

**BLOGS**

Settlement

Eleventh Circuit Holds Franchisor's Justified Threat of Criminal Prosecution Does Not Justify Setting Aside Settlement Agreement with Franchisee for Duress

The Eleventh Circuit Court of Appeals recently upheld a settlement agreement between a franchisor and former franchisee that the franchisee alleged was obtained under the threat of criminal prosecution. *Sewalk v. Valpak Direct Mktg. Sys., LLC*, 2024 WL 767619 (11th Cir. Feb. 26, 2024).

The Eleventh Circuit Court of Appeals recently upheld a settlement agreement between a franchisor and former franchisee that the franchisee alleged was obtained under the threat of criminal prosecution. *Sewalk v. Valpak Direct Mktg. Sys., LLC*, 2024 WL 767619 (11th Cir. Feb. 26, 2024). SMS Business Entities, Inc. (SMS) entered into a franchise agreement with Valpak to operate and sell advertising under the Valpak name in southern Colorado. Sewalk, SMS's principal and owner, was not a party to the franchise agreement but filed a Chapter 11 bankruptcy petition listing the value of the franchise as \$12,000. However, Sewalk did not identify the franchise agreement on the bankruptcy schedules and he did not notify Valpak about his bankruptcy case until shortly before it was dismissed. Valpak terminated the franchise agreement pursuant to a provision in the agreement allowing termination if Sewalk, as owner of SMS, "files or has filed against [him] a petition in bankruptcy." SMS and Sewalk then sued Valpak in a Florida federal district court alleging that the termination of the franchise agreement violated the automatic stay in Sewalk's bankruptcy case and, in this suit, valued the franchise at \$1,000,000. The district court directed the parties to attend mediation, which they agreed would be confidential, and dismissed the case without prejudice after receiving the mediation report, but provided the parties sixty days to move to reopen the matter upon a showing of good cause. SMS and Sewalk moved to reopen the matter, alleging that during the mediation Valpak threatened to report them to the authorities for bankruptcy fraud if they did not quickly agree to the terms of the settlement agreement. The district court denied SMS and Sewalk's motion to reopen the matter, in part because SMS and Sewalk improperly disclosed the confidential details of what occurred during the mediation. It also concluded that "Valpak's negotiation position was not extortion, coercion, or duress," and held that under Florida law, a threat of criminal prosecution does not justify rescission of the settlement agreement.

On appeal, the Eleventh Circuit agreed with the district court that a justified threat of criminal prosecution will not constitute duress and will not justify obtaining relief from a contract under Florida law. The Eleventh Circuit held that Valpak was justified in believing that Sewalk intentionally made false statements under oath because when Sewalk filed for bankruptcy, he listed his business as having a low valuation, but then listed a high valuation in the case against Valpak. Pointing to Florida's criminal extortion statute, SMS and Sewalk argued that even if Valpak's

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threat was justified, it still amounted to extortion sufficient to void the settlement agreement. The Eleventh Circuit rejected this argument, concluding that the weight of case law from the Florida Supreme Court recognizes the general principle that a threat of lawful criminal prosecution will not constitute duress.