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Loose Lips Sink Ships: Defamation Claims and Their Effect on the Franchisee/Franchisor Relationship

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Let's assume you acquire a new franchise operation, and as a result, turn around the brand and help franchisees recover past due royalties. You may be eager to share the good news for your company, your newly acquired franchisees and your brand. However, statements made to reporters, public relations firms or other third parties may cause unexpected problems. Or assume you are a franchisor embroiled in a heated dispute with a franchisee over providing business leads. A regular customer asks a member of your sales force his opinion regarding the franchisee. What may seem like an innocuous or offhand, informal, unofficial response by a non-management employee may expose the franchisor to liability. While you may think these statements are protected under the First Amendment right to freedom of speech, this right is not without limits when it comes to business reputations. Damage arising from defamation may be difficult to prove, but dealing with the media and other third parties may become a trap for the unwary.

What types of statements constitute defamation? Defamatory statements can be either written (libel) or verbal (slander). Whether made orally or in writing, courts will consider a statement to be defamatory if it is published to a third party, and damages the reputation of the plaintiff. Where the defamatory language refers to a public figure or relates to a matter of public concern, the injured party must also prove that the statement is false, and the party making the statement knew or should have known that the statement would cause harm.

A statement made only to the injured party, no matter how inflammatory or unsubstantiated, will not support a claim for defamation. However, a defamatory statement need not be published in a newspaper or other widely disseminated media. An offhand comment by an employee to a customer regarding a competitor's business or products may support an action for defamation.

For instance, in *Fashion Boutique of Short Hills, Inc. v. Fendi USA, Inc.*, a Fendi franchisee sued the luxury brand for business slander and disparagement of goods. Fashion Boutique's lawsuit alleged that when its franchisor, Fendi Stores, Inc., decided to open its own retail store in New York City, the franchisor embarked on a campaign of disparagement which caused the loss of Fashion Boutique's entire business. The court found that several statements made by employees of Fendi Stores were actionable – such as statements that Fendi planned to shut down the boutique in the near future, that Fendi was having problems with the boutique and that products sold by the boutique were not real Fendi products. While these statements were false and actionable, Fashion Boutique was not able to prove that they caused a decline in sales and eventual loss of the business. Franchisors in dual distribution systems should consider the adverse impact of such practices on franchise sales when a prospective franchisee contacts the franchisee of the store perceived to have been impacted by such statements, which may result from commission driven sales people trying to capture customers and sales-related compensation.

Second, in order to recover for defamation, the injured party must prove that the defamatory statements caused actual harm to the party claiming defamation. In *MapInfo Corp. v. Spatial Re-engineering Consultants*, the defendant alleged in a counterclaim against the plaintiff that it lost sales due to plaintiff's personnel making false and disparaging statements to resellers and customers. The only evidence the defendant produced was its perception that it received a "cold shoulder" when it attempted to sell to those customers. The court found

this speculation as to why the defendant was given the cold shoulder was not sufficient to prove harm from the alleged defamatory statements.

In some cases, the words are considered defamatory per se, in that they are defamatory on their face. The injured party need not prove any special harm to recover damages. For example, in one case, a national franchisor acquired a brand from a competitor who had an ongoing dispute with a franchisee regarding royalty payments. In an interview regarding the transaction, the national franchisor commented that its management style was different from the previous franchisor. The prior franchisor alleged that by comparing itself to prior management, the national franchisor through innuendo and implication intended to injure the business reputation of the prior franchisor. The prior franchisor also alleged that the statements were defamatory per se, and it did not have to prove that it suffered any special harm from the statements. In determining whether a statement will constitute slander per se, courts look to the plain meaning of the words and will not infer any negative connotation or innuendo.

An exception to defamation applies in the context of statements made in the course of judicial proceedings. While statements made in court or in a pleading filed with a court are privileged, the privilege does not extend beyond this limited context. In *Associated/ACC International, Ltd. v. DuPont Flooring Systems Franchise Co*., Inc. et al., a defendant franchisor filed a counterclaim alleging defamation where the plaintiff franchisee disseminated a press release accusing the franchisor of fraud. In its defense, the franchisee claimed that statements in the press release were privileged, as they merely restated allegations in the complaint, and were attributed to the lawsuit. The court found that statements made by a litigant outside the course of judicial proceedings are not absolutely privileged.

In giving interviews to newspapers or public relations firms, or even discussing business matters with a third party, business owners are well advised to proceed with caution, as seemingly casual comments about a franchisee or competitor may give rise to a defamation lawsuit.