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NEWSLETTER

Meineke v. RLB: Another Look at Lost Future Profits

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One of the many decisions facing a franchisor upon the termination of a franchise agreement is whether to assert a claim against the former franchisee for lost profits. While an award of lost profits can mitigate the franchisor's losses, at least in situations where the former franchisee or a guarantor is not judgment proof, a number of judicial decisions have imposed obstacles to the successful pursuit of such claims. Although designated as non-precedential, the Fourth Circuit's recent decision in *Meineke Car Care v. RLB Holdings,* Bus. Franchise Guide (CCH) ¶14,586 (4th Cir. Apr. 14, 2011), suggests that some of those obstacles may be removed as courts continue to consider the issue.

The most frequently cited case on lost future profits is the California Court of Appeal's decision in *Postal Instant Press, Inc. v. Sealy,* Bus. Franchise Guide (CCH) ¶10,893 (Cal. App. 2d Dist. Mar. 28, 1996). *Sealy* involved a franchisee that defaulted on its obligations to pay royalties. When the default was not cured, the franchisor terminated the franchise agreement and obtained a judgment for the unpaid past royalties and lost future profits. The Court of Appeal, however, reversed the award of lost future profits. The appellate court held that the franchisor's lost profits were not proximately caused by the franchisee's breach because it was the franchisor that had terminated the franchise agreement. *Sealy* thus suggests that, if a franchisor terminates the franchise agreement for the non-payment of monetary obligations, as is commonly the case, the franchisor will be unable to collect lost future profits.

A number of courts have followed *Sealy* in denying lost future profits to a terminating franchisor. *See, e.g., Kissinger, Inc. v. Singh,* Bus. Franchise Guide (CCH) ¶12,747 (W.D. Mich. Nov. 25, 2003)

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(agreeing with the analysis in *Sealy* and finding that the franchisor was not entitled to recover future royalty payments, as the proximate cause of that loss was the franchisor's decision to terminate the franchise agreement); *Burger King Corp. v. Hinton,* Bus. Franchise Guide (CCH) ¶12,329 (S.D. Fla. May 7, 2002) (holding that lost future profits were not proximately caused by the franchisee's breach because the franchisor had previously terminated the franchise agreement for non-payment of monies owed); *I Can't Believe It's Yogurt v. Gunn,* Bus. Franchise Guide (CCH) ¶11,197 (D. Colo. Apr. 15, 1997) (holding that "any loss of future royalties was proximately caused by [franchisor's] election to terminate the Franchise Agreements").

Other courts have not specifically rejected *Sealy* but have distinguished their cases from the situation in *Sealy. See, e.g., Lady of America Franchise Corp. v. Arcese,* Bus. Franchise Guide (CCH) ¶13,561 (S.D. Fla. May 25, 2006) (finding that a franchisor could bring a lost future profits claim because the franchisee had effectively terminated her franchise agreement by sending a letter indicating her intention to close her franchised unit); *Oil Express National, Inc. v. D'Alessandro,* Bus. Franchise Guide (CCH) ¶11,400 (N.D. Ill. Apr. 27, 1998) (denying a motion for summary judgment on the issue of lost future royalties because the franchisee had been charged with anticipatory repudiation, which was not an issue in the *Sealy* case); *Burger King Corp. v. Barnes,* Bus. Franchise Guide (CCH) ¶11,413 (S.D. Fla. Mar. 23, 1998) (granting lost future profits because the franchisee had abandoned the franchise).

Still other courts have distinguished *Sealy* when the franchise agreement contains a liquidated damages clause. In *Radisson Hotels International, Inc. v. Majestic Towers, Inc.,* Bus. Franchise Guide (CCH) ¶13,680 (C.D. Cal. Jan. 25, 2007), the district court found that the rule in *Sealy* did not apply because the presence of a liquidated damages clause indicated that the franchisee explicitly accepted the indemnification responsibility in consideration of the right to become a franchisee.

Into this landscape comes the *Meineke* decision, in which the Fourth Circuit takes its turn with the issue of lost future profits. The case involved a franchisee that closed its four units prior to the end of the franchise term. The franchisor terminated the franchises and filed suit for, among other things, prospective royalties and advertising fund contributions. The District Court rejected these claims as a matter of law on summary judgment. The Fourth Circuit reversed, holding that governing North Carolina law generally permitted the recovery of lost profits and that nothing in the parties' agreement or the nature of the franchise relationship precluded such an award. While refusing to specifically follow or reject *Sealy*, the Fourth Circuit stated that the franchisee's breach was "so comprehensive as to constitute a de facto abandonment of the [Franchise Agreements] by the sole decision of the franchisee." Accordingly, the Fourth Circuit determined that the franchisee's breach of the agreements, rather than the consequent termination by the franchisor, was the proximate cause of the franchisor's lost profits.

While the *Meineke* case arose in a somewhat different context and does not specifically reject the *Sealy* court's holding, it does appear to limit the reach of *Sealy* and possibly signal a reassessment of some of the legal impediments to obtaining an award of lost profits. However, particularly because the Fourth Circuit's decision is based on a bare summary judgment record, and is limited to remanding the matter for trial, the ultimate significance of *Meineke* is not entirely clear. Among other things, the Fourth Circuit's reference to potential issues of fact regarding the "commercial feasibility" of continued operation of the franchised units

could result in a defense that might be difficult to refute in many termination cases. Because the issue of lost profits is still in a state of flux, franchisors should continue to monitor the situation to determine whether the pursuit of lost future profits following the termination of a franchisee is a worthwhile endeavor, especially in the absence of a liquidated damages clause in the franchise agreement.