franchisees. Questions of territory and exclusivity are "crucial to the success of the franchisee," but may be less important to the franchisor, he notes. Unlike mainstream franchisees, who can appeal to the courts, cartel franchisees must resolve their disputes in "the traditional manner."

In closing, Wainwright argues that the cartels' adoption of the franchise model ultimately may imperil their brand. The cartels' surge in growth has resulted in a corresponding surge in infighting. Thus, "rival franchisees spend their time murdering each other (and innocent civilians) rather than trafficking drugs," to the detriment of the efficiency of their operations.

Wainwright never avoids the brutality of the cartels or excuses their devastating impact. In the end, *Narconomics* shows that the cartels' adoption of traditional business concepts such as franchising makes them more terrifying, not less so. ■

Defense for Nondisclosure Of Liability for Lost Profits

By Keith J. Kanouse, Kanouse and Walker, PA, and Mackenzie Dimitri, Einbinder Dunn & Goniea LLP

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Franchisors increasingly are suing terminated franchisees pursuant to their franchise agreements for lost profits or liquidated damages. These damages usually take the form of the royalties and national advertising contributions the franchisee would have paid through the end of the term, less the costs the franchisor saves by not having to provide ongoing services to the terminated franchisee during that time.

The scant case law on franchisors' recovery of lost profits suggests that the parties and the court immediately focus on the franchisor's contractual right to recover these damages under general contract principles, without first considering whether the franchisor disclosed or was required to disclose in its Franchise Disclosure Document (FDD) its right to claim them as damages.

Given the importance of franchisees' post-termination obligations under their franchise agreements, should franchisors have an affirmative obligation to provide specific pre-sale disclosure of franchisees' potential liability for lost profits? The authors believe the answer to this question is "yes." In this article, they address a franchisor's obligation to disclose its right to seek lost profits or liquidated damages from terminated franchisees, as well as a franchisee's ability to assert an affirmative defense against recovery of these damages when such disclosure is not provided. (This article *does not* discuss whether a franchisor is barred from recovering lost profits if it is the party that terminated the franchise agreement. *See Postal Instant Press Inc. v Sealy*, 51 Cal. Rptr. 2d 365 (Cal. Ct. App. 1996) and its progeny.)

Disclosure of Other Post-Termination Fees

The Federal Trade Commission's (FTC's) Franchise Rule and the North American Securities Administrators Association's (NASAA's) 2008 Franchise Registration and Disclosure Guidelines require the franchisor to disclose in Item 6 of its FDD all other fees (beyond initial fees disclosed in Item 5) that the franchisor may impose on the franchisee during the term of the franchise agreement and upon termination. The franchisor also must disclose in Item 17(i) of the FDD the franchisee's obligations upon termination or non-renewal of the franchise agreement.

Many franchisors have chosen to add a post-termination liquidated damages provision to their franchise agreements in lieu of a lost profits provision because of the burden and cost involved in having experts calculate the amount of lost profits with "reasonable certainty," as the law requires. *See e.g. Lucas v. Clark*, 347 S.W.3d 800, 803 (Tex. Ct. App. 2011) (a "reasonably-certain-evidence standard" requires opinions or estimates of lost profits to be "based on objective facts, figures, or data from which the amount of lost profits can be ascertained") (citations omitted); *see also Hardee's Food Sys., Inc. v. Hallbeck*, 2011 WL 4407435, at *3 (E.D. Mo. Sept. 21, 2011) (citations omitted). If a franchise agreement contains a post-termination liquidated damages provision, it is common practice – and, in the

authors' view, required – for the franchisor to disclose this in Items 6 and 17(i) of its FDD.

Obligation to Disclose Right to Recover Lost Profits

By the same token, in the authors' view, a franchisor is obligated to disclose in Items 6 and 17(i) of its FDD not only its right to recover "damages," generally, but also its right to recover lost profits specifically. If the franchise agreement does not expressly provide for the franchisor to recover lost profits, upon termination and the FDD does not specifically disclose this fee in Items 6 and 17(i), then a franchisee should assert as an affirmative defense that the franchisor is precluded from recovering lost profits because this right was not disclosed and was not within the reasonable contemplation of the parties.

The authors have found only one court decision directly supporting their view, *see Lady of Am. Franchise Corp. v. Arcese*, Bus. Fran. Guide (CCH) ¶ 13,561 (S.D. Fl. May 25, 2006), and one arbitration award rejecting it.*

There is little reported authority on this subject, for various reasons. First, many franchise agreements require arbitration, and arbitration decisions regarding lost profits go unreported. In addition, as noted above, "lost profits" is not included in the list of examples of "Other Fees" required to be disclosed in Item 6 of the FDD, which currently includes "royalties, and fees for lease negotiations, construction, remodeling, additional training or assistance, advertising, advertising cooperatives, purchasing cooperatives, audits, accounting, inventory transfers and renewals." Likewise, "lost profits" is not included in the list of provisions of the franchise agreement concerning "Renewal, Termination, Transfer and Dispute Resolution," that must be disclosed in Item 17 of the FDD, which currently includes provisions for terminated franchisees to pay all monies due the franchisor, comply with covenants not to compete, assign their leases or de-identify their business premises, return confidential information, and pay damages. If lost profits were included in these lists of examples, franchisors would be more likely to list them, and that would generate additional authority and guidance on this subject.

Decisions Involving Lost Profits

In many actions to recover lost profits, the franchisee fails to defend against the franchisor's claims, and lost profits are awarded in default judgments. *See, e.g., Precision Franchising LLC v. K-Squared, Inc.*, 2011 WL 4407936, at *8 (E.D. Va. Aug. 29, 2011) (default judgment for franchisor including $378,443 in lost profits damages); *Century 21 Real Estate LLC v. RealtyComp.com*, 2015 WL 1009660, at *8 (N.D. Cal. Mar. 6, 2015) (default judgment for franchisor including lost profits damages); *Grout Doctor Global Franchise Corp. v. Groutman, Inc.*, 2015 WL 2353698, at *3 (E.D. N.C. May 15, 2015) (same); *Century 21 Real Estate LLC v. Paramount Home Sales, Inc.*, 2007 WL 2403397, at *5 (E.D. N.Y. Aug. 20, 2007) (same); *Maaco Enters., Inc. v. Cintron*, 2000 WL 669640, at *5 (E.D. Pa. May 17, 2000) (default judgment for franchisor including nine years of future lost royalty payments).

In *Meineke Car Care Ctrs., Inc. v. RLB Holdings, Inc.*, 423 Fed. Appx. 274 (4th Cir. 2011), the courts analyzed whether lost profits are recoverable if not addressed in the franchise agreement. In that case, the district court dismissed on summary judgment the franchisor's claim for lost future royalties because they were not expressly addressed in the franchise agreement. But the appellate court reversed that ruling, holding that lost future royalties are not automatically precluded when not expressly addressed in the agreement but would have to be within the parties' contemplation to be recoverable. Thus, the court found that an issue of fact precluded summary judgment.

In *Legacy Acad., Inc. v. JLK, Inc.*, 765 S.E.2d 472 (Ga. Ct. App. 2014), a state appellate court likewise held that the trial court erred in concluding a franchisor could not recover lost future royalties where the franchise agreement provided that the franchisor could terminate and seek "actual and consequential damages suffered" if the franchisee defaulted. (The appellate court nevertheless upheld the trial court's conclusion that the franchisor failed to prove lost royalties with sufficient specificity.)

The authors are not aware of any case in which the failure to disclose lost profits was asserted as an affirmative defense, other than *Arcese*, Bus. Fran. Guide (CCH) ¶ 13,561. In that case, after the franchisee closed its Lady of America Fitness Center franchise, the franchisor sued the franchisee for breach of the parties' agreement and sought payment for the 111 months remaining on the agreement. The franchisee argued that lost profits damages were not within her reasonable contemplation because the franchisor failed to include future royalties as a franchise fee in Item 6 of its Uniform Franchise Offering Circular (UFOC) and did not specifically list it as a fee owed upon termination in Item 17 of the UFOC. The court stated that the question of whether the franchisor complied with its disclosure obligations pursuant to the UFOC Guidelines, "does not impact whether, as a result of the plain language of the parties' agreement, Arcese contemplated the possibility of paying future royalties upon breach of the agreement." The court then noted that Arcese did not raise this issue in

her counterclaims against the franchisor for violating the Florida Deceptive and Unfair Trade Practices Act, Fla. Stat. § 501.201 *et seq.*, and therefore it declined to address whether the franchisor's UFOC violated that statute "for its failure to plainly state that the franchisee was required to pay future royalties upon termination." *Arcese*, Bus. Fran. Guide (CCH) 13,561 at n.8.

Conclusion

In these authors' view, if a franchisor adopts a policy of seeking lost profits from terminated franchisees, it should specifically say so in its franchise agreement and in Items 6 and 17(i) of its FDD. And if a franchisee that is sued for lost profits had no reason to contemplate that it could be subject to these damages – either through the express terms of its franchise agreement or through disclosures in Items 6 and 17(i) of the franchisor's FDD – it should raise this as an affirmative defense. The same logic applies to post-termination liquidated damages provisions.

* *Editor's Note: Author Keith Kanouse served as an expert witness for a franchisee in the arbitration referenced in this article, in which the franchisor was awarded lost profits even though its right to recover them was not expressly disclosed in its FDD.* ■

Canada's Competition Law: What Franchises Should Know

By Mark Katz, Davies Ward Phillips & Vineberg LLP and Joseph Adler, Hoffer Adler LLP

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Although franchising in Canada is governed principally by provincial legislation, franchisors and franchisees operating there must also comply with the federal Competition Act, R.S.C. 1985, c. C-34, as amended. The Competition Act, which has no provincial or territorial counterparts, applies to all businesses and industries in Canada. Its objective is to "maintain and encourage competition in Canada."

This article provides a primer on aspects of the Competition Act most relevant to the franchise industry.

The Competition Act is administered and enforced by the Commissioner of Competition, who heads the Competition Bureau (Bureau). The Bureau has a wide array of investigative tools at its disposal, including the power to obtain search warrants and wiretaps and to compel production of documents and testimony under oath.

The Competition Act's prohibitions are broadly divided into two categories: criminal offenses and "reviewable matters," also referred to as "reviewable practices." The principal criminal offenses under the Act are criminal agreements between competitors (conspiracies) and bid-rigging. Certain deceptive marketing practices, including pyramid schemes and multi-level marketing plans, are also criminal offenses. These offenses are prosecuted in the criminal courts by federal prosecutors. They are subject to sanctions such as fines and imprisonment.

The principal reviewable matters under the Act include abuse of dominance (monopolization); distribution practices such as exclusive dealing, market restrictions, tied selling, and refusal to deal; price maintenance; non-criminal agreements between competitors; mergers; and deceptive marketing practices such as misleading "ordinary sales price" representations. These matters are governed by a civil adjudication regime, with applications brought by the Bureau principally to the Competition Tribunal (Tribunal), a specialized administrative body. Potential remedies include injunctive-type relief and administrative monetary penalties.

Private enforcement of the Competition Act is also available. For reviewable matters, private parties may seek leave from the Tribunal to apply for relief where the Bureau has declined to bring proceedings. This right of private application is only available for certain reviewable matters (for example, it does not apply to allegations of abuse of dominance), and damages may not be claimed. For criminal offenses, on the other hand, private parties may sue for damages.

Few successful private applications have been brought under the reviewable matters provisions. But civil claims for damages for criminal offenses are common, usually in the form of class actions, and have yielded substantial damages, typically from negotiated settlements.

Criminal Conspiracies

Section 45 of the Act makes it a criminal offense