



The GPMemorandum

TO: OUR FRANCHISE CLIENTS AND FRIENDS

FROM: GRAY PLANT MOOTY'S FRANCHISE AND DISTRIBUTION PRACTICE GROUP

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This section of *The GPMemorandum* addresses non-judicial developments, trends, and best practices of interest to franchisors. Reports of recent judicial developments begin on page 3.

KLARFELD AND CANTOR JOIN GPM'S FRANCHISE & DISTRIBUTION GROUP

Peter Klarfeld and Arthur Cantor have joined Gray Plant Mooty's Washington, DC office as members of its Franchise and Distribution practice group.

Klarfeld is recognized as one of the most experienced franchise trial and appellate lawyers in the country, having served as lead counsel for franchisors in some of the most important cases in franchising. Klarfeld currently serves on the Governing Committee of the ABA's Forum on Franchising, and recently served as cochair of the Forum's 2008 Annual Meeting in Austin, Texas. He is a frequent author and speaker on franchise topics, and is the editor of the well-respected treatise, [*Covenants Against Competition in Franchise Agreements*](#). Klarfeld has been recognized as one of the nation's leading franchise lawyers by *Chambers USA*, as one of the "Best Lawyers in America" in franchise law by *Best Lawyers*, and as a "Legal Eagle" by *Franchise Times*. He previously worked at the U.S. Department of Justice as an attorney-advisor in the Office of Legal Counsel.

Cantor has more than 30 years of experience counseling and representing clients on franchising and antitrust matters. In addition to his extensive experience with franchise and antitrust litigation, Cantor counsels franchisors on a variety of issues, including franchisee and franchise system disputes, structuring franchise arrangements, and ownership of competing franchise systems. He is recognized as one of the deans of the U.S. franchise bar, particularly in the area of antitrust, having served on the faculty of PLI's Antitrust

Law Institute for 13 years. Cantor has been listed in *The Best Lawyers in America* for franchise law and *The International Who's Who of Business Lawyers* (franchise). He previously served in the U.S. Department of Justice Antitrust Division and was a member of the Antitrust Division's Special Trial and Appellate sections.

Prior to joining Gray Plant Mooty, Klarfeld and Cantor practiced in the Washington, DC office of Wiley Rein, LLP.

SOCIAL MEDIA AND LEGAL ISSUES

"Social media" refers to online tools or Web sites that allow interaction between the Web site operator and Web site users, or among users, and usually permit user-generated content to be posted. Examples of social media include Facebook, Twitter, YouTube, LinkedIn, blogs and other interactive Web sites. Social media can be a valuable tool for marketing purposes but can also create serious headaches for franchisors when it comes to maintaining brand integrity. Recent examples have shown that the damage to a brand from an employee with poor judgment and a video camera can register in the millions of dollars. The following are key points to keep in mind when dealing with social media:

- Franchisors who use social media to promote their own brands should remember to comply with advertising laws and securities laws in their corporate communications. Franchisors should make clear that they are the source of any content they post on social media and not try to post anonymously.
- Franchisors may want to monitor brand-related content on social media outlets and other Internet sites for negative comments. Responding to negative news using social media outlets as quickly as possible may help to control its spread.
- Social media Web sites may provide a complaint process to promptly remove material that infringes copyrights or other intellectual property rights. If a franchisor wants content removed, review the complaint process of each site to see if this quick and inexpensive option applies.
- Establish a policy on social media for corporate employees and consider offering a form policy for franchisees to use with their employees. Educating employees about consequences (including termination) for behavior online that negatively impacts the brand may actually prevent these incidents from occurring.

RECENT CASES

Here are summaries of recent cases of interest to franchisors:

CLASS ACTIONS

FRANCHISEES' CLASS ACTION CERTIFICATION DENIED

In an important decision upholding a contractual prohibition of collective actions, a Colorado federal court last month refused to certify a class of franchisees in *Bonanno v. Quiznos Franchise Co.*, 2009 WL 1068744 (D. Colo. Apr. 20, 2009). This ruling was based on language in the franchise agreement that a franchisee's claim "may not be consolidated with another proceeding between Franchisor and any other entity or person." The court found this clause an effective bar to the proposed class action fraud challenge to the franchisor's practices for selling Quiznos franchises. In so ruling, the court found that the franchise agreement prohibition of collective actions was not unconscionable or overreaching under Colorado law, nor was the alleged "right" to proceed as a class akin to such things as waiver of a right to a jury trial. In short, the "plaintiffs do not have a substantive right to proceed as a class," the court held.

Several other motions remain pending in the case, including a request by the franchisor for summary judgment.

ANTITRUST

DISTRICT COURT DISMISSES FRANCHISEE'S TYING CLAIM BECAUSE MARKET FOR FRANCHISES WAS NOT RELEVANT MARKET

An Ohio federal court recently dismissed a franchisee's claim against its franchisor for illegal tying in violation of Section 1 of the Sherman Act. *Arnold v. Petland, Inc.*, No. 2:07-cv-01307 (S.D. Ohio Mar. 26, 2009). The Arnolds, owners of a failed Petland franchise, claimed, after being supplied with sick puppies and stale pet food, that Petland illegally tied the purchase of puppies and pet food from Petland's preferred supplier to the ownership of the Petland franchise. Noting that dismissal of a tying claim is appropriate where a plaintiff has improperly limited its definition of a product market for the tying product to exclude potential substitutes, the district court held that the Arnold's alleged relevant market, "the market for pet store franchises," was unreasonably narrow in light of "equivalent investment opportunities...."

DISTRICT COURT REFUSES TO DISMISS FRANCHISEE'S TYING CLAIM

In an opinion issued four days after the *Petland* decision, an Illinois federal court denied Harley Davidson, Inc.'s motion to dismiss the tying claim of an independent manufacturer of plastic merchandise bags. *Packaging Supplies, Inc. v. Harley-Davidson, Inc.*, No. 08-cv-400 (N.D. Ill. Mar. 30, 2009). Whereas the court in *Petland* focused upon the existence of market power in the market for the tying product, the *Packaging Supplies* court evaluated whether the plaintiff had properly alleged that the defendant possessed market power in the market for the tied product.

Packaging Supplies alleged that Harley-Davidson sent an "edict" to its dealers directing them not to purchase their bags from PSI and instead to purchase their bags only from Harley-Davidson's merchandising division, despite the fact that many franchisees preferred PSI's bags. The district court denied Harley-Davidson's contention that PSI had failed sufficiently to allege both a tying arrangement and that Harley-Davidson would acquire market power in the tied market. The district court noted that many of Harley-Davidson's dealers would have preferred to buy from PSI but feared repercussions if they continued to do business with PSI. Moreover, relying on the principle that where "forcing" is present "competition on the merits in the market for the *tied* claim is restrained," the court further held that PSI had pled facts sufficient to show that Harley-Davidson had sufficient market power in the tying market to "appreciably restrain free competition in the market for the tied product."

TERMINATIONS

COURTS UPHOLDS TERMINATION DESPITE PASSAGE OF TIME

In a case that further buttresses the termination rights of franchisors, both a bankruptcy and federal district court upheld such rights despite the fact that more than seven months passed between the date the franchisees had received their notices of termination and the date the franchisor announced that it would seek to enforce them. The franchisee at issue in *In re Making the Dough, Inc.*, 2009 WL 975170 (Bkrtcy. M.D. Pa. Mar. 27, 2009), and *Domino's Pizza Franchising LLC v. Making the Dough, Inc.*, 2009 WL 1011584 (M.D. Pa. Apr. 15, 2009), owned two pizza franchisees near Harrisburg, Pennsylvania. In August 2008, Domino's terminated the franchise agreements because the franchisees had failed to obtain insurance as required, to make timely royalty payments or payments for food and supplies, to install an upgraded computer system, and to submit cash flow statements to the franchisor. The termination notices stated that Domino's would stay enforcement of the terminations for thirty days, to allow the franchisees to sell their locations. Despite the deadline, the franchisor continued to provide food and supplies to the franchisees, who operated their stores until March 2009, at which time the franchisees were informed that the terminations would be

enforced. They filed for bankruptcy the next day and, at the same time, for an injunction to stay enforcement of the terminations.

Neither party questioned the validity of Domino's grounds for termination or that the franchisees had failed to cure their numerous defaults. The franchisees claimed, however, that their continued performance of the contracts after receipt of the termination notices created an "implied novation," substituting for the original agreements. They also contended that Domino's had waived the franchisees' performance under the franchise agreements by accepting the continued operation of the stores after serving the termination notices. The bankruptcy court rejected both arguments. With respect to waiver, the court concluded that Domino's had escaped this fate by specifically providing in its notice that it was staying enforcement of the terminations to allow the franchisees to sell their stores. Moreover, the court noted that the franchisees had benefited from Domino's forbearance in allowing them to operate after the termination notices had been issued and that it would be "a gross distortion of the law to find an implied waiver where the party who relied upon a purportedly misleading act or representation by another benefited as a result thereof while only the party who misled them suffered a detriment."

Shortly thereafter, the federal district court in Pennsylvania issued a temporary restraining order terminating the franchise agreements and enforcing the post-termination covenant not to compete.

FRANCHISOR AWARDED ATTORNEYS' FEES AND COSTS FOR EARLY TERMINATION OF FRANCHISE

In *Guesthouse Int'l Franchise Sys., Inc. v. British Am. Properties*, 2009 WL 792570 (M.D. Tenn. Mar. 23, 2009), a Tennessee federal court awarded franchisor Sumner Ventures, Inc. (formerly Guesthouse International) \$82,651.95 in attorneys' fees and costs as well as damages in the amount of \$358,708.28 on its claims that the franchisee had breached the parties' hotel franchise. As reported in Issue No. 116 of *The GPMemorandum*, the court granted in part the franchisor's motion for summary judgment on its claims that the franchisee had breached the agreement in failing to comply with its standards. The franchisee had filed counterclaims alleging that the franchisor had fraudulently induced it into entering into the parties' agreement and had failed to deliver a UFOC, but the court denied those counterclaims finding they were barred under the one-year statute of limitations period of the Tennessee Consumer Protection Act. In awarding fees and costs, the court denied the franchisee's motion for reconsideration of the court's prior decision on summary judgment. It also found that the franchisor's fees and costs were reasonable given the amount of work performed in the case and extensive briefing on various motions.

CONTRACTS

PROTECTED TERRITORY FOUND TO BE AMBIGUOUS

A recent decision illustrates the importance of carefully describing the bounds of a protected territory in a franchise agreement. In *Ingraham v. Planet Beach Franchising Corp.*, 2009 WL 909567 (E.D. La. Apr. 1, 2009), the franchisee opened a Planet Beach tanning salon in a suburb of Philadelphia. The franchise agreement prohibited Planet Beach from establishing another franchise within the protected territory, defined as “Philadelphia, PA 30,000 in Population.” When Planet Beach established another franchise within five miles of the plaintiffs’ location, the plaintiffs sued claiming that Planet Beach had infringed on their protected territory. Planet Beach moved for summary judgment, arguing that the franchise agreement did not prohibit the establishment of the new franchise because the franchise agreement only guaranteed a “geographic buffer” between franchises, such that franchises could permissibly have overlapping territories so long as a new franchise was not physically located in the protected territory of another franchisee. The court rejected that argument.

Planet Beach also argued that the court must interpret the territorial restriction in the franchise agreement in connection with the provisions of the UFOC, which more clearly explained the concept of overlapping territories. The court disagreed, finding that Planet Beach had not expressly incorporated the terms of the UFOC into its franchise agreement. The court also denied Planet Beach’s motion for summary judgment on the plaintiffs’ claim that Planet Beach had orally modified their territory. Planet Beach argued that any such oral modifications would be barred by the franchise agreement’s integration clause. The court disagreed, holding that such evidence would be admissible due to the ambiguous nature of the territory restriction at issue. It denied Planet Beach’s motion for summary judgment.

PARTIES FAILED TO AGREE ON ESSENTIAL TERMS

Real estate franchisor Cendant Corporation has prevailed against a variety of claims arising out of a prospective subfranchise arrangement in Greece. *Katsiavrias v. Cendant Corp.*, 2009 WL 872172 (D.N.J. Mar. 30, 2009). A prospective franchisee sued Cendant after not receiving exclusive subfranchise rights to Greece. Earlier, after sending a letter of intent to the potential subfranchisee, Cendant had heard nothing. It then went so far as to inform the party of a competing offer for the subfranchising rights before signing with another company. In evaluating Cendant’s summary judgment motion, the federal court in New Jersey found that “[b]ecause the parties did not intend to be bound until after a formal written agreement was executed and because the parties failed to agree on essential terms, any alleged agreement is unenforceable.” The court

similarly found no evidence supporting the prospective franchisees' other claims, and therefore granted Cendant's motion for summary judgment in its entirety.

FRANCHISEE'S SIGNING OF ONE FRANCHISE AGREEMENT DID NOT BIND IT REGARDING EARLIER AGREEMENTS

In *Honey Dew Assoc. v. Creighton Muscato Enter., Inc.*, 73 Mass. App. Ct. 846 (Mass. App. Ct. Mar. 23, 2009), the Massachusetts Court of Appeals vacated a judgment against a franchisee for failing to pay advertising fees. The Court found that by signing a newer franchise agreement with an ad fee clause in it, the corporate franchisee had not agreed to pay ad fees for all of its owner's earlier established locations in the name of other commonly-owned entities.

Specifically, franchisor Honey Dew added a provision in its franchise agreement that the franchisee agreed to contribute to an ad fund if a majority of the franchisees agreed to support it. Critically, the provision contained a clause that made it applicable not only to the shop at issue, but also to any existing locations the franchisee owned, provided that if a different person or entity owned those shops, they also signed off on the new agreement. In this instance, the corporate franchisee only signed on behalf of the company that owned the shop at issue and not on behalf of the companies that owned the pre-existing locations. The court held that the franchisee entity that signed the agreement did not have the power to bind other companies to the agreement, even though they shared the same president. The judgment was vacated with instructions that the contract claims against the franchisee be dismissed.

FRAUD

FRANCHISEE'S SALES FRAUD CLAIMS FOUND TO BE TIME BARRED

In *Allan Rand and Iron Horse Venture Group, Inc. v. CM Franchise Sys., Inc.*, 2009 WL 667227 (Wash. Ct. App. Mar. 16, 2009), a Washington appellate court affirmed a decision that Rand's fraud claims were barred by the statute of limitations. In June 2003, Rand and CM Franchise Systems, Inc. entered into a subfranchise agreement for certain territories in Washington and Oregon. CM was not registered in Washington when the agreement was executed. Rand's business subsequently failed and, in March 2007, he sued CM seeking rescission of the agreement and damages. In particular, Rand alleged that CM fraudulently misrepresented the earnings data for the franchised stores during the sale process and that CM sold an unregistered franchise.

Under the applicable statute of limitations, Rand was obligated to bring his fraud claims within three years after he discovered, or using due diligence should have discovered, the basis for the fraud. When he signed the subfranchise agreement, Rand knew that

the financial information CM provided for two stores included CM's highest performing store and that CM was not registered in Washington. CM also gave Rand contact information for CM's franchisees and, in the subfranchise agreement that Rand drafted, Rand acknowledged conducting an independent investigation of the business. Based on these facts, the court determined that Rand, through due diligence, could have discovered the earnings disparity between CM's highest performing store and the other franchised store in 2003. As a result, the appellate court affirmed, finding that the statute of limitations barred the plaintiffs' claim.

ARBITRATION

AMOUNT IN CONTROVERSY IN ACTION TO CONFIRM ARBITRATION AWARD IS BASED ON ORIGINAL AMOUNT OF DAMAGES SOUGHT

In *U-Save Auto Rental of America, Inc. v. Furlo*, 2009 WL 901922 (S.D. Miss. Mar. 31, 2009), a Mississippi federal district court denied a franchisee's motion to set aside the judgment and dismiss franchisor U-Save's suit to confirm the arbitration award based upon lack of subject matter jurisdiction. In reaching its decision, and finding that it had jurisdiction over U-Save's suit to confirm the award, the court held that the amount in controversy in U-Save's suit should be determined based on the amount the franchisee demanded in the underlying complaint rather than the amount of the arbitration award. Noting a split of authority among the circuits, the court followed the "demand" approach whereby, for the purpose of determining whether the amount in controversy met the \$75,000 jurisdictional threshold for federal court, the potential arbitration award was the amount that the franchisee had demanded in the underlying complaint, not the arbitration award itself. Because the franchisee sought \$250,000 in its complaint, the threshold was met. The court also found that federal policy favoring arbitration would be contradicted if a party chose to arbitrate instead of litigate but then could not enforce the subsequent arbitration award.

CHOICE OF FORUM

COURT GRANTS MOTION TO DISMISS UNDER THE DOCTRINE OF FORUM NON CONVENIENS

In a blow to plaintiffs seeking to sue U.S. franchisors in a domestic forum for injuries allegedly incurred at franchised locations outside of the U.S., an Illinois federal court dismissed a lawsuit arising out of the death of an Illinois resident at a franchised hotel in Mexico. In *Wozniak v. Wyndham Hotels and Resorts, LLC*, 2009 WL 901134 (N.D. Ill. Mar. 31, 2009), an Illinois federal court granted the defendant franchisor's motion to dismiss under the doctrine of *forum non conveniens*. The case arose when plaintiff and her husband, who were from Illinois, stayed at a Wyndham hotel while on a trip to

Cozumel, Mexico. Plaintiff's husband was walking in the lobby of the hotel when he slipped and fell over the side of a stairwell, ultimately dying from injuries sustained from the fall. The plaintiff filed a wrongful death action in Illinois state court against Wyndham Hotels and Resorts, the franchisor of the involved hotel. Wyndham removed the action to federal court and then moved to dismiss.

In granting the motion, the court found that Mexico was an available and adequate alternative forum, as the vast majority of relevant documents and physical evidence relating to the case were located in Mexico, likely witnesses were located in Mexico, and Mexican law governed the dispute. After balancing the public and private interest factors, the court concluded that given the tenuous connection of the controversy to Illinois, litigating the case in Illinois would be unnecessarily burdensome for Wyndham. The court also found that while great deference is given to the plaintiff's choice of forum, in this case the private and public interest factors overwhelmingly favored dismissal.

PRACTICE OF FRANCHISE LAW

COURT HOLDS THAT FRANCHISOR DID NOT ENGAGE IN WITNESS TAMPERING

In *I'mnaedaft, LTD v. The Intelligent Office System, LLC*, 2009 WL 1011200 (D. Colo. Apr. 15, 2009), the plaintiff, a former franchisee of Intelligent Office Systems ("IOS"), requested a court order preventing IOS from interfering with subpoenas that the plaintiff had issued to several of IOS' franchisees. As part of the request, the plaintiff also sought a "no contact" order preventing IOS from having any further contact with non-party franchisees.

The court denied the plaintiff's request and determined that IOS did not interfere with the subpoenas or tamper with any witnesses. The court held that the e-mails sent by IOS to the non-party franchisees after they received the subpoenas did not advocate non-compliance or suggest methods for delaying compliance with the subpoenas. Rather, the e-mails simply provided information that allowed the franchisees to make their own decision regarding whether to hire an attorney to respond to the subpoenas. Further, the court held that it would be inappropriate to issue a "no contact" order given the on-going business relationship between IOS and its franchisees and the possibility that several of the non-party franchisees may be witnesses in the case.

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