The GPMemorandum

TO: **OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS**

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

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Below are summaries of recent legal developments of interest to franchisors.

ADVERTISING

SUPREME COURT HOLDS COMPANY CAN SUE COMPETITOR FOR UNFAIR COMPETITION EVEN IF IT COMPLIES WITH FDA LABELING REGULATIONS

In an 8-0 decision announced on June 12, 2014, the Supreme Court held that a company may sue a competitor for unfair competition under the Lanham Act because of false or misleading food and beverage labeling and advertising, even when the labeling and advertising otherwise meet the requirements of the Federal Food Drug and Cosmetic Act ("FDCA"). *POM Wonderful LLC v. Coca-Cola Co.*, 189 L. Ed. 2d 141 (U.S. June 12, 2014). POM, a pomegranate juice producer that markets and sells a pomegranate-blueberry juice, sued Coca-Cola under the Lanham Act for misleading labeling of the pomegranate-blueberry juice sold by its Minute Maid Brand. Minute Maid was one of POM's main competitors in the pomegranate-blueberry juice market. Although Coca-Cola's product only consisted of 0.3% pomegranate juice and 0.2% blueberry juice, the words "POMEGRANATE BLUEBERRY" appeared prominently on the juice's label. Coca-Cola contended that because its label met all content and labeling requirements of the FDCA, it was not false or misleading.

The issue before the Supreme Court was whether the FDCA displaces the Lanham Act with respect to food and beverage labeling. It found that the FDCA did not expressly preclude private parties' claims under the Lanham Act; nor did the Lanham Act expressly limit itself to claims outside the FDA's oversight. The Court determined that the Lanham Act and the FDCA complement one another and could be applied consistently. It noted that the FDCA only preempts inconsistent state law. Finally, the Court dismissed the government's argument that the Lanham Act claim was precluded to the extent that the FDCA or FDA regulations specifically require or authorize the challenged portions of the label.

As a result of the decision, food and beverage companies, including franchisors, should install comprehensive labeling controls to ensure that their labeling and advertising fully comply with both the FDCA and the Lanham Act. Food and beverage franchisors should avoid using labeling or advertising as a means to prop up the quality or quantity of a certain ingredient and make sure their labeling and advertising accurately reflects their products' ingredients or qualities without creating false or misleading commercial impressions.

CLASS ACTIONS

NINTH CIRCUIT AFFIRMS APPROVAL OF CLASS SETTLEMENT, INCLUDING FEES

The United States Court of Appeals for the Ninth Circuit has affirmed a ruling from a federal California court, approving a proposed class action settlement agreement that included nearly a million dollars in fees to the plaintiffs' attorneys. *Laguna v. Coverall N. Am., Inc.*, 2014 U.S. App. LEXIS 10259 (9th Cir. June 3, 2014). In 2009, the plaintiffs brought a class action suit against Coverall, a janitorial franchising company, alleging that Coverall misclassified California franchisees as independent contractors allowing them to avoid certain protections afforded to franchisees, and that Coverall breached its franchise agreements by taking existing accounts from franchisees and reselling the same customer accounts to other franchisees. After the named plaintiffs agreed to a settlement, an objector contested the agreement which gave former franchisees a credit of $750 and a payment of $475, gave new franchisees the right to rescind their franchise agreements, and provided injunctive relief requiring certain changes to the franchise agreements and Coverall's operating procedures. The objector also challenged the award of $994,800 in attorneys' fees to the class counsel.

The Ninth Circuit concluded that the settlement was fair, reasonable, and adequate. A majority of the appellate panel members held the district court had correctly considered the elements of the settlement agreement and had properly applied the lodestar method in gauging the fairness of the attorneys' fees. (Recommending that the case be remanded, a dissenting judge felt there was a lack of information to support the validity of both the settlement agreement and the attorneys' fees.) Despite the objections, the majority held that Ninth Circuit Rule 23(e) has "never required a district court to assign a monetary value to purely injunctive relief," and the court "put[s] a good deal of stock in the product of an arms-length, non-collusive, negotiated resolution."

INTERNET

COURT FINDS FTC SUFFICIENTLY ALLEGED THAT FRANCHISOR AND OTHER DEFENDANTS OPERATED AS A COMMON ENTERPRISE IN DATA BREACH CASE

In another recent decision a federal court in New Jersey denied the motion of Wyndham Worldwide Corporation, Wyndham Hotel Group, LLC, and Wyndham Hotel Management, Inc. (collectively, the "Wyndham Entities") to dismiss the complaint brought by the FTC for unfair or deceptive acts or practices based on breaches of the property management computer system used by the Wyndham franchisor and its franchisees. *FTC v. Wyndham Worldwide Corp.*, 2014 U.S. Dist. LEXIS 84913 (D.N.J. June 23, 2014). The FTC alleged that franchisor Wyndham Hotels and Resorts, along with its affiliates, engaged in (1) deceptive practices by misrepresenting that it used "industry standard practices" and "commercially reasonable efforts" to secure the data it collected from guests, and (2) unfair practices by failing to protect customer data based on data security breaches that occurred between 2008 and 2010. Wyndham Hotels and Resorts filed a separate motion to dismiss, which the court denied on April 7, 2014, although it gave Wyndham Hotels and Resorts leave to file an interlocutory appeal of the decision. (We reported on this decision in Issue 180 of *The GPMemorandum*.) The Wyndham Entities also filed a motion to dismiss the FTC's complaint arguing that, among other things, they cannot be held liable for Wyndham Hotels and Resorts' violations under a common-enterprise theory.

After considering the variety of factors alleged by the FTC, the court found that the FTC pleaded sufficient facts to reasonably infer a common-enterprise claim based on the lack of distinction between the defendants. Specifically, the FTC asserted that the defendants conducted business practices "through an interrelated network of companies that have common ownership, business functions, employees and office locations." The FTC additionally alleged that during certain time periods, Wyndham Worldwide and Wyndham Hotel Group had responsibility for Wyndham Hotels and Resorts' information security program. In response, the Wyndham Entities argued that they are engaged in legitimate and separate business endeavors, and that common-enterprise liability is appropriate only when separate corporations "are so interrelated that no real distinction exists between them." Noting that the Wyndham Entities' arguments only attacked the merits of the FTC's claim rather than the sufficiency of its pleadings, the court denied their motion to dismiss.

POST-TERMINATION INJUNCTIONS: NONCOMPETE COVENANTS

AGREEMENT PARTIALLY ENFORCED IN NEW YORK, DESPITE ARGUMENT THAT FRANCHISOR FAILED TO PROVIDE PROPER SALES DISCLOSURE TO FRANCHISEE

A federal district court in New York enforced part of a noncompete covenant that existed between a franchisor and former franchisee, finding some of the provision overly broad and only enforcing the aspects necessary to protect the franchisor's legitimate business interests. *Mister Softee, Inc. v. Tsirkos*, 2014 U.S. Dist. LEXIS 77434 (S.D.N.Y. June 5, 2014). In moving for a preliminary injunction, Mister Softee sought, among other things, enforcement of covenants that barred former franchisee Tsirkos from competing in former and other franchise territories throughout four boroughs of New York City and all of Long Island for two years after the termination of the franchise. In addition to challenging the scope of the prohibition, Tsirkos' primary defense was that the underlying franchise agreement was unenforceable under New York law because Mister Softee did not provide him a prospectus before the franchise was sold.

Noncompete covenants are upheld in New York to the extent they are reasonable in time and area, necessary to protect legitimate interests of the beneficiary, not harmful to the general public, and not unreasonably burdensome to the restricted party. The court concluded that restricting competitive activity within Tsirkos' former territories and the surrounding area protects a legitimate business interest of Mister Softee. The court, however, did not find any legitimate business interests requiring a restraint outside of Tsirkos' former territories and nearby areas. Those areas have other ice cream businesses, and the court did not find that the particular training, sales method knowledge, or other experience gained by Tsirkos as a result of the franchise agreement created an unfair competitive advantage in those areas. Rather, the competitive advantage Tsirkos gained as a result of the franchise agreement only existed in the locations where Tsirkos obtained particularized customer knowledge or goodwill. As to the defense that Mister Softee failed to provide a prospectus before selling the franchise, the court was unsympathetic, as Mister Softee had made the prospectus available to Tsirkos and he rejected the document, saying he "knew everything about the system." Therefore, the court only enforced the noncompete covenant within a five-mile radius of Tsirkos' former franchise territory.

STATE FRANCHISE LAWS

NEW JERSEY FEDERAL COURT DISMISSES TERMINATION CHALLENGE UNDER STATE'S FRANCHISE PRACTICES ACT

A New Jersey federal district court last week dismissed a franchisee's wrongful termination counterclaims alleging violation of the New Jersey Franchise Practices Act ("NJFPA"). *Kumon N. Am., Inc. v. Timban*, 2014 U.S. Dist. LEXIS 84907 (D.N.J. June 23, 2014). Under the NJFPA, a franchisor normally may not terminate, cancel, or fail to renew a franchise unless it provides advanced written notice of such action and the action is taken for "good cause." After Kumon asserted claims against franchisee Timban for continuing to operate his formerly franchised Kumon Math and Reading Center after termination of his franchise agreement, Timban's counterclaim alleged, among other things, that Kumon's termination was wrongful and violated the NJFPA. Timban argued that, although he made multiple late royalty payments to Kumon, he substantially complied with the franchise agreement because he promptly cured his defaults; thus, he said Kumon lacked "good cause" to terminate the agreement.

The court explained the purpose behind the NJFPA was not to protect franchisees that have lost their franchises as a result of their own misconduct, and it noted a franchisor has a defense to any action under the NJFPA if it shows that the franchisee failed to substantially comply with the agreement. The court held that timely royalty payments constituted "precisely the benefit that Kumon justifiably expected to receive under the Franchise Agreement" and Timban's failure to make these payments constituted a "good cause" to terminate.

DAMAGES TO FRANCHISOR

FEDERAL COURT AWARDS DEFAULT JUDGMENT DAMAGES FROM GUARANTORS

The United States District Court for the District of New Jersey recently granted a $570,000 default judgment damage award in favor of a franchisor. *Howard Johnson Int'l, Inc. v. Ebuehi*, 2014 U.S. Dist. LEXIS 73560 (D.N.J. May 29, 2014). The defendants were co-owners of Viva Vista Ventures, Inc., which entered into a hotel franchise agreement with Howard Johnson. They provided a guarantee that if Viva defaulted on its obligations, they would perform. After Viva stopped operating the facility as a Howard Johnson location, the franchisor sent Viva a termination letter that triggered certain obligations, including payment of liquidated damages, past due recurring fees, and attorneys' fees.

Although the guarantors answered the complaint, they later became unresponsive and ceased to defend. The court found Howard Johnson entitled to a default judgment because the uncontested facts demonstrated that Viva and the individual guarantors failed to perform their obligations under valid contracts. Further, the court found that absent default, the franchisor would be prejudiced because it would have no other means of vindicating its claims. Howard Johnson received an award totaling $570,934.26, which included costs, attorneys' fees, damages under the franchise agreement and guarantee, and interest.

CHOICE OF FORUM

PUERTO RICO FEDERAL COURT UPHOLDS CLAUSE SELECTING FLORIDA FORUM

A federal court in Puerto Rico granted a franchisor's motion to transfer a case to the United States District Court for the Southern District of Florida based on the forum selection clause in the franchise agreements. *Caribbean Rests., LLC v. Burger King Corp.*, 2014 U.S. Dist. LEXIS 76352 (D.P.R. June 3, 2014). Burger King and Caribbean Restaurants entered into 182 franchise agreements for Burger King restaurants located throughout Puerto Rico. When Burger King attempted to assert control over Caribbean's expenditure of funds for advertising, promotion, and public relations, by requiring Caribbean to contribute its four percent local advertising and promotion requirement to Burger King, Caribbean filed suit in Puerto Rico, claiming that Burger King violated Puerto Rico's "Law 75" and breached franchise agreements and other obligations. Burger King moved to dismiss or transfer based on the parties' contractual choice of Florida forum in their contracts.

The Puerto Rico court found that the forum selection clauses were freely negotiated and free from fraud and overreaching. The court noted that when a contract contains a valid forum selection clause, a district court should transfer the case, unless extraordinary circumstances unrelated to the convenience of the parties clearly disfavor transfer. In this case, the court found all relevant public interest factors weighed in favor of granting the transfer.

TERMINATIONS

CALIFORNIA FEDERAL COURT DENIES SUMMARY JUDGMENT ON TERMINATION

A federal court in California has refused to summarily grant a declaratory judgment that a franchisor properly terminated an agreement with its franchisee. *Valvoline Instant Oil Change Franchising, Inc. v. RFG Oil, Inc.*, 2014 U.S. Dist. LEXIS 77382 (S.D. Cal. June 4, 2014). After franchisee RFG failed to make timely payments, Valvoline terminated its license agreement. But Valvoline agreed to forgo enforcement remedies and early termination fees if RFG released all claims and entered into a new "We Feature" Agreement by which RFG would continue to operate its various locations and would continue to sell exclusively Valvoline products, but would debrand the locations themselves and would no longer pay royalties to Valvoline. Under the new agreement, RFG agreed not to alter, adulterate, or commingle Valvoline's products. Valvoline later learned that RFG breached the We Feature Agreement. In response, Valvoline filed suit for a declaratory judgment confirming the termination, and moved for summary judgment. RFG opposed the motion arguing that the agreement was not enforceable, and termination was improper, because there was not a meeting of the minds regarding the terms of the agreement.

The court held summary judgment inappropriate as to whether the We Feature Agreement and other agreements were properly terminated. As often occurs, the court found factual disputes precluded summary judgment. For example, the court viewed the record as unclear on whether communications between the parties demonstrated an agreement on all of the terms of the We Feature Agreement, particularly as to when certain payments would be made by RFG. Because of the various disputes on material factual issues, the court refused to grant summary judgment.

Along with the attorneys indicated on the next page, Phil Kunkel, a principal in our firm, and summer associates Ashley Bailey, Riley Conlin, Kathryn Hauff, Leah Leyendecker, Lynn Ling, and Amanda Sicoli, as well as law clerk Tomi Mendel, all contributed to this issue.

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