Use of Customer Survey Data Upheld in Hotel Franchise Terminations

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In most cases, courts and state legislatures have made it more difficult for franchisors to terminate franchise agreements. However, one federal court in New York recently upheld the use of negative guest satisfaction surveys as a basis for termination.

In *HLT Existing Franchise Holding, LLC v. Worcester Hospitality Group, LLC* (U.S. Ct. App., 2nd Cir., Case No. 14-593-cv, April 9, 2015), the U. S. Court of Appeals for the Second Circuit upheld a franchisor's decision to terminate a franchise based primarily upon negative results of guest satisfaction surveys.

The terminated Hampton Inn franchisee, seeking damages and injunctive relief based on the franchisor's termination decision, argued that the guest satisfaction surveys were inadmissible hearsay statements and should not have been considered by the court in assessing whether the franchisor acted properly in terminating the franchise. "Hearsay" is defined as any out-of-court statement offered into evidence to prove the truth of the matters asserted in the statement. (Fed. R. Evid. 801(c)). The guest satisfaction surveys were clearly out-of-court statements. However, the court reasoned that the surveys were not offered to prove the truth of the matters asserted in the survey reports, but rather "were admitted solely for the purpose of showing their effect on [the franchisor's] decision to terminate the franchising agreement." The court relied on a line of cases holding that a statement offered to show its effect on the listener is not hearsay. The survey data tended to show that the franchisor did not act arbitrarily, irrationally or in violation of its implied obligation of good faith and fair dealing. The court found it proper to consider the survey data for that purpose.

Failing in its primary argument, the franchisee pursued a different line of attack by pointing out that the survey data was not even collected by the franchisor. The survey data was actually collected by Medallia, Inc., a large third-party survey administrator, and transmitted to the franchisor. Since it came from a third party, the franchisee reasoned it should not have been considered by the court. The court found that Medallia regularly compiled guest survey scores at the time the guests submitted those survey responses. Medallia's reports recorded guest impressions in the course of regularly conducted business activity. Additionally, the franchisee did not dispute the trustworthiness of Medallia's records. Thus, the court found that the survey results were properly considered.

Finally, the franchisee claimed that the liquidated damages provision in the franchise agreement should not be enforced. The court noted that a contractual provision fixing damages in the event of future breach will be enforced if the preset amount bears a reasonable proportion to the probable loss and the actual loss is difficult or impossible to estimate with any precision. The burden rests with the party seeking to avoid the payment of damages. Expressing a reluctance to "interfere with the parties' agreements," the court upheld the liquidated damages provision.

Twenty-one states currently have some version of franchise relationship statutes. Seventeen of those statutes require the franchisor to show good cause in order to justify franchise termination or non-renewal of the franchise. Additionally, most states' laws require any contracting party to meet an obligation of "good faith and fair dealing." As this case demonstrates, guest satisfaction surveys can provide a powerful tool to help franchisors meet that legal hurdle. Franchisors should ensure that such surveys are compiled and recorded in a manner that ensures they will be admissible in court, particularly at the summary judgment stage where they may make the difference between efficient disposition and protracted litigation.