When Franchisors Compete: Understanding the Boundaries Between Healthy and Unfair Competition for Franchisees

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I. INTRODUCTION

Franchising accounts for a huge and growing portion of American economic activity. According to a study performed by PricewaterhouseCoopers for the International Franchise Association Educational Foundation, in 2005 franchised businesses (including establishments owned by franchisors and those owned by franchisees) employed 11 million workers and generated over $880 billion in direct economic output – 4.4% of total private sector economic output.\(^1\) Between 2001 and 2005, franchised businesses grew more rapidly than many other sectors of the American economy.\(^2\) During this period, direct economic output of franchised businesses expanded by over 41% (from $625 billion to $881 billion), compared to a 26% increase in output for all businesses in the United States. Employment by franchised businesses increased by 12.6% from 2001 – 2005, while employment generated by all businesses grew by only 3.5%.\(^3\)

Continued expansion, for individual franchise systems and franchising as a whole, will require, among other things, a continuing supply of customers at two different levels of commerce – businesspeople willing to purchase franchises and consumers willing to buy the goods and services that franchised businesses sell. Franchisors often compete directly with each other for both ultimate consumers and prospective franchisees. While competition for consumers has generated a fair amount of litigation related to branding and advertising of goods and services, the battle for prospective franchisees has not. That may change, however, as the economy softens. Some franchisors may cross the line into actionable misconduct, while others may use litigation as a competitive tool to protect their turf.

This paper explores the boundaries of fair competition when franchisors compete for consumers and franchisees. We begin by reviewing the most likely causes of action arising out of the competition for the ultimate consumers of the franchisors’ respective goods or services – trademark and trade dress infringement and dilution, false advertising, and cyberpiracy. The focus then shifts to the competition for prospective franchisees. After reviewing the fundamental principles of the law on tortious interference with contract and prospective business relations, the paper discusses cases involving claims by one franchisor that a competing franchisor tortiously interfered with the plaintiff’s existing or prospective franchise agreements. Next, we consider ways that a franchisor interested in the possibility of recruiting franchisees from other systems can best manage the attendant risks, including prudent business practices designed to minimize the likelihood of claims by other franchisors, and the possibility of pre-emptive, declaratory judgment litigation to establish the propriety of the franchisor’s recruiting efforts. We then assess, with one recent dispute as a guide, “Little FTC Acts” and other state unfair competition laws as potential bases for a franchisor to challenge a competing franchisor’s conduct in selling franchises. Finally, the paper appraises the issues that can arise when a franchisor, rather than or in addition to filing suit, reports a competitor’s alleged misconduct to regulatory agencies.


\(^2\) Id.

\(^3\) Id.
II. TRADEMARKS, TRADE DRESS AND CYBERPIRACY DISPUTES

One common scenario seen in the case law arises where a franchisor appears, whether intentionally or not, to trade upon the goodwill of another by using names, designs or web addresses that will confuse the consumer about the origin of the product or service being offered. Competitors have responded with lawsuits against the offending franchisor under the Lanham Act, asserting claims for trademark infringement, trade dress infringement, trademark and trade dress dilution, and cyberpiracy. Using illustrative decisions from disputes between these franchisors, this section of the paper discusses the elements of each of these causes of action and the remedies available to the successful plaintiff.

A. Trademark Infringement

To succeed on a trademark infringement claim, the franchisor-plaintiff must prove (1) ownership of a valid trademark and (2) likely confusion with the defendant’s similar mark. 5

1. Ownership of a Valid Trademark

The first person to use a trademark is the owner. This first use of a trademark gives rise to common law trademark rights. Although not required for protection of trademark rights, a user can register its mark on the Principal Register of the United States Patent and Trademark Office (USPTO), which provides substantive and procedural benefits. Registered marks are presumed valid after five years. If the owner of the trademark can establish that its mark is valid and protectable, it can prevent competitors from using the mark or a confusingly similar one.

In order to be protectable, the trademark must be distinctive and indicate the source of the product or service. 6 “Trademark distinctiveness is . . . an evanescent quality,” 7 classified on a continuum as: [a] generic; [b] descriptive; [c] suggestive; and [d] arbitrary or fanciful. 8

a. Generic Marks

The Lanham Act does not protect generic terms because they are “in the public domain and available for all to use.” 9 Courts determine whether a mark is generic by looking at its common usage, as reflected in “dictionaries, newspapers, consumer surveys, advertisements, and other publications.” 10 While a trademark “placed on the Federal Register attain[s] a presumption of validity after five years,” that presumption fails if a trademark is found to be generic. 11 For example, in Aureflam Corp v. Pho Hoa Phat I, Inc., Aureflam (operating as Pho

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5 Applied Info. Scis. Corp. v. eBAY, Inc., 511 F.3d 966, 969 (9th Cir. 2007) (internal citation omitted).
6 1 ANNE GILSON LA LONDE, GILSON ON TRADEMARKS § 2.01 (2007) (hereinafter GILSON ON TRADEMARKS).
7 Id.
8 Steak n Shake Co. v. Burger King Corp., 323 F. Supp. 2d 983, 992 (E.D. Mo. 2004) (citing WSM Inc. v. Hilton, 724 F.2d 1320, 1325 (8th Cir. 1984)).
9 Steak n Shake Co., 323 F. Supp. 2d at 992 (quoting Cellular Sales, Inc. v. MacKay, 942 F.2d 483, 486 (8th Cir. 1991)).
Hoa) sued Pho Hoa Phat (PHP) for trademark infringement and unfair competition.\textsuperscript{12} PHP counterclaimed, seeking cancellation of Aureflam’s trademark on the ground that it was generic because Pho Hoa is allegedly a Vietnamese term for restaurants serving beef noodle soup. The court denied Aureflam’s motion to dismiss the counterclaim, finding that PHP’s allegations, if proved, were sufficient to support the claim that Aureflam’s trademark was generic and therefore not entitled to any protection.\textsuperscript{13}

b. Descriptive Marks

Descriptive trademarks “describe a characteristic” of the product.\textsuperscript{14} A descriptive trademark qualifies for protection if it acquires a “secondary meaning” which consumers associate with a particular producer or distributor, instead of just the product,\textsuperscript{15} and if the alleged holder has exclusive use of the mark.\textsuperscript{16}

As one recent dispute between franchisors illustrates, however, a descriptive mark will not qualify for protection simply because it is most often associated with a particular business, even if that business has been using the mark for an extended period. Steak n Shake v. Burger King arose out of Burger King’s introduction of the “Angus Steak Burger” as a menu item and application to register the “Great American Steakburger” as a federal trademark.\textsuperscript{17} Steak n Shake had been using the term “steakburger” since the 1960’s and its current logo touted that it was “Famous for Steakburgers.”\textsuperscript{18} Steak n Shake argued that “steakburger” qualified as descriptive because when customers heard the term, they thought of the Steak n Shake product,\textsuperscript{19} but the court disagreed and denied Steak n Shake’s preliminary injunction motion.\textsuperscript{20} The court noted that others used the term “steakburger” and reasoned that even if consumers identified the term most often with Steak n Shake, there was no evidence that the word had acquired a secondary meaning.\textsuperscript{21} In reaching that conclusion, the court relied on Burger King’s example of baby back ribs.\textsuperscript{22} Due to Chili’s effective marketing campaign, a large percentage of the public might be inclined to associate baby back ribs with Chili’s, but because consumers would still recognize that baby back ribs were available from other sources, the term remained

\textsuperscript{12} Id. at 950.

\textsuperscript{13} Id. at 953.

\textsuperscript{14} Steak n Shake Co., 323 F. Supp. 2d at 992 (citing A.J. Canfield Co. v. Honickman, 808 F.2d 291, 296 (3d Cir. 1986)).


\textsuperscript{16} Steak n Shake Co., 323 F. Supp. 2d at 994.

\textsuperscript{17} Id. at 985.

\textsuperscript{18} Id. at 987.

\textsuperscript{19} Id. at 989-90.

\textsuperscript{20} Id. at 996.

\textsuperscript{21} Id. at 993.

\textsuperscript{22} Id. at 994.
c. **Suggestive Marks**

Suggestive trademarks are inherently distinctive, and therefore qualify for protection without proof of a secondary meaning. Suggestive trademarks “merely suggest, but do not explicitly describe” a product. Consumers are required to use “imagination, thought, or perception to link the trademark with the goods.” Examples of suggestive trademarks include “Equine Technologies” for horse hoof pads, “L’Eggs” for panty hose, “Survivor” for beach-related goods, and “Brakleen” for brake parts cleaner.

d. **Arbitrary and Fanciful Marks**

Like suggestive trademarks, arbitrary and fanciful marks are inherently distinctive and qualify for protection without proof of secondary meaning. Arbitrary trademarks “use common words, symbols, and pictures that do not suggest or describe any quality or characteristic of the goods or services.” In other words, “[a]n arbitrary mark applies a common word in an unfamiliar way.” Apple computers, Camel cigarettes, and Beefeater gin are typical examples of arbitrary marks. Fanciful trademarks are a combination of letters, numbers, or symbols “selected for the sole purpose of functioning as a trademark.” Prominent examples of fanciful trademarks include Exxon and Google.

2. **Likely Confusion with Defendant’s Similar Mark**

The Lanham Act’s protections extend to all valid, non-generic trademarks. To prevail on a trademark infringement claim, a franchisor-plaintiff must prove likelihood of confusion with the defendant’s similar mark. In assessing likely confusion, courts consider: (1) the strength of the asserted mark; (2) the similarity between the parties’ marks; (3) the competitive proximity of the parties’ products; (4) the defendant’s intent to confuse; (5) evidence of actual confusion; and

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23 Id.

24 Id. at 985.

25 *Gilson on Trademarks* § 2.04[1], [3].

26 Id. at § 2.04[1].

27 Id. (quoting Interstellar Starship Servs. v. Epix, Inc., 304 F.3d 936, 943 n.6 (9th Cir. 2002)).

28 Id. at § 2.04[2] (internal citations omitted).

29 Id. at § 2.04[1], [3].

30 Sally Beauty Co. v. Beauty Co, Inc., 304 F.3d 964, 976 (10th Cir. 2002) (citing King of the Mountain Sports, Inc., v. Chrysler Corp. 185 F. 3d 1084, 1095 (10th Cir. 1999)).

31 Lane Capital Mgmt., Inc. v. Lane Capital Mgmt., Inc., 192 F.3d 337, 344 (2d Cir. 1999).

32 *Gilson on Trademarks* § 2.04[3].

33 *Sally Beauty Co.*, 304 F.3d at 976 (internal citation omitted).

34 *Gilson on Trademarks* § 2.04[4].

35 See Al-Site Corp. v. VSI Int’l, Inc., 174 F.3d 1308, 1328 (Fed. Cir. 1999).
(6) the degree of care reasonably expected of consumers.\textsuperscript{36} These factors “imply no mathematical precision, and a plaintiff need not show that all, or even most . . . are present in any particular case to be successful.”\textsuperscript{37}

\textit{Societe des Hotels Meridien v. LaSalle Hotel Operating P’ship, L.P.} considered the likelihood of confusion in relation to a Lanham Act claim based upon alleged “reverse palming off.” Reverse palming off occurs when “A sells B’s product under A’s name.”\textsuperscript{38} The plaintiff, which managed hotels under the “Le Meridien” mark, had leased and operated hotels in New Orleans and Dallas owned by the plaintiff.\textsuperscript{39} The agreements between Meridien and LaSalle gave LaSalle the option to acquire Meridien’s leasehold interests in the properties if Meridien’s ownership changed.\textsuperscript{40} Meridien’s sale of its hotel management business triggered the option, which LaSalle exercised, and LaSalle later terminated the leases and made arrangements with defendant Starwood to manage the properties as Westin hotels. LaSalle’s termination of the leases resulted in arbitration, and in Texas and Louisiana state court litigation between Meridien and LaSalle. The Louisiana court enjoined LaSalle from converting the New Orleans hotel into a Westin and LaSalle failed in its effort to evict Meridien from the Dallas property.\textsuperscript{41} Thus, Meridien remained in control of both hotels, when Starwood engaged in the conduct that gave rise to the federal case – circulation of a hotel directory that identified the Dallas and New Orleans properties as Westins. Meridien sued Starwood and LaSalle in the United States District Court for the Southern District of New York, claiming violations of the Lanham Act and state law and seeking an injunction preventing further distribution of the hotel directory.\textsuperscript{42} The court denied the injunction motion, holding that Meridien had failed to show either a likelihood of success on the merits or “sufficiently serious questions . . . with respect to consumer confusion.”\textsuperscript{43} Meridien later amended its complaint to assert the reverse palming off claim. The court granted Starwood’s and LaSalle’s motions to dismiss the claim because, among other reasons, it concluded that “Starwood’s publication of the directories with photos of Meridien-managed hotels created only a small likelihood of confusion” and that “any such confusion would, in any event, benefit Meridien and not Starwood since Meridien would reap the benefits of any sales generated by those directories.”\textsuperscript{44}

The Second Circuit reversed, holding that Meridien had sufficiently stated a claim for reverse palming off by alleging that the defendants were holding themselves out as the source of services when they were not.\textsuperscript{45} The defendants argued that because they did not use

\textsuperscript{36} Steak n Shake Co., 323 F. Supp. 2d at 994-95 (internal citation omitted).


\textsuperscript{38} Societe des Hotels Meridien v. LaSalle Hotel Operating P’ship, L.P., 380 F.3d 126, 131 (2d Cir. 2004) (quoting Waldman Publ’g Corp. v. Landoll, Inc., 43 F.3d 775, 780 (2d Cir. 1994)).

\textsuperscript{39} Id. at 128.

\textsuperscript{40} Id.

\textsuperscript{41} Id.


\textsuperscript{43} Id. at *5.

\textsuperscript{44} Id. at *1.

\textsuperscript{45} Societe des Hotels Meridien, 380 F.3d at 131.
Meridien’s trademarks, they did not generate confusion.\textsuperscript{46} The appellate court summarily dismissed that argument, noting that “it is precisely the removal of a competitor’s trademark from a product that is the hallmark of [reverse palming off] claims.”\textsuperscript{47}

3. Other Barriers to Trademark Infringement Claims

Two other trademark disputes between competing franchisors illustrate additional, potential barriers to successful infringement claims.\textsuperscript{48} In \textit{D & J Master Clean, Inc. v. Servicemaster Co.}, \textit{D & J Master Clean} requested a preliminary injunction against Servicemaster based on trademark infringement and unfair competition claims.\textsuperscript{49} While \textit{D & J Master Clean} used the mark “MASTER CLEAN”, Servicemaster changed its mark from “ServiceMASTER” to “ServiceMASTER Clean.”\textsuperscript{50} The court denied \textit{D & J Master Clean}'s preliminary injunction motion, in part because Servicemaster’s alteration appeared to be protected by the “tacking rule.”\textsuperscript{51} Under this rule, a minor change to an otherwise non-infringing trademark, which does not change the mark’s overall commercial impression, does not affect the user’s rights dating back to the first use of the mark in its original form.\textsuperscript{52}

Also, a common law trademark is only recognized if its use was “deliberate and continuous, not sporadic, casual or transitory.”\textsuperscript{53} In \textit{McDonald’s Corp. v. Burger King Corp.}, McDonald’s sued Burger King, claiming trademark infringement and unfair competition due to Burger King’s use of “Big Kids Meal” to denote a larger-portion children’s meal.\textsuperscript{54} Because McDonald’s used “Big Kid’s Meal” for “merely [seventeen] days in a limited geographic area,” its use was not deliberate and continuous, and the court therefore granted Burger King summary judgment.\textsuperscript{55}

B. Trade Dress Infringement

The Lanham Act’s protections also extend to “trade dress,” which incorporates “all elements making up the total visual image by which [a] product is presented to customers.”\textsuperscript{56}

\textsuperscript{46} Id.
\textsuperscript{47} Id. (internal citation omitted).
\textsuperscript{49} \textit{D & J Master Clean, Inc.}, 181 F. Supp. 2d at 821,824.
\textsuperscript{50} Id. at 822-24.
\textsuperscript{51} Id. at 825.
\textsuperscript{52} See id. The court, however, ultimately found that \textit{D & J Master Clean} was entitled to a jury trial.
\textsuperscript{53} \textit{McDonald’s Corp.}, 107 F. Supp. 2d at 790 (quoting \textit{Circuit City Stores, Inc. v. CarMax, Inc.}, 165 F.3d 1047, 1054–55 (6th Cir. 1999)).
\textsuperscript{55} \textit{McDonald’s}, 107 F. Supp. 2d at 790-91.
\textsuperscript{56} \textit{Best Cellars, Inc. v. Grape Finds at Dupont, Inc.}, 90 F. Supp. 2d 432, 449 (S.D.N.Y. 2000) (internal citations omitted).
Trade dress includes product packaging or “dressing” and product design.\textsuperscript{57} A claim for trade dress infringement requires the franchisor-plaintiff to establish (1) “that its trade dress is either inherently distinctive or that it has acquired distinctiveness through a secondary meaning[]” and that its trade dress is non-functional; and (2) likely confusion with the defendant’s similar trade dress.\textsuperscript{58}

To be protected, trade dress must be “nonfunctional;” this ensures that a useful product feature is not unfairly monopolized.\textsuperscript{59} “Functionality, a term developed at common law . . . has meant many things to many courts.”\textsuperscript{60} One leading commentator has lamented that “there are as many definitions of what is ‘functional’ as there are courts.”\textsuperscript{61} Despite this lack of definitional clarity, the United States Supreme Court issued an opinion “reaffirming the importance of the functionality doctrine,”\textsuperscript{62} and established a two-step test to determine whether particular trade dress is functional.\textsuperscript{63} First, the trade dress is functional if it is either an essential product feature or a feature that affects the product’s cost or quality.\textsuperscript{64} Second, the trade dress is functional if allowing the plaintiff to maintain exclusive use would put “competitors at a significant non-reputation-related disadvantage.”\textsuperscript{65}

In \textit{Best Cellars, Inc. v. Grape Finds at Dupont, Inc.}, Best Cellars, a wine retailer, sought a preliminary injunction against Grape Finds to prevent infringement of its trade dress.\textsuperscript{66} Best Cellars created a wine store architecturally distinct from other wine stores, which it dubbed an “anti-wine store.”\textsuperscript{67} Instead of grouping wine by “grape type or place of origin,” Best Cellars developed a “wine by style” categorization system.\textsuperscript{68} Within the store, wines were organized according to “taste and weight”: fizzy; fresh; soft; luscious; juicy; smooth; big; and sweet.\textsuperscript{69} The court viewed Best Cellars’ trade dress as arbitrary, and therefore eligible for Lanham Act protection, because “Best Cellars achieved its goal of designing an ‘anti-wine store’; [a]s such[,] the trade dress is not suggestive of the product being sold, let alone descriptive or generic.”\textsuperscript{70} Best Cellars’ unique design was evident based on the “huge number of articles” and numerous awards praising the distinctive look.\textsuperscript{71}

\textsuperscript{57} \textit{Wal-Mart Stores, Inc.}, 529 U.S. 205, 209 (2000).
\textsuperscript{58} \textit{Best Cellars, Inc}, 90 F. Supp. 2d at 450-51 (internal citations omitted).
\textsuperscript{59} \textit{Gilson on Trademarks} § 2A.04.
\textsuperscript{60} \textit{Id.}
\textsuperscript{61} \textit{1 J. Thomas McCarthy, McCarthy on Trademarks and Unfair Competition} § 7:69 (4th ed. 1997).
\textsuperscript{62} \textit{Gilson on Trademarks} § 2A.04.
\textsuperscript{64} \textit{Id.} at 24.
\textsuperscript{65} \textit{Id.}
\textsuperscript{66} \textit{Best Cellars, Inc.}, 90 F. Supp. 2d at 434.
\textsuperscript{67} \textit{Id.} at 436.
\textsuperscript{68} \textit{Id.}
\textsuperscript{69} \textit{Id.} at 435–36.
\textsuperscript{70} \textit{Id.} at 451-52.
After deciding that Best Cellars’ trade dress was distinctive, the court applied an eight-factor test in determining the likelihood of consumer confusion between Best Cellars’ and Grape Finds’ trade dress. The factors were: “(1) the strength of the plaintiff’s trade dress, (2) the similarity between the two trade dress, (3) the proximity of the products in the marketplace, (4) the likelihood that the prior owner will bridge the gap between the products, (5) evidence of actual confusion, (6) the defendant’s bad faith, (7) the quality of defendant’s product, and (8) the sophistication of the relevant consumer group.” After discussing each factor, the court found “seven of the eight factors weigh in favor of Best Cellars[,]” and granted Best Cellars’ motion for a preliminary injunction.

Conversely, in Dippin’ Dots, Inc. v. Frosty Bites Distribution, LLC, the United States Court of Appeals for the Eleventh Circuit affirmed summary judgment for the defendant on the plaintiff-franchisor’s trade dress infringement claim. Plaintiff Dippin’ Dots franchised businesses that manufacture and distribute flash frozen ice cream in the form of small round colored frozen beads. Defendant Frosty Bites also sold flash frozen ice cream in the form of small colored beads and nuggets. The district court found that Dippin’ Dots trade dress was functional, and thus not distinctive, because: (1) the colors used identified the flavor of ice cream being served; (2) the small size of the beads correlated to the products’ cost and quality because larger beads would result in more air between the beads thereby requiring larger packaging; and (3) the small beads were also tied to the product’s quality because smaller beads result in less crystal formation, making the ice cream creamier. The court went on to hold that if competitors were prevented “from making a product with these qualities” they would be placed at a “disadvantage unrelated to reputation.”

C. Trademark or Trade Dress Dilution

The Lanham Act also establishes a cause of action for trademark or trade dress dilution. A dilution claim, like an infringement claim, requires a violation of a valid, non-generic trademark or trade dress. It is distinguishable, however, based on two elements. First, instead of confusion, a dilution claim requires proof of a “dilution of the distinctive quality” of the franchisor-plaintiff’s trademark or trade dress, which occurs by blurring or tarnishment.
“[D]ilution by blurring is association arising from the similarity between a mark or trade name and a famous mark that impairs the distinctiveness of the famous mark.” 81 A court will consider “all relevant factors,” including: (1) the degree of similarity between the accused mark or name and the famous mark; (2) the degree of distinctiveness of the famous mark; (3) the extent to which the owner of the famous mark is engaging in substantially exclusive use of the mark; (4) the degree of recognition of the famous mark; (5) whether the user of the accused mark or name intended to create an association with the famous mark; and (6) any actual association. 82 “[D]ilution by tarnishment is association arising from the similarity between a mark or trade name and a famous mark that harms the reputation of the famous mark.” 83

Second, a dilution claim requires the additional factor of a “famous” valid trademark or trade dress. 84 Famous is defined as “a household name.” 85 This strict definition prevents anti-dilution from “becom[ing] a rogue law that turns every trademark, no matter how weak, into an anti-competitive weapon.” 86

“Fair use” of a famous mark is not actionable as dilution by blurring or tarnishment. 87 Fair use includes use in connection with advertising or promotion that allows consumers to compare goods or services, and “parodying, criticizing, or commenting upon the famous mark owner or the goods or services of the famous mark owner.” 88 Fair use also includes news reporting and commentary, as well as any noncommercial use of a mark. 89

In Best Cellars, Inc. v. Grape Finds at Dupont, Inc., because Best Cellars was popular only within New York City, Boston, and Seattle, and only with the “retail wine world,” it was not famous enough to warrant a preliminary injunction on its trade dress dilution claim. 90 Similarly, in Newport Pacific Corp. v. Moe’s Southwest Grill, LLC, Mo’s Restaurants were deemed “not famous enough” to support a trademark dilution claim because there were only six Mo’s Restaurants and all were in Oregon. 91 Accordingly, the Oregon federal court granted summary judgment to defendant Moe’s Southwest Grill. 92

82 Id. § 1125(c)(2)(B)(1)(i)-(vi)
83 Id. § 1125(c)(2)(C) (internal quotations omitted).
84 Best Cellars, Inc., 90 F. Supp. 2d at 458-59.
85 Newport Pac. Corp. v. Moe’s Sw. Grill, LLC, No. 05-995-KI, 2006 WL 2811905, at *7 (D. Or. Sept. 28, 2006) (citing Thane Int’l Inc. v. Trek Bicycle Corp., 305 F.3d 894, 911 (9th Cir. 2002)).
86 Steak n Shake Co., 323 F. Supp. 2d at 992 (internal citation omitted).
88 Id. § 1125(c)(3)(A)(ii).
89 Id. § 1125(c)(3)(B)-(C).
90 Best Cellars, Inc., 90 F. Supp. 2d at 459.
92 Id. Moe’s Southwest Grill later sought attorneys’ fees and costs, arguing that Mo’s Restaurants acted in bad faith by seeking a nationwide injunction when it had outlets only in Oregon. The court denied the request for $655,716 in attorneys’ fees but awarded $28,022.13 in costs. Newport Pac. Corp. v. Moe’s Sw. Grill, LLC, No. 05-995-KI, 2006 U.S. Dist. LEXIS 87190 (D. Or. Nov. 29, 2006).
D. Cyberpiracy

To protect against cyberpiracy, Congress enacted the Anticybersquatting Consumer Protection Act in 1999 as an amendment to the Lanham Act. A successful cyberpiracy claim requires the franchisor-plaintiff to show: (1) ownership of a valid trademark, and that (2) the trademark is distinctive or famous; (3) the defendant’s domain name is identical, confusingly similar to, or dilutive of the trademark; (4) the defendant used, registered, or trafficked in the domain name; and (5) the defendant had a bad faith intent to profit. Essentially, the defendant “us[es] the domain name to direct business [away] from the trademark holder.” The requirement of bad faith intent to profit is designed to “balance the interests of . . . those who would make fair uses of a mark online, such as for comment, criticism, parody, and news reporting.”

In *HER, Inc. v. RE/MAX First Choice, LLC*, HER and RE/MAX were in direct competition for real estate sales in Central Ohio. RE/MAX registered domain names that were similar to HER agents’ names and HER’s registered trademark and domain name “Real Living.” Those websites then redirected consumers to the RE/MAX website. HER sought a preliminary injunction against RE/MAX. RE/MAX contended that the only purpose of the registered domain names was to “provide legitimate criticism” of HER. In granting the preliminary injunction, the court reasoned that RE/MAX’s use of HER agents’ names and “Real Living” was “clearly confusing as it creates the appearance that [HER has] permitted the use of the trademarks and names by [RE/MAX].” In a later opinion, the court granted HER’s motion to transfer the offending domain names to its ownership pending the outcome of the trial.
E. Remedies

Remedies for trademark/trade dress infringement or dilution and for cyberpiracy include injunctions, damages, and attorneys' fees.104

1. Injunctions

Under the Lanham Act, courts consider the four, familiar factors in deciding whether to grant preliminary injunctive relief: (1) the likelihood of success on the merits of the claim(s); (2) the threat of irreparable harm if the injunction is not granted; (3) the balance between that harm and the harm the defendants would incur if the injunction was granted; and (4) the public interest.105 Proof of a Lanham Act violation is, by itself, proof of irreparable harm.106 Likelihood of success on the merits, however, may be more difficult to prove, and courts will only issue a preliminary injunction if that element is satisfied.107

2. Damages

The Lanham Act's damages section, 15 U.S.C. § 1117, is “a broad remedial provision, which allows the district court substantial discretion in awarding damages.”108 A plaintiff may recover actual damages, including lost royalties. Where infringement was in bad faith or resulted in the defendant's unjust enrichment, the plaintiff may also be able to recover lost profits. The court has the discretion to increase the plaintiff's actual damages up to three times. Punitive damages, however, are not allowed and “the award must not be inequitable.”109

3. Attorneys’ Fees and Costs

The Lanham Act also empowers courts to award reasonable attorneys' fees in exceptional cases.110 A prevailing defendant, as well as a plaintiff, may recover fees.111 The prevailing party may also recover costs.112


105 See Steak n Shake Co., 323 F. Supp. 2d at 990 (internal citations omitted).

106 Id. at 995 (“[T]rademark infringement ‘by its very nature’ results in irreparable harm to the owner of the mark and will be presumed, unless the trademark is already weak.”) (internal citation omitted).

107 See, e.g., id. at 990 (denying a motion for a preliminary injunction because Steak n Shake did not show that it was likely to succeed or that irreparable harm would occur if the injunction was denied); see also Best Cellars, Inc., 90 F. Supp. 2d at 458 (granting a motion for a preliminary injunction based on a finding that Best Cellars would likely prevail on the merits of its trade dress claim); see generally discussion supra Part A.1-2.

108 Dial One of the Mid-South, Inc. v. Bellsouth Telecomms., Inc., 401 F.3d 603, 609 (5th Cir. 2005).

109 Id. (internal citations omitted).


111 San Juan Prods., Inc. v. San Juan Pools, Inc., 849 F.2d 468 (10th Cir. 1988) (plaintiff asserted claims in bad faith, to harass or to delay, thus defendant was entitled to recover its attorney’s fees).

4. **Other Relief**

A defendant may be ordered to turn over or destroy infringing products or materials.\(^{113}\) Criminal penalties can also be imposed.\(^{114}\)

III. **FALSE ADVERTISING CLAIMS**

Advertising campaigns are a frequent source of tension between competing franchisors, and marketing can sometimes cross the line from simple promotion to false advertising. There are common law causes of action for defamation and disparagement, but these claims are often hard to win because of the difficulty of proving with specificity that a false statement caused damages.\(^{115}\) Consequently, franchisors generally assert claims for product disparagement through a statutory cause of action, most commonly the Lanham Act.\(^{116}\)

Section 43(a) of the Lanham Act provides:

\[(a)(1) \text{ Any person who, or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description or fact, or false or misleading representation of fact, which--}. . . . (B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person’s goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.}\(^{117}\)

To sustain a claim of false advertising under the Act, a plaintiff must prove that: (1) the defendant made a false or misleading statement in an advertisement about its services or products; (2) the statement actually deceived or had a tendency to deceive a substantial segment of its audience; (3) the deception was material; (4) the defendant caused its false statement to enter interstate commerce; and (5) the plaintiff has been or is likely to be injured as result of the false statement, either by direct diversion of sales from itself to defendants or by loss of goodwill associated with its services.\(^{118}\)

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\(^{116}\) Another means of challenging a competitor’s deceptive advertising is to file a challenge at the National Advertising Division. See Andrew Caffey, Benjamin Dinkins & Andrew Strenio, *Advertising Disputes: Current Federal Standards and the Promise of the National Advertising Division Process*, A.B.A. Forum on Franchising § W-10 (2000).


\(^{118}\) This test has been adopted by the First, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh Circuits and the District of Columbia. Some courts have stated a three part test requiring that the ad’s message: (1) be false or deceptive; (2) be material; and (3) actually deceive or have a tendency to deceive the purchasers of the product or service. See 1 Zamore, *Business Torts* §7.03[1][b] (1989). This test variance does not conflict with the majority approach or appear to produce different case outcomes. See United Indus. Corp. v. Clorox Co., 140 F.3d 1175, 1180 (8th Cir. 1998); Skil Corp. v. Rockwell Int'l Corp., 375 F. Supp. 777, 783 (N.D. Ill. 1974).
A. The Statement is False or Misleading

The key to a claim under Section 43(a) of the Lanham Act is establishing that the subject advertisement expresses or suggests a false message. To determine the underlying message communicated to the consumer, a court will examine an individual slogan or advertisement in the overall context of the defendant’s advertising campaign. For example, in *Avis Rent A Car System, Inc. v. Hertz Corp.*, Hertz’s commercials boasted that “Hertz has more new cars than Avis has cars.” While Avis actually had more cars, Hertz’s inventory of cars available for rent to the public was slightly larger. Relying on the parties’ reputations as car renters and on customer surveys, the Second Circuit found that the advertisement referred to cars available for rent, not total cars, and was therefore not false or misleading.

Although a statement may be accurate, its use in a commercial setting can still be misleading. In another advertisement that resulted in litigation, a shaving product company’s commercial featured a man rubbing his hand down his face while the announcer bragged that the moisturizing strip on the defendant’s shaving razor was “six times smoother” than its competitors’ strips. The defendant argued that the “six times smoother” reference was only to the moisturizing strip on the razor’s head, and not the actual quality of the shave the razor provides. The court rejected this argument, finding that in the context of the ad, the message conveyed was that a purchaser would get a smoother shave from the defendant’s razor than from competing products.

Once the message is identified, the plaintiff must establish that it is untrue. In order to be actionable, an advertisement must either be literally false or imply a false fact – it cannot be mere “puffery” or hyperbole. “Bald assertions of superiority or general statements of opinion cannot form the basis of Lanham Act liability.”

To constitute false advertising under the Lanham Act, the statement at issue must make a “specific and measurable claim, capable of being proved false or of being reasonably interpreted as a statement of objective fact.” Thus, a simple conclusory statement that one’s product is better or superior is not actionable. For example, the Eighth Circuit rejected a challenge to a producer’s claim that its pasta was “America’s favorite pasta” because the phrase was not a specific, measurable claim. Statements that a product is new and novel and “comparable in quality” are also mere puffery.

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120 *Id.* at 382.

121 *Id.* at 384-385.


123 *Id.*


125 See *Pizza Hut, Inc. v. Papa John’s Int’l, Inc.*, 227 F.3d 489, 494 (5th Cir. 2000).

126 *Id.* at 496 (internal citations omitted).

127 *Coastal Abstract Serv., Inc. v. First Am. Title Ins. Co.*, 173 F.3d 725, 731 (9th Cir. 1999).

If an advertising statement is claimed to be “literally” false, courts then determine whether the statement is purportedly based upon “testing” or is an unsubstantiated statement of superiority. If the message is supposedly based upon testing, to establish falsity the plaintiff must show that the defendant’s testing is unreliable or does not support the claim being made. If the claim is a bald assertion, the plaintiff must demonstrate that the message is false through expert testimony, scientific evidence or customer testing. In sum, even though a plaintiff may easily be able to establish that a defendant has little substantiation for claims made in its marketing campaign(s), it is the plaintiff’s burden to demonstrate by a preponderance of the evidence that the message is false, irrespective of the defendant’s reliance on tests or other studies in support of the advertisements at issue.

Consequently, it is easier for a franchisor to meet its burden of establishing falsity where the defendant’s claims are based on testing. As one court recognized, “proving the falsity of a fact asserted in an advertising claim may well be more difficult than merely proving that a test asserted to validate the claim is not sufficiently reliable to do so.” The lower standard applied in cases where an advertisement cites testing to support its claims seems to reflect a concern that consumers will be more apt to rely on statements that they believe are supported by scientific processes.

Additionally, if the message conveyed by the advertisement is found to be unambiguous and literally false, no extrinsic evidence regarding the public’s perception of the message is required.

Context is key. Even though an advertisement does not contain a literally false statement, it will be considered literally false “if the words or images, considered in context, necessarily and unambiguously imply a false message.” If the message is ambiguous, to establish falsity the plaintiff must produce evidence of consumers’ understanding and reaction to the advertisement to establish that it is misleading. This is generally accomplished through time-consuming and expensive consumer surveys that the court may reject, as it did in a recent

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130 Anheuser-Busch, Inc. v. DuBois Brewing Co., 175 F.2d 370, 377 (3rd Cir. 1949).

131 Castrol Inc. v. Quaker State Corp., 977 F.2d 57, 63 (2d Cir. 1992):

Where the defendant’s advertisement claims that its product is superior, plaintiff must affirmatively prove defendant’s product equal or inferior. Where . . . defendant’s advertisement explicitly or implicitly represents that tests or studies prove its product superior, plaintiff satisfies its burden by showing that the tests did not establish the proposition for which they were cited.

(Internal citation omitted).

132 U-Haul Int’l v. Jartran, Inc., 522 F. Supp. 1238, 1248 (D. Ariz. 1981) (emphasizing that “[d]efendant d[oes] not have to prove the truth of its asserted product claims; the burden . . . rest[s] on [plaintiff] and plaintiff cannot “sustain its burden of persuasion” with proof “that [defendant] had done little, if any, testing” of its own products compared to plaintiff’s.).


135 Time Warner Cable, Inc. v. DIRECTTV, Inc., 497 F.3d 144, 148 (2d Cir. 2007).
franchise case. There, Jack in the Box ran an advertising campaign for its new hamburger, boasting that it was made from 100% sirloin beef. Carl’s Jr. and Hardee’s restaurants used Angus beef in their burgers. According to the plaintiffs, the Carl’s Jr. and Hardee’s franchisors, the Jack in the Box television commercials created the misleading impression that sirloin beef was superior “by creating phonetic and aural confusion between the words ‘Angus’ and ‘anus,’” to imply that Angus beef came from the “rear-end and/or anus of beef cattle.” The plaintiffs sought a preliminary injunction to stop the commercials, relying on a consumer survey to show that the commercials caused purchasers to believe that sirloin beef was superior to Angus beef and that Angus beef was not a breed of cattle, but a cut of meat that came from the cow’s anus. The court found the survey unreliable, because it used leading and suggestive questions and consumers were provided with responses from which to choose. As the court observed, effective consumer perception surveys use “open-ended questions that permit consumers to identify the primary message of a commercials and any source of deception.” The court held that “[s]ince [the] plaintiffs only barely meet the ‘serious questions’ standard in the preliminary injunction continuum, they have a higher standard to meet in the balancing of hardships.” Turning to the balance of hardships, the court concluded that this factor favored Jack in the Box as well, because it would suffer extreme hardship and financial loss if forced to stop running the commercials.

Finally, it should be noted that the omission of certain facts from an advertisement can also be the basis for finding a misleading message. For example, in American Home Products. Corp. v. Johnson & Johnson, the defendant marketed a checklist of side effects for its analgesic products compared to the plaintiff’s products. The checklist indicated that the defendant’s products were safer, but failed to say that defendant’s products were more likely to cause liver damage since liver damage was not one of the side effects listed. The court concluded that the checklist was misleading, as the average reader might believe that the listing of side effects was complete.

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137 Id. at 1141.
138 Id. at 1143.
139 Id. at 1144-45.
140 Id.
141 Id. at 1144 (internal citation omitted).
142 Id. at 1145.
143 Id. at 1148.
145 Id. at 579.
B. The Message is Deceptive

Once it is determined that the ad’s message is false, a plaintiff must show that consumers have been, or are likely to be, deceived by the message. If the message at issue is found to be literally false, courts presume that the message is deceptive without evaluating its effect on the intended audience. If the statement is merely found to be ambiguous or misleading, then the plaintiff must show that a substantial number of consumers were misled or confused by the commercials. “The plaintiff may not rely on the judge or jury to determine, ‘based solely upon his or her own intuitive reaction, whether the advertisement is deceptive.’” Rather, the plaintiff generally relies on the same studies used to prove that the message communicated to consumers was untrue.

But if a defendant intends to deceive the public and significant funds are expended, the court may also presume that the public will be deceived. For example, in *JTH Tax, Inc. v. H&R Block E. Tax Servs., Inc.*, H & R Block ran ads featuring the slogan “spend more quality time with your refund.” The advertisement went on to ask: “Why wait [six] weeks for your tax refund when H & R Block can give you your refund amount in as little as [two] days?” The advertisement was literally false because customers did not actually receive their “refund” -- they received a loan for the tax refund amount minus H & R Block’s tax preparation fees. These ads were not part of a nationwide campaign. H & R Block released them only in the geographic area where H & R Block knew that the plaintiff was launching new franchises. Moreover, and important to the court’s decision, H & R Block was aware that IRS regulations required it clearly to disclose that these types of funds were being advanced as a loan and were not the customer’s actual refund. Based on these facts, the court determined that H & R Block acted maliciously, deliberately and in bad faith, and that the plaintiff franchisor was therefore entitled to a presumption of consumer deception.

C. The Deception is Material

A plaintiff bringing a claim under Section 43(a) of the Lanham Act, 15 U.S.C. 1125(a), must also establish that the advertisement’s deception is material. Deception is material if it actually misleads customers. If the message of the ad is literally false, no further analysis is necessary.

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146 Clorox Co. v. Proctor & Gamble Commercial Co., 228 F.3d 24, 33 (1st Cir. 2000) (“If the advertisement is literally false, the court may grant relief without considering evidence of consumer reaction.” (internal citation omitted)).


149 See U-Haul Int’l Inc. v. Jartran, Inc., 793 F.2d 1034, 1041 (9th Cir. 1986) (“The expenditure by a competitor of substantial funds in an effort to deceive consumers and influence their purchasing decisions justifies the existence of a presumption that consumers are, in fact, being deceived.”).


151 Id. at 934.

152 Id. at 935-36.

153 Id. at 938. The plaintiff also established deception by submitting a consumer survey which showed that twenty-two percent of those surveyed found the advertisement misleading.
needed: it will be presumed to have affected customers. But when a court finds that a statement is merely misleading, the plaintiff franchisor must offer proof that the deception affected consumers’ buying decisions. In the protracted false advertising litigation between franchisors Pizza Hut and Papa John’s, the final outcome turned on the element of material deception. The dispute started when, in response to Pizza Hut’s ads “daring” anyone to find a better pizza, Papa John’s ran a series of television commercials featuring Pizza Hut’s co-founder Frank Carney. Carney explained in the ads that although he had left the pizza business a decade ago, he had returned as a Papa John’s franchisee because he liked the taste of Papa John’s pizza better than any other pizza on the market. Later, Papa John’s ran a series of ads comparing the ingredients used in its pizza with those of its competitors. One series of commercials asserted that Papa John’s pizza sauce was made from “fresh, vine-ripened tomatoes,” while its competitors used remanufactured tomato paste. In other ads Papa John’s emphasized that its pizza dough was refrigerated for several days allowing the yeast to work its magic, while others only used frozen dough. Pizza Hut sued, alleging that Papa John’s advertising campaign violated Section 43(a). Pizza Hut did not contend that any of these statements was false -- in fact, it admitted that they were true. Instead, Pizza Hut contested the implied message that Papa John’s ingredients resulted in a higher quality pizza. Pizza Hut offered evidence that there was no quantifiable difference in the pizza sauces, and expert testimony that the only taste difference in the dough resulted from the type of wheat used and that freezing the dough did not affect its taste. Pizza Hut’s expert also testified that in taste tests, consumers were unable to distinguish between fresh and frozen dough. The United States Court of Appeals for the Fifth Circuit affirmed the district court judgment that these ads, used in conjunction with the slogan “Better Ingredients, Better Pizza,” were misleading.

The appellate court went on to hold, however, that Pizza Hut had failed to demonstrate that the deception in the commercials was “material” to the audience: “Pizza Hut has failed to adduce any evidence demonstrating that the facts conveyed by the slogan were material to the purchasing decisions of the consumers to which the slogan was directed.” Notably, Pizza Hut did not seek monetary damages. It wanted an injunction, so it only had to demonstrate that the ads had a “tendency to deceive” customers, as opposed to demonstrating that customers were “actually deceived.”

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154 Pizza Hut, Inc., 227 F.3d at 495.
155 Id.
156 Id. at 492-93.
158 Id. at 603.
159 Id. at 605-07.
160 Id. at 609-10.
161 Id. at 606.
162 Id. at 607.
163 The court found that the slogan, standing alone, was mere puffery. The slogan only became misleading when viewed in the context of the television commercials. Pizza Hut, Inc., 227 F.3d at 503-04.
164 Notably, Pizza Hut did not seek monetary damages. It wanted an injunction, so it only had to demonstrate that the ads had a “tendency to deceive” customers, as opposed to demonstrating that customers were “actually deceived.” Id. at 491.
demonstrates, franchisors must remember that to succeed on a Lanham Act false advertising claim, it is not enough that a competitor made misleading statements; the franchisor must also prove that consumers actually paid attention to and believed the statements.

**D. The Message Entered Interstate Commerce**

A plaintiff must also demonstrate that the advertisement at issue entered interstate commerce. The majority of courts require only that the advertisement be placed in interstate commerce while the Third and Eleventh Circuits require that the message have a substantial effect on the plaintiff’s interstate business or that the goods or services being promoted by the ads travel by interstate commerce.¹⁶⁵

Conversely, some courts have found the interstate commerce requirement met when the defendant’s intrastate activities affect the plaintiff’s interstate sales. H & R Block contended in *JTH Tax, Inc. v. H & R Block E. Tax Servs., Inc.* that the court lacked subject matter jurisdiction over JTH’s Lanham Act claim because Block’s allegedly false advertisements ran in only one state.¹⁶⁶ The court was not persuaded, noting that the plaintiff’s cause of action arose under a federal statute and that the statutory limitation “in commerce” is broadly construed.¹⁶⁷ “Thus, a plaintiff may bring a false advertising claim with regard to advertising activities that, while intrastate, may have a substantial effect on interstate commerce in the aggregate.”¹⁶⁸

**E. The Plaintiff was Injured**

Finally, the Lanham Act false advertising plaintiff must demonstrate injury by showing either that it lost business as a result of the advertising or that the advertising has affected the good will of its product or service. The required showing varies based upon the remedy sought. In order to obtain an injunction, the plaintiff must establish that the ad threatens irreparable harm. A plaintiff need not provide evidence that consumers were actually deceived by the advertisement; rather, it need only show that the message being conveyed has a tendency to deceive customers.¹⁶⁹

Because Section 43(a) was not designed to punish competitors, in order to recover actual monetary damages, the plaintiff must prove that the public relied on the deceptive advertising in making purchasing decisions. This evidence can be established through customer surveys, customer testimony, or by the fact the advertising is literally false. Section 35 of the Lanham Act allows for monetary recovery:

> [T]he plaintiff shall be entitled . . . to recover (1) defendant’s profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action. The court

¹⁶⁵ See 1 Joseph Zamore, *BUSINESS TORTS* § 7.03[3][b] (citing cases in support of this proposition).


¹⁶⁷ *Id.* at 941.

¹⁶⁸ *Id.* (citing United States v. Lopez, 514 U.S. 549, 558 (1995)). The court further explained that the interstate commerce requirement was met because Block “used telephone lines and United States mail” and “conducted their false or misleading advertisements in multiple states nationwide,” which together satisfy the “in commerce” element. *Id.* at 942.

¹⁶⁹ Toro Co. v. Textron, Inc., 499 F. Supp. 241, 251 (D. Del. 1980), quoting Parkway Baking Co. v. Freihofer Baking Co., 255 F.2d 641, 649 (3d Cir. 1958) (“To obtain injunctive relief, however, there is ‘no requirement that purchasers actually be deceived, but only that the false advertisements have a tendency to deceive.”); *but see Pizza Hut, Inc.*, 227 F.3d at 497 (“proof of actual deception requires proof that consumers were actually deceived by the defendant’s ambiguous or true-but-misleading statements.” (internal citations and quotation marks omitted)).
shall assess such profits and damages or cause the same to be assessed under its direction . . . . In assessing damages the court may enter judgment, according to the circumstances of the case, for any sum above the amount found as actual damages, not exceeding three times [that] amount. If the court shall find that the amount of the recovery based on profits is either inadequate or excessive the court may in its discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case. Such sum in either circumstance shall constitute compensation and not a penalty.\textsuperscript{170}

Lanham Act false advertising claims can sometimes yield significant damage awards. For example, in \textit{U-Haul International Inc. v. Jartran, Inc.}, the defendant had spent over $6,000,000 on marketing and the court presumed that it had benefited by at least this amount from the deceptive advertising campaign at issue in the case.\textsuperscript{171} The court also took into account the cost of the curative advertising measures that U-Haul had undertaken, and ordered Jartran to pay damages of $40 million.\textsuperscript{172}

In \textit{JTH Tax, Inc. v. H & R Block E. Tax Servs., Inc.}, the trial court awarded JTH damages for total profits lost and ordered plaintiffs to submit a statement of their costs (“expert witnesses, paralegals, case assistants, law clerks, secretarial overtime, travel expenses, and long distance telephone calls”) and “a statement of their attorney’s fees to the court for determination.”\textsuperscript{173} On appeal, the United States Court of Appeals for the Fourth Circuit agreed with H & R Block that the district court erred in using gross profits rather than net revenues in calculating the plaintiff’s damages and in not reducing the future profits to their present value.\textsuperscript{174} Accordingly, the court vacated the award for profits and remanded for recalculation, noting, however, that the district court appropriately included attorney’s fees and costs.\textsuperscript{175} On remand, the district court held that: (1) a competitor’s gross revenues not be reduced in absence of evidence of variable costs; and (2) a 3.5% discount rate is an appropriate rate for future damages because it “reflects a modes return on a safe investment.”

Under some circumstances, a Section 43(a) claim may be a more effective and less expensive means for a franchisor to combat the effect of deceptive advertising than responding with its own advertising campaign.\textsuperscript{176} But false advertising claims must be carefully evaluated, and obviously should not be brought simply because a franchisor is irked that a competitor’s advertisements have taken aim at the franchisor or its products. When deciding whether to proceed, it is crucial for the franchisor and its counsel to assess whether a judge or jury is likely to regard the message conveyed by the advertisement as literally false or as implying false facts -- a distinction that will determine the franchisor’s burden of proof – or instead will regard the advertisement as mere puffery (i.e., that there is no basis for a lawsuit). If the franchisor needs

\begin{thebibliography}{9}
\bibitem{170} 15 U.S.C. § 1117(a).
\bibitem{171} \textit{U-Haul Int'l Inc.}, 793 F.2d at 1042.
\bibitem{172} \textit{Id.} at 1041-42.
\bibitem{175} \textit{Id.} at 217, 219.
\bibitem{176} See Ross Petty, \textit{Competitor Suits Against False Advertising: Is Section 43(a) of the Lanham Act a Pro-Consumer Rule or an Anticompetitive Tool?}, 20 U. BALT. L. REV. 381, 383 (Spring 1991) (noting that lawsuit by MCI Communications, Inc. against AT&T brought MCI favorable publicity).
\end{thebibliography}
customer surveys to prove its case, it should take into account the feasibility of these studies, their costs and the likelihood that a court will find them reliable. Finally, the franchisor must determine what type of recovery it will seek and how that will affect its burden or proof.

IV. THE LAW OF TORTIOUS INTERFERENCE

Cases where one franchisor has sued another for tortiously interfering with existing or prospective franchise relationships appear to be few and far between. The private arbitration of some of these disputes may partially explain the lack of reported decisions. For four additional reasons, however, the scarcity of these claims may not be surprising. First, virtually all franchisors include various forms of in-term and post-term covenants against competition in their franchise agreements, and many agreements also give the franchisor the right of first refusal to buy the unit if the franchisee wishes to exit the system. The vast majority of the time, the parties probably fulfill these contract terms without incident. Second, most sensible franchisors are presumably more interested in upholding their own contract clauses than challenging the enforceability of similar terms in the franchise agreements of other systems – challenges that could create precedent that might be used against them or might encourage their own franchisees to believe that they can safely ignore their restrictive covenants. Third, with regard to prospects, many potential franchisees explore opportunities with multiple systems at the same time, and franchise brokers and other sources often provide the same leads to a range of franchisors. Accordingly, under most circumstances, it would probably be difficult for a franchisor to prove that things had progressed enough with a given prospect to make a competitor’s dealings with the prospect actionable as tortious interference. Fourth, any practitioner who carefully reviews the tortious interference case law will realize that the cause of action is not easy to prove, and that the authority is a bit of a muddle, with multi-factor tests applied to a wide variety of facts, yielding precedent with little if any predictive value in the next case.

Even if these deductions are currently accurate, however, they may not remain so indefinitely. Many franchisors recognize that multi-unit operators with a track record of success in other systems are their ideal candidates, because they require less training and continuing assistance and are probably better capitalized than most prospects that are new to franchising. Many of those multi-unit operators may want to expand but be stymied in their existing system, either because it is generally mature or because the particular geographic area where the franchisee wants to add units is already densely developed. The intersection of these desires could cause franchisors and franchisees alike to assess more thoroughly than they have in the past the potential risks and rewards of challenging restrictive covenants, which might in turn cause an uptick in tortious interference claims by franchisor against franchisor.

In hopes of advancing thoughtful consideration of these issues, this section of the paper starts by reviewing the essential elements of the causes of action for tortious interference with contract and tortious interference with prospective contractual relations, known in some jurisdictions as prospective economic advantage, as well as the most common grounds on which conduct otherwise actionable as tortious interference may be privileged. We then discuss the most interesting of the few cases in which one franchisor has sued another for tortious interference with existing or prospective franchise relations.

177 See Milford Prewitt, Franchisors alter recruiting, target high-income, low-risk franchisees, NATION’S RESTAURANT NEWS, Feb. 25, 2008 at 59 (noting franchisors’ lack of training infrastructure, the increased costs of opening and running franchises, and other factors making the mutliunit franchisee the ideal franchisee to sell to).
A. The Restatement Standards

Tortious interference claims are in many ways nebulous causes of action, with nuances that vary considerably from state to state. These are also fact-specific torts, with multiple factors determining whether particular conduct is tortious and whether otherwise tortious conduct is privileged. Space does not permit a comprehensive survey of all these variables, and counsel should always research the law of the relevant jurisdiction before deciding whether a tortious interference claim is viable. However, a brief review of the key Restatement sections addressing tortious interference is a helpful prelude to discussing the case law.

One who intentionally and improperly interferes with the performance of a contract . . . , between another and a third person by inducing or otherwise causing the third person not to perform the contract, is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract.

This general standard is, however, subject to numerous provisos, all of which boil down to the basic concept that "[i]n order for the actor to be held liable . . . his interference must be improper." Sections 766 and 766A address interference with contract, while Section 766B covers interference with prospective contractual relations. To have a valid basis for the latter cause of action, a plaintiff need not prove an expectation that the prospective relationship will be reduced to a formal binding contract. That said, prospective relations generally receive significantly less protection than do relationships already governed by contract, and that difference weighs heavily in determining whether a particular alleged interference is improper.

The successful tortious interference plaintiff must prove the existence of a contract or expectancy; the inducement or causation of the third party’s abandonment of the contract or

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178 See, e.g., TruGreen Companies, L.L.C., v. Scott’s Lawn Service, et al., 508 F. Supp. 2d 937, 951-53, 954 (N.D. UT 2007) (in tortious interference action, applying Utah law to some defendants and Idaho law to others, noting the “somewhat lower standard” for making out a claim in Idaho as opposed to Utah). See also, e.g., Wal-Mart Stores, Inc. v. Sturges, 52 S.W.3d 711, 726 (Tex. 2001) (somewhat idiosyncratically requiring that “to recover for tortious interference with a prospective business relation a plaintiff must prove that the defendant’s conduct was independently tortious or wrongful.”); Days Inn Worldwide, Inc. v. Sai Baba, Inc., 300 F. Supp. 2d 583, 594 n. 5 (N.D. Ohio 2004) (noting distinction between Ohio and New Jersey standards for a claim for tortious interference with prospective relations: New Jersey, unlike Ohio, has malice requirement). The meaning that courts attribute to certain key terms in the Restatement can also vary. See, e.g., Statewide Rent-A-Car, Inc. v. Subaru of America, 704 F. Supp. 183, 186 (D. Mont. 1988) (defining malice in the manner of the Restatement, as “not malice as it is understood in the popular sense of spite or ill will, but malice in the legal sense [] meaning the intentional doing of a wrongful act without justification or excuse.”); contrast with KMS Rest. Corp. v. Wendy’s Int’l, Inc., 361 F.3d 1321, 1326 (11th Cir. 2004), (citing Ernie Haire Ford, Inc. v. Fort Motor Co., 260 F.3d 1285, 1294 n. 9 (11th Cir. 2001) (under Florida law, a malice basis for alleging tortious interference requires that the interference arise “solely out of spite, to do harm, or some other bad motive.”)


180 Id. cmt. a (emphasis added).

181 Id. § 766B.

182 Id. § 767-68.

183 Id. § 766 cmt. i.

184 Id. § 766 cmt. h.
expectancy; the defendant’s knowledge\footnote{Id. § 766 cmt. i:} of the contract in question; the defendant’s intent\footnote{See id. § 766 cmt. j. The essential element of “intent” can be established by evidence that the defendant was (1) acting with the primary purpose of influencing the contract; (2) acting with the desire to interfere, even if coupled with some additional purpose; or (3) knew that the interference was substantially certain to occur as a result of the action. See also Restatement (Second) of Torts § 8A (Ill will is relevant but not dispositive on the issue of intent.).} and purpose in interfering; and the particular means that the defendant employed.\footnote{Id. § 766 cmt. k.}

Under certain circumstances, actionable inducement can include a refusal to deal (which is potentially actionable if it is explicitly leveraged to cause a party to break its contract with another) and the offer of a better bargain.\footnote{Id. cmt. l; see also id., illus. 2. Again, this is actionable based upon the degree to which it is explicitly used as leverage. See id. cmt. m; see also id., illus. 3.} 

Merely making a contract with another party while knowing of that party’s breach of contract with a third party does not constitute inducement.\footnote{Id. cmt. n.}

The plaintiff must prove that the defendant’s conduct caused the breach, and causation is always an issue of fact.\footnote{Id. cmt. o.}

The Restatement enumerates seven factors to be balanced in determining whether a given interference with contract or prospective relation is proper or improper:

(1) the nature of the actor’s conduct,
(2) the actor’s motive,
(3) the interests of the other with which the actor’s conduct interferes,
(4) the interests sought to be advanced by the actor,
(5) the social interests in protecting the freedom of action of the actor and the contractual interests of the other,
(6) the proximity or remoteness of the actor’s conduct to the interference and
(7) the relations between the parties.\footnote{Restatement § 767, comment a, observes that “the weight carried by these factors may vary considerably and the determination of whether the interference is improper may also vary,” and also points out that “[i]t is in the application of this Section that the most frequent and difficult problems of the tort of interference with a contract or prospective contractual relation arise.” Id. § 767 cmt. a. The difficulties noted include whether the assorted factors and privileges are properly understood as affirmative defenses, with the burden on the defendant to plead and prove them, or whether instead the plaintiff must prove their absence as part of its case in chief. Id. cmt. b; see also id. cmt j; id. cmt.}

\footnote{Id. § 766 cmt. i:} To be subject to liability under the rule stated in this Section [766], the actor must have knowledge of the contract with which he is interfering and of the fact that he is interfering with the performance of the contract. Although the actor’s conduct is in fact the cause of another’s failure to perform a contract, the actor does not induce or otherwise intentionally cause that failure if he has no knowledge of the contract.

However, knowledge of the legal significance of the facts giving rise to the contractual duty is \textit{not} required; knowledge of the facts alone is sufficient. \textit{Id.}

\footnote{See id. § 766 cmt. j. The essential element of “intent” can be established by evidence that the defendant was (1) acting with the primary purpose of influencing the contract; (2) acting with the desire to interfere, even if coupled with some additional purpose; or (3) knew that the interference was substantially certain to occur as a result of the action. See also Restatement (Second) of Torts § 8A (Ill will is relevant but not dispositive on the issue of intent.).}

\footnote{Id. § 766 cmt. k.}

\footnote{Id. cmt. l; see also id., illus. 2. Again, this is actionable based upon the degree to which it is explicitly used as leverage. See id. cmt. m; see also id., illus. 3.}

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\footnote{Restatement § 767, comment a, observes that “the weight carried by these factors may vary considerably and the determination of whether the interference is improper may also vary,” and also points out that “[i]t is in the application of this Section that the most frequent and difficult problems of the tort of interference with a contract or prospective contractual relation arise.” Id. § 767 cmt. a. The difficulties noted include whether the assorted factors and privileges are properly understood as affirmative defenses, with the burden on the defendant to plead and prove them, or whether instead the plaintiff must prove their absence as part of its case in chief. Id. cmt. b; see also id. cmt j; id. cmt.}
1. **The Nature of the Actor’s Conduct**

The issue here is not only whether the actor is justified in causing the harm, but whether he is “justified in causing it in the manner in which he does cause it.” Some “improper” means are easy to identify. For example, fraudulent misrepresentations are “ordinarily a wrongful means of interference and make an interference improper;” likewise prosecuting civil litigation without a good faith basis or solely to harass. The propriety of “economic pressure” is a more subtle question, the answer to which depends upon the purpose for which it is exerted, the degree of coerciveness involved, its reasonableness, and its effects upon competition. Other aspects of the actor's conduct are also relevant, including “the question of who was the moving party in the inducement,” as active solicitation would more likely make an interference improper than would merely responding to an inquiry.

2. **The Actor’s Motive**

An action whose sole motive is to injure the other will almost always be deemed improper. If the motive to injure is a primary motive or even a casual motive, it can have significance in the balancing process. The motive of the actor is often balanced along with the means employed: if the means are independently improper, motive is less crucial to establish impropriety, and vice-versa.

3. **The Interests of the Other with Which the Actor’s Conduct Interferes**

All interests are not equal. The classic example of this precept is that interfering with a mere expectancy is often not improper, whereas interfering with an actual contract under the same circumstances would be. This is because the contract signifies “the greater definiteness of the other's expectancy and his stronger claim to security for it,” as well as the “lesser social utility of the actor's conduct” in causing a breach of a contract. Interfering with a contract that violates public policy (e.g., one that unreasonably restrains trade or competition) may also be proper.

4. **The Interests Sought to be Advanced by the Actor**

Obviously, seeking to advance one’s own economic interests is not, by itself, wrongful. But if another party’s economic interest has already been “consolidated into the binding legal

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k (noting that, among the courts “there is little consensus on who has the burden of raising the issue of whether the interference was improper or not and subsequently of proving that issue.”).

192 *Id.* § 767 cmt. c.
193 *Id.*
194 *Id.*
195 *Id.*
196 *Id.*
197 *Id.* cmt. d.
198 *Id.* cmt. e.
199 *Id.*
obligation of a contract. . . . that interest will normally outweigh the actor’s own interest in taking that established right from him.

5. **The Social Interests**

Where one party’s individual economic interest coincides more readily with an overarching social interest – for example, the social interest in competition – that interest will more readily justify an act of interference with the other’s contract or prospective advantage.

6. **The Proximity or Remoteness of the Actor’s Conduct to the Interference**

The incidental by-products of the interference – the unforeseen or remote chain leading, for example, from the interference with one contract to later effects on other connected contracts – are not generally improper, absent conduct that is independently tortious or unlawful.

7. **The Relations Between the Parties**

The relationship between the parties may also be important for determining whether the interference by one against the other is improper. Thus, where two parties are competitors, or one party is the agent or advisor of the other, the interference with the contracts or prospective advantage may be deemed of greater propriety than otherwise. Again, whether the relation interfered with is a prospective contract, a contract terminable at will, or a long-term contract with detailed termination requirements is also an important factor.

a. **Privileges Regarding Prospective Relationships**

In cases involving alleged interference with prospective relations, whether an action might otherwise be “improper” does not end the analysis, because a privilege may shield an interferer from liability for his interference. It bears repeating that these privileges only apply to activities concerning prospective relations (and also at-will contracts) – they do not immunize conduct related to long-term contracts like franchise agreements. The privileges involve: (a) interference with a competitor’s prospective or at-will relations, arising out of competitive activity; (b) actions by a person with a financial interest in the business of a third party (e.g., an investor); and (c) an actor seeking to influence the business policies of another party, who has an interest in those policies.

(1) **Normal Competitive Activities**

Under Section 768, someone who intentionally causes a third person not to enter into a prospective contract, or not to continue an existing contract terminable at will, “with another who is his [or her] competitor,” has not improperly interfered with the relationship, so long as (1) the prospective contractual relationship concerns a matter actually related to the competition, (2) the means employed are not wrongful, (3) the actions do not unlawfully restrain trade, and

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200 *Id.* cmt. f.

201 *Id.* cmt. g.

202 *Id.* cmt. h.

203 *Id.* cmt. i.

204 See generally *id.* cmt. b.
(4) the actor’s purpose is, at least in part, to advance its interest in competing with its competitor. The basic principle is simple:

If one party is seeking to acquire a prospective contractual relation, the other can seek to acquire it too. Even an option to renew or extend a contract is prospective while not exercised. But an existing contract, if not terminable at will, involves established interests that are not subject to interference on the basis of competition . . . . One’s privilege to engage in business and to compete with others implies a privilege to induce third persons to do their business with him rather than with his competitors.

The interfering competitor may use such means as persuasion and the exertion of limited economic pressure, including a limited refusal to deal with third persons who deal with a competitor. All of this is subject to the qualification that the matter of the interference must involve the competition. The actor interfering with the prospective advantage or at-will contracts of his competitor must be careful that this interference does not constitute an unlawful restraint of competition, or result in an illegal monopoly. While the actor here may in part be motivated by otherwise improper motives (revenge, hatred, etc.), if it is at least in part also oriented towards the actor’s competitive interests vis-à-vis the other party, the conduct is not actionable as tortious interference.

(2) An Actor with an Interest in the Third Party Allegedly Interfered With

Section 769 of the Restatement recognizes a privilege for an actor having a financial interest in the business of the person being induced (such as an investor or bondholder) and provides that, where wrongful means are not employed and the actor is seeking to protect his interests, a person who has financial interests in the business of a third party can interfere in that party’s prospective relations (though not established contracts) with others. “Wrongful means,” which destroy the privilege, can include violation of a fiduciary duty, including the duty that a corporate director or officer owes the corporation.

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205 Id. § 768
206 Id. cmts. a, b; see also id. cmts. h, i (describing the difference between contracts terminable at will and other types of contracts, as well as giving the social reasons for privileging competitive interference with the latter but not the former).
207 Id. cmt. e.
208 Id.
209 Id. cmt. f.
210 Id. cmt. g.
211 Id. § 769.
212 Id. cmt. d.
Section 771 permits an actor to interfere with the prospective relations or at-will contracts of another, where the actor wishes to influence the business policies of the other (e.g., hours of business, wage policy), and has an economic interest in these policies.\(^{213}\) The policies that the actor seeks to influence must not unlawfully restrain trade, and the actor must not use wrongful means.

**b. Privileges Regarding Contractual Relationships**

The Restatement identifies two privileges that extend to the protection for interference to actual contracts, beyond at-will agreements. These privileges are therefore available as a defense to a claim of tortious interference with an existing franchise relationship. The first, set forth in Section 773, protects the interferer who is asserting in good faith a legally protected interest of its own, or threatening to protect this interest by appropriate means. As the Restatement notes, this privilege is of:

narrow scope and protects the actor only when (1) he has a legally protected interest, and (2) in good faith asserts or threatens to protect it, and (3) the threat is to protect it by appropriate means. Under these circumstances his interference is not improper although he knows that his conduct will cause another to break his contract or otherwise refuse to do business with a third person.\(^{214}\)

At least some courts have interpreted this privilege to include within its protection those who honestly believe they are acting to protect a legally protectable interest, even where they are not right.\(^{215}\) This privilege might come into play, for example, if one franchisor invoked a franchise agreement covenant against competition to try to stop a franchisee from performing under a later franchise agreement with competitor, and the second franchisor sued the first one for tortious interference with contract.

The second privilege, described in Section 774, covers illegal agreements and those contrary to public policy. Interference with such a contract gives rise to no liability.

**B. A Look at the Case Law -- Franchisor v. Franchisor Claims of Tortious Interference with Existing or Prospective Franchisee Relationships**

Given the dearth of reported cases involving tortious interference claims by one franchisor against another, and the extremely fact-specific nature of the decisions, it is difficult to draw broad conclusions from the precedent to help guide future conduct. The four decisions discussed below indicate, however, that (1) courts will take a dim view of clandestine dealings or oddly structured transactions between a franchisor and the franchisees of its competitor; (2) courts will not credit a franchisor’s protestations that it was unaware of the restrictive covenants in the franchise agreements of a competing system, at least when the contract provisions are common in the particular industry; and (3) evidence that representatives of a defendant franchisor made disparaging comments about the plaintiff franchisor when trying to recruit the plaintiff’s franchisees can be especially damaging to the defendant.

\(^{213}\) Id. § 771.

\(^{214}\) Id. § 773 cmt. a.

A franchising tortious interference claim arose in somewhat unusual circumstances in *Escape Enter., Ltd. v. Gosh Enter., Inc., et al.*, where a grilled steak sandwich franchisor, Great Escape, sued a competing franchisor, Gosh, for trying to purchase several franchised locations from Great Escape franchisees.\(^{216}\) Great Escape’s franchise agreements included a clause restricting the franchisees’ right to assign their franchises. Relying on that clause, Great Escape rejected the proposed transaction and informed its franchisees that it would not consent to the sale of any franchised restaurants to its competitor.\(^{217}\) When Great Escape later learned that Gosh had induced other Great Escape franchisees to enter into contracts to sell Gosh their restaurants, it moved to enjoin Gosh from engaging in any transaction to acquire any Great Escape units.\(^{218}\) While the case was pending, Great Escape discovered that Gosh and other defendants were negotiating to purchase some or all of thirty-three Great Escape franchised restaurants from a lender that had taken over the restaurants’ operation after repossessing the assets from a defaulting multi-unit franchisee.\(^{219}\) Great Escape argued that the injunction should block this transaction, as well as any Gosh purchases directly from Great Escape franchisees.

The trial court agreed and entered a preliminary injunction, and the Ohio Court of Appeals affirmed.\(^{220}\) The defendants claimed that no contract existed between the repossessing debtor (as opposed to the defaulting franchisee) and Great Escape, so that no actionable interference could have occurred. But the appellate court concluded that there was a substantial likelihood that, in repossessing the franchisee’s assets, the lender had stepped into the franchisee’s shoes and assumed its obligations under the agreements.\(^{221}\)

At least two courts have addressed claims by real estate franchisors for tortious interference with contract, arising out of attempts by a competitor to expand into the plaintiff’s territory via contracts with the plaintiff’s franchisees.\(^{222}\) In *Prudential Real Estate Affiliates, Inc. v. Long & Foster Real Estate, Inc., et al.*, the plaintiff franchisor entered into a seven-year franchise agreement with the defendant Porter, which required him to work exclusively with Prudential unless the franchisor gave him written consent to do otherwise.\(^{223}\) Porter, allegedly in severe health and financial trouble, conducted secret negotiations with the defendant Long & Foster, the country’s third largest independent real estate brokerage company, to purchase his business.\(^{224}\) During the negotiations Porter disclosed that he had three years remaining on his agreement with Prudential; nevertheless, he finalized an agreement to sell his business to Long

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\(^{217}\) Id. at *1.

\(^{218}\) Id.

\(^{219}\) Id.


\(^{221}\) *Escape Enter., Ltd*, 2005 WL 1252504, at *8,24.


\(^{224}\) Id. at *3-4.
Prudential sued Porter for breach of contract and Long & Foster for tortious interference. The district court granted Long & Foster summary judgment on the tortious interference claim, but the United States Court of Appeals for the Fourth Circuit, applying Maryland law, reversed.

Long & Foster contended that it was unaware of any restriction on transfer in Porter's contract with Prudential. The Fourth Circuit rejected this definition of "knowledge," noting that Long & Foster was a "major player" in the real estate business, that restrictions on transfer were common in such agreements, and that Long & Foster's decision not to ask for a copy of Porter's contract amounted to "[a] second form of 'knowledge [which] has often been called deliberate ignorance or willful blindness." The court also rejected Long & Foster's claim that, as a matter of law, it had not induced Porter to breach. As the court explained, whether Long & Foster approached Porter or vice versa was a question of fact, not law, and the favorable terms of the agreement between Porter and Long & Foster might themselves be evidence that Long & Foster had induced the breach. "Given Long & Foster's knowledge of Porter's dire financial straits," the court noted, "a finder of fact could reasonably infer that the attractive package offered by Long & Foster induced Porter to breach his contract with Prudential." The Fourth Circuit also gave significant weight to Prudential and Long & Foster's competitive relationship and to Long & Foster's motivation for its transaction with Porter:

The evidence in the record indicates that, prior to the purchase of Porter's business, Long & Foster was hoping to expand its operations in the area. In fact,

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225 Id. at *4.

226 See id. at *5, n.2 ("The district court ruled that . . . Porter breached his contract with Prudential" and the parties "thereafter entered into a settlement" agreement.).

227 Id. at *6.

228 Id. at *7-8 (internal citations omitted):

Under Maryland law, a plaintiff claiming intentional interference with contractual relations generally must establish that: (1) a contract or legally protected interest existed between the plaintiff and a third party; (2) the defendant knew of the contract; (3) the defendant intentionally induced the third party to breach or otherwise rendered performance of the contract impossible; (4) the interference was wrongful or without justification; (5) the contract was subsequently breached or terminated by the third party; and (6) the plaintiff suffered damages as a result.

When a contract is not terminable at will – as was the case with the contract between Porter and Prudential – wrongdoing or lack of justification is per se improper, under (4). Id. at *9-*10.

229 Id. at *25.

230 Id. at *13,*15 (internal citation and quotations omitted); see also Eric P. Voigt, Driving Through the Dense Fog: Analysis of and Proposed Changes to Ohio Tortious Interference Law, 55 CLEV. ST. L. REV. 339, 351-352 (2007) (arguing that "constructive knowledge standard would require defendants to take reasonable affirmative steps to learn about the existence of a contract or a business relationship (and the relevant details) between a plaintiff and third party . . . . tortious interference law should not reward interferers for taking no action or for taking actions that keep interferers ignorant of others' contracts and business relationships.").


232 Id. at *24, *18-19.

233 Id. at *19 (citing RESTATEMENT (SECOND) OF TORTS § 766 cmt. k); see also § 766 cmt. m (noting that inducement taking the form of the offer of a better bargain can constitute interference).
Holloway stated in the newspaper article that Long & Foster "had been looking to expand, but recruiting one agent at a time is a long, cumbersome process." Porter had been in the real estate business for many years and was well-respected in the industry. His name and reputation, therefore, would be an asset to Long & Foster. And because Prudential was left with no affiliated office in the Salisbury area after the sale, Long & Foster's purchase of the business also eliminated one of its competitors from the market. Thus, Long & Foster's purchase of the business reduced its competition and gave it immediate access to an office, equipment, and an additional sales force in an area where it had been hoping to expand. If Porter had complied with the franchise agreement by notifying Prudential about Long & Foster's offer, Prudential might well have exercised its right of first refusal, which would have required Long & Foster to continue the "long, cumbersome process" of trying to expand. Thus, it would not be unreasonable to infer from the evidence of the good fit between what Long & Foster needed and what Porter had to offer that Long & Foster sought out Porter and induced him to breach his contract with Prudential.234

Heavener, Ogier Services, Inc., v. R.W. Florida Region, Inc. and R.W. Florida, Inc., involved claims of tortious interference based on the solicitation of franchisees in one system by a competing franchisor.235 The two real estate franchisors competed for franchisee prospects and one, knowing of the existing contracts between the other franchisor and its franchisees, nevertheless solicited these franchisees to enter into contracts with it instead. The Florida state trial court entered a temporary restraining order barring both franchisors from attempting to sell franchises to each other's franchisees. The appellate court affirmed the order, after carefully considering the elements of tortious interference under Florida law.236 The court paid particular attention to the distinction between an existing contract and a prospective contractual relationship, which the court described as a prospective economic advantage:

If a defendant interferes with a contract in order to safeguard a preexisting economic interest of his own, the defendant's right to protect his own established economic interest outweighs the plaintiff's right to be free of interference, and his actions are usually recognized as privileged and nonactionable. However, where a defendant has no prior economic interest of his own to safeguard but only a prospective business advantage that is not yet realized, the defendant has no such privilege to interfere with an existing contract. Here, competition and free enterprise must give way to the existing contract and the party's right to rely on that contract. One exception to this rule is where the existing contract is terminable at will; competition is then recognized as a privilege because the plaintiff's right to have the relationship continue is only an expectancy and this right loses when balanced against both the interferer's legitimate rights in pursuing a prospective business advantage and the public policy of free enterprise. However, there is an exception to this exception. Even if the contract

234 Id. at *22-*24.
235 Heavener, Ogier Servs, Inc., 418 So. 2d 1074.
236 Under Florida law, the essential elements of a tortious interference claim are "(1) an advantageous (2) business relationship (3) under which plaintiff has legal rights, plus (4) an intentional and (5) unjustified (6) interference with that relationship (7) by the defendant which (8) causes (9) a breach of that business relationship and (10) consequential damages." (Internal footnotes omitted.) Id. at 1076. The majority of "the cases generally turn upon the proof submitted with regard to elements (4) and (5); the intentional and unjustified interference." (footnotes omitted.) Id.
is terminable at will, the interferer's actions are tortious and actionable if the motive is purely malicious and not coupled with any legitimate competitive economic interest. In such a situation, the interfered party's mere expectancy that the contract will continue outweighs a purely malicious motive.237

Allegations of tortious interference were also at the heart of the numerous claims and counterclaims litigated in Lightning Lube, Inc. v. Witco Corp.238 This dispute arose out of a contractual relationship between a franchisor, Lightning Lube, and its oil and equipment supplier, Witco Corp. The contract required Witco to provide Lightning Lube and its franchisees with equipment and oil.239 Lightning Lube purchased the equipment according to a “payback plan,” and then rented it to its franchisees.240 Lightning Lube would also take orders for oil from its franchisees, and place them with Witco, which would deliver the oil to the franchisees.241 Lightning Lube fell behind on payments for equipment and oil, and Witco began selling oil directly to the franchisees.242 Around this time, Lightning Lube’s franchise system entered a downward spiral, as franchisees withheld royalty payments and declined to open new units.243 Lightning Lube alleged that Witco’s interference had created these severe problems, because Witco salesmen fanned doubts among Lightning Lube’s franchisees concerning the ownership of the equipment, the possibility that Witco would repossess the equipment from franchisees, and whether Lightning was “ripping off” its franchisees.244 Apparently, Witco also offered the franchisees free equipment and cheaper oil in order to cut Lightning Lube out of the picture.245 Lightning Lube alleged that Witco interfered for two reasons: (1) to ensure the franchisees would bypass Lightning Lube and buy only the oil Witco sold; and (2) Witco had become involved in a new venture with Lightning Lube’s competitor, franchisor Avis Lube, Inc.246

Lightning sued Witco for breach of contract, fraud, and tortious interference with both contract and prospective relations. In response, Witco brought a counterclaim alleging that Lightning Lube interfered with its relations with Lightning Lube’s franchisees, because Lightning Lube had allowed franchisees to use a competitor supplier’s oil, and also claimed that Lightning Lube defrauded the Lightning Lube franchisees.247 Lightning Lube then counterclaimed against the counterclaim, alleging that Witco had brought the fraud claim solely for the malicious purpose of forcing Lightning Lube to disclose the claim in its Uniform Franchise Offering Circular so that Lightning Lube would be unable to sell any further franchises – in other words, Lightning Lube alleged that by bringing its fraud claim, Witco had tortiously interfered with Lightning

237 Id. at 1076-77 (footnotes omitted).

238 Lightning Lube, Inc. v. Witco Corp., 4 F.3d 1153 (3d Cir. 1993).

239 Id. at 1162.

240 Id. at 1165.

241 Id. at 1163.

242 Id.

243 Id.

244 Id. at 1164.

245 Id.

246 Id.

247 Id. at 1165, 1165, n. 4.
Lube's prospective contractual relationships with parties who would otherwise have purchased its franchises.\textsuperscript{248}

The jury found for Lightning on most of the claims, and awarded $11.5 million in compensatory damages and $50 million in punitive damages. The district court reduced the total award to $9.5 million and cross-appeals followed.\textsuperscript{249}

The United States Court of Appeals for the Third Circuit began its analysis of this welter of tortious interference claims by observing that, “[a]lthough businesses have the right to compete fairly with one another, that right does not extend to actions taken with the malicious purpose of harming a competitor’s business.”\textsuperscript{250} The court concluded that Lightning Lube presented sufficient evidence that Witco’s salesmen had harassed and threatened Lightning Lube’s franchisees with the removal of equipment; spread rumors that Lightning Lube did not own the equipment; spread rumors that Lightning Lube was ripping off its franchisees; offered the franchisees cheaper oil and free equipment to “go independent”; and sowed rumors that spread to other franchisees and prospective franchisees, causing them to withhold royalty payments, close their franchises, or not buy or open new franchises.\textsuperscript{251} The court also held that Lightning Lube’s evidence of interference was sufficient, even though it related to just a handful of franchisees, and not to every franchisee with whose franchise agreement Witco had allegedly interfered, since the jury could properly infer that these specific instances of interference were meant to and did interfere with the franchise system as a whole.\textsuperscript{252} That Witco intended to harm Lightning Lube was sufficient for the jury to reach its verdict – it did not matter that Witco may not have intended the magnitude of the harm that actually ensued.\textsuperscript{253} The Third Circuit also concluded that the evidence was sufficient to support the jury’s award of $7 million in lost profits (but not the $70 million that Lightning Lube had sought).\textsuperscript{254}

At bottom, the lesson of these decisions may be a reminder that in many lawsuits, the outcome turns not upon the mechanical application of multi-factor legal tests, but on the basic emotional architecture of the case. If the judge or jury believes that a defendant charged with tortious interference has behaved in a sneaky, underhanded fashion, conscious of its own misconduct, the judge or jury will want that defendant to lose, and the elements of the tortious interference causes of action are sufficiently subjective and elastic to support that outcome, as long as there is plausible evidence that a defendant has engaged in such unappealing conduct.

\textsuperscript{248} Id. at 1167. “Lightning Lube further alleged that Witco drove away prospective franchisees by asserting a counterclaim that accused Lightning Lube of fraud when Witco knew there was no basis for such a claim.” Id. (footnote omitted). Lightning Lube claimed that, with regard to the bringing of the counterclaim, counsel for Witco threatened to “bury” him; and, upon filing the counterclaim, told him “you can’t sell no franchises now, can you . . . ?” Id. at 1196.


\textsuperscript{250} Lightning Lube, Inc., 4 F.3d at 1167.

\textsuperscript{251} Id. at 1168-69.

\textsuperscript{252} Id. at 1170-72.

\textsuperscript{253} Id.

\textsuperscript{254} Id. at 1176.
V. BEST PRACTICES FOR AVOIDING TORTIOUS INTERFERENCE LIABILITY

A. Some Sensible Business Groundrules

A franchisor can avoid tortious interference claims from competing franchisors simply by not targeting franchisees in other system as prospects. But that conservative risk management approach may not always appeal to the client. A franchisor that is eager to expand rapidly, but is encountering difficulty identifying enough quality prospects, may learn through an industry grapevine that franchisees in a particular system want to grow but are unable to add units in that system, or that they are unhappy with their economic returns or with their franchisor’s conduct. If the franchisor wants to explore possible opportunities with these franchisees from the other system, but to do so as prudently as possible, counsel should try to persuade the franchisor to proceed cautiously, one step at a time, to enable a careful assessment of the risks and potential rewards in light of the facts as they are gathered and the governing law.

The starting point should be the terms of the franchisee’s current franchise agreement, an assessment of whether those terms would, on their face, prevent the franchisee from purchasing a franchise in your client’s system, and consideration of whether the particular provisions are enforceable under the applicable law. After that analysis, if the franchisor decides to approach another system’s franchisee, it should carefully document its communications and avoid any comments about the other franchisor that might later be construed as disparaging, part of an attempt to undermine the existing franchise relationship, or evidence of an assault on the competing franchisor’s entire system. Finally, if the negotiations lead to a possible deal, the franchisor should avoid offering special financial incentives or contract concessions, which the other franchisor might later be able to characterize successfully as inducements to breach.

1. Read the Franchise Agreement

The franchisor should never, under any circumstances, rely on the representations of the other system’s franchisee concerning the terms of its franchise agreement. The franchisee may not understand those terms, or may be so eager to do a deal with your client that it overlooks some potentially important provisions. Counsel needs to obtain a copy of the agreement (either from the franchisee or from another source) and read it carefully. If this does not happen and then the franchisor and the other system’s franchisee engage in a transaction and the other franchisor sues, the court will almost certainly assume the defendant franchisor adopted a pose of willful ignorance – that it wanted to deny specific knowledge of the contents of the other system’s franchise agreement because it had reason to know what they were. Any such conclusion is likely to color – to the defendant franchisor’s significant detriment – the court’s assessment of all the other facts in the case.

2. On its Face, Would the Franchise Agreement Bar the Other System’s Franchisee from Buying the Franchise?

In many cases, a cursory review of the franchise agreement may establish that a transaction between the franchisor and the other system’s franchisee would breach the contract. To cite an easy example, if the franchisor franchises hamburger restaurants, the other system sells hamburgers too, and the other system’s franchise agreement contains an in-term or post-term covenant barring the franchisee from operating a restaurant selling hamburgers except within the franchisee’s current system, the risks of proceeding are manifest (unless, as discussed below, there is reason to believe that the covenants violate the public policy of the jurisdiction where the franchisee is located or are otherwise unenforceable). On the other hand, if the restrictive covenant in the other system’s franchise agreement is limited to the sale of particular products that the franchisor does not sell and has no intention of offering in the future,
the franchisor may be able to proceed with negotiating a deal with the other system’s franchisee.

But the analysis of the restrictive covenants will not always be so cut and dry. If the contract language leaves room for reasoned debate about the meaning of a restrictive covenant, or about a covenant’s applicability to a particular set of facts because of the precise nature of the franchise systems at issue, any franchisor that decided to proceed further would be taking a significant risk. If a franchisor sells a franchise to a franchisee from another system who is subject to such a covenant and the other franchisor sues for tortious interference, the outcome of the case may turn on the court’s interpretation of the contract language – under circumstances like these, a question of fact, the answer to which may be impossible to predict in advance, and expensive and painful to learn as events unfold.

3. Are the Franchise Agreement Provisions Likely Enforceable Under the Law that Probably Governs?

In many jurisdictions, it is highly likely that typical franchise agreement in-term and post-term restrictive covenants will be enforced. But there are already exceptions to that rule, and judicial receptivity to such contract provisions could change over time. Accordingly, the location of the other system’s franchisee to whom your client wants to sell a franchise may matter a great deal in assessing the risks of proceeding with the transaction. If the restrictive covenant in the franchise agreement of the other system’s franchisee is unenforceable under the law that the forum court is likely to apply, then your client probably would not be liable for tortious interference if it engages in a transaction with that franchisee.

255 See, e.g., Comedy Club, Inc. v. Improv. W. Assocs., 514 F.3d 833 (9th Cir. 2008) (pursuant to California Business and Professional Code § 16600, courts will not invalidate restrictive covenants per se, but covenants that “will foreclose competitions in a substantial share of the affected line of commerce” are not enforceable); Edwards v. Andersen LLP, No. BC 294853 (Cal. filed Aug. 7, 2008) (holding a provision prohibiting former employee from working with former clients for eighteen months after the termination of his employment invalid under the Cal. Bus. & Prof. Code § 16600). See also Mail Boxes Etc., USA, Inc. v. Considine, 2000 U.S. App. LEXIS 16185 (9th Cir. Wash. July 11, 2000); Kelton v. Stravinski, 138 Cal. App. 4th 941 (Cal. App. 5th Dist. 2006); Scott v. Snelling & Snelling, Inc., 732 F. Supp. 1034 (N.D. Cal. 1990); Dayton Time Lock Service, Inc. v. Silent Watchman Corp., 52 Cal. App. 3d 1 (Cal. App. 2d Dist. 1975) (noting generally that § 16600 significantly limits restrictive covenants in franchise agreements). Georgia similarly limits by statute restrictive covenants. See Ga CONST. art. 3, § 6, ¶ V (c) (“The General Assembly shall not have the power to authorize any contract . . . [that will] have the effect of defeating or lessening competition”). See, e.g. Jackson & Coker, Inc. v. Hart, 405 S.E.2d 253 (Ga. 1991) (finding statute that authorized the enforcement of every contract in partial restraint of trade was unconstitutional insofar as it related to restrictive covenants, ancillary to employment contracts); T.E. McCutcheon Enterprises v. Snelling & Snelling, Inc., 212 S.E.2d 319 (Ga. 1974) (noncompetition covenant effective for two years within a ten mile radius void); WAKE Broadcasters v. Crawford, 114 S.E.2d 26 (Ga. 1960) (noncompetition clause lasting eighteen months within a 50 mile radius declared unenforceable); Allen v. Hub Cap Heaven, Inc. 484 S.E.2d 259 (Ga. Ct. App. 1997) (a nondisclosure covenant with no time limit is unenforceable); BJM & Associates, Inc. v. Norrell Services, 855 F. Supp. 1481 (E.D. Ky 1994) (finding, under Georgia law, covenant not to compete in franchise contract between temporary personnel services franchisor and franchisee was unenforceable); but see Smallbixpros Inc., v. Court, 414 F. Supp.2d 1245 (M.D. Ga. 2006) (upholding a covenant not to compete for the purpose of obtaining a preliminary injunction where the agreement was limited to a year, covered only one eight-zip-code territory and precluded the operation of similar business and the diversion of customers).

256 The franchisor should also consider the choice of law and forum selection clauses in the other system’s franchise agreement, and assess their likely enforceability.
4. **Document the Communications, and Don’t Say Anything Bad About the Competing Franchisor**

This guidance falls into the category of easier said than done, but the risks of failing to follow it can be substantial. In trying to close any deal with a prospect, it is easy for a franchise sales person not only to speak in glowing terms about the franchise he is selling, but also to try to cast doubt on any competing offerings that the prospect is considering. That is a natural feature of competition, but when the prospect is already under contract with another franchisor, the risks of negative commentary about a competitor increase, because the sales person’s conduct is no longer privileged under the Restatement standards discussed above and similar state laws. If a salesperson aggressively begins to denigrate the competing franchisor, *Lightning Lube* illustrates what can happen in later tortious interference litigation, and disparaging commentary could also give rise to other causes of action, such as common law unfair competition and claims under state statutes prohibiting unfair and deceptive trade practices.

5. **Avoid Financial Incentives and Contract Concessions**

As discussed above, a plaintiff claiming tortious interference with contract must prove that the defendant induced the breach. Offering a franchisee from another system the franchisor’s standard deal is less likely to look like an inducement than if the franchisor gives the franchisee special economic incentives, agrees to forgo certain standard contract terms, or offers to pay attorneys fees for the franchisee if his current franchisor sues.

B. **The Possibility of a Preemptive Strike Under the Declaratory Judgment Act**

A franchisor may perceive attractive recruiting opportunities among the existing franchisees of another system, but be reluctant to approach these prospects, for fear that it will be on the receiving end of a tortious interference claim from their existing franchisor. It may be that the franchisor interested in trolling for franchisees in another system faces a stark choice, between persuading those franchisees to sign contracts with it and thereby risk turning itself into a defendant, and ignoring the potential opportunities. But there may also be a third, creative alternative for this franchisor to consider: a suit against the other franchisor, seeking a declaratory judgment that the restrictive covenants in the franchise agreements in the other system are unenforceable, or on their face do not bar the franchisees from buying and operating a franchise in the plaintiff franchisor’s system. As discussed below, decisions involving non-compete provisions in employment agreements hold that a new employer (analogous to the

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257 This discussion about the possible use of the Declaratory Judgment Act is not theoretical. It is based upon an action that the pizza and submarine sandwich franchisor Marco’s Franchising, LLC (“Marco’s”) brought against Doctor’s Associates, Inc. (“DAI”), the Subway franchisor, in which Mr. Dunham represents DAI. This suit is currently pending in the United States District Court for the Northern District of Ohio, as Case No. 3:08-CV-00649-JZ. When this paper was submitted for publication, the court had not yet ruled on the standing and ripeness issues discussed in the text. Marco’s has alleged, in sum, that numerous Subway franchisees are interested in purchasing Marco’s franchises, but that Marco’s was deterred from consummating these transactions because in correspondence between the parties, DAI took the position that a Subway franchisee’s purchase of a Marco’s franchise would violate the covenant against competition in the Subway franchise agreement and make Marco liable for tortious interference with DAI’s contract with that franchisee. (Thousands of Subway stores now sell pizza as well as submarine sandwiches.) According to Marco’s, rather than execute a franchise agreement with any Subway franchisee and thereby expose itself to a claim by DAI, Marco’s decided to bring this lawsuit, seeking a declaration that the potential transactions between it and Subway franchisees would not constitute tortious interference with DAI’s contract rights. DAI has moved to dismiss this claim on the grounds that Marco’s lacks standing to bring it, and that the claim is not ripe.
franchisor interested in selling to franchisees in other systems) lacks standing to challenge the enforceability of the covenant against competition in the agreement between the would-be employee and the former employer, and depending upon the specific circumstances, there may be problems with the ripeness of the franchisor’s claim as well. To the authors’ knowledge, however, there are no decisions on comparable facts in franchise cases, and unless and until there is case law squarely rejecting this declaratory judgment tactic, it may represent another way for the franchisor to manage the risks associated with soliciting franchisees in other systems.

Under the Declaratory Judgment Act:

[i]n a case of actual controversy within its jurisdiction, . . . any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.  

The United States Supreme Court recently reiterated the Act’s requirements for issuance of a declaratory judgment, in *MedImmune, Inc. v. Genentech, Inc.:*

Our decisions have required that the dispute be definite and concrete, touching the legal relations of parties having adverse legal interests; and that it be real and substantial and admit of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts. . . . Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.  

However, federal judges are not required to hear declaratory judgment actions. Because the language of the Declaratory Judgment Act is permissive (“may declare”), the statute “has been understood to confer on federal courts unique and substantial discretion in deciding whether to declare the rights of litigants.”

As in every other type of case, moreover, the declaratory judgment plaintiff, “as the party invoking federal subject matter jurisdiction, has the burden of persuading the court that all of the requirements necessary to establish standing to bring the lawsuit have been met.” Standing is “the threshold question in every federal case” and when the plaintiff lacks standing, the court lacks subject matter jurisdiction and must dismiss the case.  

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258 28 U.S.C. § 2201(a) (emphasis added).


263 *Steel Co. v. Citizens for a Better Env’t*, 523 U.S. 83, 94, 102 (1998). A declaratory judgment plaintiff must satisfy both constitutional standing requirements and prudential standing restrictions: “[A] plaintiff must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties.” *Warth*, 422 U.S.
In our hypothetical, the franchisor considering a possible declaratory judgment action is obviously not a party to the franchise agreement between the competing franchisor and its franchisee. Just as clearly, the potential plaintiff is not a third party beneficiary of that franchise agreement. The most that can be said of the potential plaintiff in this connection is that it could become an *incidental* beneficiary of *non-enforcement* of certain provisions of the other system’s franchise agreement – the covenants against competition – but that hypothetical future status is probably inadequate to confer standing in an action challenging those covenants.  

At least four courts have applied these principles to challenges by new employers to the non-compete provisions in earlier employment agreements of the individuals they want to hire (or already have). The plaintiff hospital and medical services provider in *Defiance Hospital, Inc. v. Fauster-Cameron, Inc.*, were prospective employers who wanted to hire the defendant medical clinic’s nurse anesthetist employees, and brought a declaratory judgment action seeking an order that the defendant’s non-compete agreements with those employees were unreasonable and thus unenforceable. The court noted that the plaintiffs sought not just a declaratory judgment concerning the non-compete covenants themselves, but also a declaration “that [ProMedica West, one of the plaintiffs] would not be liable to defendants in any way should it hire former employees of [the Clinic] who have entered into such agreements.” This characterization of the claim did not persuade the court, which quickly dispatched the claim for lack of standing:

> It is a well-settled principle of contract law that only a party to a contract or an intended third-party beneficiary may bring an action on a contract. Plaintiffs are neither parties to the employment contracts between the Clinic employees and the Clinic, nor are they third-party beneficiaries. Because plaintiffs lack standing to sue to enfore or void the employment contracts, Count Four of plaintiffs’ complaint must fail as a matter of law.

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264 See *Mark-It Place Foods, Inc. v. New Plan Excel Realty Trust, Inc.*, 156 Ohio App. 3d 65, 81 (Ohio Ct. App. 2004) (“[O]nly an intended third party beneficiary may exert rights to a contract to which it is not a party. . . . An incidental beneficiary under a contract to which he is not a party cannot recover from the promisor in breach” (internal citations omitted)); *see also* *Clem v. Steiner*, 2003 Ohio 4865, P19-P20 (Ohio Ct. App. 2003) (“Only a party to a contract or an intended third-party beneficiary of a contract may bring an action on a contract. The parties to the contract must intend that a third party benefit from the contract in order for the third party to have enforceable rights under the contract. There must be evidence that the promisor assumed a duty to the third party” (internal citations omitted)); *Gazo v. City of Stamford*, 255 Conn. 245, 261 (Conn. 2001) (“[T]he ultimate test to be applied in determining whether a person has a right of action as a third party beneficiary is whether the intent of the parties to the contract was that the promisor should assume a direct obligation to the third party . . . the only way a contract could create a direct obligation between a promisor and a third party beneficiary would have to be, under our rule, because the parties to the contract so intended” (internal citations omitted)); *Metropolitan Life Ins. Co. v. McCarson*, 467 So. 2d 277, 279 (Fla. 1985) (“It is axiomatic in contract law that an incidental beneficiary cannot enforce the contract.”); *Fort Lincoln Civic Ass’n v. Fort Lincoln New Town Corp.*, 944 A.2d 1055, 1064-1065 (D.C. 2008). *See also* *Restatement (Second) of Contracts* § 315.


266 *Id.* at 1118 (internal quotations omitted).

267 *Id.* (internal citation omitted).
Several other courts have relied on *Defiance Hospital* to hold that a prospective employer lacks standing to challenge through a declaratory judgment action the enforcability of a non-compete provision in a prospective employee’s contract with another employer, even if the prospective employer attempts to frame the issue as fear of getting sued. The plaintiff in *Premier Pyrotechnics, Inc. v. Zambelli Fireworks Mfg. Co.*, sought a declaratory judgment concerning a non-compete agreement between the plaintiff’s new employee and his former employer. The plaintiff had actually hired the defendant’s former employee and the defendant had then threatened to sue the plaintiff for tortiously interfering with its employment contract with that former employee. Even so, the *Premier Pyrotechnics* plaintiff lacked standing to sue. The court noted that the plaintiff had received letters from the defendant threatening legal action for interfering with defendant’s employment contracts. The plaintiff argued that it was not seeking a declaratory judgment concerning the validity of the non-compete covenant itself, but that the “the gravamen of its complaint is that defendant has threatened legal action against plaintiff for impermissibly interfering with defendant’s allegedly protected interests.” That argument failed. The court declared that “[p]laintiff’s protestations that this case is not about interpretation of the employment contract . . . are unavailing;” held that the mere threat of future litigation by the former employer-defendant was too attenuated and hypothetical to create a ripe case or controversy; and cited *Defiance Hospital* to support its conclusion that the plaintiff lacked standing. The court further pointed out that the defendant had started an arbitration against its former employee, and that the same issues that the plaintiff sought to raise it the lawsuit would arise in this arbitration, too. The court emphasized the discretionary nature of declaratory judgments, affirmed that arbitration was the proper forum for resolving the pending issues, and concluded that the former employee (not the plaintiff-prospective employer) was the proper party in the dispute with the defendant.

Similarly, in *Bowhead Info. Tech. Servs., LLC v. Catapult Tech., Ltd.*, the court recognized that “[c]ourts routinely hold that a plaintiff that has hired (or wishes to hire) the employees of a competitor does not have standing to sue that company to seek nullification of a non-compete agreement between the competitor and its employees.” The *Bowhead* complaint alleged standing based on the defendant’s threat to sue the plaintiff and its employees to enforce its non-compete agreements. The court noted the hypothetical and

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269 *Id.* at *1-2.

270 See *id.* at *6.

271 *Id.* at *2.

272 *Id.* at *4-5.

273 *Id.* at *6.

274 *Id.*

275 *Id.* at *9.

276 *Id.* at *9-10.


278 *Id.*
attenuated nature of this “threat of litigation,” which had been made nine months previously and not further pursued and concluded that this threat was not “immediate and real.” The court concluded that “the unfulfilled and unrepeated threats of litigation nine months ago cannot serve as the basis for declaratory relief.” Once again, the mere fact that the defendant had threatened to sue the plaintiff did not confer standing on the plaintiff or otherwise create a justiciable controversy.

Finally, in *Eaton Vance Mgmt. v. ForstmannLeff Assocs., LLC*, the plaintiff, the new employer of the defendant’s former employee, sought a declaratory judgment invalidating a restrictive covenant/non-compete provision in the employee’s agreements with her former employer. The clause in question restricted the defendant’s former employees from soliciting or working with any former clients of the defendant for one year after leaving the defendant’s employ. Again, the *Eaton Vance* plaintiff had actually hired one of the defendant’s former employees, and that former employee had actually taken her former employer’s clients with her. That employee had attempted to join claims against the defendant, but the court dismissed those claims because they were covered by an arbitration agreement between the defendant and its former employee and the defendant had already brought an arbitration. The court observed, among other things, that deciding whether to entertain a plaintiff’s action for a declaratory judgment requires consideration of “whether the proposed remedy is being used merely for ‘procedural fencing’ or a ‘race to res judicata.’” Citing *Defiance Hosp.*, the court granted the defendant-former employer’s motion to dismiss and declared:

> [U]nless a party has contractual privity or is a third-party beneficiary of a contract, it lacks standing to enforce the terms of the agreement. Eaton Vance was neither a party to nor a third-party beneficiary of the Employment Agreement. Therefore, it lacks standing to sue under the Agreement . . . . Parties who lack standing to enforce an agreement also lack standing to seek a declaration of rights under the contract . . . . The law does not permit Eaton Vance to use the Declaratory Judgment Act to avoid the well-settled requirements of contractual privity. Eaton Vance therefore lacks standing to pursue this action.

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279 *Id.* at 173.
280 *Id.* at 174.
281 *Id.* at 172.
283 *Id.* at *2.
284 *Id.* at *2-4.
285 *Id.* at *7-15. The *Eaton Vance* court invoked its discretion to dismiss the former employee’s direct claims, rather than staying them pursuant to Federal Arbitration Act § 3, “[p]articularly in the context of a declaratory judgment request.” *Id.* at *15.
286 *Id.* at *7 (emphasis added) (internal citations omitted).
287 *Id.* at *16-17, *19 (internal citations omitted).
There would seem to be no principled basis for applying a different standard to a dispute between franchisors, simply because the provision that a plaintiff seeks to challenge appears in a franchise agreement, rather than an employment contract.\textsuperscript{288}

Even if our hypothetical franchisor did have had standing, its suit might still lack the requisite ripeness for a court to issue declaratory relief. The ripeness doctrine "prevent[s] the courts, through premature adjudication, from entangling themselves in abstract disagreements."\textsuperscript{289} Only if the probability of the future event occurring is substantial and "of sufficient immediacy any reality to warrant the issuance of a declaratory judgment" will a case be ripe for pre-enforcement review under the Declaratory Judgment Act.\textsuperscript{290} Courts routinely dismiss cases challenging non-competition covenants, even when the plaintiff is a party to the contract, because the claims are not ripe.\textsuperscript{291}

Finally, our hypothetical franchisor would be seeking judicial intervention based on the rights of a third party (the other system’s franchisee) not present in the litigation, and unless and until that third party actually purchases a franchise in the plaintiff’s system, there may never be a cognizable case or controversy. The Supreme Court has held that where the independent

\textsuperscript{288} In the actual Marco’s/DAI litigation, Marco’s has argued that the Supreme Court’s \textit{MedImmune} decision lowered the threshold for declaratory judgment jurisdiction, by holding that a party threatened with the possibility of a claim need not take the last step that would expose it to liability (here, executing a Marco’s franchise agreement with a Subway franchisee) in order for there to be a cognizable case or controversy under the Declaratory Judgment Act. See Russian Std. Vodka (USA), Inc. v. Allied Domeq Spirits & Wine USA, Inc., 523 F. Supp. 2d 376, 382 (S.D.N.Y. 2007) (interpreting \textit{MedImmune} as creating a "lower threshold" for declaratory judgment jurisdiction). \textit{But see} Kreinberg v. Dow Chem. Co., 2007 U.S. Dist. LEXIS 70359 (D. Mich. 2007), 27-29 (interpreting \textit{MedImmune} as being premised on a "coercive dilemma . . . such as the cost and expense of a patent enforcement action"; and rejecting defendant’s counterclaim for declaratory judgment where an "event that would transform [the] issue into a case or controversy . . . has not [transpired]," and where defendant "seeks a determination of rights based on a hypothetical situation that has not occurred"). With respect to Defiance Hospital and the other employment non-compete decisions on which DAI relies, Marco’s has essentially dismissed them as wrongly decided, arguing that under this precedent, no party threatened with a tortious interference suit could ever invoke the Declaratory Judgment Act to obtain a ruling, in advance, that it would not be liable for tortious interference if it proceeded with the transaction that generated the threat.


\textsuperscript{291} \textit{See Mozdzierc Consulting, Inc. v. Mile Marker, Inc.}, No. 04-CV-74925-DT, 2006 U.S. Dist. LEXIS 13788, *11-12 (E.D. Mich. Mar. 28, 2006) (discussing overlapping requirements of standing and ripeness, and finding lack of ripeness for declaratory judgment concerning non-compete where "Defendants [had] not filed an action against Plaintiffs to enforce . . . Agreement and Plaintiffs [had] not alleged that they [were] seeking representative contracts with others which [might] compete with Defendants’ business"); \textit{Lyman v. St. Jude Med. S.C., Inc.}, 423 F. Supp. 2d 902, 906 (D. Wis. 2006) (finding that ripeness required for declaratory judgment was absent where plaintiffs had not indicated concrete plan to compete, nor defendants definite intent to sue; the contract in question had not been breached, and litigation was not otherwise “imminent” or “inevitable”); \textit{Weber v. Churchill Commc’ns Corp.}, No. 86 Civ. 2894 (JFK), 1988 U.S. Dist. LEXIS 1094, *9 (S.D.N.Y. Feb. 8, 1988) (holding that, where former employee was presently employed by non-competitive employer, future enforcement of non-compete agreement was too speculative to warrant declaratory judgment); \textit{Bruhn v. Stp Corp.}, 312 F. Supp. 903, 905-06 (D. Colo. 1970) (holding that, where employers bound by non-compete merely expressed a “desire” or an “intent” to pursue opportunities that might violate the agreement, the suit was too hypothetical and hence unripe for a declaratory judgment; plaintiffs were “merely apprehensive,” but had not actually “begun to pursue a course of action that would lead them down the path of litigation"). \textit{See also} C. Wright, A. Miller & M. Kane, 10B FEDERAL PRACTICE AND PROCEDURE: CIVIL 2d § 2757, 484 (1998) (citing \textit{Bruhn} as exemplifying where “controversy too hypothetical” for suit to be ripe).
actions of one or more third parties are necessary to the cause of action, the absence of those parties defeats the claim – especially in a declaratory judgment case.\textsuperscript{292}

In our judgment, because of all the aforementioned factors, there is real reason to doubt whether a franchisor could employ a declaratory judgment action to obtain, in advance, a ruling conclusively establishing whether it faces potential liability if it contracts with a franchisee from another system. As noted above, however, as of this writing no court has decided these issues in a franchise case. Creative franchisor counsel may therefore have an interesting opportunity to attempt to break new ground.

VI. CLAIMS UNDER STATE UNFAIR TRADE PRACTICE AND UNFAIR COMPETITION STATUTES

Trademark and trade dress infringement, false and misleading advertising, and interference with franchise relationships are not, of course, the only claims that competing franchisors might have against one another. For example, there are reported decisions involving antitrust and patent infringement claims by one franchisor against another, which are beyond the scope of this paper.\textsuperscript{293} There is, however, one other form of franchising specific, competition-related cause of action that warrants attention here. The Federal Trade Commission ("FTC") and state regulators require franchisors to issue a Franchise Disclosure Document ("FDD"), formerly known as the Uniform Franchise Offering Circular ("UFOC"), to provide prospective franchisees with material information about the franchise offering. Obviously, the FDD is not meant to serve as an advertisement for the offering. But if a franchisor fails to comply with applicable disclosure regulations, either by omitting required information or including in its FDD false or misleading representations, that can present a distorted picture of the franchise opportunity and thereby confer a potentially significant, unfair advantage in the competition for new franchisees. A competing franchisor has no standing under the FTC Franchise Rule to challenge such misconduct, because the FTC Act does not create a private right of action. Likewise, the state statutes and regulations governing a franchisor’s disclosure obligations probably do not give a competing franchisor any direct means of redress when the first franchisor allegedly violates those obligations. However, another category of state statutes, including those sometimes called “Little FTC Acts,” may afford the competing franchisor a means of challenging the first franchisor’s misuse of the FDD, as well as other unfair competitive conduct.

\textsuperscript{292} See Simon v. E. Ky. Welfare Rights Org., 426 U.S. 26, 41-42 (1976) ("[A] federal court [may] act only to redress injury that fairly can be traced to the challenged action of the defendant, and not injury that results from the independent action of some third party not before the court." (emphasis added)); Lujan v. Defenders of Wildlife, 504 U.S. 555, 562 (1992) (when causation hinges on independent third parties, the plaintiff has the burden of showing that the third parties’ choices “have been or will be made in such a manner as to produce causation and permit redressability of injury.”). In ACLU v. NSA, the United States Court of Appeals for the Sixth Circuit emphasized this requirement in no uncertain terms, dismissing the plaintiffs’ declaratory judgment action where the damage allegedly flowing from the wrong complained of necessarily implicated in the chain of causation the independent conduct of absent third parties. ACLU v. NSA, 493 F.3d 644, 670 (6th Cir. 2007).

Certain state statutes modeled on the FTC Act provide broad protection against unfair and deceptive trade practices. Many of these statutes are not simply consumer protection statutes – they also create causes of action for business competitors. The Connecticut Unfair Trade Practices Act (“CUTPA”), 42 Conn. Gen. Stat. § 42 – 110a, et seq. is one example. CUTPA sweepingly provides that “[n]o person shall engage in unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce,” and expresses the legislature’s intent that courts construing this broad language be guided by FTC and federal court interpretations of Section 5(a)(1) of the FTC Act (which, as noted above, confers no private right of action). In assessing CUTPA claims, courts consider whether (1) the alleged unfair practice, regardless of whether it has previously been considered unlawful, offends public policy as it has been established by statutes, the common law or otherwise; (2) the complained of actions were immoral, unethical, oppressive or unscrupulous; and (3) the practice caused a substantial injury to consumers, competitors or other businesspeople. The CUTPA plaintiff need not satisfy all three factors to establish a violation, and this expansive, flexible standard creates lots of room for good faith pleading and for case-by-case determinations of what is an unfair method of competition or an unfair and deceptive practice. The remedies available under CUTPA are wide-ranging as well – actual damages, punitive damages, injunctive relief, attorneys’ fees, and the possibility of a class action – and every CUTPA plaintiff must mail a copy of its complaint to Connecticut’s Attorney General, thereby increasing the risk that a defendant will have to battle both private litigants and the State.

Another state statute, California’s Unfair Competition Law, California Business and Professions Code Section 17200 et seq., prohibits “any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising.” Unlike CUTPA, the California statute does not allow recovery of compensatory or punitive damages, but it does allow private parties, including competitors, to sue for injunctive relief.

Bi-coastal litigation between two competing franchisors, Edible Arrangements International (“EA”) and Fresh Fruit Bouquet (“Fresh Fruit”), demonstrates the potential claims available under these (and similar) statutes, and suggests that state unfair competition laws could be powerful tools for a franchisor seeking to halt a competitor’s wrongful conduct, especially in connection with an FDD in a registration state. EA and Fresh Fruit each sell franchises for retail outlets that sell fresh fruit arranged to resemble floral bouquets. Fresh Fruit’s founder, James Notaris, was a lawyer and accountant who had applied, along with his wife, to become an Edible Arrangements franchisee. As part of the application process, Mr. and

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295 42 CONN. GEN. STAT. § 42 – 110b(a).

296 Id. § 42-110b(b).


298 Rudel Machinery, 68 F. Supp. 2d at 129.

299 Id. § 42-110b(g).

300 CAL. BUS. & PROF. CODE § 17200.

301 Mr. Dunham represented Edible Arrangements in each of the cases discussed in the text in connection with the events described. He is no longer involved in either matter.
Mrs. Notaris executed a document requiring them to keep confidential everything they learned from EA. After extensive communications with EA, Mr. Notaris broke off contact and then started his own business, Fresh Fruit, selling the same types of products that EA franchisees sell. EA sued Mr. Notaris, his wife, and their company in Connecticut federal court, alleging among other things that they had misappropriated EA’s trade secrets and trade dress, were infringing EA’s trademarks, and were violating CUTPA (the “Connecticut case”).

The Connecticut case settled, but shortly thereafter a new dispute arose concerning Fresh Fruit and the Notarises’ compliance with their obligations under the settlement agreement. Meanwhile, Fresh Fruit and the Notarises had established a franchising company and begun to offer franchises for sale in various states, including California. However, Fresh Fruit’s California UFOC failed to disclose the Connecticut case. Also, in apparent violation of the requirement that a UFOC include financial statements audited by an independent accountant, the financial statements appended to Fresh Fruit’s California UFOC had been audited by an accounting firm whose principal was Mr. Notaris’s father, and where Mr. Notaris himself had worked for a decade.

EA sued Mr. Notaris, Fresh Fruit and affiliated defendants in the United States District Court for the Central District of California, alleging that the Fresh Fruit UFOC violated the California Unfair Competition Law, California Business and Professions Code Section 17200 et seq. (“UCL”). EA claimed that the defendants’ UCL “violations have caused it irreparable harm by giving defendants an unfair competitive advantage over EA in the franchise market.” EA moved for a preliminary injunction shutting down Fresh Fruit’s franchising activities in California until it had validly registered its California offering with a UFOC that satisfied all applicable disclosure requirements.

The defendants later became active in the California case, as described below, but they failed to oppose the preliminary injunction motion, which the court granted. The court began its analysis of EA’s likely success on the merits by noting that “[t]he scope of the UCL is extremely broad” and “[v]irtually any law – federal, state or local – can serve as a predicate for a § 17200 action.” The court then reviewed the “whole suite of laws” that EA “alleged that the defendants have violated . . . as part of their efforts to sell competing franchises in California,” including the litigation disclosure requirements of the 1993 UFOC Guidelines. The court concluded that the Fresh Fruit UFOC should have disclosed the Connecticut case, because it involved allegations of deceptive practices, and that the failure to disclose was material, “because a prospective purchaser of a Fresh Fruit . . . franchise would consider information regarding the suit, and the defendants’ alleged use of EA’s proprietary information in creating a competing edible fruit bouquet franchising business, ‘important in making a decision about the

302 The Connecticut court later granted EA’s motion to rescind the settlement agreement. Edible Arrangements Int’l, Inc. v. Notaris, et al., No. 3:05CV197 (AWT) at 4-7 (D. Conn. filed January 16, 2007) (Magistrate Judge’s recommended ruling to rescind settlement agreement, which the District Judge adopted).


304 Id. at 3.

305 Id.

306 Id. at 3.

307 Id. at 3-4.
The court concluded that the failure to disclose the lawsuit therefore violated the “mandatory disclosure provisions” of California’s franchise regulations and “thereby the UCL.”

Because the accounting firm owned by Mr. Notaris’s father, where Mr. Notaris himself had previously worked, had audited the financial statements included in the UFOC, the court also had no difficulty determining “that the defendants violated the UCL by misrepresenting that an independent accountant audited the financial statements.”

In addition, EA alleged that Mr. Notaris and his wife had been offering Fresh Fruit franchises for sale in California before the franchise had been registered with the Department of Corporations. “Presented with no evidence to the contrary,” the court held that because any such unregistered offers were unlawful under the California Corporations Code, they violated the UCL as well.

Turning to irreparable harm, the court observed that the “edible fruit bouquet franchising business is currently undergoing a period of rapid expansion,” and that it would be “exceedingly difficult to accurately calculate the damage to the plaintiff’s business that would result from the defendants’ further use of an incomplete and misleading franchise offering circular following its premature entry into the . . . market.” The court also pointed out that the UCL does not provide for damages. Finally, the court assessed the balance of hardships and concluded that it “also weighs in the plaintiff’s favor,” largely because “[u]nlike customers for consumable goods, it would be difficult if not impossible for EA to win back purchasers of the defendants’ franchise given its character as a long-term, capital investment.”

The court was unmoved by the potential hardship that an injunction would impose on the defendants, because any lost sales opportunities that they might suffer “will be entirely due to the defendants’ prior disregard for California’s franchise regulations and an injunction will prevent them only from unfairly competing.” Accordingly, the court entered a preliminary injunction that barred the defendants from (1) using any UFOC in California that did not comply with all applicable statutory and regulatory requirements; (2) soliciting franchisees or otherwise advertising or marketing Fresh Fruit franchises in California until they had properly registered with the State of California a lawful UFOC; and (3) entering into any franchise agreements in California until they had properly registered a lawful UFOC.

After the injunction issued, the defendants filed a counterclaim, alleging that EA had itself violated the UCL by failing to disclose in its UFOCs two lawsuits with another competitor. When EA amended its UFOC to disclose this counterclaim, it included information about the

308 Id. at 4. (quoting UFOC Guidelines, Item 3(iii)).
309 Id. at 4.
310 Id. at 5.
311 Id.
312 Id.
313 Id. at 6.
314 Id.
315 Id. (Emphasis in original.)
316 Id. at 6-7.
earlier, underlying cases, and the California Department of Corporations approved the amended UFOC. EA then moved to dismiss the counterclaim as moot and the court granted the motion, after concluding that EA’s “amended UFOC disclosures comply with the UFOC Guidelines’ litigation disclosure standards.”

Whether the outcome would have been different if the Fresh Fruit defendants had opposed the preliminary injunction is obviously unknowable, but the court did not simply rubber-stamp EA’s motion. It conducted its own, independent analysis, set forth in a reasoned opinion with ample citations. Moreover, the court’s logic would appear to apply with undiminished force to a wide range of potential franchisor misconduct, including but not limited to registration and disclosure violations, assessed under numerous state unfair trade practice statutes. Thus, this unreported decision marks another pathway for franchisors to consider when they conclude that another franchisor is competing unfairly and causing them harm, and the result in this case -- halting a competitor’s sales efforts in a huge market -- is unquestionably appealing.

But the EA/Fresh Fruit cases also illustrate the unfortunate tendency of American litigation to mushroom. It is probably safe to say that when one competitor sues another, the first punch is rarely the last. Any franchisor contemplating suing a competitor needs to understand that fact, and also needs to understand that litigating claims and counterclaims in one jurisdiction, let alone two, is an expensive and distracting undertaking. If the competitor’s misconduct is truly egregious and causing serious injury, litigation may be a franchisor’s only effective recourse. Before filing suit, however, the franchisor and its counsel should step back and assess -- as dispassionately as possible -- whether the range of likely lawsuit outcomes justifies the attendant expense, stress, and potential exposure to inbound claims, or whether the battle should instead stay confined to the marketplace.

VII. COMPLAINING TO GOVERNMENT AGENCIES ABOUT A COMPETING FRANCHISOR

If a franchisor believes that another franchisor is competing unfairly by, for example, failing to comply with applicable registration and disclosure laws, or employing fraud to attract new franchisees, turning the other cheek and suing are not the only options. The FTC and numerous state agencies have a range of enforcement powers at their disposal to stop such
misconduct.\textsuperscript{319} For the complaining franchisor, action by a regulator may seem far preferable to suing the competitor. Regulatory proceedings will not allow the complaining franchisor to recover damages, but they may spare the franchisor the great diversion of time, attention and money that litigation so often entails. In addition, if the goal is to stop harmful misconduct by a competitor as soon as possible, the weight of a government agency, actively engaged, will sometimes be more likely than private litigation to accomplish that result. Moreover, the complaining franchisor may be leery of potential counterclaims in a lawsuit, and may assume that an approach to one or more regulators is unlikely to have any comparable, potentially adverse consequences.

Of course, the FTC and state franchise regulators are understaffed and stretched thin and therefore may not have the resources available even to conduct an investigation into alleged misconduct, let alone to commence proceedings to stop it. Also, regulators obviously understand that a franchisor complaining about a competitor’s conduct has the option of filing suit, which may be a disincentive to dedicating the agency’s limited resources to a competitor’s complaint. And if litigation is already pending, a regulator may be even more reluctant to act, because it does not want to be perceived as taking sides in a private dispute.

For all these reasons, a franchisor contemplating a complaint to a government agency regarding a competitor’s conduct should realize that under most circumstances, this is unlikely to lead to government action halting that conduct. But the expense and effort involved in making the complaint will probably be modest, at least compared to litigation, and the potential rewards if the agency becomes interested and takes action could be major. Accordingly, is there any reason a franchisor should not bring its competitor’s alleged misconduct to the attention of regulators with the authority to stop the bad behavior and punish the competitor?

In our view, there are several reasons why every franchisor should, at a minimum, proceed cautiously in deciding whether to call regulators’ attention to the conduct of a competitor. First, in the authors’ experience, the regulators will not keep the identity of the complaining party confidential. Quite the contrary: most regulators will require a complaint to be in writing before they will even consider it, and the assumption should be that the regulators will send the competitor copies of any documents they receive. This means that the target of the complaint may, like many litigation defendants, swing back, by recounting in the administrative equivalent of a counterclaim the purported misconduct of the complaining franchisor. The effort of contacting the governmental agency may still be worth it, as long as the franchisor that initiated the process itself has a spotless record. However, any franchisor contemplating a regulatory complaint against a competitor should always undertake an objective assessment of its own actions, to satisfy itself that the regulators would have no legitimate cause for concern about the franchisor’s conduct. Otherwise, approaching regulators about a competitor’s conduct can boomerang, with the complaining franchisor having to expend significant energy trying to justify its own behavior. Even if the first franchisor to contact the regulators has, in fact, done nothing wrong, and the target of its complaint is a bad actor, the dueling allegations of misconduct can cause already overburdened regulators to turn their

\textsuperscript{319} For an enlightening discussion of those enforcement powers, see Martin Cordell, Joseph Punturo & Mary Beth Trice, \textit{A Basic Guide to Handling Disclosure and Registration Violations}, A.B.A FORUM ON FRANCHISING, W-14 (2007). The paper also includes a Table of Enforcement Powers, setting forth by state seven categories of regulatory action, ranging from denial, suspension or revocation of a franchise registration to a column succinctly headed “Prison.” Id. at app. B.
attention to other issues, where they do not feel that they are being asked to referee a private fight.\textsuperscript{320}

Finally, some franchisors or their counsel might believe that a complaint to a government agency needs less investigation and good faith basis than are required to file a lawsuit. The absence of administrative procedure analogs to Rule 11 and its state court counterparts could encourage the filing of frivolous, bad faith complaints with regulators. The United States Constitution safeguards the right of individuals and corporations alike to petition their government,\textsuperscript{321} but that protection is not limitless. Courts have long recognized a “sham exception” to this right.\textsuperscript{322} Thus, a franchisor whose complaints to regulators about a competitor’s conduct lacked a good faith basis could be exposing itself to causes of action from the competitor for unfair competition, unfair trade practices and the like. Perhaps more important, any franchisor that made ill-founded charges against a competitor would be jeopardizing its credibility with regulators who may be exercising significant authority over the franchisor, on matters large and small, for many years to come. To state the obvious, that would not be a prudent course.

\textbf{VIII. CONCLUSION}

For any franchisor concerned that a competitor is using unfair tactics in efforts to attract new consumers or franchisees, the law affords a variety of weapons that can help the franchisor protect its interests, including federal and state statutory causes of action, common law claims, and the right to petition regulators to intervene. A franchisor that is suffering or threatened with material harm from unfair competition may really have no choice but to deploy one or more of these weapons, if it wants to maintain its position in the market. Some times, however, filing suit or lodging a complaint with a government agency may simply commence a spiral of charges.

\textsuperscript{320} As a panel at the 2007 Forum on Franchising observed, “[a] compliant franchisor is likely to be at a competitive disadvantage to the scofflaw.” However, this panel, which included two experienced state regulators, also gave this cautionary advice:

\begin{quote}
Before filing a complaint about a competitor with a state regulator or the FTC . . . a franchisor should make sure that its own house is in order. Should the violator find out who dropped the dime, it may monitor the tipster’s franchise filings, disclosure documents and sales practices for any cracks that could support a retaliatory complaint. To avoid needlessly creating enemies, it may be more prudent to limit reporting competitor violations to those serious and substantive offenses likely to cause actual harm to franchise investors and the reputation of the franchisor’s industry.
\end{quote}

\textit{Id.} at 15 (2007).


\textsuperscript{322} If the petitioning is a mere “sham” to cover an attempt to interfere directly with the business relationships of a competitor, Noerr Pennington immunity does not apply. In Prof’l Real Estate Investors Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 60-61 (1993) the Supreme Court explained that in order for litigation to be a “sham:”

\begin{quote}
First, the lawsuit must be objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits. Only if [the] challenged litigation is objectively meritless may a court examine the litigant’s subjective motivation. Under the second part of the [test], a court should focus on whether the baseless suit conceals an attempt to interfere directly with a competitor’s business relationships . . . through the use of the governmental process—as opposed to the outcome of that process—as an anticompetitive weapon.”
\end{quote}

\textit{Id.} (internal citations and quotations omitted.) Courts have held that the sham litigation exemption to Noerr Pennington immunity applies to petitions to agencies. See Herr v. Pequea Twp., 274 F.3d 109, 116 (3d Cir. Pa. 2001).
and counter-charges, which can expose the franchisor to liability or unwanted regulatory scrutiny, cost large sums to litigate, and ultimately end up weakening the franchisor in the marketplace.

Pique – no matter how well-founded it may be – is a bad reason to run those risks. Before suing a competitor for Lanham Act violations, tortious interference, unfair trade practices or unfair competition, or bringing a competitor’s alleged misconduct to the attention of regulators, the franchisor should appraise the full range of potential downstream consequences, in order to make a considered judgment whether the game is worth the candle.  

323 According to the Alliance Francaise, this expression is derived from the 16th Century French practice of playing cards by candlelight. At the end of the evening, if the host’s winnings were not enough to cover the cost of the candles, the game had not been worth playing.
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