss of good will and patient referrals, which was impossible to ascertain.²⁵

The Appellate Division reversed the order of the trial court that denied the corporation's motion for preliminary injunctive relief. The court granted a preliminary injunction directing the hospital to reinstate the corporation pending the underlying action.

Therefore, both the Second and Third Departments have stated that the injunctive relief in a situation similar to that of plaintiffs should be granted.

The Supreme Court, New York County,²⁶ held:

The claim of irreparable injury is met with a glib response that money damages would make petitioner whole if the License Agreement has been wrongfully terminated. This ignores the real threat that termination poses to the continued existence of Innomed whose only asset is the valuable sublicense. Furthermore, Innomed has a valuable marketing agreement with Pfizer, Inc., that would be defeated. This agreement generates substantial revenues from which royalties on the plastic comb are supposed to be paid to Comb Associates. Be-

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sides, the calculation of petitioner's damages if the license passes to another is an exercise in speculation. It is true that part of these damages will be measured by the actual sales of the new licensee. But, if those sales could be greater had the license not been terminated, petitioner would be entitled to a higher sum incapable of measurement. In any event, the possibility that money damages may be adequate does not prevent injunctive relief.²⁷

As a fallback position, a franchisor will attempt to have a bond imposed upon the franchisee. This can be quite devastating to the franchisee if it cannot afford the bond fee. The franchisee will submit that the court should grant the franchisee's request for injunctive relief without requiring the franchisee to post a bond.²⁸

In relevant part, the rule states that

[n]o restraining order or preliminary injunction shall issue except upon the giving of security by the applicant,

in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained.²⁹

The franchisee will state that the franchisor has only benefited financially from the plaintiffs' operations of their franchises. In addition, the clear trend is that since the plaintiffs' sales have been increasing, the benefit to the defendant shall only increase.

The language of Rule 65(c) has been held to give the court "[w]ide discretion to set the amount of a bond, and even to dispense with the bond requirement 'where there has been no proof of likelihood of harm.'"³⁰

The franchisee's final argument will be that the franchisor will continue to profit from the franchisee's efforts. The franchisee will emphasize that the posting of a bond will be a significant financial hardship for the franchisee, which it should not be required to endure.

In conclusion, the franchisee will state that based upon the irreparable harm that the franchisee will have and the lack of harm the franchisor will have if the court grants the requested injunctive relief, the injunctive relief requested by the franchisee should be granted. In addition, the franchisee will state that the requested injunctive relief must be granted to preserve the *status quo ante*. Finally, the franchisee will state that should the injunctive relief not be granted, it will be impossible to properly compensate plaintiffs at the successful conclusion of the trial.

For the reasons described here, in many cases the injunctive relief requested by the franchisee should be granted.

1. *Honig v. Doe*, 484 U.S. 305, 328 (1988).
2. *Two Wheel Corp. v. American Honda Corp.*, 506 F. Supp. 806 (E.D.N.Y.), *aff'd*, 633 F.2d 206 (2d Cir. 1980).
3. *Lepore v. New York News, Inc.*, 365 F. Supp. 1387 (S.D.N.Y. 1973).
4. *Milsen Co. v. Southland Co.*, 454 F.2d 363, 366 (7th Cir. 1971). See *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197 (2d Cir. 1970); *Interphoto Corp. v. Minolta Corp.*, 295 F. Supp. 711 (S.D.N.Y.), *aff'd*, 417 F.2d 621 (2d Cir. 1969) (emphasis added); see also *Lepore*, 365 F. Supp. at 1389.
5. *Laguardia Assocs. v. Holiday Hospitality Franchising, Inc.*, 92 F. Supp. 2d 119 (E.D.N.Y. 2000).
6. *Id.* at 131.
7. *Progressive Restaurant Sys., Inc. v. Wendy's Int'l, Inc.*, 1990 U.S. Dist. LEXIS 9289, 17 Fed. R. Serv. 3d (Callaghan) 786 (N.D.N.Y. 1990).
8. *Holford USA v. Cherokee, Inc.*, 864 F. Supp. 364, 374 (S.D.N.Y. 1994).
9. *Id.* at 374.
10. *Hughes Network Sys. v. Interdigital Communications Corp.*, 17 F.3d 691 (4th Cir. 1994).
11. *Id.* at 691.
12. *Id.* at 699 (emphasis added).
13. *Zurn Constructors, Inc. v. B.F. Goodrich Co.*, 685 F. Supp. 1172 (D. Kan. 1988).
14. *Id.* at 1181.
15. *Ferry-Morse Seed Co. v. Food Corn, Inc.*, 729 F.2d 589, 593 (8th Cir. 1984).
16. *Quantum Corporate Funding, Ltd. v. Assist You Home Health Care Servs. of Va., L.L.C.*, 144 F. Supp. 2d 241 (S.D.N.Y. 2001).
17. *Id.* at 248 (emphasis added).
18. *Nemer Jeep-Eagle, Inc. v. Jeep-Eagle Sales Corp.*, 992 F.2d 430 (2d Cir. 1993).
19. *Id.* at 433.
20. *Abdul Wali v. Coughlin*, 754 F.2d 1015, 1025 (2d Cir. 1985) (emphasis added).
21. *Electronic Specialty Co. v. Int'l Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969).
22. *U.S. Ice Cream Corp. v. Carvel Corp.*, 136 A.D.2d 626, 523 N.Y.S.2d 869 (2d Dep't 1988).
23. *Id.* at 628.
24. *Wasilkowski, v. Amsterdam Mem'l Hosp.*, 92 A.D.2d 1016, 461 N.Y.S.2d 451 (3d Dep't 1983).
25. *Id.* at 1016.
26. *Saferstein v. Wendy*, 137 Misc. 2d 1032, 523 N.Y.S.2d 725 (Sup. Ct., N.Y. Co. 1987).
27. *Id.* at 1035-36 (emphasis added).
28. Federal Rules of Civil Procedure 65(c).
29. *Id.*
30. *Doctor's Assocs. v. Distajo*, 107 F.3d 126, 136 (2d Cir. 1997) (quoting *Doctor's Assocs. v. Stuart*, 85 F.3d 975, 985 (2d Cir. 1996)); see *Clarkson Co. v. Shaheen*, 544 F.2d 624, 632 (2d Cir. 1976).

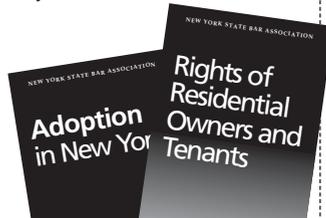
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