

“BENEFIT OF BARGAIN” DAMAGES IN FRANCHISE TERMINATIONS

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What is a franchisor entitled to recover as damages when a franchisee shuts down operations before the end of the franchise agreement term?

Franchisors typically seek “prospective” or “benefit of the bargain” damages from the franchisee. That is the amount of royalties and advertising fund contributions the franchisor **would have** received if the franchise had operated to the end of its contractual term, i.e. the benefit of the franchise agreement for which the franchisor bargained. Some franchise agreements deal with this issue explicitly, some do not.

Here are three important points to consider about franchisor prospective damages under North Carolina law:

1. Not Required to Be Addressed in the Franchise Agreement.

The franchise agreement does not have to provide explicitly for prospective damages in order for a franchisor to recover them from a franchisee in court. In Meineke Car Care Centers, Inc. v. RLB Holdings, LLC, Case No. 09-2030 (4th Cir. 4/14/11) (unpublished), the United States Court of Appeals for the Fourth Circuit, applying North Carolina law, recently held that Charlotte-based franchisor Meineke could recover prospective damages from a franchisee that shut down its operations before the end of its franchise agreement term despite the fact that the franchise agreement was silent on the issue.

2. Franchisors Have to Prove Proper Calculation of Prospective Damages.

Franchisors have the burden to prove the proper calculation of claimed benefit of the bargain damages. In Meineke the Court approved Meineke’s calculation of its lost future royalties “by using the average weekly sales of the shop in prior years, multiplying that average sum by the number of weeks in the three-year period for which it sought relief, and then multiplying that amount by an average historical royalty rate to determine the prospective franchise fees Meineke lost as a result of the breach. From that sum, Meineke deducted its incremental savings resulting from the premature closing of the franchise and then discounted that amount to present value.”

3. Franchisors Have to Minimize Their Damages.

Franchisors seeking prospective damages from franchisees have to show that they have tried to minimize their damages. In Meineke the franchisor claimed that it had minimized its damages by only seeking recovery for the three year period it said it would take to rebrand the abandoned territory, rather than the total number of years remaining on the franchise agreement term. The Court held it was up to the jury to decide if the three year limitation satisfied Meineke’s duty to minimize its damages.

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