

**JUDICIAL UPDATE
PRESENTED TO
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by

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LIQUIDATED DAMAGES

General Observations:

- Enforceable if carefully drafted.
- Drafting: Keep in mind remaining term of agreement; discount for future value; how long should you go out.
- Franchise agreement should expressly state that these are only in lieu of royalties, and possibly marketing fund fees (if that is the case).

Country Inn & Suites v. Interstate Properties, LLC, 2008 U.S. Dist. LEXIS 54265 (M.D. Fla. Jul. 16, 2008).

- Liquidated damage clause upheld.
- Three times the royalty and marketing fees for 12 months immediately preceding date of termination.
- Franchisee's argument that liquidated damage didn't take into account remaining term of agreement was rejected.
- Similar result in La Quinta Corp. v. Heartland Properties, LLC, 2008 WL 2742965 (W.D. Ky. Jul. 14, 2008).

Country Inns & Suites by Carlson, Inc. v. Nayan, LLC, 2008 WL 4735267 (S.D. Ind. Oct. 28, 2008).

- Liquidated damages was only one component of damages.
- Trademark infringement.

LOST FUTURE ROYALTIES OR PROFITS

Historical Perspective: Lost future royalties were generally considered recoverable until a California court, in the Sealy case, said they were not if the franchisor terminated the franchise agreement. The court also said that their recovery would be unconscionable. Over the following years, courts in three or four other jurisdictions agreed. Recently, however, the trend has been shifting, slowly, in the opposite direction.

As for damages resulting from lost profits generally, it appears that franchisee award opportunities are limited, which should make these cases more difficult to accept by lawyers who work on contingencies.

Progressive Child Care Systems v. Kids ‘R’ Kids Int’l, 2008 WL 4831339 (Tex. Ct. App. Nov. 6, 2008).

- Applies Georgia law.
- Lost profits could be recovered as damages if they can be proved with reasonable certainty and were “contemplated by the parties.”
- Note drafting implication.
- 25 year term agreement.

Meineke Car Care Centers, Inc. v. L.A.C. 1603 LLC, 2008 U.S. Dist. LEXIS 33566 (W.D. N.C., Apr. 23, 2008).

- Contrary result.
- Franchisor could not prove that fees would be realized but for the termination.
- Franchisor claimed it was entitled to three years of “lost profits.” Court said this was speculative.
- Case currently on appeal to the 4th Circuit.

Environmental Biotech, Inc. v. Sibbitt Enterprises, Inc., 2008 U.S. Dist. LEXIS 98870 (M.D. Fla. Nov. 24, 2008).

- Franchisee not allowed to recover lost profit damages because franchisee failed to provide reasonably certain evidence of its lost profits. Bad expert witness, it appeared.
- Under Florida law, franchisee could not recover loss of value of business unless business was destroyed.

Western Kentucky Coca-Cola Bottling Co., Inc. v. Red Bull N.A., Inc., 2008 WL 4876520 (W.D. Ky. Nov. 12, 2008).

- Failure to give reasonable notice. Damages must relate to the lack of notice and plaintiff's lost opportunity to put "his house in order."

Hijazi Medical Supplies v. AGA Medical Corp., 2008 WL 4861517 (D. Minn. Nov. 10, 2008).

- Wrongful termination of distributorship agreement.
- However, manufacturer could have lawfully terminated it about 8 months later.
- Damages could only be recovered for this eight month period.

Quizno's Franchising II v. Zig Zag Restaurant Group, Bus. Franchise Guide (CCH) ¶ 14,046 (D. Col. Dec. 31, 2008).

- Court awarded “rescission” damages.
- Charade of a field test. Franchisor ran restaurants during part of the period in issue.
- Rescission damages awarded when damages were irreparable and ordinary contract damages were difficult to assess.
- Damages included direct investments, advances, loans and net operating loss, less all income; lost opportunity interest on direct investment; and costs of lease default.
- Not entitled to “salary losses—*i.e.* receiving less salary as a result of spending time running franchise.

FRAUD

Observations:

- Fraud cases remain very hard to prove due to the number of hurdles that must be addressed.
- Reasonable reliance seems to be the main “out” for franchisors.
- Financial Performance Representations/Earnings Claims—very few cases.
- Problem of reviewing FPRs/pro formas.
- Interesting question: What happens if they are not in FDD, but accurate?
- The more franchisee does in the way of due diligence, the more he hurts his case if he goes to court.

Kiddie Academy Domestic Franchising LLC v. Faith Enterprises DC LLC, Bus. Franchise Guide (CCH) ¶ 14,185 (N.D. Md. Jul. 17, 2009).

- Pro formas. Franchisor representative said “looks okay to me.” Also said franchisees had a profitability rate in the mid to high teens.
- Inaccurate.
- Conflicting documents. Put franchisee on notice of possible deception.

Martrano v. Quizno’s Franchise Co., Bus. Franchise Guide (CCH) ¶ 14,161 (W.D. Pa. Jun. 15, 2009).

- Franchisor represented in FDD that it would negotiate discounts. Didn’t do so.
- Disclaimer where franchisee filled in “none” not a valid waiver.

Cold Stone Creamery, Inc. v. Lenora Foods 1, LLC, Bus. Franchise Guide (CCH) ¶ 14,144 (11th Cir. Jun. 3, 2009).

- Florida Little FTC Act.
- Lower court ruling in favor of franchisor affirmed on appeal.
- Franchisee had to show reliance. Did not prove this here.
- Usual disclaimers regarding earnings claims. Franchisee conducted independent investigation.

PCJ Franchising Co. LLC v. Newsome, Bus. Franchise Guide (CCH) ¶ 14,006 (E.D. N.C. Oct. 24, 2008).

- Representation in UFOC allowed in as an exception to integration clause.
- Did not violate parol evidence rule.
- Information about financial success arguably misleading; including results of affiliates which had markedly more favorable financial structure than franchisees.

Rand v. CM Franchise Systems, Inc., 2009 WL 667227 (Wash. Ct. App. Mar. 16, 2009).

- Franchisee must perform some due diligence before purchasing franchise.
- Statute of limitations. When should franchisee have known that claims about earnings of best store were skewed vis-à-vis the entire system?

DISCLAIMERS

Observation: Another mixed bag, but courts are showing a tendency not to enforce them without showing that they are not creating a stacked deck in the franchisor's favor.

Westerfield v. Quizno's Franchise Co., LLC, 2008 WL 2512467 (E.D. Wis. Apr. 16, 2008).

- Earlier judgment reversed/modified.
- Court had originally ruled that disclaimers and non-reliance clauses killed franchisees' claims of fraud.
- Exculpatory clauses are unenforceable on public policy grounds where the alleged harm is caused intentionally or recklessly.

Emfore Corp. v. Blimpie Assoc., Ltd., 51 A.D. 3d 434 (N.Y. App. Div. 2008).

- Questionnaire.
- Waiver of fraud claims was unenforceable.

Waldron v. George Weston Bakeries, Inc., 2008 WL 5255826 (D. Me. Dec. 16, 2008).

- Defendant manufacturer terminated plaintiff distributors.
- Party to contract cannot be liable for tortious interference.

CLASS ACTIONS

Observations:

- Mixed bag.
- Not as easy to bring as one often believes.
- Must show, among other things, commonality; large group; and effect on judicial efficiency.

Danvers Motor Co., Inc. v. Ford Motor Co., 543 F.3d 141 (3d Cir. 2008).

- Class certification denied.
- Blue Oval Program designed to improve customer service.
- Many non-common issues—certification period, whether dealer received rebates, expenses to incur certification.

Bonanno v. The Quiznos Franchise Co., LLC, Bus. Franchise Guide (CCH) ¶ 14,129 (D. Colo. Apr. 20, 2009).

- Court upheld validity of franchise agreement, against allegations of class-wide arbitration clause being substantive unconscionable.
- Seven part test: standardized form; opportunity to read and understand; fine print; commercially reasonable justification; substantively unfair; relationship between the parties; and other surrounding circumstances.

McDonald's French Fries Litigation, Bus. Franchise Guide (CCH)
¶ 14,153 (N.D. Ill. May 6, 2009).

- Allegedly, McDonald's misrepresented ingredients.
- Class action status denied because individual issues predominated.
- Class over-inclusive—not limited to persons who saw or knew of McDonald's representations that the potato products were allergen free and purchased the products because of that representation.

ARBITRATION

Observations:

- For years, I have been undecided whether arbitration clause is good or bad. Finally decided, bad. Others disagree. Real split within franchise bar, even between lawyers on the same side.
- Too many frolics and detours: who arbitrates validity; procedural unconscionability; substantive unconscionability; who can participate in or be bound by the arbitration: officers, directors, third parties; scope of arbitration.
- Can be expensive.
- For what reasons can an arbitration award be appealed?
[Manifest disregard of the law?]

Tips:

- **Tactical decisions in drafting:** Long, short; balanced, imbalanced; whose rules will be followed; one or three arbitrators; arbitrators' qualifications. Draft precisely.
- **Strategic issue:** In what contexts are disputes likely to arise?

Case Handyman and Remodeling Services, LLC v. Schuele, 959 A.2d 833 (Md. Ct. App. 2008).

- Plaintiffs were customers of defendant's franchisee. Contract between franchisee contained arbitration clause. Franchisor not party to contract.
- Court held that franchisor could take advantage of the arbitration clause and require arbitration.
- Critical element; claim arose out of the contract.

1-800-Radiator of Wisconsin, LLC. V. 1-800 Radiator Franchise, Inc., 2008 WL 2782894 (E.D. Wis. Jul. 15, 2008).

- Arbitration clause had a carve-out for usage of marks or “system.”
- Court decided to interpret the carve-out narrowly.
- Court noted that franchisee’s position would lead to almost all disputes being arbitrated and made carve-out almost meaningless.

Awuah v. Coverall North America, Inc., 554 F.3d 7 (1st Cir. 2009).

- Appellate court held that court gets to decide validity of arbitration claim. Contra to general rule that arbitrator decides if there is reference to AAA rules. See Ahluwalia v. QFA Royalties, LLC, 2009 WL 262466 (Col. Ct. App. Feb. 5, 2009).

Bencharsky v. Cottman Transmission Systems, LLC, 625 F.Supp. 2d 872 (N.D. Cal. 2008)

- Issue was what state law covered the validity of arbitration clause.
- Court found Pennsylvania law’s public policy was contra to California’s. Therefore, court did not honor parties’ choice of law provision (Pennsylvania).
- But, see Smith v. Paul Green School of Rick Music Franchising, LLC, 2008 WL 2037721 (C.D. Cal. May 5, 2008), where California court reached opposite conclusion.

Coffee Beanery, Ltd. v. WW, L.L.C., 300 F. App’x 415 (6th Cir. Nov. 14, 2008).

- Manifest disregard of the law was issue.
- Issue was whether failure to disclose grand larceny conviction as being a violation of law. Arbitrator had ignored. Court found to the contrary.
- There are cases to the contrary.

Donaldson Co., Inc. v Burroughs Diesel, Inc., Bus. Franchise Guide (CCH) ¶ 14,184 (8th Cir. Jul. 20, 2009).

- Supplier could not take advantage of arbitration clause contained in franchise agreement.

Kam-Ko Bio-Pharm Trading Co. v. Mayne Pharma (USA), Inc., Bus. Franchise Guide (CCH) ¶ 14,095 (9th Cir. Mar. 11, 2009).

- International Chamber of Commerce Arbitration. Cost estimated to be \$220,000.
- Not substantively unconscionable, as franchisee alleged.

Awuah v. Coverall North America, Inc., 554 F.3d 7 (1st Cir 2009).

- Issue was whether arbitration clause could provide illusory remedy.
- Arbitration clause had cost sharing; no class wide arbitrations; prohibited arbitrator from striking offensive clauses, limitation on relief; shorter statute of limitations; losing party prevails provision; and provision allowing only franchisor to go to court.
- Appellate court decided arbitrator should have decided validity of arbitration clause.

IJL Dominicana S.A. v. It's Just Lunch International, LLC, Bus. Franchise Guide (CCH) ¶ 14, 072 (C.D. Cal. Feb. 6, 2009).

- Two provisions of arbitration clause (waiver of punitive damages; bar of class-wide actions) were declared substantively unconscionable. Balance of arbitration clause was enforceable.
- There was severability clause.

MEDIATION

Observations:

- Courts like mediation. Gets cases off their docket.
- In Australia, mandatory!
- Better off controlling mediation process than having court impose it. Issue of who is the mediator.
- Question: Should franchisor include mandatory mediation clause?
- Key is who is the mediator? Is it better to have a franchise lawyer, or a good mediator.
- Need careful drafting of agreement. How much detail?

General Theme: Enforceable.

Cottman Transmission Sys., LLC v. Wolfsgruber, 621 F.Supp. 2d 266 (E.D. Pa. 2008).

- Mediation clause upheld. Case dismissed. Franchisee had to pay fees and costs as required by franchise agreement.

TERMINATIONS AND OTHER POST-TERM ISSUES

Observations:

- If you want TRO or preliminary injunctions; act quickly.
- Review your current form of franchise agreement carefully—Has it covered the typical situations franchisor sees? How does it handle real estate issues, especially if there are other parties (landlords, affiliates of franchisee) involved? Does it provide for recovery of lost future royalties and is it clear that this is not the exclusive remedy? Are the enumerated events of default exclusive? Are trade dress and phone number issues, if applicable, appropriately addressed? What about confidential information return?

Melt Franchising, LLC v. PMI Enterprises, Inc., Bus. Franchise Guide (CCH) ¶ 13,933 (C.D. Cal. Jun. 26, 2008).

- Waited two months before bringing action.
- Suggests no irreparable harm.

Warsteiner Importers Agency, Inc. v. Republic National Distributing Co., LLC, 2008 WL 2484213 (M.D. Fla. Jun. 19, 2008).

- Supplier sold beer to distributor who was selling outside territory. Distributor asked for preliminary injunction.
- Monetary damages would be adequate. Supplier could pay franchisee for loss of value.

LJL Transportation, Inc. v. Pilot Air Freight Corp., 962 A.2d 639 (Pa. 2009).

- Material breach of agreement—in this case engaging in a side business, diverting revenues—warranted ignoring notice and cure rights granted in the agreement.
- Case is a bit of an aberration because most franchise agreements would not have granted a cure right in these circumstances.
- Consider disclosure issue: Does a franchisor have to state in Item 17 that notice and cure rights might be inapplicable.
- How does this square with good cause and notice provisions in franchise relationship laws?

Gueyffier v. Ann Summers, Ltd., 43 Cal. 4th 1179 (Cal. 2008).

- Franchisor failed to provide operation manuals, training and assistance and advertising. Franchisee failed to give required notice and cure opportunity.
- Arbitrator said notice and opportunity to cure in these circumstances would have been an “idle act.” There had been a disastrous opening.
- Contract had clause saying no changes in terms of agreement by arbitrator.
- Trial court affirmed award for franchisee.
- Appellate court overruled.
- Supreme Court reversed. Arbitrator could determine that notice and cure provisions inapplicable.

Cottman Transmission Sys., LLC v. Wolfsgruber, 2008 U.S. Dist. LEXIS 50685 (E.D. Pa. Jun. 30, 2008).

- Liquidated damages is only one element of relief. Can be injunctive relief, as well as award of other types of damages.

ANTITRUST

Overall Observation: Antitrust law, as applicable to franchising, is dead.

Historical Perspective: In 1970s, center of focus.

- Tying arrangements
- Maximum price fixing
- Minimum price fixing
- Dual distribution

Today: Antitrust law has become franchisor friendly.

- Maximum price fixing: State Oil Co. v. Kahn, 522 U.S. 3 (1997): no longer per se illegal.
- Minimum price fixing: Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007): no longer per se illegal.
- Tying Arrangements: Difficult to prove market power.

Massey, Inc. v. Moe's Southwest Grill, LLC, 2008 U.S. Dist. LEXIS 106897 (N.D. Ga. Oct. 24, 2008).

- No antitrust injury—more in nature of contract breach.
- Kickback claim belonged to franchisees' suppliers.

Bansavich v. McLane Company, Inc., 2008 U.S. Dist. LEXIS 25817 (D. Conn. Apr. 1, 2008), also 2008 U.S. Dist. LEXIS 89071 (D. Conn. Oct. 31, 2008).

- Tying case involving Mobil Oil convenience store.
- “Exclusive Products” allegedly tied with tobacco products.
- Court had market definition issues; found in favor of defendant.

Siemer v. The Quizno's Franchise Company LLC, 2008 U.S. Dist. LEXIS 25907 (N.D. Ill. Mar. 31, 2008).

- No tying claim unless there is demonstrated market power in the tying product market. Market must include all products having reasonable interchangeability. Plaintiffs had tried to define market as “ownership interest in quick service toasted sandwiches.”

Beuff Enters. Fla, Inc. v. Villa Pizza, LLC, 2008 U.S. Dist. LEXIS 50591 (D. N.J. Jun. 24, 2008).

- Tying case.
- Definition of “distinctive services that only Villa Pizza provides in Florida.” Too narrow.

Sheridan v. Marathon Petroleum Co., LLC, 530 F.3d 590 (7th Cir. 2008).

- Designated provider of credit card services tied to Marathon gasoline.
- Insufficient allegation of monopoly power.
- See also Rick-Mik Enterprises, Inc. v. Equilon Enterprises, LLC, 532 F.3d 963 (9th Cir. 2008), and Trane U.S., Inc. v. Meehan, Jr., 563 F. Supp. 2d 743 (N.D. Ohio 2008).

ATTORNEY'S FEES/LIABILITY

Summary:

- Awards are not a sure thing.
- Who is the prevailing party.
- What is good for the goose is good for the gander—reciprocity if clause is unilateral.
- Attorney liability is increasing.
- For the layman: watch out for illegal practice of law.
- Suits against lawyers for fraud, negligence.

Magna Cum Latte, Inc. v. Smith, Bus. Franchise Guide (CCH) ¶ 13,895 (Bankr. S.D. Tex. May 9, 2008).

- Don't have to win on all counts to be “prevailing party.”

Best Western International, Inc. v. Mahroom, 2008 WL 2116917 (D. Az. May 20, 2008).

- Unilateral fee provision under Arizona law made bilateral.

Bores v. Domino's Pizza, LLC, 2008 WL 4755834 (D. Minn. Oct. 27, 2008).

- Court reduced recoverable amount of fees from \$1.2 mm to \$450,000.
- Reasons: Out of state law firm; rates higher than necessary; too many lawyers (20); case was overlawyered; simple contract dispute; terms were unambiguous; unnecessary discovery.
- **Note:** judge was probably peeved because his original decision in this case in favor of franchisees was reversed.

Bonner v. Lyons, Pipes Cook, P.C., Bus. Franchise Guide (CCH)
¶ 14,119 (Ala. Apr. 3, 2009).

- Malpractice claim. Attorney gave notice asking for renewal too late. Representing franchisee.
- Franchisee failed to pay renewal fee. Renewal attempt by franchisee was ineffective for this reason as well. Lawyer not held liable.

State of Nebraska v. Orr, 277 Neb. 102, Bus. Franchise Guide (CCH)
¶ 14,064 (Jan. 30, 2009).

- Attorney sanctioned for not being competent in preparation of franchise documents for client.

Dream Dinners--?

- Attorneys sued for participating in fraud.

TRADEMARKS

Observation: Franchisee almost always wins preliminary injunction case where trademark infringement case is the sole issue. Situation is typically more complicated by the presence of a non-compete provision, which may be unenforceable. Decisions often split.

Domino's Pizza Franchising LLC v. Making the Dough, Inc., Bus. Franchise Guide (CCH) ¶ 14,135 (M.D. Pa. Apr. 15, 2009).

- Dominic's was new name. Terminated franchisee. Very typical case.

Patsy's Italian Restaurant, Inc. v. Banas d/b/a/ Patsy's, 575 F. Supp. 2d 427 (E.D. N.Y. 2008).

- Trademark infringement litigation.
- Both parties lost. One had to refer to its restaurant services using Patsy's Italian Restaurant; other had to refer to restaurant as Patsy's Pizzeria.
- Both using Patsy's; both had federal registrations.
- Both federal registrations cancelled. Defendant (Pizzeria) had licensed others to use marks beyond the scope of federal trademark protection.

VICARIOUS LIABILITY

Observation: Franchisor wins as long as it doesn't exert too much control over franchisees. Where facts and agreement are not clear-cut, it is difficult for a franchisor to get summary judgment on a vicarious liability case.

Thompson v. McDonald's Corp., Bus. Franchise Guide (CCH) ¶ 14,160 (Cal. Ct. App. Jun. 15, 2009).

- Cashier shot. Window would not automatically lock. Summary judgment to McDonald's denied.

SUPPLY ISSUES

Bores v. Domino's Pizza, LLC, 530 F.3d 671 (8th Cir. 2008).

- Franchisees required to buy specified computer system. Single sourcing.
- Language “from any source.” Franchisees wanted specs. Defendant argued that designation of source by name was a spec.

DISCRIMINATION

Observation: Be careful about what you say and how you make the communication. *E.g*, emails.

Elbanna v. Captain D's LLC, Bus. Franchise Guide (CCH) ¶14,080 (M.D. Fla. Feb. 17, 2009).

- Franchisor refused to grant additional franchise to franchisee because franchisee did not meet financial test and was a bad operator. Court affirmed.
- Statements: “Sneak attack his Operation; “don’t you get it? We don’t want you as a franchise, “ not approvable: and [the individual] is bad news did not evidence racial bias.

OTHER CASES

Pearle Vision, Inc. v. Adler, 2008 WL 2704407 (S.D. Ohio, Jul. 3, 2008).

- Lease Assignment. Requirement in franchise agreement, but not in lease.
- Court found no waiver by franchisor. Direct lease between franchisee and landlord. Originally between franchisor and landlord.

Klosek v. American Express Co., 2008 WL 4057534 (D. Minn. Aug. 26, 2008).

- Franchisor adopted new brand name.
- Court upheld. Contract allowed franchisor in its sole discretion to adopt substitute proprietary marks.

Sunshine Restaurant Partners, LP v. Shivshakti One, Inc., Bus. Franchise Guide (CCH) ¶ 14,022 (S.D. Fla. Nov. 5, 2008).

- Advertising fees. Local co-op. Franchisor used monies to advertise company owned stores exclusively.
- Case decided in favor of franchisees on motion to dismiss.