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In This Issue

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Class Action Litigation and the Editor-in-Chief's Holiday Reading

CHRISTOPHER P. BUSSERT

Christopher P. Bussert

One of my holiday traditions for years has been to read from cover to cover between Christmas and New Year's Day one of the many "must read" books gathering dust on my bookshelf at home. This year, I decided to read John Grisham's *King of Torts*, an exciting story about a lawyer's meteoric rise and fall in pursuing class action litigation. Until recently, the sum total of my knowledge of class action litigation was gleaned from the combination of Mr. Grisham's novel, what I remembered from civil procedure class in law school and the bar exam, occasional news stories on massive class action monetary recoveries and settlements, and, finally, late-night television advertising in which class action law firms routinely troll for clients who claim injury from allegedly defective pharmaceuticals or medical devices.

Franchise lawyers no longer have the luxury of relegating class action litigation to their dusty bookshelves. Indeed, as recent advance sheets have demonstrated, a number of franchise systems have been subjected to class action litigation in which a wide variety of operational issues have been challenged with varying levels of success. Franchisors have not been taken totally unaware by this development. Many have sought to derail class actions through various means, most commonly by including language in their franchise agreements prohibiting franchisees from pursuing class actions. For those who are interested in learning more on this subject, this issue should serve as an excellent resource. Fresh from their involvement in class action litigation involving the Quizno's system, Mark Leitner and Joseph Goode provide an excellent overview of the basics of class action litigation, the pitfalls faced by both franchisors and franchisees, and recent developments involving class action prohibitions in franchise agreements. Joel Rosen and James Shrimp then examine class action litigation from a different perspective, namely, the extent to which franchisors can be compelled to participate in class action and consolidated arbitration proceedings.

This issue is by no means limited to class action litigation; a number of other interesting and timely topics are covered as well. Having been the recipient (and giver) of a number of gift cards, I am particularly intrigued by Craig Knobbe, Nathan Cook, and Lynne Hanson's piece that navigates the complex world of gift cards including expiration dates, service fees, and dormancy charges. Carman Caruso provides a thoughtful response to an article published in the Fall 2010 issue (*see* Robert Kry, *Mac's Shell and the Future of Constructive Termination*, 30:2 FRANCHISE L.J. 67). Nicole Liguori Micklich and Michael Pepe analyze statutory prohibitions on franchisors requiring franchisees to release claims as part of a settlement of a dispute. Finally, Bethany Appleby, Marcus Banks, and Amy Cheng review recent franchisee and distribution cases.

Ring in the New Year by taking advantage of everything that the *Franchise Law Journal* and the Forum offer.

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Franchisee Claims for Constructive Termination Under the PMPA After *Mac's Shell*

Carmen D. Caruso

Suppose you are a franchise attorney and have two new gas station clients.

Your first client is suffering severe business losses and will likely be forced to close her doors because the price of fuel from the franchisor is simply too high to compete at the retail level and earn a sustainable profit. Sales have dropped, but for the moment your client is hanging on and counting on you to devise a legal strategy that will save the day.

Your second new client has the same underlying problem—the franchisor's fuel pricing is too high for him to operate his gas stations profitably—but the difference is that he has abandoned the business. He is simply looking to you to recover damages—as much as possible.

This article examines the potential claims of each of your clients following the U.S. Supreme Court's recent decision in *Mac's Shell Service, Inc. v. Shell Oil Products Co.*,[1] in which, as we know from Robert Kry's insightful article in the last issue of this *Journal*,[2] the Court, in a unanimous opinion written by Justice Alito, held that the Petroleum Marketing Practices Act (PMPA) does not provide a claim for constructive termination while the franchisee remains in business. The Court expressly declined to decide whether the PMPA provides a remedy for constructive termination where the franchisee is no longer operating its business.[3]

This article examines from the franchisee's viewpoint the claims and remedies that may be available to your new clients in light of the *Mac's Shell* decision. To set the stage, it is worth reviewing the background of the *Mac's Shell* case and considering the state of affairs created by the opinion of the U.S. Court of Appeals for the First Circuit, which the Supreme Court reversed. In 2008, the First Circuit held in *Mac's Shell* that a service station dealer could bring suit and recover damages for constructive termination despite continuing to operate the business while the claim was being litigated.[4] The dealers in *Mac's Shell* complained that the cancellation of a previous rent subsidy, which effectively increased their cost of fuel, spelled the demise of their business and hence was a constructive termination of the franchise relationship. The First Circuit accepted that view, holding that the cancellation of the rent subsidy—which had been implemented by an assignee of Shell, the original franchisor under the contracts at issue—was "such a material change that it effectively ended the lease, even though [the franchisee] continued to operate [its] franchise."[5] The court concluded that "it would be unreasonable . . . [t]o require an actual abandonment of years of work and investment before we recognize a right of action under the PMPA."[6] Thus, the First Circuit affirmed a jury verdict for damages stemming from this constructive termination even though the gas station franchisee, at least for the time being, remained in business.

Carmen D. Caruso

A NOVEL APPROACH

Prior to the First Circuit's decision in *Mac's Shell*, claims for constructive termination under the PMPA had generally been limited to the situation where an assignment of the franchise agreement resulted in the loss of one of the three statutory components of a franchise relationship under the PMPA: "(1) the right to occupy leased marketing premises, (2) the right to sell motor fuel under a trademark owned or controlled by a refiner, and (3) the right to be supplied with that fuel."[7] Constructive termination claims under the PMPA were almost always rejected if the franchisee continued to occupy the premises that were leased from the refiner, continued to receive fuel, and continued to enjoy the right to use the franchisor's trademark.[8]

IMPLICATIONS OF THE FIRST CIRCUIT'S DECISION

Under the First Circuit's holding in *Mac's Shell*, just about anything that threatened to run a franchisee out of business would seemingly give rise to a claim for constructive termination. The most common dealer complaint, i.e., that fuel prices are too high, arguably would have been grounds for a claim under the First Circuit's opinion. More esoteric claims, such as one based on lost sales due to a consumer boycott, could also have been pleaded as constructive termination claims under the First Circuit's logic. Boycotts are not uncommon. Shortly after the 2010 Gulf Oil spill, a group of consumers launched a Boycott BP movement on Facebook; environmentalists had started a similar action against Exxon (albeit not on Facebook) after the 1989 Exxon Valdez spill.[9] And citing the so-called Chavez factor, commentators noted that Citgo was unlikely to be affected by a 2006 boycott stemming from Hugo Chavez's critical remarks about President Bush.[10]

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Other implications from the First Circuit's decision stemmed from the PMPA itself and created some dilemmas for the practitioner. Under the PMPA, a strict one-year statute of limitations begins running from "the later of—(1) the date of termination of the franchise or nonrenewal of the franchise relationship; or (2) the date the franchisor fails to comply with the requirements of section 2802, 2803 or 2807 of this title."[11] Determining the date when a constructive termination occurs (while the franchisee remains in business) would not be an easy task. On the facts of *Mac's Shell*, was it the day that the rent subsidy was first taken away? Or did the statute not begin to run until dealers actually went out of business and closed their doors? Few lawyers would have been comfortable assuming the latter. The First Circuit opinion thus created an incentive for the early filing of constructive termination claims whenever a franchisor's business practices threatened to drive the franchisee out of business, even if the dealer went out of business sometime later.

No doubt *Mac's Shell* has closed the doors on claims for constructive termination under the PMPA when the franchisee remains open.

A related dilemma arising from the First Circuit's opinion resulted from the PMPA's express preemption of state law claims. The Act provides:

> To the extent that any provision of this subchapter applies to the termination (or the furnishing of notification with respect thereto) of any franchise, . . . no State or any political subdivision thereof may adopt, enforce, or continue in effect any provision of any law or regulation (including any remedy or penalty applicable to any violation thereof) with respect to termination (or the furnishing of notification with respect thereto) of any such franchise or to the nonrenewal (or the furnishing of notification with respect thereto) of any such franchise relationship unless such provision of such law or regulation is the same as the applicable provision of this subchapter.[12]

From this broad preemption language, it was obvious that constructive termination under the PMPA, as interpreted by the First Circuit, threatened to displace state law claims for breach of contract arising from the same conduct. Worse, if a franchisee did not file suit for constructive termination within the one-year period under the PMPA, it ran the risk that the franchisor would argue that the state law claims were preempted when the franchisee did attempt to file them. The franchisee thus would be exposed to the possibility of being left with no viable claims after the expiration of one year from the beginning of the contract breach at issue.

The First Circuit's decision, in effect, encouraged franchisees to file constructive termination claims within one year of the first signs of trouble in the franchise relationship whenever the issues that the franchisee was experiencing might be sufficient to drive it out of business. Such a result could be problematic. For example, although franchisees might experience high fuel costs during a certain period of time, fuel costs fluctuate. What if, after the case was filed but before trial, the circumstances changed and the franchisee was not at immediate risk of going out of business? Where a claim is based on high fuel prices, circumstances might change due to market fluctuations, or the franchisor itself might be able to influence the circumstances. Finally, if a franchisor faced claims for constructive termination based on high fuel prices, nothing would stop it from lowering those prices before the trial to damage the credibility of the dealer/plaintiff.

For all of these reasons, the First Circuit's decision in *Mac's Shell*, while applauded by the franchisee/dealer bar, actually created some interesting dilemmas for potential plaintiffs that had not been fully resolved at the time of the Supreme Court's decision.

HAS THE SUPREME COURT ACTUALLY EXPANDED FRANCHISEE RIGHTS?

As Mr. Kry explained in his article, the Supreme Court reversed the First Circuit, holding that there can be no claim for constructive termination under the PMPA where the franchisee remains in business.[13] Focusing on the literal definition of *termination* as being "the end" of something, the Court drew a bright line and held that "a necessary element of any constructive termination claim under the PMPA is that the complained-of conduct forced an end to the franchisee's use of the franchisor's trademark, purchase of the franchisor's fuel, or occupation of the franchisor's service station."[14]

However, in three separate footnotes in its opinion, the *Mac's Shell* Court made clear that it was not deciding whether the PMPA recognizes any claim for constructive termination and was "leav[ing] the issue for another day."[15] To be clear, it would have been dicta for the Court to have reached this issue on the facts presented in *Mac's Shell*, but predictably the Court's opinion has brought to the forefront the issue of whether a franchisee can state an actionable claim under the PMPA for constructive termination where the franchisee establishes that the franchisor's conduct drove it out of business. Moreover, and as Mr. Kry has noted, this issue is likely to be highly relevant under statutes that regulate the manner in which franchisees or dealers may be terminated.

In *Al's Service Center v. BP Products North America, Inc.*, decided after *Mac's Shell*, Judge Posner of the Seventh Circuit interpreted the Supreme Court's three footnotes as an expression of its "skepticism" that such claims exist.[16] However, Judge Posner added that "[w]e don't know *why* the Court is skeptical; without a doctrine of constructive termination, there would be . . . a big loophole in the Petroleum Marketing Practices Act."[17] Coming from a jurist who admittedly views the entire PMPA as "rank interferences with liberty of contract," Judge Posner's observation that the PMPA is not complete without judicial recognition of a constructive termination doctrine is quite compelling.[18]

Mr. Kry questions Judge Posner's observation that the absence of judicially recognized constructive termination claims would create a loophole in the PMPA and suggests that the purported loophole is only superficial. However, it is fair to say that Mr. Kry's apparent reluctance to see the courts recognize claims for constructive termination under the PMPA may stem from the fact that gas station franchisees already have other remedies under state law for oppressive franchisor conduct. These are primarily claims for breach of contract in one form or another, including claims under U.C.C. § 2-305 for bad faith in setting fuel prices under the open-price term of a fuel supply contract. However, it is equally fair to say that the existence of state law remedies for breach of contract arguably would stand as an objection to the existence of the PMPA itself. This is the basis for Judge Posner's questioning why Congress decided to enter this field in the first place.[19] For franchisors to object to the recognition of a constructive termination remedy under the PMPA on the grounds that state law provides remedies for breach of contract is a bit like a general's fighting the previous war.

Federal courts are naturally reluctant to expand remedies beyond the express language of a statute or to create an implied cause of action.[20] But franchisees that have ceased operating their business should not be deterred by this historical reluctance. In the three footnotes that caught Judge Posner's attention, the Supreme Court in *Mac's Shell* clearly invited further litigation on whether constructive termination is actionable under the PMPA. Given the potentially powerful remedies available under the PMPA, including three that would not be available under state law, i.e., punitive damages[21] and attorney fees and expert witness fees (if the plaintiff recovers more than nominal damages),[22] it is likely that "terminated" gas station franchisees will file constructive termination claims until the questions left open by *Mac's Shell* are definitively resolved.

DO CONSTRUCTIVE TERMINATION CLAIMS HAVE A FUTURE?

Franchisees seeking to pick up where *Mac's Shell* left off have some persuasive arguments at their disposal. Several passages in the Supreme Court's opinion that strongly suggest the Court would uphold a constructive termination claim under the PMPA under the right facts, beginning of course with the fact that the franchisee is no longer operating the business.

First, the Court noted that constructive termination claims had been recognized in other analogous areas of law, such as employment law, where "courts have long recognized a theory of constructive discharge," and landlord-tenant law, which has "long recognized the concept of constructive eviction."[23] The Court explained that "in these and other contexts, a termination is deemed 'constructive' because it is the plaintiff, rather than the defendant, who formally puts an end to the particular legal relationship—not because there is no end to the relationship at all."[24] Significantly, the Court continued by observing that

> [t]here is no reason why a different understanding should apply to constructive termination claims under the PMPA. At the time when it enacted the statute, Congress presumably was aware of how courts applied the doctrine of constructive termination in these analogous legal contexts. . . . And in the absence of any contrary evidence, we think it reasonable to interpret the Act in a way that is consistent with this well-established body of law.[25]

To be clear, the Court was seeking to be consistent with other areas of law in requiring an actual termination before there could be any discussion of a constructive termination claim, as opposed to actually recognizing the claim for constructive termination under the PMPA when an actual termination occurs. However, by the Court's own words, and in the absence of any contrary congressional intent, it would seem eminently logical to construe the PMPA as recognizing constructive termination in a way that is analogous to the constructive discharge of an employee or the constructive eviction of a tenant.

Second, in reaching its holding, the Court noted "that a necessary element of any constructive termination claim under the PMPA is that the complained-of conduct forced an end to the franchisee's use of the franchisor's trademark, purchase of the franchisor's fuel, or occupation of the franchisor's service station."[26] If the Court were not inclined to recognize a claim for constructive termination under the PMPA, this language would appear superfluous.

Third, the Court's interpretation of the PMPA gives further support for the recognition of a constructive termination claim under the PMPA. As the Court explained, "when given its ordinary meaning, the text of the PMPA prohibits only that franchisor conduct that has the effect of ending a franchise."[27] The emphasis on franchisor conduct, as opposed to the franchisor's decision to implement a termination, leaves plenty of room for franchisor misconduct that causes the franchisee to announce the end of the relationship, in ways that a court could find analogous to an employee's resignation under circumstances giving rise to a constructive discharge claim.

Thus, claims for constructive termination may prove to be viable in cases where the franchisor's conduct has indeed led the franchisee to end the relationship, most likely by going out of business. Other possible scenarios are also foreseeable. For example, instead of closing its doors, a franchisee might feel compelled to sell the business at a loss to mitigate its damages. In *Mac's Shell*, the Court was clearly creating a bright-line test, i.e., the franchise relationship has either ended or it has not (and if it has not ended, there can be no claim for constructive termination). But in cases in which the relationship has ended, it will not always be clear where to draw the line when a franchisor's conduct compelled the franchisee to end the relationship, as opposed to other cases where a franchisor's conduct contributed to the franchisee's business decision to quit the relationship. Assuming the courthouse doors will be open to constructive termination claims under the PMPA, the ultimate contours of this potential claim remain to be decided in the classic common law tradition on a case-by-case basis.

BURDEN OF PROOF

Returning to the hypothetical of high fuel prices actually driving the franchisee out of business, the next question becomes: What is the franchisee's burden of proof to establish the franchisor's liability? Case law construing U.C.C. § 2-305 has created numerous defenses for franchisors in their pricing decisions, discussion of which is beyond the scope of this article. Would the standard defenses to a U.C.C. pricing claim apply under the PMPA? Arguably, the answer would be no. Under *Mac's Shell*, the simple question would be framed as whether the franchisor's conduct has effectively ended the franchise relationship,[28] but merely framing the issue and determining the type of proof that will be needed to prevail may be two different things. In making an analogy to employment law, the Supreme Court in *Mac's Shell* cited *Pennsylvania State Police v. Suders*, where the Court held that employment conditions must be "so intolerable that a reasonable person would have felt compelled to resign."[29] To the Court, this formulation for a constructive discharge claim (based on a hostile environment) went beyond the standard for hostile work environment sexual harassment claims, where the offending behavior "must be sufficiently severe or pervasive to alter the conditions of the victim's employment."[30]

Thus, it would appear that if the Supreme Court is to recognize claims for constructive termination in violation of the PMPA after a franchisee is driven out of business, the claim will not be available for every breach of contract that would be actionable under state law. Only where the franchisor's misconduct is so egregious that the franchisee is left without real choice except to shut down can we expect to see the Supreme Court uphold constructive termination claims in this area. In these more extreme cases, a court would be more than justified in allowing the plaintiff to invoke the more powerful statutory remedies than would be available under state law. Of course, claims for constructive termination under this standard will raise serious questions of fact as the courts will have to sort out the franchisees that were truly forced out of business from those that were merely disgruntled and looking to seize the first opportunity to head for the exit. But this is exactly what trials are for, and the judicial determination of whether a constructive termination occurred should be no more difficult than determining whether an employee was constructively discharged or a tenant constructively evicted.

For the client who has been driven out of business, the PMPA arguably provides a claim for constructive termination. At a minimum, it is impossible for franchisors at this juncture in the law to argue conclusively that no such claim exists. However, it simply is not clear just how egregious the franchisor's conduct will have to be to constitute a constructive termination under the PMPA; undoubtedly, the lower courts may reach inconsistent results, and indeed some lower courts may elect categorically to reject these claims until they are approved at the circuit level. However, the good news is that if these claims are allowed to proceed, at least the Supreme Court's bright-line approach to whether a termination has occurred should resolve at least some of the practical dilemmas raised by the First Circuit's decision. There should no be no lingering doubt as to when the statute of limitations will run, i.e., it will run from the point that the franchise is ended.

The ultimate contours of potential claims under the PMPA remain to be decided in the classic common tradition on a case-by-case basis.

WHAT ABOUT THE FRANCHISEE THAT IS STILL OPERATING?

Unfortunately, *Mac's Shell* apparently leaves the franchisee that remains in business without a PMPA remedy. The injunctive relief provided by the PMPA is available where "the franchisee shows—the franchise of which he is a party has been terminated."[31] The statute states the fact of termination in the past tense. The PMPA contains no express statutory provision for an injunction against termination before it occurs, i.e., before it is announced by the franchisor in the case of an actual termination as contemplated in the statute. Because we know from *Mac's Shell* that constructive termination does not occur until the franchisee is actually driven out of business, it would appear to be an insurmountable stretch to try and invoke the PMPA injunction provisions while the franchisee is still operating.

Moreover, although the prospect of declaratory relief might be promising in theory, the Supreme Court in *Mac's Shell* rejected that argument en route to concluding that the franchisee must end the business before any claim of constructive termination may be considered under the PMPA.[32]

This means that to protect a gas station franchisee that complains of being driven out of business by high fuel prices but is still operating, an attorney will be forced to pursue state law remedies while the franchisee remains in business. One can envision the scenario of a franchisee initially pleading a state law claim for breach of the duty under U.C.C. § 2-305 to set fuel prices fairly under the open price term of a fuel supply agreement and arguably seeking both injunctive relief and damages for lost profits. Hopefully, that strategy would suffice; but if not, a constructive termination claim theoretically could be pleaded if the dealer is ultimately forced to close its doors before trial. In that situation, the preemptive effect of the PMPA presumably would apply. If the PMPA claim is upheld, the state law breach of contract claims arguably would arguably be dismissed, and the litigation would most likely shift to federal court. For the franchisee, this could be a positive trade, given the PMPA's enhanced remedies of punitive damages and attorney fees.

Or is it really that simple? If a franchisee attempts under state law to obtain and successfully gets an injunction against a continuing breach of contract that threatens its viability, a constructive termination presumably has been prevented. But what if the request for a state court injunction is denied? Is it realistic to expect the franchisee to prevail later on a PMPA constructive termination claim where the burden of proof may be higher than that for a breach of contract under state law? This question cannot be answered in the abstract. A request for injunctive relief might be defeated for numerous reasons, but certainly there will be reason for concern on the part of the franchisee's counsel. Moreover, the franchisor's counsel would be expected in this scenario to bring the franchisee's defeat at the state court injunction stage to the attention of the federal court once a constructive termination claim is filed.

CONCLUSION

No doubt *Mac's Shell* has closed the door on claims for constructive termination under the PMPA when the service station franchisee remains open, leaving the franchisee in those dire straits to its traditional remedies under state law. However, the language and logic of the Supreme Court's opinion certainly leaves open the prospect for constructive termination claims if the franchisee is forced out of business. Future litigation will be necessary not only to settle the viability of constructive termination claims but also to clarify the franchisee's burden of proof to establish that it was truly forced out of business in ways that would meet the criteria for this still-undefined claim.

Moreover, as Mr. Kry notes, we can expect to see *Mac's Shell* being argued with respect to claims for constructive termination under state franchise acts and other industry-specific statutes that are intended to protect franchisees and dealers from arbitrary terminations that destroy their equity. Absent distinctions based on the language of particular statutes or legislative histories, the Supreme Court's opinion in *Mac's Shell* will be highly persuasive.

ENDNOTES

1. 130 S. Ct. 1251 (2010).

2. Robert Kry, Mac's Shell *and the Future of Constructive Termination*, 30 FRANCHISE L.J. 67 (2010).

3. *Mac's Shell*, 130 S. Ct. at 1251.

4. Marcoux v. Shell Oil Prods. Co., 524 F.3d 33, 44–47 (1st Cir. 2008).

5. *See Mac's Shell*, 130 S. Ct. at 1257 (quoting Mac's Shell v. Shell Oil Prods. Co., 524 F.3d 33 (1st Cir. 2008)).

6. *Mac's Shell*, 524 F.3d at 46.

7. Paul D. Sanson, Vaughan Finn & Karen T. Staib, *A Tale of Two Claims: The First Circuit Weighs In on Constructive Termination and Constructive Non-Renewal*, AM. BAR ASS'N SECTION OF ENV'T, ENERGY, & RESOURCES 23D ANNUAL PETROLEUM MARKETING ROUNDTABLE (Oct. 15, 2008) (citing Ackley v. Gulf-Oil Corp., 726 F. Supp. 353, 361 (D. Conn. 1989), *aff'd*, 889 F.2d 1280 (2d Cir. 1989)).

8. *Id.* (citations omitted). Sanson, Finn, and Staib note that the lone exception prior to the First Circuit's decision in *Mac's Shell* had been *Barnes v. Gulf Oil Corp*., 795 F.3d 358, 362–63 (4th Cir. 1986), where the court allowed a constructive termination claim to proceed based on the franchisee's claim that it could no longer receive motor fuel at the stipulated franchise price. *Id.*

9. Sarah Wheaton, *Protesters Gather at BP Gas Stations*, N.Y. TIMES, June 2, 2010.

10. Mark Jewell, *Citgo Likely Not Hurt by Chavez Factor*, WASH. POST., Nov. 7, 2006, *available at* www.washingtonpost.com/wp-dyn/content/article/2006/11/07/AR2006110700928.html.

11. 15 U.S.C. § 2805(a).

12. 15 U.S.C. § 2806(a)(1).

13. Mac's Shell Serv., Inc. v. Shell Oil Prods. Co., 130 S. Ct. 1251, 1261–62 (2010).

14. As Mr. Kry has explained, "[u]nder the PMPA, the trademark rights, fuel-supply agreement, and lease of the premises are three distinct components of the petroleum franchise, and termination of any one suffices to implicate the statute. 15 U.S.C. § 2801(1)(B)." Kry, *supra* note 2, at 68 n.15.

15. *Mac's Shell*, 130 S. Ct. at 1257 n.4, 1260 n.8, 1261 n.9, 1262 n.11.

16. *See* Al's Serv. Ctr. v. BP Prods. N. Am., Inc., 599 F.3d 720, 726 (7th Cir. 2010).

17. *Id.* at 726 (citations omitted) (emphasis in original).

18. *Id.* at 722 (citations omitted); *see also* State Oil Co. v. Alayoubi, 966 F. Supp. 653 (N.D. Ill. 1997) (citing Brach v. Amoco Oil Co., 677 F.2d 1213 (7th Cir. 1982) (noting that the PMPA protects the "goodwill built up over years by a hard-working franchisee")).

19. *Id.*

20. Sanson, Finn & Staib, *supra* note 7, at 4 (citations omitted).

21. 15 U.S.C. § 2805(d)(1)(B).

22. 15 U.S.C. § 2805(d)(1)(C).

23. Mac's Shell Serv., Inc. v. Shell Oil Prods. Co., 130 S. Ct. 1251, 1258 (2010) (citations omitted).

24. *Id.* at 1259.

25. *Id.* (citation omitted).

26. *Id.* at 1262.

27. *Id.* at 1254.

28. *Id.*

29. 542 U.S. 129, 130 (2004).

30. *Id.* at 131.

31. 15 U.S.C. § 2805(b)(2)(A)(i).

32. *Mac's Shell*, 130 S. Ct. at 1258.

Can't Give It Away: Statutory Prohibitions That Protect Franchisees from Releases

Nicole Liguori Micklich and Michael V. Pepe

Most states regulate the relationship between manufacturers and distributors in certain industries, such as motor vehicle or petroleum product sales, and many regulate the relationship between franchisors and franchisees in other businesses as well. Legislatures enacting franchise and distribution laws act on the basis of a shared recognition that prospective franchisees often face significant initial investment decisions without adequate information and come from a position of little, if any, meaningful bargaining power. As a result, registration and disclosure requirements exist in many states to protect prospective franchisees at the outset of the franchise relationship. Most of these laws require franchisors to disclose specific information directly to prospective franchisees, and many additionally direct franchisors to register and file documents with the appropriate state agency or authority.

Some states also regulate the franchise or distribution relationship after its inception because legislatures perceive that the inequities of the franchise relationship extend beyond initial disclosures. Statutes requiring franchisors to have good cause for termination or nonrenewal of a franchise offer some protection to existing franchisees. In addition, some state statutes address advertising, the rights of franchisees to associate with one another, rebating, covenants not to compete, exclusivity, notice of termination or nonrenewal, and nonwaiver of statutory rights and release prohibitions.

This article discusses the statutory provisions concerning releases in state franchise and dealership acts. It also provides practitioners with a useful survey. For convenience, the authors have included a table that compiles release language from franchise and distribution acts in each of the fifty states, the District of Columbia, and federal acts specifically applicable to franchises and dealerships. Release prohibitions in franchise and distribution acts derive from the same concept of unequal bargaining power that underscores most franchise laws. It is telling that the FTC Rule, in an addition to the prohibitions of the old Franchise Rule, makes it an independent violation for a franchisor to disclaim, or require a franchisee to waive reliance on, any representation made in the disclosure document.[1]

In terms of the state-specific franchise and distribution laws that regulate releases, most prohibit the franchisor from requiring the franchisee prospectively to agree to a release or waiver[2] of protections afforded the franchisee by that specific act or regulation.[3] Most also apply only to

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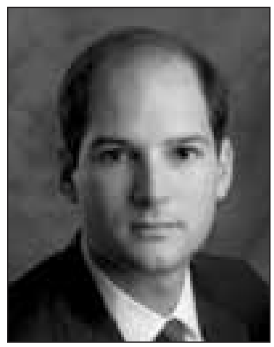

Michael V. Pepe

prospective franchisees.[4] Many statutes expressly permit existing franchisees to enter into releases, provided there is adequate consideration or the release is executed in connection with or as part of a voluntary settlement agreement.[5] Problems arise for franchisors when they seek to include language in the franchise agreement to bargain around statutory protections and prohibitions. As the survey reflects, the state statutory prohibitions vary in scope.

Thus. this article examines three distinctions—in terms of legislation and case law—among statutory release prohibitions: first, whether the release prohibition applies only to claims under the respective franchise act; second, whether existing or only prospective franchisees are protected by the release prohibition; and, third, whether the law prohibits only prospective releases.

Beyond these issues, however, the authors hope to encourage readers to consider all of the available options when asserting a release as a defense or arguing that a release is invalid. For example, an applicable unfair and deceptive trade practices act or even consumer protection act may alone, or in conjunction with the franchise act, prohibit or invalidate a release that a franchisee executed. On the other hand, common law considerations may convince a court to enforce a release that a franchisor insisted upon, particularly if the claim released was known to the franchisee at the time of execution.

DOES THE PROHIBITION APPLY ONLY TO CLAIMS UNDER THE FRANCHISE ACT?

LEGISLATION

Most state franchise acts prohibit releases or waivers of claims arising under the act itself,[6] but a few statutes forbid franchisors from requiring franchisees to relieve the franchisor of any liability. The Utah New Automobile Franchise Act and Utah Powersport Vehicle Franchise Act, for example, prohibit franchisors from requiring franchisees prospectively

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to agree to a release that would relieve a franchisor of "any liability."[7] The Georgia Motor Vehicle Fair Practices Act prohibits franchisors from requiring dealers prospectively to assent to a release that would relieve any person from liability to be imposed "by law," without limitation to that act.[8] Evidently, the Georgia legislature purposefully avoided such a limitation. In its statutes regulating dealers of agricultural equipment, the Georgia legislature made it unlawful and a violation of that code for a manufacturer to require a dealer to assent to a release that would relieve any person from liability imposed "by this article," as opposed to "by law."[9]

Other state acts forbid franchisors from requiring franchisees to release or waive any right that a franchisee has under any state law. The Illinois Franchise Disclosure Act of 1987 states that "[a]ny condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this Act or any other law of this State is void."[10] The South Dakota Franchise Act provides:

> Any condition, stipulation, or provision in any agreement evidenced by a franchise agreement, sales agreement, security agreement, or other form of agreement or arrangement of like effect, purporting to waive compliance with any provision of this chapter, or other provision of state law applying to such agreements is void as a matter of public policy.[11]

Three other state franchise acts have unique and more specific provisions. The Iowa Franchise Act prohibits franchisors from obligating a franchisee, as a condition to a transfer of a franchise, to relinquish any rights unrelated to the franchise proposed to be transferred or to enter into a release of claims that is not mutual.[12] The Minnesota Motor Vehicle Fuel Franchise Act prohibits parties to a marketing agreement from requiring that the other party assent to a release and further prohibits the inclusion of a release of claims as a condition to entering into the marketing agreement.[13] Such a waiver or release is void.[14] The Louisiana Motor Vehicle Commission Law prohibits franchisors from requiring dealers to assent to a release that would relieve any person from liability to be imposed by law unless the release is entered into in connection with a settlement agreement to resolve a pending matter or litigation.[15]

The federal Petroleum Marketing Practices Act (PMPA) includes a release prohibition that covers waivers of federal and state law. It states that "[n]o franchisor shall require, as a condition of entering into or renewing the franchise relationship, a franchisee to release or waive—(A) any right that the franchisee has under this subchapter or other Federal law; or (B) any right that the franchisee may have under any valid and applicable State law."[16] The Virginia Petroleum Products Franchise Act prohibits waivers of rights afforded by that act and also by the PMPA: "Any provision in any agreement or franchise purporting to waive any right or remedy under this chapter or any applicable provisions of the Petroleum Marketing Practices Act (15 U.S.C. § 2802 et seq.) shall be null and void."[17]

CASE LAW

When confronted with waiver and release allegations, courts inevitably examine the scope of release provisions to determine how broad the provision is, regardless of the applicable law. Courts also frequently will consider issues of fraud, duress, illegality, or mistake. Where the applicable law does not limit the scope of claims a franchisee can legally waive or the conditions under which the release may be validly executed, courts look to certain factors to determine whether the release is valid. Such factors include whether (1) the parties were in an adversarial relationship at the time the release was executed, (2) the party signing the release was represented by counsel, (3) the releasor knew that he or she should not rely on the releasee's representations, (4) the releasor demanded information or relevant materials prior to executing the release, and (5) there was consideration.[18]

Arizona, for example, does not have a general franchise act applicable to hotel franchises that prohibits the release of certain claims. Thus, when Ramada Franchise Systems franchisees signed an amendment to their franchise agreement that released the franchisor from "any and all claims and causes of action whatsoever," and there was no fraud or mutual mistake, the release was valid.[19] The release was found to bar the franchisees' claim that the doctrine of equitable recoupment should limit the amount of damages awarded to the franchisor.[20]

In *Western Chance #2, Inc. v. KFC Corp.*, the Ninth Circuit, also applying Arizona law, held that a genuine issue of material fact existed as to the intended scope of a general release the parties had executed in connection with litigation over the closure of one of the franchisee's outlets, thus precluding summary judgment.[21] The general release purported to release franchisor Kentucky Fried Chicken from "any and all claims, demands, causes or action, and liabilities of every kind and nature, known and unknown, suspected and unsuspected, held by [franchisee] and relating to the subject matter of the litigation or any other matter involving [franchisee's] franchise and commercial relationship with KFC."[22]

The North Dakota Motor Vehicle Dealer Licensing Law also does not prohibit releases of certain claims by existing franchisees.[23] Thus, when the District of New Jersey was faced with release language in a settlement agreement between Ford Motor Company and one of its distributors, calling for the application of North Dakota law, the court noted that under North Dakota law, "[i]f [a] contract is unambiguous, the intentions of the parties are to be ascertained from the contract alone."[24] The release provision stated:

> The Wallwork Parties release and forever discharge Ford . . . from all claims, actions, causes of actions, rights, or obligations, whether known or unknown, whether contingent or liquidated, of every kind, nature and description which arise directly or indirectly from any act or omission, or alleged act or omission, by each or any of the Ford Released Parties that occurred on or prior to the date of this Agreement

> which the Wallwork Parties . . . has, had or may have against [Ford], including, without limitation, all allegations made or which could have been made in the Action and any and all liability, actions, claims, demands, causes of action, or suits arising out of, or resulting from, or in any manner pertaining to, damages, loss of enjoyment, loss of services, loss of business, loss of business opportunities, loss of profits, contractual rights, torts and any and all claims which might hereinafter result to the Wallwork Parties, arising out of or in any way connected with the Wallwork Parties' operation of the Ford dealership and other operations in Fargo, North Dakota, provided that (i) third-party claims brought for personal injury, product liability, breach of warranty; (ii) the obligations set forth under paragraphs 19, 21 and 23 of Wallwork's Ford Sales and Service Agreement for car and light truck; and (iii) Ford's obligation to make customary payments or grant customary credits for transactions between Ford and Wallwork in the ordinary course of business, are not released.[25]

The release was unambiguous and barred the Wallwork parties' claims in the case, the court held. As a result, the court granted Ford's summary judgment motion with respect to those claims.[26]

Courts also regularly examine the underlying franchise agreements between the parties in determining the validity of release provisions. The fact that the underlying agreement calls for the execution of releases at the time of renewal, transfer, or termination may support a franchisor's claim that a release in its favor is valid. In the Ford Motor Company case discussed above, the court was called upon to examine other release language in light of applicable Michigan law.[27] Multiple Ford dealers elected to terminate their dealership agreements following Ford's sale of its heavy-truck business, when Ford stopped supplying heavy trucks to its dealers.[28] The resigning dealers were required to execute general releases.[29] The Ford Heavy Duty Truck Sales and Service Agreements executed by plaintiffs all contained the following provision:

> TERMINATION BENEFITS FULL COMPENSATION; GENERAL RELEASE 23. In the event of termination or nonrenewal of this agreement by the Company, the Company, within thirty (30) days after the effective date thereof, shall submit to the Dealer (1) a written tender of the benefits provided for in paragraph 21 (and in paragraph 22 where applicable) and (2) a form for the Dealer to use to elect either to reject all of such benefits or to accept one or more of them as full and complete compensation for such nonrenewal or termination. The Dealer shall have thirty (30) days after receipt of such form to return the same to the Company evidencing his election. If the Dealer fails to return the form stating such election within such thirty (30) days, the Dealer shall be deemed to have elected to accept such benefits. *Upon the Dealer's election to accept any of such benefits, or upon the Dealer's demand of any such benefits upon any termination or nonrenewal by the Dealer, the Company shall be released from any and all other liability to the Dealer with respect to all relationships and actions between the Dealer and the Company, however claimed to arise except any liability that the Company may have under subparagraph 19(f) and said paragraphs 21 and 22, and except for such amounts as the Company may have agreed in writing to pay to the Dealer.* Simultaneously with the receipt of any benefits so elected or demanded, the Dealer shall execute and deliver to the Company a general release with exceptions, as above described, satisfactory to the company.[30]

The termination letters for all of the resigning dealers, which effectively terminated their agreements with Ford, stated that the resignations were being conducted pursuant to the provisions of the Ford Heavy Duty Truck Sales and Service Agreements. Most of the letters specifically referenced paragraph 23 of those agreements.[31] Although the resigning dealers argued that Ford improperly obtained the releases, the court noted that this argument ignored the fact that the subject of the release was in exchange for termination benefits that were agreed upon well before the pending dispute arose.[32] The court held that the resigning dealers' releases were enforceable under Michigan law.[33]

The question for a court confronted with a release that is not prohibited by statute may be whether it appears to be "mere enforcement of terms to which [the franchisees] agreed when originally signing their franchise agreement."[34] In a case involving former owners of a West Coast Video franchise outlet in Maryland, the federal bankruptcy court in the Eastern District of Pennsylvania suggested in dicta that a general release by the former franchisees of the debtor West Coast Video was valid and barred their claims against the franchisor.[35]

The release in the West Coast Video case was executed as part of the franchisees' assignment of their West Coast Video franchise to a buyer that assumed the franchisees' debt. In the release, the franchisees agreed to

> [r]elease absolutely, unconditionally and forever discharge Franchisor and its officers, directors, affiliates, shareholders, agents and servants from any and all claims, actions, causes of action, damages, costs, debts, obligations, responsibilities, and liabilities of every name, nature, kind and description whatsoever, whether in tort, in contract, or under statute, arising directly or indirectly out of the negotiation of, execution of, performance of, non-performance of, or breach of the Franchise Agreement.[36]

The bankruptcy court specifically took note that there was no evidence of coercion, direct consideration was received, and language contained in the original franchise agreement executed by the franchisee supported the franchisor's insistence that the franchisees execute a general release in favor of the franchisor as an absolute condition to its approval of the sale.[37] The bankruptcy court made its observations "as guidance to the parties and to possibly assist the overburdened state court in assessing the merits" of the matter.[38]

As the bankruptcy court anticipated, the release was later held valid and enforceable by the Eastern District of Pennsylvania against the franchisees under Pennsylvania law. The release was found to bar the franchisees' Racketeer Influenced and Corrupt Organizations (RICO) Act claims against the franchisor. The franchisees argued unsuccessfully that the Maryland Franchise Registration and Disclosure Law (MFRDA) applied to their case (because their outlet operated in Maryland) and invalidated the release.[39] The franchisees relied on § 14-226 of the MFRDA, which provides: "As a condition of the sale of a franchise, a franchisor may not require a prospective franchisee to agree to a release, assignment, novation, waiver, or estoppel that would relieve a person from liability under this subtitle."[40]

Other state acts forbid franchisors from requiring franchisees to release or waive any right that a franchisee has under any state law.

The district court held that Pennsylvania law applied but found that even assuming Maryland law applied to the case, § 14-226 did not invalidate the release at issue because the parties' franchise agreement did not require the prospective franchisee to assent to a release. Rather, it stated that the franchisor may require a release as a condition of providing consent to a transfer or other such act.[41] The district court found that by the time the franchisees were required to sign the release, they were no longer prospective franchisees protected by § 14-226 of the MFRDA.[42]

On appeal, the Third Circuit affirmed. The court, however, did not address whether the district court correctly held § 14-226 inapplicable on the ground that plaintiffs were not prospective franchisees when they executed the release. The court instead held that assuming the Maryland law applied, the release barred plaintiffs from bringing their federal RICO action notwithstanding § 14-226 because § 14-226 invalidated the release only as to causes of action "grounded in the MFRDA."[43] Maryland could have forbidden franchisors from requiring franchisees to agree to a release that would relieve a person from liability generally, as other states have done, by invalidating releases of any claims or liability, but instead Maryland had limited the scope of its prohibition to liability only "under this subtitle."[44] Thus, the RICO action was barred by the release.

In a case involving a proposed transfer of an America's Favorite Chicken fast-food franchise, a Michigan appellate court analyzed similar statutory language limiting release prohibitions to the franchise act. That court held that the franchisor had good cause not to consent to the franchisees' transfer of a franchise where the franchisees refused to execute a general release that the franchisor required as a condition to its consent to the transfer.[45] The Michigan Franchise Investment Law (MFIL) provides in § 27:

> Each of the following provisions is void and unenforceable if contained in any documents relating to a franchise: (b) A requirement that a franchisee assent to a release, assignment, novation, waiver, or estoppel which deprives a franchisee of rights and protections provided in this act. This shall not preclude a franchisee, after entering into a franchise agreement, from settling any and all claims.[46]

The America's Favorite Chicken franchisees refused to execute a general release to accomplish a transfer of their franchise even after the franchisor modified the release so that it did not encompass any claims the franchisees had under the MFIL. As a result of the franchisees' refusal to execute the release, the franchisor refused to consent to the transfer. The franchisees claimed their refusal to sign a release was not good cause for the franchisor to refuse to consent to the transfer of their franchise.

The court disagreed with the franchisees and held that provisions of the franchise agreement entitling the franchisor to demand release of any and all claims as a condition of approving the transfer of the franchise were valid. The franchise agreement between the parties stated that the franchisor "shall not unreasonably withhold consent to any transfer," provided, however, that prior to the time of the transfer, the franchisee shall have "executed a General Release under seal, in a form satisfactory to Franchisor, of any and all claims against Franchisor."[47] The franchisees' refusal to provide the release at the time of the transfer was a default of the franchise agreement, and failure to cure that default was good cause under the MFIL for the franchisor not to approve the transfer.[48]

According to the court,

> Under terms of the parties' contract, defendant was entitled to demand a release of any and all claims as a condition of approving the transfer of the franchise. Thus, unless the provision is void and unenforceable under the MFIL, defendant was entitled to withhold approval because plaintiffs refused to release their claims.[49]

The court determined that the release sought by the franchisor did not encompass any claims the franchisees had against the franchisor under the MFIL and did not deprive the franchisees of any protections provided for by that statute and therefore was not void or unenforceable. Further, it was commercially reasonable for the franchisor to require resolution of all non-MFIL claims before the franchisor approved a transfer, the court concluded.[50]

The New York Franchise Sales Act also prohibits franchisors from requiring releases by franchisees that relieve the franchisor from liability under the act.[51] Specifically, the act provides that "[i]t is unlawful to require a franchisee to assent to a release, assignment, novation, waiver or estoppel which would relieve a person from any duty or liability imposed by this article."[52] New York courts have held that a waiver or release provision pursuant to which a franchisor seeks unlawfully to avoid the antifraud provisions of the New York Franchise Sales Act is contrary to the purposes of the act and will not bar a franchisee's claims.[53] After executing a franchise agreement containing a general waiver and release, a Union Carbide franchisee brought fraud claims against the franchisor. The franchisor argued that the franchisee's misrepresentation claims were precluded by the waiver and release provision, pursuant to which the "[f]ranchisee expressly and specifically waives any claims, demands or damages arising from . . . the loss of association with or identification of Union Carbide Marble Care, Inc."[54] The court held that the provision in the franchise agreement unlawfully permitted the franchisor to circumvent the antifraud provisions of the act by contracting out of statutory liability.[55] Accordingly, the court denied the franchisor's motion to dismiss those portions of the complaint alleging violations of the New York Franchise Sales Act.[56]

Expressing a similar sentiment, in *Capital Equipment, Inc. v. CNH America, LLC*, the Eastern District of Arkansas noted that the franchisor could not use its dealership agreements to require franchisees to release statutory claims under the Arkansas Franchise Protection Act.[57] Like many such statutes, the Arkansas Franchise Protection Act prohibits a franchisor from requiring a franchisee to assent to a release that would relieve a person of liability imposed by that act "at the time of entering into the franchise arrangement."[58] As discussed further in the next section, an existing franchisee may be bound by a release executed later in the franchise relationship.

Most statutes that prohibit franchisors from requiring releases seem designed to protect prospective or new franchisees.

DOES THE PROHIBITION APPLY ONLY TO NEW OR PROSPECTIVE FRANCHISEES?

LEGISLATION

Most statutes that prohibit franchisors from requiring releases seem designed to protect prospective or new franchisees from waiving claims that arose during the disclosure process, about which they probably have no knowledge when executing the franchise agreement. This is not surprising given the purpose of most franchise acts. In fact, of the many acts with nonwaiver and release provisions prohibiting releases of liability under the specific act or chapter, nearly half limit the protection to new or prospective franchisees. For example, the Arkansas Franchise Practices Act prohibits any franchisor from requiring a franchisee at the time of entering into a franchise arrangement to assent to a release that would relieve any person from liability imposed by that act.[59] The Nebraska Franchise Practices Act contains the same prohibition,[60] as do the New Jersey Franchise Practices Act,[61] the Hawaii Franchise Investment Law,[62] and the Connecticut Gasoline Dealer's Act.[63] The Missouri Motor Vehicle Franchise Protection Act and the Missouri Motorcycle and All-Terrain Vehicle Franchise Practices Act both make it unlawful for a franchisor to require a franchisee at the time of entering into a franchise arrangement to assent to a release that would relieve any person from liability imposed by those acts,[64] as does the Pennsylvania Gasoline, Petroleum Products and Motor Vehicle Accessories Law.[65] The North Dakota Franchise Investment Law provides: "Any condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this chapter or any rule or order hereunder is void."[66] The Illinois Franchise Disclosure Act of 1987, Minnesota Franchise Act, and Wisconsin Franchise Investment Law do substantively the same.[67]

On the other hand, affording specific attention to existing franchisees in the midst of termination, cancellation, or nonrenewal, the Alabama Motor Vehicle Franchise Act provides in relevant part:

> Notwithstanding the terms, provisions, or conditions of any dealer agreement or franchise or the terms or provisions of any waiver, prior to the termination, cancellation, or nonrenewal of any dealer agreement or franchise, the following acts or conduct shall constitute unfair and deceptive trade practices: (3) For any manufacturer, factory branch, factory representative, distributor, or wholesaler, distributor branch or distributor representative to do any of the following: To prospectively assent to a release, assignment, novation, agreement, waiver, or estoppel (i) which would relieve any person from any liability or obligation under this chapter.[68]

The Iowa Franchise Act is also attentive to existing franchisees. That act voids any provision requiring a franchisee to waive compliance with or relieve a person of a duty or liability imposed by, or a right provided by, the act, including rights provided by the act related to transfer, encroachment, and termination.[69] The Iowa Franchise Act further provides that "[a] franchisor, as a condition to a transfer of a franchise, shall not obligate a franchisee to undertake obligations or relinquish any rights unrelated to the franchise proposed to be transferred, or to enter into a release of claims broader than a similar release of claims by the franchisor against the franchisee which is entered into by the franchisor."[70] This provision is unique among the state franchise acts.

Other acts appear to extend their prohibitions beyond prospective or new franchisees but use language less specific than the Iowa Franchise Act.[71] The Michigan Franchise

Investment Law, for example, makes void and unenforceable any provision in any document relating to a franchise that a franchisee assent to a release or waiver depriving it of rights and protections provided by that law.[72]

CASE LAW

As discussed above, at least one court has held that the MFRDA did not invalidate a release executed by a video store franchisee because the parties' franchise agreement did not require the prospective franchisee to assent to a release. Rather, the franchise agreement permitted the franchisor to require a release from the franchisee as a condition of providing consent to a transfer later. By the time the franchisees were required to sign the release, they were no longer prospective franchisees protected by § 14-226 of the law.[73] This outcome, and the statutory language in most franchise acts that evidences a legislative intent to protect prospective franchisees, is consistent with the idea expressed in some statutes and cases that parties ought to be able to settle bona fide disputes or enter into valid release agreements for consideration and absent duress.[74]

As the South Carolina Supreme Court noted in *Toyota of Florence, Inc. v. Lynch*, the state's Manufacturers, Distributors and Dealers Act does not make any and all releases void; rather, the plain language of the act invalidates a release only if the dealer is required to assent to it.[75] Specifically, the act provides:

> (3) It shall be deemed a violation of paragraph (a) of § 56-15-30 for a manufacturer, a distributor, a wholesaler, a distributor branch or division, a factory branch or division, or a wholesale branch or division, or officer, agent or other representative thereof:
>
> (k) To require a motor vehicle dealer to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by this chapter.[76]

A South Carolina federal district court relied on the holding in *Lynch* when it decided *Hyman v. Ford Motor Co.*[77] The parties there had entered into a dealership agreement in 1991. Paragraph 21 stated, in relevant part:

> Upon termination or nonrenewal of this agreement by the Company, the Dealer may elect as provided in paragraph 23 or, upon termination or nonrenewal of this agreement by the Dealer, the Dealer may demand in his notice of termination or nonrenewal, to have the Company purchase or accept upon return from the Dealer, in return for his general release specified in paragraph 23: [unused parts and inventory].
>
> Paragraph 23 in turn provided:
>
> In the event of termination or nonrenewal of this agreement by the Company, the Company, within thirty (30) days after the effective date thereof, shall submit to the Dealer (1) a written tender of the benefits provided for in paragraph 21. . . . Upon the Dealer's election to accept any of such benefits, or upon the Dealer's demand of any such benefits upon any termination or nonrenewal by the Dealer, the Company shall be released from any and all other liability to the Dealer with respect to all relationships and actions between the Dealer and the Company. . . . Simultaneously with the receipt of any benefits so elected or demanded, the Dealer shall execute and deliver to the Company a general release with exceptions, as above described, satisfactory to the Company.[78]

In 1996, the dealer executed a general release in exchange for the repurchase of assets by Ford and the assignment of the dealership agreement to a replacement dealer.[79] The general release was supported by adequate consideration.[80] The court noted that even if the dealer was under economic duress at the time of the assignment of the dealership agreement, the dealer did not allege that he was under duress when he entered into the franchise agreement, which called for the release Ford demanded at the time of the assignment.[81] The court therefore determined that the general release was not void. The release did not violate the South Carolina Regulation of Manufacturers, Distributors and Dealers Act because the dealer was not required to execute the release but "did so under his own volition, after consultation with his attorney. Further, he voluntarily entered into the agreement with Ford in 1991 and agreed to the terms of the parts return privileges."[82] The court also noted that the dealer ratified the release by retaining the benefits of the release, nearly $200,000 for over three years.[83]

As in the Ford Motor Company cases discussed in this section and above, it is not uncommon for franchisors, and particularly motor vehicle manufacturers, to require franchisees to execute releases in connection with the exercise of certain termination options. In a case involving Volkswagen, a Pennsylvania district court held that a motor vehicle dealer had standing to bring an action against an automobile manufacturer alleging breaches of the parties' franchise agreement, despite having signed a release.[84] The dealer executed a "Surrender of Dealer Agreement, Assignment of Franchise and Release" document in connection with the transfer of its franchise. The release stated that the manufacturer would be released from "all claims, demands, causes of action, judgments and executions . . ." except for "any claims that may exist against [manufacturer] with respect to its actions concerning the proposed dealership transferees."[85] The court found that the transfer agreement between the dealer and its successor did not convey clear intent to release the manufacturer from all liability with respect to the transfer, and the release carved out claims such as those advanced in the case.[86] However, in examining the dealership's claims, the court found that the dealer did not meet its burden of proving the manufacturer liable on all counts, and the court directed verdict to enter in favor of the manufacturer on all counts.[87]

A general release executed in connection with a transfer that removes a franchisee from a franchisor's system will, more often than not, successfully prevent the franchisee from later maintaining an action against the franchisor.[88] A closer call arises when a franchisee executes a general release in connection with a renewal or extension of one agreement, and the franchisor later applies the release to preclude claims arising out of or related to a separate agreement. In a GNC Franchising case, though, another Pennsylvania district court granted summary judgment in favor of a franchisor on a franchisee's claims of breach of contract and failure to negotiate the renewal of a sublease. The court found that both claims were barred by a general release executed by the franchisee in connection with, and in consideration of, an extension of the expiration date of a franchise agreement for a store unrelated to the articulated claims.[89] The general release provided:

> For and in consideration of the extension of the expiration date of the Franchise Agreement for GNC Store #6561 located at Perris Plaza, 1688 North Perris Blvd., Suite 3 in Perris, California, as of *April 26, 2004*, the Franchisee and the respective corporate parents, subsidiaries, affiliates and successors in interest and each of their respective directors, officers, agents, servants, employees as applicable (collectively "Franchise"), whether specifically mentioned herein or not, do hereby release, acquit and forever fully discharge Franchisor and each of its respective parents, subsidiaries and affiliates successors in interest, and each of its respective directors, officers, agents, servants, employees and whether specifically mentioned herein or not, of and from any and all liability, actions, causes of action, claims, demands, damages, costs, expenses, and compensation of whatsoever nature or character, whether known or unknown, foreseen or unforeseen, direct or indirect, contingent or actual, liquidated or unliquidated, whether in contract or in tort on account of or in any way connected with or related to Franchisor's offer, sale, grant of, construction or operation of or development and/or franchise rights in any and all franchise locations now or at any time awarded to the undersigned and from the inception of any contract with Franchisor to the date of this Release. It is the express intention of the undersigned that this Release be as broad as permitted by law. Franchisee represents and warrants that execution hereof is free and voluntary; that no inducements, threats, representations, or influences of any kind were made or exerted by or on behalf of Franchisor; and that, prior to the execution hereof, undersigned was given the opportunity, if desired, to consult with counsel. This Release shall be binding upon the undersigned, their heirs, successors and legal representatives.[90]

Although the franchise outlets were located in California, the agreements at issue included Pennsylvania choice-of-law provisions; and, as such, the release was not prohibited by statute. The court found that the release barred the contract-based claims and granted summary judgment on the franchisee's tortious interference claim on other grounds.[91]

DOES THE PROHIBITION IMPOSE LIMITATIONS ONLY ON PROSPECTIVE LIABILITY?

LEGISLATION

Most motor vehicle franchise acts, as well as some other franchise acts, prohibit franchisors from requiring dealers prospectively to assent to a release that would relieve any person from liability under that specific act.[92] The Colorado Automobile Dealers Act and Powersports Vehicle Dealers Act do so but, unlike most other acts, specifically and expressly permit such a release "in settlement of a bona fide dispute."[93] The Delaware Motor Vehicle Franchising Practices Act prohibits franchisors from requiring dealers prospectively to assent to a release that would relieve any person from liability under that act[94] but goes on to state that it "shall not preclude dealers . . . from entering into valid releases consistent with the policy of this chapter." But "in no case shall a general release required to be executed as a condition to renewal of a franchise agreement be deemed to be consistent with the policy of this chapter."[95]

The Georgia Motor Vehicle Fair Practices Act prohibits franchisors from requiring dealers prospectively to assent to a release that would relieve any person from liability to be imposed by law without limitation to that act.[96] Like the Georgia Motor Vehicle Fair Practices Act, the Louisiana Motor Vehicle Commission Law does not limit the scope of prohibited releases to that specific law. The statute prohibits franchisors from requiring dealers to assent to a release that would relieve any person from liability to be imposed by law unless the release is entered into in connection with a settlement agreement to resolve a pending matter or litigation.[97] The Massachusetts Automobile Dealer's Bill of Rights Statute prohibits releases that would prospectively relieve any person from liability imposed by that law, however, only if the manufacturer coerced the dealer to assent to the release.[98]

A significant number of other motor vehicle franchise acts prohibit a manufacturer from requiring a motor vehicle dealer to assent to a release that would relieve any person from liability imposed by that particular statute and that would do so without limitation as to whether the manufacturer requires the release prospectively.[99] The New York Franchised Motor Vehicle Dealer Act, like at least six other such acts, prohibits a motor vehicle franchisor from requiring a franchised dealer to assent to a release that would relieve any person from liability imposed under that article. The New York law alone expressly adds that it does not prohibit the dealer from entering into a valid release or settlement agreement with a franchisor.[100]

Beyond the automobile acts, the Indiana Deceptive Franchise Practices Act prohibits prospective releases as follows:

> Sec. 1. It is unlawful for any franchise agreement entered into between any franchisor and a franchisee who is either a resident of Indiana or a nonresident who will be operating a franchise in Indiana to contain any of the following provisions: (5) Requiring the franchisee to prospectively assent to a release, assignment, novation, waiver, or estoppel which purports to

relieve any person from liability to be imposed by this chapter or requiring any controversy between the franchisee and the franchisor to be referred to any person, if referral would be binding on the franchisee. This subdivision does not apply to arbitration before an independent arbitrator.[101]

The Tennessee Franchise Terminations, Nonrenewals or Modifications Law is similar. It provides:

> No franchisee may prospectively assent to a release, assignment, novation, waiver or estoppel which would relieve any person from any liability or obligation under this part, or would require any controversy between a franchisor or franchisee to be referred to any person other than the duly constituted courts of this state or the United States, or a state regulatory agency charged by law with adjudicating such controversy, if the referral would be binding on the franchisee.[102]

The California Franchise Investment Law expressly permits modifications of franchise agreements between franchisors and existing franchisees and states that the modification may include a general release of all known and unknown claims by a party to the modification.[103]

CASE LAW

Prospective releases purport to relieve the releasee of all liability for anything it does in the future after the release is signed. Many releases of claims against franchisors are not prospective and release only those claims the franchisee may have on the date of the agreement. This eliminates the need for legal analysis of whether a claim is barred, leaving the courts to decide only issues of fact. Notwithstanding, there are those franchisors that seek and obtain prospective releases.

In the well-known decision *Scheck v. Burger King Corp.*,[104] the Southern District of Florida was faced with two release provisions, including one that arguably released future claims. The first release provided in relevant part:

> [I]n further consideration of the execution of this Agreement . . . [the parties] mutually release one another . . . of and from any and all claims whatsoever in law or in equity, which it may have, nor has or may have by reason of any matter, cause or thing whatsoever arising out of or in connection with the Lease, the relationship between [the parties] or any other cause or circumstance.[105]

The second release clearly applied only retrospectively and stated:

> Assignor and Assignee hereby mutually release each other . . . of and from any and all claims whatsoever, in law or in equity, which they have or may have by reason of any matter, cause or thing whatsoever arising out of or in connection with the Agreements, relationships, or a course of dealings between [the parties] or for any other cause or circumstance which existed prior to the date of this Agreement.[106]

The court recognized that "[u]nder Florida law, a general release 'will ordinarily be regarded as embracing all claims or demands which had matured at the time of its execution.'"[107] And "[c]onversely, a general release cannot be held to bar a claim which did not exist when it was signed."[108] Therefore, the releases did not bar the franchisee's claims against the franchisor raised in the action. Even though the franchisee may have had an idea that those claims would arise, they were not yet ripe at the time of the execution of the release.[109]

Also following Florida law, the Middle District of Florida recently held that a release provision of a settlement agreement between a new motor vehicle franchisor and a franchised dealer, in which the dealer released the franchisor from liability for any act committed by the franchisor with respect to its dealership prior to the date of the agreement, was not void as a matter of public policy.[110] The court explained, "The Florida legislature . . . has set forth . . . specifically its policy concerning releases relating to motor vehicle dealerships in Section 320.64(20) of the Florida Statutes. This provision prohibits, in a franchise agreement, the prospective release of claims concerning violations of the DPA."[111] The court found that as the release did not apply prospectively, it did not "run afoul" of § 320.64(20), so the court did not hold the release invalid as contrary to public policy.[112]

Similarly, in *Lee v. GNC Franchising, Inc.*, the Ninth Circuit held that a release executed by a franchisee in consideration of a renewal was not unconscionable or in violation of California public policy because the release did not purport to absolve the franchisor of future liability for fraud or other intentional wrongs.[113] Likewise, the First Circuit, in *Rochester Ford Sales, Inc. v. Ford Motor Co.*, was called upon to construe Michigan and New Hampshire law and enforced a release that was not "prospective" or "mandatory" but rather was executed in accordance with the terms of the original dealership agreement, much like in the other cases involving Ford Motor Company discussed in this article.[114] The court held that the release here was not a "prospective release" and therefore did not violate Michigan's Dealer-Agreement Statute;[115] furthermore, it was not "mandatory" and therefore was not prohibited by New Hampshire's Vehicle Manufacturers, Distributors and Dealers Act.[116] The release was given in exchange for Ford's approval of a transfer of the dealership and repurchase of parts in the dealership's inventory.[117] The dealership was free to refuse the repurchase and assignment option and retain its right to sue Ford Motor Company but chose otherwise.[118]

In *Edwards v. Kia Motors of America, Inc.*, the Alabama Supreme Court answered a question regarding releases certified to it by the Eleventh Circuit upholding the validity of a retrospective release based on the Alabama Motor Vehicle Franchise Act.[119] In that case, plaintiff dealer sought to sell his dealership. Pursuant to his dealership agreement with Kia, the dealer was required to secure Kia's approval of the transfer.[120] Kia required the dealer to execute a mutual release agreement as a condition of its approval of the sale, which provided in relevant part that the parties agreed to release, acquit and forever discharge one another of and from all claims which have arisen or may ever arise, demands and causes of action arising from, related to, or in any manner connected with the sale and service of Kia Products, including, without limitation, the Dealer Agreement, and from any and all claims for damages, related to or in any manner connected with the Dealer Agreement or the parties' business relationship.[121]

After executing the release and selling the dealership, the dealer brought an action alleging that Kia violated Alabama's Motor Vehicle Franchise Act and engaged in other wrongful acts.[122] Faced with the release, the Eleventh Circuit certified the following question to the Alabama Supreme Court: "[Does] the Franchise Act permit[] an automobile dealer to bring a claim under the Act, despite the fact that both parties already executed a mutual release agreement in which the dealer relinquished all existing legal claims against the manufacturer in exchange for valid consideration[?]"[123] The state supreme court answered the question in the negative.

At least one decision has upheld a prospective release where adequate consideration was given and the release terms were ambiguous.

The Alabama Motor Vehicle Franchise Act provides in relevant part:

Notwithstanding the terms, provisions, or conditions of any dealer agreement or franchise or the terms or provisions of any waiver, and notwithstanding any other legal remedies available, any person who is injured in his business or property by a violation of this chapter by the commission of any unfair and deceptive trade practices, or because he refuses to accede to a proposal for an arrangement which, if consummated, would be in violation of this chapter, may bring a civil action in a court of competent jurisdiction in this state to enjoin further violations, to recover the damages sustained by him together with the costs of the suit, including a reasonable attorney's fee.[124]

Therefore, the state court found the dispositive issue before it to be whether the legislature intended the term *any waiver* to apply to the type of mutual release agreement required by *Kia*,

in other words, whether the legislature intended § 8-20-11 [of the Motor Vehicle Franchise Act] to apply so broadly as to preclude parties subject to [the Motor Vehicle Franchise Act] from reaching any form of binding agreement by which then existing, ripe claims could be mutually settled without resort to judicial determination of the claim.[125]

In concluding it did not, the court considered the purpose of the Motor Vehicle Franchise Act, which, it stated, "is to protect the state's citizens from abuses by motor vehicle manufacturers and dealers, and, to that end, to regulate manufacturers and dealers and the dealings between manufacturers and their dealers."[126] "If the legislature had wished to include the settlement and release of known claims in the language of § 8-20-11," the court noted, "it knew how to do so."[127] The court explained that "[t]he legislature lists prospective releases and waivers in describing specific unfair trade practices under the Franchise Act. . . . The legislature did not similarly include a retrospective release as an unfair trade practice or include such a release in its list of ineffective provisions in § 8-20-11."[128] Thus, the remedial purpose of the Motor Vehicle Franchise Act prohibited the dealer, having released Kia from such claims, from bringing his action against Kia.

Despite the public policy issues that underscore the prohibitions on prospective releases in this context, at least one case has upheld a prospective release of a franchisor by a franchisee where adequate consideration was given and the terms of the release were unambiguous. Under Louisiana law, the Eastern District of Louisiana held that an unambiguous provision in an assignment agreement releasing a franchisor from future claims by its franchisee, following assignment of franchise rights to a third party, was valid and supported by adequate consideration despite the franchisee's claim that the franchisor unreasonably withheld consent to transfer by requiring the franchisee to sign the release.[129] The release in that case provided:

Assignor hereby forever relinquishes all rights, interests and claims of whatever nature to, in or under the Development Agreement and Franchise Agreements, the purchase thereof and the relationships created thereby, and does hereby forever discharge and release Franchisor, its predecessors, its successors, and its present and former officers, directors, agents and employees from any and all claims, causes of action, obligations and liabilities arising from, under or out of the Development Agreement and Franchise Agreements prior to the effective date hereof, and further does hereby generally release all said parties from all manner of action(s), cause(s) of action, suits, damages, judgments, executions, claims and demands whatsoever in law or in equity which Assignor ever had, now has or may hereafter have, known or unknown, arising out of, under, from or in connection with the Development Agreement and Franchise Agreements, the purchase thereof, the relationships created thereby, or any other act or occurrence of any kind whatsoever.[130]

CONCLUSION

Although many of the release regulations are borne from the idea that a franchisee must be protected from a more powerful franchisor, the protection is not absolute. Statutes vary in how they limit the scope of acceptable releases. As the cases discussed above demonstrate, concepts of mutuality, good faith, and adequate consideration generally will support the validity of a general release, particularly where it is retrospective in nature.

ENDNOTES

1. 16 U.S.C. § 436.9 (Mar. 30, 2007).

2. The focus of this article is on releases and release language and specifically does not analyze federal arbitration act preemption issues that arise in connection with no-waiver statutes. For a discussion regarding whether integration clauses and choice-of-law provisions violate no-waiver statutes, see W. Michael Garner, 2 Franchise & Distribution Law & Practice § 10:46.

3. See table accompanying this article: Ark. Code Ann. § 4-72-206; Cal. Bus. & Prof. Code § 20010; Conn. Gen. Stat. §§ 42-133f, 42-133l; D.C. Code § 36-303.01; Haw. Code R. § 482E-6; Mo. Ann. Stat. §§ 407.825, 407.1034; Neb. Rev. Stat. § 87-406; N.J. Stat. Ann. § 56:10-7; Ohio Rev. Code Ann. § 1334.06; Pa. Cons. Stat. § 202.4.

4. See accompanying table: Ark. Code Ann. § 4-72-206; Conn. Gen. Stat. § 42-133l; Mo. Ann. Stat. §§ 407.825, 407.1034; Neb. Rev. Stat. § 87-406; N.J. Stat. Ann. § 56:10-7; Pa. Cons. Stat. § 202-4.

5. See accompanying table: Georgia Motor Vehicle Franchise Practices Act, Ga. Code Ann. § 10-1-623 (June 4, 2010); Ga. Code Ann. § 10-1-627 (June 4, 2010); Illinois Franchise Disclosure Act of 1987, Ill. Comp. Stat. 705/41; Louisiana Motor Vehicle Commission Law, La. Rev. Stat. Ann. § 32:1261; Massachusetts Equipment Dealers Law, Mass. Gen. Laws ch. 93G, § 10; Michigan Franchise Investment Law, Mich. Comp. Laws § 445.1527; Missouri Motorcycle and All-Terrain Vehicle Franchise Practices Act, Mo. Ann. Stat. § 407.1034; Nebraska Beer Distribution Law, Neb. Rev. Stat. § 53-221; New York Franchised Motor Vehicle Dealer Act, N.Y. Veh. & Traf. Law § 463; Rhode Island Franchise Investment Act, R.I. Gen. Laws § 19-28.1-15; Tennessee Franchise Terminations, Nonrenewals or Modifications Law, Tenn. Code Ann. § 47-25-1507; Vermont Machinery Dealerships Law, Vt. Stat. Ann. tit. 9, § 4080; Virginia Motor Vehicle Dealers Act, Va. Code Ann. § 46.2-1572.3 (Apr. 8, 2010); Washington Franchise Investment Protection Act, Wash. Rev. Code Ann. § 19.100.220; Wisconsin Motor Vehicle Dealers Law, Wis. Stat. Ann. § 218.0133; Wyoming Relations Between Malt Beverage Distributors and Manufacturers Act, Wyo. Stat. Ann. § 12-9-104.

6. Ala. Code § 8-20-4; Ark. Code Ann. § 4-72-206; D.C. Code § 36-310.01; Fla. Stat. §§ 686.413, 686.611; Haw. Code R. § 482E-1; Ind. Code § 23-2-2.7-1; Md. Code Ann. § 14-226; Mich. Comp. Laws § 445.1527; Neb. Rev. Stat. § 87-406; N.H. Rev. Stat. Ann. § 339-C:8; N.J. Stat. Ann. § 56:10-7; N.Y. Gen. Bus. Law § 687; Okla. Stat. Ann. tit. 15, § 245A; Or. Rev. Stat. § 650.210; Tenn. Code Ann. § 47-25-1510; Wash. Rev. Code Ann. § 19.100.180; Wyo. Stat. Ann. § 12-9-104.

7. Utah Code Ann. §§ 13-14-201, 13-35-201.

8. Ga. Code Ann. § 10-1-662(a)(6) (June 4, 2010).

9. *Compare* Ga. Code Ann. § 13-8-15(c)(10), *with* Ga. Code Ann. § 10-1-662 (June 4, 2010).

10. Ill. Comp. Stat. Ann. 705/41.

11. S.D. Codified Laws § 37-5-12.

12. Iowa Code § 523H.5.

13. Minn. Stat. § 80F.11.

14. *Id.*

15. La. Rev. Stat. Ann. § 32:1261.

16. 15 U.S.C. § 2805 (2010).

17. Va. Code Ann. § 59.1-21.11.

18. *See* Hall v. Burger King Corp., 912 F. Supp. 1509 (S.D. Fla. 1995).

19. Ramada Franchise Sys., Inc. v. Capitol View II Ltd. P'ship Venture, 132 F. Supp. 2d 358 (D. Md. 2001).

20. *Id.*

21. W. Chance #2, Inc. v. KFC Corp., 957 F.2d 1538 (9th Cir. 1992).

22. *Id.* at 1543.

23. N.D. Cent. Code § 39-22-01 et seq.

24. Bayshore Ford Truck v. Ford Motor Co., No. 99-741, 2009 WL 3817930 (D.N.J. Nov. 16, 2009) (quoting First Nat'l Bank & Trust Co. v. Scherr*,* 435 N.W.2d 704, 706 (N.D. 1989)).

25. *Id.* at *11.

26. *Id.*

27. *Id.* at *8.

28. *Id.* at *1.

29. *Id.* at *7.

30. *Id.* at *8.

31. *Id.*

32. *Id.* at *10.

33. *Id.*

34. *In re* W. Coast Video Enters., Inc., 174 B.R. 906, 913 (E.D. Pa. 1994) (reopening case to determine rights of former franchisees of debtor and holding that the franchisees were unknown creditors and the releases of nondebtors included in the reorganization plan could not be enforced against them).

35. *Id.*

36. Brief of Appellees, Williams v. Stone, No. 96-1433, 1996 WL 3341447, at *6 (3d Cir. Sept. 20, 1996).

37. *W. Coast Video*, 174 B.R. at 913.

38. *Id.*

39. Williams v. Stone, 923 F. Supp. 689 (E.D. Pa. 1996), *aff'd,* 109 F.3d 890 (3d Cir. 1997).

40. Md. Code Ann. § 14-226.

41. 923 F. Supp. at 692–93.

42. *Id.*

43. 109 F.3d at 894.

44. *Id.* at 894.

45. Franchise Mgmt. Unltd., Inc. v. Am.'s Favorite Chicken, 561 N.W.2d 123 (Mich. Ct. App. 1997), *appeal granted*, 577 N.W.2d 690 (1998), *vacated and leave to appeal denied*, 590 N.W.2d 570, *reconsideration denied*, 595 N.W.2d 843 (1999).

46. Mich. Comp. Laws § 445.1527.

47. *Franchise Mgmt.*, 561 N.W.2d at 126.

48. *Id*.

49. *Id*.

50. *Id.* at 247–48. For a discussion and comparison of releases construed under Michigan law that are limited to claims relating to the surrender of a franchise and therefore not general releases of liability between franchisor and franchisee, and releases that apply to all claims, both known and unknown, and therefore a general

release that applies to all conduct between the parties, see *Pinnacle Pizza Co., Inc. v. Little Caesar Enterprises, Inc*., 560 F. Supp. 2d 786 (D.S.D. 2008).

51. N.Y. Gen. Bus. Law § 687.

52. *Id.* The Washington Franchise Investment Protection Act does the same. Wash. Rev. Code Ann. § 19.100.180. In these statutes, and others like them, the word *require* seems critical: parties who enter voluntarily into settlement agreements or releases under other conditions for valuable consideration are unlikely to be deemed to have been required to assent to a release. However, it is noteworthy that when enacting the New York Franchised Motor Vehicle Dealer Act statute with a virtually identical prohibition, the New York legislature added the following language: ". . . provided that this paragraph shall not be construed to prevent a franchised motor vehicle dealer from entering into a valid release or settlement agreement with a franchisor." N.Y. Veh. & Traf. Law § 463. Furthermore, the Washington legislature expressly permitted releases as part of a negotiated settlement in connection with a bona fide dispute, arising after the franchise agreement has taken effect, in which the person giving the release is represented by counsel. Wash. Rev. Code Ann. § 19.100.220.

53. A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc., 618 N.Y.S.2d 155 (Sup. Ct. 1994).

54. *Id.* at 158.

55. *Id.* at 159.

56. *Id.* at 162.

57. 471 F. Supp. 2d 951 (E.D. Ark. 2006).

58. Ark. Code Ann. § 4-72-206.

59. *Id.* § 4-72-206.

60. Neb. Rev. Stat. § 87-406.

61. N.J. Stat. Ann. § 56:10-7.

62. Haw. Code R. § 482E-6.

63. Conn. Gen. Stat. § 42-133l.

64. Mo. Ann. Stat. §§ 407.825, 407.1034.

65. Pa. Cons. Stat. § 202-4.

66. N.D. Cent. Code § 51-19-16(7).

67. *See* Ill. Comp. Stat. 705/41; Minn. Stat. § 80C.21; Wis. Stat. Ann. § 553.76.

68. Ala. Code § 8-20-4 (2010).

69. Iowa Code § 523H.4.

70. *Id.* § 523H.5.

71. *See* Mich. Comp. Laws § 445.1527; Miss. Code Ann. § 75-77-19; Mont. Code Ann. § 16-3-221; Neb. Rev. Stat. § 53-221; Nev. Rev. Stat. § 482.3638; N.H. Rev. Stat. Ann. § 339-C:8; N.Y. Gen. Bus. Law § 687; N.C. Gen. Stat. § 20-308.22; R.I. Gen. Laws § 6-46-11; S.D. Codified Laws § 37-5-12; Tenn. Code Ann. § 47-25-1507; Vt. Stat. Ann. tit. 9, § 4080; Wash. Rev. Code Ann. § 19.100.180; Wyo. Stat. Ann. § 31-16-108.

72. Mich. Comp. Laws § 445.1527.

73. Williams v. Stone, 923 F. Supp. 689, 692–93 (E.D. Pa. 1996).

74. *Compare* Gruver v. Midas Int'l Corp., 925 F.2d 280 (9th Cir. 1991) (holding that where franchisees knew of potentially successful claim for misrepresentation but nevertheless executed releases in favor of franchisor in connection with satisfaction of debts owed to franchisor, there was no economic duress), *with* Eulrich v. Snap-On Tools Corp., 853 P.2d 1350 (Or. Ct. App. 1993), *cert. granted, judgment vacated*, 512 U.S. 1231, 114 S. Ct. 2731 (1994) (holding that where a franchisor insisted on a release in connection with the repurchase of franchisee's inventory when franchisee was in financial distress, it was not error for a jury to find economic duress that voided release); *accord* Dupage Forklift Serv., Inc. v. Mach. Distrib., Inc., No. 94 C 7357, 1995 WL 623093 (N.D. Ill. Oct. 20, 1995).

75. 442 S.E.2d 611 (S.C. 1994).

76. S.C. Code Ann. § 56-15-40.

77. Hyman v. Ford Motor Co., 142 F. Supp. 2d 735 (D.S.C. 2001).

78. *Id.* at 743.

79. *Id.* at 740.

80. *Id.* at 743.

81. *Id.* at 745–46.

82. *Id.* at 746.

83. *Id.* at 748–49.

84. Sabe Staino Motors, Inc. v. Volkswagen of Am., Inc., No. Civ.A.99-5034, 2005 WL 1041196 (E.D. Pa. Apr. 29, 2005).

85. *Id.* at *8.

86. *Id.*

87. *Id.*

88. *See* Wells v. Entre Computer Ctrs., Inc., 915 F.2d 1566 (4th Cir. 1990) (holding that under Texas law, general releases executed by franchisees at the time they transferred rights under various franchise agreements were valid and effective; the last release each franchisee signed coincided with the termination of that franchisee's relationship with the franchisor, and all of the franchisees' claims were covered by the releases, which the franchisees entered into voluntarily and in accordance with the provisions of their original franchise agreements); *accord* Brock v. Entre Computer Ctrs., Inc., 933 F.2d 1253 (4th Cir. 1991) (applying Virginia law and reaching same result); Blockbuster, Inc. v. C-Span Entm't, Inc., 276 S.W.3d 482 (Tex. 2008) (entering judgment in favor of franchisor, holding that under Texas law a general release executed in connection with the transfer of franchises from the individual franchisee to the individual's corporation did not lack consideration where the agreements contained recitations of consideration and franchisor's consent to the transfer was only effective upon execution of documents including the release; the claims raised by the franchisee fell within the scope of the release because the release applied to claims under the agreements at issue (federal, state, or local law), and the franchisee's breach of contract and fraudulent inducement claims arose under state law).

89. GNC Franchising, LLC v. Farid, No. 2:05-cv-1741, 2007 WL 1437443 (W.D. Pa. May 14, 2007).

90. Mem. Supp. of Plaintiff's Motion Summary Judgment, GNC Franchising, LLC v. Farid, 2007 WL 4782622 (W.D. Pa. Mar. 15, 2007).

91. *Farid*, 2007 WL 1437443, at *3.

92. Alabama Motor Vehicle Franchise Act, Ala. Code § 8-20-4; Connecticut Motor Vehicle Dealer's Act, Conn. Gen. Stat. § 42-133bb; Florida Automobile Dealer's Act, Fla. Stat. § 320.64; Idaho Dealers and Salesmen Licensing Act, Idaho Code Ann. § 49-1613; Maine Motor Vehicle Dealers Act and Maine Personal Sports Mobile Business Practices Act, Me. Rev. Stat. Ann. tit. 10, §§ 1174, 1243; Michigan Dealer-Agreement Statute, Mich. Comp. Laws § 445.1573; Minnesota Motor Vehicle Sales and Distribution Regulations, Minn. Stat. § 80E.12 (May 13, 2010); Nebraska Motor Vehicle Industry Relation Act, Neb. Rev. Stat. § 60-1436; North Carolina Motor Vehicle Dealers and Manufacturers Licensing Law,

N.C. Gen. Stat. § 20-305; Tennessee Motor Vehicle Sales Licensing Act, Tenn. Code Ann. § 55-17-114.

93. Colo. Rev. Stat. §§ 12-6-120, 12-6-501.

94. Del. Code Ann. tit. 6, § 4913.

95. *Id.* § 4914.

96. Ga. Code Ann. § 10-1-662(a)(6) (June 4, 2010).

97. La. Rev. Stat. Ann. § 32:1261.

98. Mass. Gen. Laws ch. 93B, § 4.

99. Illinois Motor Vehicle Franchise Act, Ill. Comp. Stat. 710/4; Nevada Franchises for Sales of Motor Vehicles Act, Nev. Rev. Stat. § 482.3638; New Hampshire Regulation of Business Practices Between Motor Vehicle Manufacturers, Distributors and Dealers Act, N.H. Rev. Stat. Ann. § 357-C:3; New Mexico Motor Vehicle Dealers Franchising Act, N.M. Stat. § 57-16-5; New York Franchised Motor Vehicle Dealer Act, N.Y. Veh. & Traf. Law § 463; South Carolina Regulation of Manufacturers, Distributors and Dealers Act, S.C. Code Ann. § 56-15-40; Vermont Motor Vehicle Manufacturers, Distributors, and Dealers Franchising Practices Act, Vt. Stat Ann. tit. 9, § 4096.

100. N.Y. Veh. & Traf. Law § 463.

101. Ind. Code § 23-2-2.7-1.

102. Tenn. Code Ann. § 47-25-1510.

103. Cal. Corp. Code § 31125.

104. 756 F. Supp. 543 (S.D. Fla. 1991), *overruled on other grounds by* Burger King Corp. v. Weaver, 169 F.3d 1310 (11th Cir. 1999).

105. 756 F. Supp. at 546, n.3.

106. *Id.* at 547, n.4.

107. *Id.* (quoting Sottile v. Gaines Constr. Co., 281 So. 2d 558, 561 (Fla. Dist. Ct. App. 1973), *cert. denied*, 289 So. 2d 737 (Fla. 1974).

108. *Id.*

109. *Id.* at 547.

110. Action Nissan, Inc. v. Hyundai Motor Am., 617 F. Supp. 2d 1177 (M.D. Fla. 2008). The release provision at issue provided: "[Plaintiff] and its Shareholders hereby release, acquit, and agree not to sue [Defendant] for any act committed by [Defendant] with respect to its Hyundai dealership prior to the date of this Agreement." *Id.* at 1185.

111. *Id.* at 1189.

112. *Id.*

113. 73 F. App'x 202 (9th Cir. 2003).

114. 287 F.3d 32, 35–36 (1st Cir. 2002); *see also* Hyman v. Ford Motor Co., 142 F. Supp. 2d 735 (D.S.C. 2001).

115. *Rochester Ford Sales*, 287 F.3d at 41.

116. *Id.* at 41, n.5.

117. *See id.* at 35–36.

118. *Id.* at 41, n.5.

119. 8 So. 3d 277 (Ala. 2008).

120. *Id.* at 278.

121. *Id.*

122. *Id.* at 279.

123. *Id.* at 278–79.

124. *Id.* at 283–84.

125. *Id.* at 280.

126. *Id.* at 282 (quoting Sutherlin Toyota, Inc. v. Toyota Motor Sales USA, Inc., 549 So. 2d 460, 461 (1989)).

127. *Id.*

128. *Id.*

129. Am.'s Favorite Chicken Co. v. Suryoutomo, 889 F. Supp. 916 (E.D. La. 1995).

130. *Id.* at 918.

SELECTED RELEASE LANGUAGE

State	Notable Language	Other Release Language[1]
Alabama	It shall be a violation of this chapter for a supplier to do any of the following: (9) To require the dealer to agree to a release, agreement, waiver, or any other modification that would relieve supplier or dealer from liability imposed by this chapter. Alabama Tractor, Lawn and Garden and Light Industrial Equipment Franchise Act a/k/a Equipment Franchise Act, Ala. Code § 8-21A-3.	• Alabama Tractor, Lawn and Garden and Light Industrial Equipment Franchise Act a/k/a Equipment Franchise Act, Ala. Code § 8-21A-12. • Alabama Motor Vehicle Franchise Act, Ala. Code § 8-20-4 (2010); Ala. Code § 8-20-5; Ala. Code § 8-20-11.
Alaska	The terms and conditions in an agreement between a manufacturer and a new motor vehicle dealer in this state, including a motor vehicle franchise agreement, that are inconsistent with the law of this state do not have any force or effect in this state. Alaska Motor Vehicle Transactions Act, Alaska Stat. § 45.25.100.	

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
Arizona	A. In the event of any termination, cancellation or failure to renew, whether by mutual agreement or otherwise, a distributor shall make or cause to be made a good faith offer to repurchase from the dealer, his heirs, successors and assigns, at the current wholesale prices, any and all merchantable products purchased by such dealer from the distributor, provided that the distributor shall have the right to apply the proceeds against any existing indebtedness owed to him by the dealer and that such repurchase obligation is conditioned upon there being no other claims or liens against such products by or on behalf of other creditors of the dealer. Such repurchase shall not constitute a waiver of the dealer's other rights and remedies under this article. Arizona Petroleum Products Franchise Act, ARIZ. REV. STAT. § 44-1558.	
Arkansas	It shall be a violation of this subchapter for any franchisor, through any officer, agent, or employee to engage directly or indirectly in any of the following practices: (1) To require a franchisee at the time of entering into a franchise arrangement to assent to a release, assignment, novation, waiver, or estoppel which would relieve any person from liability imposed by this subchapter. Arkansas Franchise Practices Act, ARK. CODE ANN. § 4-72-206.	
California	(c) Any modification of a franchise agreement with an existing franchisee of a franchisor shall be exempted from the provisions of this chapter, if all of the following are met . . . provided (A) the agreement is not executed within 12 months after the date of the franchise agreement, and (B) the modification does not waive any right of the franchisee under the California Franchise Relations Act (Chapter 5.5 (commencing with Section 20000) of Division 8 of the Business and Professions Code), but the modification may include a general release of all known and unknown claims by a party to the modification. California Franchise Investment Law, CAL. CORP. CODE § 31125.	• California Franchise Relations Act, CAL. BUS. & PROF. CODE § 20010. • California Motor Vehicle Dealers Act, CAL. VEH. CODE § 11713.3.
Colorado	(1) It shall be unlawful and a violation of this part 1 for any manufacturer, distributor, or manufacturer representative: (o) To require, coerce, or attempt to coerce any motor vehicle dealer to prospectively agree to a release, assignment, novation, waiver, or estoppel that would relieve any person of a duty or liability imposed under this article except in settlement of a bona fide dispute. Colorado Automobile Dealers Act, COLO. REV. STAT. § 12-6-120.	• Colorado Powersports Vehicle Dealers Act, COLO. REV. STAT. § 12-6-523.
Connecticut	(f) No franchisor, directly or indirectly, through any officer, agent or employee, shall do any of the following: (1) Require a franchisee at the time of entering into an agreement to assent to a release, assignment, novation, waiver, or estoppel which would relieve any person from liability imposed by sections 42-133j to 42-133n, inclusive. Connecticut Gasoline Dealer's Act, CONN. GEN. STAT. § 42-133l.	• Connecticut Franchise Act, CONN. GEN. STAT. § 42-133f. • Connecticut Motor Vehicle Dealer's Act, CONN. GEN. STAT. § 42-133v; CONN. GEN. STAT. § 42-133bb; CONN. GEN. STAT. § 42-133ee.

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language[1]**
Delaware	(b) This chapter shall not preclude dealers, manufacturers or distributors from entering into valid releases or settlement agreements consistent with the policy of this chapter. In no case shall a general release required to be executed as a condition to renewal of a franchise agreement be deemed to be consistent with the policy of this chapter. Delaware Motor Vehicle Franchising Practices Act, DEL. CODE ANN. tit. 6, § 4914.	• Delaware Motor Vehicle Franchising Practices Act, DEL. CODE ANN. tit. 6, § 4906; DEL. CODE ANN. tit. 6, § 4913; DEL. CODE ANN. tit. 6, § 4916.
District of Columbia	(a) All marketing agreements shall be in writing and shall be subject to the nonwaiverable conditions set forth in this section, whether or not such conditions are expressly set forth in such marketing agreements. For the purposes of this section, the term "marketing agreement" shall also include any oral or written collateral or ancillary agreement. No marketing agreement shall: (9) Contain any provision which requires the retail dealer to assent to any release, assignment, novation, waiver, or estoppel which would relieve any person from any liability imposed by this subchapter or would negate any rights granted to a retail dealer by this subchapter. District of Columbia Retail Service Stations Act, D.C. CODE § 36-303.01.	
Florida	Unfair methods of competition and unfair or deceptive acts or practices in the conduct of the manufacturing, distribution, wholesaling, franchising, sale, and advertising of equipment are declared to be unlawful. (3) It is deemed a violation of this section for a manufacturer, factory branch or division, distributor, distributor branch or division, wholesaler, or wholesale branch or division, or officer, agent, or other representative thereof: (l) To require a dealer to assent to a release, assignment, novation, waiver, or estoppel which would relieve any person from liability imposed by ss. 686.40-686.418. Florida Agricultural Machinery and Equipment Franchise Act a/k/a Sales, Distribution, and Franchise Relationships Act, FLA. STAT. § 686.413.	• Florida Automobile Dealer's Act a/k/a Florida's Dealer Protection Act, FLA. STAT. § 320.64. • Florida Agricultural Machinery and Equipment Franchise Act a/k/a Sales, Distribution, and Franchise Relationships Act, FLA. STAT. § 686.611.
Georgia	(c) It shall be deemed a violation of Code Section 13-8-14 for a manufacturer, a distributor, a wholesaler, a distributor branch or division, a factory branch or division, or a wholesale branch or division, or officer, agent, or other representative thereof: (10) To require a dealer to assent to a release, assignment, novation, waiver, or estoppel which would relieve any person from liability imposed by this article. Georgia Regulation of Agricultural Equipment Manufacturers, Distributors, and Dealers Act, GA. CODE § 13-8-15.	• Georgia Motor Vehicle Franchise Practices Act, GA. CODE § 10-1-623; GA. CODE § 10-1-624; GA. CODE. § 10-1-627 (June 4, 2010). • Georgia Motor Vehicle Franchise Continuation and Succession Act, GA. CODE § 10-1-651 (June 4, 2010). • Georgia Motor Vehicle Fair Practices Act, GA. CODE § 10-1-662 (June 4, 2010). • Georgia Sale of Recreational Vehicles Act, GA. CODE § 10-1-679.1. • Georgia Retail Petroleum Product Dealers Act, GA. CODE § 10-1-721.

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
Hawaii	Without limiting the other provisions of this chapter, the following specific rights and prohibitions shall govern the relation between the franchisor or subfranchisor and its franchisees: (2) For the purposes of this chapter and without limiting its general application, it shall be an unfair or deceptive act or practice or an unfair method of competition for a franchisor or subfranchisor to: (F) Require a franchisee at the time of entering into a franchise to assent to a release, assignment, novation, or waiver which would relieve any person from liability imposed by this chapter. Any condition, stipulation or provision binding any person acquiring any franchise to waive compliance with any provision of this chapter or a rule promulgated hereunder shall be void. This paragraph shall not bar or affect the settlement of disputes, claims or civil suits arising or brought under this chapter. Hawaii Franchise Investment Law, Haw. Code § 482E-6.	
Idaho	(2) It shall be unlawful for any manufacturer licensed under this chapter to require, attempt to require, coerce, or attempt to coerce, any new vehicle dealer in this state to: (g) Prospectively assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability to be imposed by this chapter or to require any controversy between a dealer and a manufacturer, distributor, or representatives, to be referred to any person other than the duly constituted courts of the state or the United States, or to the director, if that referral would be binding upon the dealer. Idaho Motor Vehicles Dealers and Salesmen Licensing Act, Idaho Code § 49-1613.	
Illinois	§ 20. Nonrenewal of a franchise. It shall be a violation of this Act for a franchisor to refuse to renew a franchise of a franchised business located in this State without compensating the franchisee either by repurchase or by other means for the diminution in the value of the franchised business caused by the expiration of the franchise where: (a) the franchisee is barred by the franchise agreement (or by the refusal of the franchisor at least 6 months prior to the expiration date of the franchise to waive any portion of the franchise agreement which prohibits the franchisee) from continuing to conduct substantially the same business under another trademark, service mark, trade name or commercial symbol in the same area subsequent to the expiration of the franchise; or (b) the franchisee has not been sent notice of the franchisor's intent not to renew the franchise at least 6 months prior to the expiration date or any extension thereof of the franchise. Illinois Franchise Disclosure Act of 1987, 815 Ill. Comp. Stat. 705/20.	• Illinois Franchise Disclosure Act of 1987, Ill. Comp. Stat. 705/26; Ill. Comp. Stat. 705/41. • Illinois Motor Vehicle Franchise Act, 815 Ill. Comp. Stat. 710/4. • Illinois Equipment Fair Dealership Law, 815 Ill. Comp. Stat. 175/10.
Indiana	§ 1. It is unlawful for any franchise agreement entered into between any franchisor and a franchisee who is either a resident of Indiana or a nonresident who will be operating a franchise in Indiana to contain any of the following provisions: (5) Requiring the franchisee to prospectively assent to a release, assignment, novation, waiver, or estoppel which purports to relieve any person from liability to be imposed by this chapter or requiring any controversy between the franchisee and the franchisor to be referred to any person, if referral would be binding on the franchisee. This subdivision does not apply to arbitration before an independent arbitrator. Indiana Deceptive Franchise Practices Act, Ind. Code § 23-2-2.7-1.	

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
Iowa	9. A franchisor, as a condition to a transfer of a franchise, shall not obligate a franchisee to undertake obligations or relinquish any rights unrelated to the franchise proposed to be transferred, or to enter into a release of claims broader than a similar release of claims by the franchisor against the franchisee which is entered into by the franchisor. Iowa Franchise Act, IOWA CODE § 523H.5.	• Iowa Franchise Act, IOWA CODE § 523H.4. • Iowa Motor Vehicle Franchisers, IOWA CODE § 322A.21 (Mar. 22, 2010) (text subject to final changes). • Iowa Equipment Dealership Agreements, IOWA CODE § 322F.9. • Iowa Motor Fuel and Special Fuel, IOWA CODE § 323.13.
Kansas	Any term of a dealership agreement, either expressed or implied, which is inconsistent with the terms of this act shall be void and unenforceable and shall not waive any rights which are provided to any person by this act. Kansas Agricultural Equipment Dealership Act, KAN. STAT. § 16-1206.	
Kentucky	(1) It shall be a violation of this section for any manufacturer, distributor, factory branch, or factory representative licensed under this chapter to require any new motor vehicle dealer in the Commonwealth: (i) To prospectively assent to a release, assignment, novation, waiver, or estoppel which would relieve any person from liability to be imposed by this law, or to require any controversy between a dealer and a manufacturer, distributor, or representative, to be referred to any person other than the duly constituted courts of the Commonwealth or the United States of America, or to the commissioner, if the referral would be binding upon the dealer. Kentucky Motor Vehicle Sales Act, KY. REV. STAT. ANN. § 190.070.	• Kentucky Motor Vehicle Sales Act, KY. REV. STAT. ANN. § 190.045; KY. REV. STAT. § 190.062.
Louisiana	It shall be a violation of this Chapter: (iv) To assent to a release, assignment, novation, waiver, or estoppel which would relieve any person from liability to be imposed by law, unless done in connection with a settlement agreement to resolve a matter pending a commission hearing or pending litigation between a manufacturer, distributor, wholesaler, distributor branch or factory branch, or officer, agent, or other representative thereof. Louisiana Motor Vehicle Commission Law, LA. REV. STAT. § 32:1261.	• Louisiana Motor Vehicle Commission Law, LA. REV. STAT. § 32:1261(v).
Maine	The following acts are unfair methods of competition and unfair and deceptive practices. It is unlawful for any: Manufacturer or an officer, agent or other representative of a manufacturer: To require a personal sports mobile dealer to assent to a release assignment, novation, waiver or estoppel that would relieve any person from liability imposed by this chapter. Maine Personal Sports Mobile Business Practices Act, ME. REV. STAT. tit. 10, § 1243.	• Maine Motor Vehicle Dealers Act, ME. REV. STAT. tit. 10. § 1174. • Maine Franchise Laws for Power Equipment, Machinery and Appliances, ME. REV. STAT. tit. 10, § 1363. • Maine Motor Fuel Distribution and Sales Act, ME. REV. STAT. tit. 10, § 1454.
Maryland	As a condition of the sale of a franchise, a franchisor may not require a prospective franchisee to agree to a release, assignment, novation, waiver, or estoppel that would relieve a person from liability under this subtitle. Maryland Franchise Registration and Disclosure Law, MD. CODE ANN., BUS. REG. § 14-226.	

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
Massachusetts	(c) It shall be deemed a violation of subsection (a) of section 3 for a manufacturer, distributor or franchisor representative: (11) to coerce a motor vehicle dealer to assent to a release, assignment, novation, waiver or estoppel which would prospectively relieve any person from liability imposed by this chapter. Massachusetts Automobile Dealer's Bill of Rights Statute, Mass. Gen. Laws ch. 93B § 4.	• Massachusetts Petroleum Products Marketing Act, Mass. Gen. Laws ch. 93E, § 4A. • Massachusetts Equipment Dealers Law, Mass. Gen. Laws ch. 93G, § 10.
Michigan	§ 27. Each of the following provisions is void and unenforceable if contained in any documents relating to a franchise: (b) A requirement that a franchisee assent to a release, assignment, novation, waiver, or estoppel which deprives a franchisee of rights and protections provided in this act. This shall not preclude a franchisee, after entering into a franchise agreement, from settling any and all claims. Michigan Franchise Investment Law, Mich. Comp. Laws § 445.1527.	• Michigan Farm and Utility Equipment Act, Mich. Comp. Laws § 445.1457. • Michigan Dealer-Agreement Statute, Mich. Comp. Laws § 445.1573. • Michigan Recreational Vehicle Franchise Act, Mich. Comp. Laws § 445.1945.
Minnesota	It shall be unlawful for any manufacturer, distributor, or factory branch to require a new motor vehicle dealer to do any of the following: (j) prospectively assent to a release, assignment, novation, waiver, or estoppel whereby a dealer relinquishes any rights under sections 80E.01 to 80E.17, or which would relieve any person from liability imposed by sections 80E.01 to 80E.17 or to require any controversy between a new motor vehicle dealer and a manufacturer, distributor, or factory branch to be referred to any person or tribunal other than the duly constituted courts of this state or the United States, if the referral would be binding upon the new motor vehicle dealer. Minnesota Motor Vehicle Sales and Distribution Regulations, Minn. Stat. § 80E.12 (2010).	• Minnesota Franchise Act, Minn. Stat. § 80C.21. • Minnesota Motor Vehicle Sales and Distribution Regulations, Minn. Stat. § 80E.06; Minn. Stat. § 80E.08; Minn. Stat. § 80E.17; Minn. Stat. § 80E.135 (May 13, 2010). • Minnesota Motor Vehicle Fuel Franchise Act, Minn. Stat. § 80F.11. • Minnesota Agricultural Machinery Dealership Law, Minn. Stat. § 325E.064.
Mississippi	(3) Notwithstanding any provision in a franchise agreement to the contrary, any requirement that a dealer waive its right to a trial by jury is void and unenforceable. Mississippi Motor Vehicle Commission Law, Miss. Code Ann. § 63-17-119.	• Mississippi Repurchase of Inventories from Retailers Upon Termination of Contract Law, Miss. Code Ann. § 75-77-19.
Missouri	Notwithstanding the terms of any franchise agreement, the performance, whether by act or omission, by a motor vehicle franchisor of any or all of the following acts enumerated in this section are hereby defined as unlawful practices, the remedies for which are set forth in section 407.835: (10) To require a motor vehicle franchisee at the time of entering into a franchise arrangement to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by sections 407.810 to 407.835. Missouri Motor Vehicle Franchise Protection Act, Mo. Ann. Stat. § 407.825.	• Missouri Motorcycle and All-Terrain Vehicle Franchise Practices Act, Mo. Ann. Stat. § 407.1034.
Montana	A wholesaler of beer licensed to conduct business in the state may not waive any of the protections or agree to any provision contrary to 16-3- 221 through 16-3-226 by any conduct, including but not limited to the signing of any contract or agreement with terms contrary to those provisions. Montana Regulation of Brewers, Beer Importers, and Beer Wholesalers Act, Mont. Code Ann. § 16-3-221.	

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
Nebraska	It shall be a violation of sections 87-401 to 87-410 for any franchisor, directly or indirectly, through any officer, agent or employee, to engage in any of the following practices: (1) To require a franchisee at the time of entering into a franchise arrangement to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by sections 87-401 to 87-410. Nebraska Franchise Practices Act, Neb. Rev. Stat. § 87-406.	• Nebraska Liquor Control Act, Neb. Rev. Stat. § 53-170. • Nebraska Beer Distribution Law, Neb. Rev. Stat. § 53-221. • Nebraska Motor Vehicle Industry Relation Act, Neb. Rev. Stat. § 60-1436.
Nevada	It is an unfair act or practice for any manufacturer, distributor or factory branch, directly or through any representative, to: 1. Require a dealer to agree to a release, assignment, novation, waiver or estoppel which purports to relieve any person from liability imposed by this chapter, or require any controversy between a dealer and a manufacturer, distributor or representative to be referred to any person or agency except as set forth in this chapter if that referral would be binding on the dealer, except that this section does not prevent the parties from mutually agreeing to arbitration pursuant to law. Nevada Franchises For Sales of Motor Vehicles Act, Nev. Rev. Stat. § 482.3638.	• Nevada Alcoholic Beverage Franchise Act, Nev. Rev. Stat. § 597.157.
New Hampshire	Any of the following provisions in an agreement or lease, if one is included, whether oral or written, between a supplier and dealer, shall be void as against public policy: IV. Provisions requiring a dealer to assent to any release, assignment, novation, waiver, or estoppel which would relieve any person from liability imposed by this chapter. New Hampshire Regulation of Gasoline Franchises Act, N.H. Rev. Stat. § 339-C:8.	• New Hampshire Regulation of Business Practices Between Motor Vehicle Manufacturers, Distributors and Dealers Act, N.H. Rev. Stat. § 357-C:3; N.H. Rev. Stat. § 357-C:7; N.H. Rev. Stat. § 357-C:12.
New Jersey	It shall be a violation of this act for any franchisor, directly or indirectly, through any officer, agent or employee, to engage in any of the following practices: a. To require a franchisee at time of entering into a franchise arrangement to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by this act. New Jersey Franchise Practices Act, N.J. Stat. Ann. § 56:10-7.	• New Jersey Franchise Practices Act, N.J. Stat. Ann. § 56:10-7.4. • New Jersey Act to Regulate Retail Sale of Motor Fuels, N.J. Stat. Ann. § 56:6-23.
New Mexico	It is unlawful for any manufacturer, distributor or representative to: N. require a motor vehicle dealer to assent to a release, assignment, novation, waiver or estoppel that would relieve any person from liability imposed by Chapter 57, Article 16 NMSA 1978. New Mexico Motor Vehicle Dealers Franchising Act, N.M. Stat. Ann.§ 57-16-5.	
New York	It is unlawful to require a franchisee to assent to a release, assignment, novation, waiver or estoppel which would relieve a person from any duty or liability imposed by this article. New York Franchise Sales Act, N.Y. Gen. Bus. Law § 687.	• New York Franchise Sales Act, N.Y. Gen. Bus. Law § 687. • New York Motor-Fuel Franchise Law, N.Y. Gen. Bus. Law § 199-e.- • New York Franchised Motor Vehicle Dealer Act, N.Y. Veh. & Traf. Law § 463.

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
North Carolina	It shall be unlawful for any manufacturer, factory branch, distributor, or distributor branch, or any field representative, officer, agent, or any representative whatsoever of any of them: (13) To require, coerce, or attempt to coerce any new motor vehicle dealer in this State to prospectively assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability to be imposed by this law or to require any controversy between a new motor vehicle dealer and a manufacturer, distributor, or representative, to be referred to any person other than the duly constituted courts of the State or the United States of America, or to the Commissioner, if such referral would be binding upon the new motor vehicle dealer. North Carolina Motor Vehicle Dealers and Manufacturers Licensing Law, N.C. Gen. Stat. § 20-305.	• North Carolina Motor Vehicle Dealers and Manufacturers Licensing Law, N.C. Gen. Stat. § 20-305(31); N.C. Gen. Stat. § 20-308.1; N.C. Gen. Stat. § 20-308.2. • North Carolina Motor Vehicle Captive Finance Source Law, N.C. Gen. Stat. § 20-308.15; N.C. Gen. Stat. § 20-308.22. • North Carolina Farm Machinery Franchise Act, N.C. Gen. Stat. § 66-188.
North Dakota	7. Any condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this chapter or any rule or order hereunder is void. North Dakota Franchise Investment Law, N.D. Cent. Code § 51-19-16.	• North Dakota Miscellaneous Provisions, N.D. Cent. Code § 57-01-09.
Ohio	Notwithstanding the terms, provisions, or conditions of any agreement, franchise, or waiver, no franchisor shall: (N) Require or request a franchisee to waive any requirements of this section. Ohio Dealers Act, Ohio Rev. Code § 4517.59.	• Ohio Business Opportunity Purchasers Protection Act, Ohio Rev. Code § 1334.06; Ohio Rev. Code § 1334.15. • Ohio Alcoholic Beverage Franchise Act, Ohio Rev. Code § 1333.83. • Ohio Dealers Act, Ohio Rev. Code § 4517.55.
Oklahoma	A. It shall be a violation of Section 245 et seq. of this title for a supplier: 10. To require an equipment dealer to assent to a release, assignment, novation, waiver, or estoppel which would relieve any person from liability imposed by Section 245 et seq. of this title. Oklahoma Manufacturers, Wholesalers and Distributors--Repurchase of Inventory Law, Okla. Stat. Ann. tit. 15 § 245A.	• Oklahoma Regulation and Licensing of Motor Vehicle Manufacturers, Distributors, Dealers, Salespersons Law, Okla. Stat. Ann. tit. 47, § 565.2.
Oregon	(1) Notwithstanding the terms of any franchise or other agreement, it is unlawful for any manufacturer, distributor or importer to cancel, terminate or refuse to continue any franchise without showing good cause, provided the dealer protests the termination by filing a complaint in court of competent jurisdiction within the time period specified in subsection (3) of this section. Oregon Motor Vehicle Dealers Franchise Act, Or. Rev. Stat. § 650.140.	• Oregon Motor Fuel Franchise Act, Or. Rev. Stat. § 650.210.
Pennsylvania	It shall be a violation of this act for any lessor supplier, directly or indirectly, through any officer, agent or employee to engage in the following practices: (1) To require a lessee dealer at the time of entering into an agreement to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by this act. Pennsylvania Gasoline, Petroleum Products and Motor Vehicle Accessories Law, 73 Pa. Cons. Stat. § 202-4.	• Pennsylvania Board of Vehicles Act, 22A Pa. Cons. Stat. § 818.12; 22A Pa. Cons. Stat. § 818.29.

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
Rhode Island	A condition, stipulation or provision requiring a franchisee to waive compliance with or relieving a person of a duty of liability imposed by or a right provided by this act or a rule or order under this act is void. An acknowledgement provision, disclaimer or integration clause or a provision having a similar effect in a franchise agreement does not negate or act to remove from judicial review any statement, misrepresentations or action that would violate this act or a rule or order under this act. This section shall not affect the settlement of disputes, claims or civil lawsuits arising or brought under this act. Rhode Island Franchise Investment Act, R.I. Gen. Laws § 19-28.1-15.	• Rhode Island Motor Fuel Distribution and Sales Act, R.I. Gen. Laws § 5-55-4. • Rhode Island Equipment Dealership Act, R.I. Gen. Laws § 6-46-11. • Rhode Island Fair Dealership Act, R.I. Gen. Laws § 6-50-3. • Rhode Island Regulation of Business Practices Among Motor Vehicle Manufacturers, Distributors, and Dealers Law, R.I. Gen. Laws § 31-5.1-4; R.I. Gen. Laws § 31-5.1-13.
South Carolina	(3) It shall be deemed a violation of paragraph (a) of § 56-15-30 for a manufacturer, a distributor, a wholesaler, a distributor branch or division, a factory branch or division, or a wholesale branch or division, or officer, agent or other representative thereof: (k) To require a motor vehicle dealer to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by this chapter. South Carolina Regulation of Motor Vehicles Manufacturers, Distributors and Dealers Act, S.C. Code Ann. § 56-15-40.	• South Carolina Farm Implementation Franchise Act, S.C. Code Ann. § 39-59-120.
South Dakota	No person may, directly or indirectly, in connection with the offer or sale of a franchise: (8) Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments. However, this provision is not intended to prevent a prospective franchisee from voluntarily waiving specific contractual terms and conditions set forth in his or her disclosure document during the course of franchise sale negotiations. So. Dakota Franchise Investment Law, S.D. Codified Laws § 37-5B-26.	• South Dakota Franchise Investment Law, S.D. Codified Laws § 37-5B-21. • South Dakota Franchise Act, S.D. Codified Laws § 37-5-12.
Tennessee	No franchisee may prospectively assent to a release, assignment, novation, waiver or estoppel which would relieve any person from any liability or obligation under this part, or would require any controversy between a franchisor or franchisee to be referred to any person other than the duly constituted courts of this state or the United States, or a state regulatory agency charged by law with adjudicating such controversy, if the referral would be binding on the franchisee. Tennessee Franchise Terminations, Nonrenewals or Modifications Law, Tenn. Code Ann. § 47-25-1510.	• Tennessee Franchise Terminations, Nonrenewals or Modifications Law, Tenn. Code Ann. § 47-25-1507; Tenn. Code Ann. § 47-25-1509. • Tennessee Petroleum Trade Practices Act, Tenn. Code Ann. § 47-25-622. • Tennessee Repurchase of Terminated Franchise Inventory Law, Tenn. Code Ann. § 47-25-1313. • Tennessee Motorcycle and Off-Road Vehicle Dealer Fairness Act, Tenn. Code Ann. § 47-25-1913. • Tennessee Motor Vehicle Sales Licensing Act, Tenn. Code Ann. § 55-17-114.

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
Texas	A waiver of this chapter is contrary to public policy and void. Texas Business Opportunity Act, Tex. Bus. & Com. Code Ann. § 51.006.	• Texas Sale or Lease of Motor Vehicles Law, Tex. Occ. Code Ann. § 2301.003.
Utah	(1) A franchisor may not in this state: (e) require a franchisee to prospectively agree to a release, assignment, novation, waiver, or estoppel that would: (i) relieve a franchisor from any liability, including notice and hearing rights imposed on the franchisor by this chapter; or (ii) require any controversy between the franchisee and a franchisor to be referred to a third party if the decision by the third party would be binding. Utah New Automobile Franchise Act, Utah Code Ann. § 13-14-201.	• Utah New Automobile Franchise Act, Utah Code Ann. § 13-14-201(1)(l); Utah Code Ann. § 13-14-201(1)(gg). • Utah Powersport Vehicle Franchise Act, Utah Code Ann. § 13-35-201.
Vermont	Any of the following provisions in an agreement or lease, if one is included, whether oral or written, between a supplier and dealer, shall be void as against public policy, except as provided herein: (3) Provisions requiring a dealer to assent to any release, assignment, novation, waiver, or estoppel which would relieve any person from liability imposed by this chapter. Vermont Service Station Operators, Oil Companies and Franchises Act, Vt. Stat. Ann. tit. 9, § 4108.	• Vermont Machinery Dealerships Law, Vt. Stat. Ann. tit. 9, § 4080; Vt. Stat. Ann. tit. 9, § 4082. • Vermont Motor Vehicle Manufacturers, Distributors, and Dealers Franchising Practices Act, Vt. Stat. Ann. tit. 9, § 4089; Vt. Stat. Ann. tit. 9, § 4096; Vt. Stat. Ann. tit. 9, § 4099.
Virginia	(c) Any condition, stipulation or provision binding any person to waive compliance with any provision of this chapter or of any rule or order thereunder shall be void; provided, however, that nothing contained herein shall bar the right of a franchisor and franchisee to agree to binding arbitration of disputes consistent with the provisions of this chapter. Virginia Retail Franchising Act, Va. Code Ann. § 13.1-571.	• Virginia Wine Franchise Act, Va. Code Ann. § 4.1-416. • Virginia Beer Franchise Act, Va. Code Ann. § 4.1-515. • Virginia Motor Vehicle Dealers Act, Va. Code Ann. § 46.2-1572.3 (Apr. 8, 2010). • Virginia Petroleum Products Franchise Act, Va. Code Ann. § 59.1-21.11; Va. Code Ann. § 59.1-21.11:1.
Washington	Without limiting the other provisions of this chapter, the following specific rights and prohibitions shall govern the relation between the franchisor or subfranchisor and the franchisees: (2) For the purposes of this chapter and without limiting its general application, it shall be an unfair or deceptive act or practice or an unfair method of competition and therefore unlawful and a violation of this chapter for any person to: (g) Require franchisee to assent to a release, assignment, novation, or waiver which would relieve any person from liability imposed by this chapter, except as otherwise permitted by RCW 19.100.220. Washington Franchise Investment Protection Act, Wash. Rev. Code Ann. § 19.100.180.	• Washington Franchise Investment Protection Act, Wash. Rev. Code Ann. § 19.100.220. • Washington Motor Vehicles Dealers and Manufacturers Law, Wash. Rev. Code Ann. § 46.70.132; Wash. Rev. Code Ann. § 46.70.134. • Washington Motorsports Vehicles Law, Wash. Rev. Code Ann. § 46.93.030. • Washington Manufacturers' and Dealers' Franchise Agreements Act, Wash. Rev. Code Ann. § 46.96.0005; Wash. Rev. Code Ann. § 46.96.030; Wash. Rev. Code Ann. § 46.96.140; Wash. Rev. Code Ann. § 46.96.190.

SELECTED RELEASE LANGUAGE		
State	**Notable Language**	**Other Release Language**[1]
West Virginia	Every franchise agreement between a producer and a dealer shall be subject to the following provisions whether or not they are expressly set forth in the agreement: . . . (6) The right of either party to a trial by jury or to the interposition of counterclaims or crossclaims shall not be waived; (7) Liability imposed on, and rights granted to, any person by this article shall not be waived. West Virginia Petroleum Products Franchise Act, W. Va. Code Ann. § 47-11C-3.	
Wisconsin	(6)(a) This section does not restrict the right of a motor vehicle dealer to pursue any other remedy available against a grantor who terminates, cancels or does not renew an agreement. (b) A grantor may not make the termination benefits payments under sub. (2) or (4) contingent on the motor vehicle dealer releasing or waiving any rights, claims or remedies. Wisconsin Motor Vehicle Dealers Law, Wis. Stat. Ann. § 218.0133.	• Wisconsin Motor Vehicle Dealers Law, Wis. Stat. Ann. § 218.0133(9)(a). • Wisconsin Franchise Investment Law, Wis. Stat. Ann. § 553.76.
Wyoming	(a) It shall be a violation of this act for a manufacturer or manufacturer's officer, agent or other representative thereof: (vii) To require a malt beverage distributor to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by this act. However, nothing in this section shall be construed to limit or prohibit good faith dispute settlements entered into by the parties. Wyoming Relations Between Malt Beverage Distributors and Manufacturers Act, Wyo. Stat. Ann. § 12-9-104.	• Wyoming Motor Vehicle Franchises Act, Wyo. Stat. Ann. § 31-16-108; Wyo. Stat. Ann. § 31-16-109.
FTC Rule	It is an unfair or deceptive act or practice in violation of Section 5 of the Federal Trade Commission Act for any franchise seller covered by part 436 to: (h) Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments. Provided, however, that this provision is not intended to prevent a prospective franchisee from voluntarily waiving specific contract terms and conditions set forth in his or her disclosure document during the course of franchise sale negotiations. 16 U.S.C. § 436.9 (Mar. 30, 2007).	
PMPA	(f) Release or waiver of rights (1) No franchisor shall require, as a condition of entering into or renewing the franchise relationship, a franchisee to release or waive (A) any right that the franchisee has under this subchapter or other Federal law; or (B) any right that the franchisee may have under any valid and applicable State law. 15 U.S.C.A. § 2805.	

Endnote

1. A full version of this chart. including the language of all of the cited provisions affecting release language, is available from the authors.

Class Action Prohibitions and the Effect of Contract Rules on the Collective Pursuit of Common Claims

Mark M. Leitner and Joseph S. Goode

Disputes in the Quizno's submarine sandwich system have recently shed light on the relationship between franchising and the class action provisions of the Federal Rules of Civil Procedure. In August 2010, a federal district court in Chicago approved a class action settlement between Quizno's and its franchisees valued at $206 million.[1]

Mark M. Leitner

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The franchisee class achieved this result despite an earlier decision by a Colorado federal district court enforcing a class action prohibition contained in a Quizno's standard franchise agreement and denying class action certification to a group of Quizno's franchisees that had bought franchises but never opened stores.[2]

Adding even more drama and legal uncertainty to franchise law, only two months after Quizno's prevailed in Colorado, a Pennsylvania federal court issued a contrary ruling, holding the Quizno's class action prohibition unenforceable as an impermissible restriction on the court's right to manage efficiently its own caseload.[3] Before the Colorado and Pennsylvania decisions, courts had rarely addressed the enforceability of class action prohibitions in the franchise context.

These difficult-to-reconcile cases involving franchise agreements in the same system highlight the uncertainty franchisors face when they seek to prohibit class actions in their franchise documents. Franchisors obviously prefer to avoid class actions at all costs. Can they do so by including class action prohibitions in their franchise agreements? Their ability to enforce such prohibitions likely will resurface as an issue for courts to address in the years to come.

This article uses the Quizno's class actions litigated by the authors as the focal point for an examination and analysis of the enforcement of contractual class action prohibitions in the context of franchise disputes. The authors review how courts have dealt with these prohibitions in other contexts, discuss the Quizno's cases in detail, and conclude by offering several potential analytical frameworks for evaluating the enforceability of class action prohibitions in franchise agreements.

FRANCHISING AND CLASS ACTIONS

Franchising "provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors rather than employees of a vast chain."[4] To achieve systemwide uniformity, franchisors typically rely on controls in the franchise agreement that apply to all franchisees. The purpose of such controls is "to achieve standardization, uniformity, and optimum public good will."[5] With uniform rules and uniform application of those rules, franchisees often have common interests and concerns.

The class action thus serves as a powerful tool to redress systemwide issues that are common to franchisees. The class action vehicle also provides the franchisor with the ability to achieve systemwide resolution of disputes with its franchisees. Congress found in its 2005 enactment of the Class Action Fairness Act (CAFA) that class actions "are an important and valuable part of the legal system when they permit the fair and efficient resolution of legitimate claims of numerous parties."[6] Class action litigation "allows for the resolution of many claims that might otherwise evade legal enforcement."[7] The procedure further offers assistance to regulators who seek to "control conduct that threatens to harm various markets."[8] Consumer class actions in particular serve the laudable purpose of enforcing "regulatory standards designed to deter fraudulent marketplace conduct that might otherwise escape regulation."[9]

Class actions often assist the vindication of rights that otherwise may not be pursued because without the ability to pool costs and resources in a class action, a given individual's losses caused by a particular violation of law may not be cost effective to pursue under the economic constraints of modern-day litigation.[10] Thus,

> [t]he policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting

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his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.[11]

Of course, the Federal Rules of Civil Procedure do "not exclude from certification cases in which individual damages run high."[12] Rather, they, and in particular Rule 23, specifically contemplate the right to obtain damages of whatever amount, as well as declaratory and injunctive relief.[13]

CLASS ACTIONS: THE BASICS

Rule 23 governs class action practice in federal court.[14] To qualify for class action treatment, a plaintiff must meet all four requirements of Rule 23(a) and at least one of the requirements of Rule 23(b). The four requirements of Rule 23(a) are simply stated but hotly litigated: (1) "the class [must] be so numerous that joinder of all members is impracticable" (i.e., numerosity); (2) there are "questions of law or fact common to the class" (i.e., commonality); (3) "the claims or defenses of the representative parties are typical" of those "of the class" (i.e., typicality); and (4) "the representative parties will fairly and adequately protect the interests of the class" (i.e., adequacy).[15]

A party need not show that joinder of all class members is impossible to satisfy the numerosity requirement of Rule 23(a), only that it is "impracticable:"[16]

> A number of factors are relevant in determining whether joinder is impracticable, including the class size, the geographic diversity of class members, the relative ease or difficulty in identifying members of the class for joinder, the financial resources of class members, and the ability of class members to institute individual lawsuits.[17]

In a typical franchise system, numerosity should not be a difficult requirement to overcome.

The same can be said for the commonality requirement of Rule 23(a)(2). Under the rule, common does not mean "factually identical."[18] It is enough that "the claim[s] arise from the same set of broad circumstances."[19] Differences in the facts supporting the claims of individual class members will not defeat commonality.[20] In fact, "[c]ommonality is not necessary on every issue raised in a class action. . . . 'Rule 23 is satisfied when the legal question linking the class members is substantially related to the resolution of the litigation.'"[21] Thus, the commonality hurdle is minimal; it "requires only a single issue common to the class."[22] With standard form franchise agreements often in play, establishing commonality in the franchise context generally should not be difficult.

Establishing typicality is often not a problem either. "The threshold for typicality is low and the claims asserted by the class representative need only be typical of, not identical to, those of other class members:[23]"

> So long as there is a nexus between the class representatives' claims or defenses and the common questions of fact or law which unite the class, the typicality requirement is satisfied. . . . A sufficient nexus is established if the claims or defenses of the class and the class representatives arise from the same event or pattern or practice and are based on the same legal theory.[24]

In the franchise context, it is not hard to see how typicality can be satisfied where uniform controls or restrictions are placed on franchisees in the system and similar legal theories are asserted under standard form franchise agreements.

The final requirement of Rule 23(a), adequacy, focuses on the ability of those purporting to represent the class fairly and adequately to do so. "[A] class representative must be part of the class and 'possess the same interest and suffer the same injury' as the class members."[25] This fundamental requirement dovetails into two questions that the court must resolve to determine if the class representative is adequate: "(1) do the named plaintiffs and their counsel have any conflicts of interest with other class members and (2) will the named plaintiffs and their counsel prosecute the action vigorously on behalf of the class?"[26] These case specific inquiries provide ample room for fact-intensive arguments for and against class certification.

A plaintiff that satisfies each requirement of Rule 23(a) must then establish the right to certification of the class by meeting at least one of the requirements of Rule 23(b). Certification under Rule 23(b)(1) requires the plaintiff to establish that the prosecution of separate individual actions would prejudice the defendant or putative class members either by (1) establishing incompatible standards of conduct for the party opposing the class or (2) adjudicating the interests of other putative class members or preventing them from protecting their interests.[27] It is relatively uncommon for certification to be pursued under this provision.

Under Rule 23(b)(2), certification is appropriate where "the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole."[28] Class action lawyers typically refer to cases invoking Rule 23(b)(2) as injunction class actions, where the representative plaintiffs seek injunctive relief on behalf of the entire class.

Rule 23(b)(3) enables a court to certify a class where "questions of law or fact common to class members predominate over any questions affecting only individual members, and [where] a class action is superior to other available methods for fairly and efficiently adjudicating the controversy."[29] This path to certification, used in an effort to obtain monetary damages, requires a showing of predominance and superiority.

The test for predominance necessarily requires the court to determine whether "common questions represent a significant aspect of the case" such that "they can be resolved for all members of the class in a single adjudication."[30] In a predominance analysis, the court identifies "the relevant factual and legal issues, and the elements of the claims and defenses in the case. . . . [H]owever, mere identification of the issues and elements of the claims and defenses is not an evaluation of the merits of the case; nor should it be."[31]

Instead, the court "must look only so far as to determine whether, given the factual setting of the case, if the [plaintiff's] general allegations are true, common evidence could suffice to make out a prima facie case for the class."[32] Even when individualized damages proceedings are necessary, it is not uncommon for courts to grant class certification on issues of liability, causation, and defenses.

In analyzing the superiority requirement of Rule 23(b)(3), courts look to four specific factors identified in the rule. First, the plaintiff will be asked to establish if the members of the class are likely to have little interest in individually controlling the prosecution of separate actions.[33] Second, the court needs to determine if litigation concerning the controversy has already been commenced by or against members of the class.[34] Third, in reviewing whether the class procedure is superior to other forms of litigation, the court must determine the "desirability or undesirability of concentrating the litigation of the claims in a particular forum."[35] Finally, the court must determine whether there are "likely difficulties in managing a class action."[36] Significantly, the existence of individual issues (for example, varying amounts of damages owed to each class member) does not necessarily establish that management of the class will be difficult under Rule 23(b)(3)(D) because the court must still weigh the benefits of proceeding as a class against that concern.[37]

CLASS ACTIONS IN THE FRANCHISING CONTEXT

The basic rules of class certification have been applied in the franchise context. For example, in *Broussard v. Meineke Discount Muffler Shops, Inc.*, the U.S. Court of Appeals for the Fourth Circuit reviewed a district court's class certification decision certifying a class of "'all persons or entities throughout the United States that were Meineke franchisees operating at any time during or after May of 1986.'"[38] Although the Fourth Circuit ultimately reversed the class certification decision based on its conclusion that the district court decision did not "conform to the requirements of Federal Rule of Civil Procedure 23(a)," reversal occurred only after a lengthy trial, jury verdict, and entry of a judgment close to $600 million against the franchisor.[39]

In *Bird Hotel Corp. v. Super 8 Motels, Inc.*, a district court in South Dakota in 2007 certified a class of 226 former and current franchisees to satisfy the numerosity requirement of Rule 23(a).[40] In certifying the class, the *Bird Hotel* court specifically found that common issues predominated due to the "standard form franchise agreements" and fact that "proof of liability [would] be the same for every class member."[41] More recently, that same court granted summary judgment on liability issues in favor of the franchisee class, leaving only a trial on damages.[42]

CLASS ACTION PROHIBITIONS AND CONTRACTUAL WAIVERS

Nearly every litigant in state and federal court has the procedural right to pursue a class action. The Federal Rules of Civil Procedure, after all, are "construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding."[43] A rule, such as Rule 23, that promotes joinder of parties with similar claims, certainly seems consistent with the foregoing admonition.

Not all courts see it that way, however. On April 20, 2009, a district court in *Bonanno v. Quizno's Franchise Co., LLC* denied class certification to a putative class of approximately 3,300 Quizno's franchisees that had purchased a franchise but had not yet opened their restaurant.[44] In addition to defending against plaintiffs' motion for class certification brought pursuant to Rule 23, Quizno's relied in the first instance on language from its franchise agreement that purported to bar the parties from seeking class relief: "The parties agree that any proceeding will be conducted on an individual, not a class-wide basis, and that any proceeding between Franchisor and Franchisee or the Bound Parties may not be consolidated with another proceeding between Franchisor and any other entity or person."[45] In *Bonanno*, the Quizno's class action waiver insulated the franchisor from exposure to a mass claim involving over 3,000 franchisees.

CLASS ACTION BARS IN THE COURTS

Many, but not all, of the decisions addressing enforceability of contractual class action prohibitions involve arbitration clauses and therefore implicate the strong federal policy favoring the enforcement of agreements to arbitrate. Although some courts assert that arbitration cases carry little precedential weight outside their original contexts,[46] as a practical matter, many of the challenges to arbitration clauses that bar class proceedings employ the very same legal standard of unconscionability involved outside the context of arbitration.[47]

As might be expected, challenges to contract provisions founded on unconscionability are fact-driven. It is consequently difficult to distill any universally applicable legal principles from the decisions, although there are exceptions. A Pennsylvania court has held that an agreement to arbitrate in a consumer contract of adhesion that waives the right to class-based relief is per se unconscionable and thus unenforceable.[48] More typical, however, is the situation of Florida's appellate courts, which have issued facially inconsistent decisions addressing the enforcement of class prohibitions in arbitration agreements for telephone service.[49] Perhaps the best summary of the state of the law comes from the Illinois Supreme Court in its review of twelve decisions striking down class action prohibitions and eight cases upholding them:

> If there is a pattern in these cases it is this: a class action waiver will not be found unconscionable if the plaintiff had a meaningful opportunity to reject the contract term or if the agreement containing the waiver is not burdened by other features limiting the ability of the plaintiff to obtain a remedy for the particular claim being asserted in a cost-effective manner.[50]

Unconscionability is not the only legal lens through which courts have evaluated the enforcement of prohibitions against class proceedings. In *Kristian v. Comcast Corp.*,[51] the First Circuit invalidated an arbitration clause forbidding class proceedings on the grounds that enforcement would have made it impossible for plaintiff to vindicate its statutory rights under the antitrust laws. This was so because individual damages were a few thousand dollars, but plaintiff's counsel would have been required to make an up-front investment well into six figures in both attorney time and expert fees.[52] "Then, factoring in the uncertainty of success, the appeal for an attorney to take on an individual plaintiff's antitrust claim shrinks even further."[53] In this case, defendant would effectively enjoy immunity from antitrust liability, negating plaintiffs' statutory rights and frustrating the social and economic goals furthered by the antitrust laws.

Nearly every litigant in state and federal court has the procedural right to pursue a class action.

Although a number of decisions apply the "vindication of statutory rights" analysis to evaluate prohibitions against class-based proceedings, the continued viability of those cases is questionable in light of the U.S. Supreme Court's April 2010 decision in *Stolt-Nielsen, S.A. v. AnimalFeeds International Corp.*,[54] which held that class-based arbitration may not be ordered when the arbitration agreement is silent on whether the class action procedure may be used.[55] The *Stolt-Nielsen* Court's focus on enforcing the parties' agreement as written may make it more difficult for parties to use the "vindication of statutory rights" principle of federal arbitration law to challenge arbitration clauses that forbid class actions.

QUIZNO'S LITIGATION

The recently settled dispute between Quizno's and its franchisees involved four putative class action lawsuits that implicated Rule 23.

Three of the four cases involved the rights of franchisees that had opened and operated at least one Quizno's restaurant. Brought in the federal courts of Wisconsin, Illinois, and Colorado, each case comprising the Franchise Operator Class Action Litigation asserted claims for violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), fraud in the inducement, breach of contract, breach of the implied covenant of good faith and fair dealing, economic duress, promissory fraud, breach of fiduciary duty, and declaratory judgment. Each of these cases also asserted various claims based on specific statutes of the forum state. The damages of each class member in the Franchise Operator Class Action Litigation varied by franchisee; in certain instances, they were significant.

The *Bonanno* case, in contrast, was brought by franchisees that had purchased franchises but had been unable to find a site for their stores and then were denied a refund of the franchise fee by Quizno's. These franchisees were called "SNOs," an acronym for "Sold But Not Opened." *Bonanno* involved claims for violation of the Colorado Consumer Protection Act (CCPA), fraudulent inducement, breach of contract, violations of the covenant of good faith and fair dealing, unjust enrichment, conspiracy, economic duress, and declaratory judgment. Plaintiffs sought a return of the franchise fee, typically $25,000, that they had paid.

Bonanno plaintiffs moved under Rule 23 for class certification, and Quizno's vigorously opposed the motion. After significant briefing, the district court heard oral argument and issued a written decision denying the motion for class certification on April 20, 2009. The district court never reached the substantive requirements of Rule 23. The sole basis for its decision was the class action prohibition contained in the Quizno's franchise agreement.

Representative plaintiffs in *Bonanno* asserted five arguments as to why the class prohibition should not be enforced. First, despite the existence of approximately 3,300 SNOs in the Quizno's system with rights similar to those of the representative plaintiffs, absent a class procedure to incentivize plaintiffs and their counsel, very few lawsuits would be brought to recoup the $25,000 franchise fees at issue. History showed that a minimal number of suits by SNOs had been asserted nationwide. Plaintiffs offered declarations from various attorneys who contended that they were interested in pursuing individual suits but could not justify the time and expense of doing so because the amount in controversy was so low. Second, plaintiffs argued that the class prohibition language was procedurally and substantively unconscionable, as a host of courts (described above) had concluded in relation to similar prohibitions in other cases. Third, the franchisees argued that the Federal Trade Commission (FTC) viewed franchisees as members of one of two classes: ordinary consumers and "sophisticated investors." Plaintiffs argued that the putative class members fell into the former camp and that such a sweeping prohibition on the ability to obtain class relief would undermine the consumer protection laws that plaintiffs sought to invoke. Fourth, *Bonanno* plaintiffs argued that the only meaningful way to level the imbalance of power between franchisor and franchisee was to ensure that the franchisees had the ability to pursue relief on behalf of thousands rather than as individuals. In short, only with the "big stick" of Rule 23 could the power imbalance typically associated with the franchising model be remedied. Finally, in the face of an argument that they knowingly signed a franchise agreement containing a class prohibition, plaintiffs asserted that they did not knowingly waive their right to invoke Rule 23.

Defendants in *Bonanno* argued vigorously against these positions. First, they invoked the contractual bar contained in the franchise agreement to assert that plaintiffs had knowingly waived their right to proceed as a class. Quizno's asserted that the language involved no ambiguity and that the plain language of the contract barred class-based litigation. Second, Quizno's relied on its own precedents (discussed above) to assert that class action prohibitions are enforceable. Third, relying on Colorado's test to determine unconscionability, Quizno's argued, among other things, that the prohibition was not thrust upon representative plaintiffs; that it was accepted at arm's length after a full and fair opportunity to read and understand it; and that the prohibition served a valid commercial purpose, namely, to provide certainty in the Quizno's system and reduce costs in the resolution of franchisee disputes. Finally, Quizno's argued that the right to proceed as a class action is a procedural right (not a substantive right), and it thus could not be substantively unfair to deny plaintiffs the right to proceed in this manner.

The district court in *Bonanno* ruled squarely in favor of Quizno's. In its decision denying class certification, the court did not address any of the Rule 23 requirements and focused exclusively on the enforceability of the class prohibition.

First, the district court concluded that the right to proceed as a class action is a procedural right, drawn from the English common law and designed to "avoid multiplicative litigation."[56] Thus, relying on the Supreme Court's decision in *Ortiz v. Fibreboard Corp.*, the court found that "Rule 23 remains a procedural tool, not a substantive right."[57]

Second, the *Bonanno* court rejected the idea that the doctrine of waiver had any application to the enforcement of a procedural right, holding instead that stringent requirements for determining whether a waiver had occurred were appropriate only when substantive constitutional rights were implicated.[58]

Third, the district court refused to follow precedent from other circuits holding class action waivers unconscionable. In so doing, the court questioned the applicability of the precedent on the basis that the prior cases involved claims far more complex, such as antitrust, than the "simple fraud and consumer protection–type claims" at issue in *Bonanno*.[59] The district court found it compelling that much of the precedent throwing out class action prohibitions arose from cases in an arbitration context and involved factual and legal circumstances different than those of the SNO class action.[60]

Fourth, after analyzing Colorado's unconscionability standards, the court concluded that the "take it or leave it" class prohibition offered by Quizno's was not unconscionable.[61] Although the district court agreed that Quizno's offered a "standard form" agreement, it noted that plaintiffs did not have to sign the agreement, had ample opportunity to review it before doing so, and were not misled simply by the placement of the class action prohibition toward the end of the agreement.[62] Further, the court specifically found that the Quizno's class prohibition served a legitimate purpose by enabling Quizno's to ensure "predictability in decision-making, budgeting and planning."[63]

Finally, the district court rejected the notion that the amount in dispute would serve as a disincentive to bring suit and, as such, could not be found to be a basis for invalidating the prohibition.[64]

FUTURE OF CLASS ACTION PROHIBITIONS

The *Bonanno* decision presents another case to add to the line of decisions enforcing class action prohibitions in franchising. Unsurprisingly, since *Bonanno* came down, other courts have continued to weigh in on the opposing side of the issue. Like many other cases, the holding of *Bonanno* is sufficiently tied to specific facts that its precedential value will primarily be persuasive. What follows are the authors' suggestions for advocates and courts alike to consider when faced with litigation regarding class action prohibitions in the franchise context.

IMPERMISSIBLE RESTRICTION OF COURT'S OWN POWERS?

Near the conclusion of its decision, the *Bonanno* court raised an issue that had not been briefed by the parties: "whether [a class action prohibition] improperly intrudes upon the Court's ability to manage its cases pursuant to the Federal Rules of Civil Procedure."[65] The district court expressed a concern that "with respect to the many different waiver provisions being inserted into contractual arrangements, at some point parties are going to overstep their bounds and intrude into the province of the courts by waiving procedural matters that affect case management and judicial economy."[66]

Ultimately, the *Bonanno* court disregarded the docket management concern and concluded that the class action bar should be enforced for two reasons. First, courts lack the power to certify a class without a request from at least one of the parties, even if class treatment would be the most efficient and economical option.[67] Second, because Rule 23 is not compulsory, "there is nothing jurisdictional about [it]"; therefore, "by enforcing the class action bar at issue, the Court will not improperly alter other procedural mandates, as would be the case if, for example, the question before the Court was the enforceability of a contractual bar on compulsory counterclaims."[68]

Not quite two months after *Bonanno* was issued, a district court in Pennsylvania reached the opposite conclusion in addressing the very same class action prohibition in the Quizno's franchise agreement.[69] In *Martrano v. Quizno's Franchise Co., LLC*, the court began its analysis by referencing Supreme Court precedent governing the interpretation of contractual forum selection clauses, which prohibits courts from automatically enforcing such clauses but instead requires the clause to be considered as merely one of many factors under the federal venue transfer statute.[70] The court reasoned that party preferences as expressed in the contract were entitled to even less weight in the class action and consolidation contexts:

> Unlike the situation with venue/forum selection clauses, in which the parties' expressed preferences are accorded substantial weight in the governing statutory framework, the parties' preferences with respect to class certification or consolidation are not among the factors encompassed within the framework of Rule 23 or Rule 42. . . . Under both Rule 23

and Rule 42, the ultimate governing standard is furtherance of efficient judicial administration, which leaves no room for enforceability of private agreements to forego the efficiencies potentially afforded by consolidated or class adjudication.[71]

The *Martrano* court concluded its analysis by noting that enforcement of a class action prohibition "could potentially force this and other courts to hold separate trials of dozens, or hundreds, or even thousands of cases involving extensively overlapping issues," a result "flatly inconsistent" with the mandate in Federal Rule of Civil Procedure 1 to "secure the just, speedy and inexpensive determination of every proceeding."[72]

The principal battleground for attacking and defending class action prohibitions has been the doctrine of unconscionability under state contract law.

The decisions in both *Bonanno* and *Martrano* acknowledge that there is no controlling precedent from higher courts directly addressing whether contractual class action prohibitions can be squared with the fundamental docket management and judicial efficiency concerns of Rule 23. The authors similarly found no cases on point. Whether parties can use private agreements to restrict the array of docket management tools available to busy federal judges poses an important public policy question. At the very least, the empirical question of whether class action prohibitions are depriving a heavily burdened federal judicial system of needed efficiencies requires further study.

COUNTERVAILING POWER ANALYSIS

Although the *Bonanno* decision ultimately enforced the Quizno's class action prohibition, the district court did acknowledge that "Quizno's retains far greater power in the parties' relationship than any one franchisee," relying upon the opinion of the franchisees' expert Professor Bert Rosenbloom to support this conclusion.[73] The approach outlined in this section draws from Professor Rosenbloom's analytical framework for evaluating power relationships in distribution channels.[74]

That framework begins with the simple concept of power in the marketing channel, defined as "the capacity of a particular channel member to control or influence the behavior of another channel member."[75] When franchising is the means of distribution, the franchisor ordinarily dominates its franchisees in the distribution channel: "[C]hannels that are contractually linked, such as in a franchised system, provide the franchisor with a strong legal power base that derives from the contract."[76] When coercive power, i.e., the threat or reality of punishment, is used to achieve a channel member's goals, it may reduce the stability and viability of the channel "and is likely to increase the possibility that the coerced channel members will seek outside assistance (such as government action) to reduce the coercion."[77]

If there are no viable means for the less powerful channel members (the franchisees) to raise and obtain resolution of their grievances, some form of collective action, such as a class action suit, may be the only realistic way to obtain redress. Before reaching the conclusion that such collective action is the only viable option for countering franchisor power, Professor Rosenbloom's methodology reviews less drastic options for practically raising and resolving grievances. The first option that might provide relief is a formal grievance procedure that identifies the franchisor officers empowered to deal with grievances and explains the process that franchisees must follow to present and resolve a dispute. Another option is a franchisee advisory council, comprised of top management representatives from the franchisor and a representative sample of franchisees. Such a council, when taken seriously by the franchisor, provides channel members with recognition in the franchisor's eyes, furnishes a vehicle for discussing mutual needs and problems, and improves communications.[78]

The third and final option is individual franchisee lawsuits against the franchisor. This option provides an adequate avenue for airing and resolving grievances and countering franchisor powers only if it is cost-effective; a relatively small franchisee attempting to sue a much larger franchisor may be required to spend substantially more in legal fees than the likely damages awarded in the event of a court victory, rendering such a case economically infeasible.

Notably, judges, many of whom have limited private practice experience in trying commercial disputes, often assume that the threshold for taking a case is much lower than it is in the real world.[79] The basic point of Professor Rosenbloom's framework is that the lower the stakes, the less likely it is that individual suits will prove to be an effective source of countervailing power on the franchisees' side.

If these three options fail to provide an adequate source of countervailing power, Professor Rosenbloom's framework suggests that a class action, through which franchisees can assert their rights collectively, is the last remaining practical means to restore the imbalance of power in the franchisor–franchisee relationship. Accordingly, when such conditions exist, contractual prohibitions against the use of class actions should not be enforced.

On the one hand, it is questionable whether courts unaccustomed to detailed factual analyses of business realities would accept this argument against the enforcement of a contractual provision. On the other hand, the kind of pragmatic approach to business litigation called for by Professor Rosenbloom's framework may be a useful tool in analyzing the potential unconscionability of contractual waiver provisions.

UNCONSCIONABILITY REVISITED

The principal battleground for attacking and defending class action prohibitions has been the state law contract doctrine of unconscionability, probably because that theory is a well-recognized legal ground under Federal Arbitration Act precedent to challenge an arbitration clause that forbids class proceedings.[80] This section discusses several trends that the authors have discerned in the case law regarding class action prohibitions.

First, the amount of money at stake in an individual dispute may be the most important element of the court's unconscionability analysis when a class action prohibition is challenged. This is essentially a recognition of the central truth that, in the words of the Seventh Circuit, when the plaintiff's financial stakes are low, "[t]he *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30."[81] Put another way, in the context of Professor Rosenbloom's analytical framework, is the potential payoff for franchisees and their lawyers, weighed against the likely fees and expenses of litigation in light of the likelihood of prevailing on the merits, sufficient to justify the cost of an individual lawsuit?

Although there are no bright-line rules, a judicial consensus appears to be developing that individual litigation will be cost-justified at a fairly low threshold, giving franchisee plaintiffs, whose initial franchise fee alone usually exceeds the threshold, a steep hill to climb to defeat class action prohibitions. The California experience is instructive. In the wake of the California Supreme Court's decision in *Discover Bank v. Superior Court*,[82] courts evaluating class action prohibitions must consider, among other things, whether "disputes between the contracting parties predictably involve small amounts of damages."[83] A federal district court called upon to apply *Discover Bank* concluded that "no court has found that the amount at issue here, more than $5,000, falls within that definition"[84] and accordingly rejected plaintiffs' challenge to an arbitration clause that barred class proceedings.

Similarly, courts faced with five-figure claims have consistently ruled that those claims were of sufficient magnitude to incentivize litigants to bring their own individual suits. *Bonanno* itself involved claims to recover an initial franchise fee of "typically" $25,000.[85] Another federal court ruled that a claim of approximately $40,000 warranted individual litigation,[86] and still another held that a $75,000 claim was too large to justify disregarding a class action prohibition.[87]

It is difficult to tell from the face of these decisions whether the courts got it right because the opinions generally do not discuss the specific costs and fees to be incurred in the prosecution of a five-figure claim weighed in light of the obstacles to recovery. Sometimes the decisions make clear that the cost-benefit analysis cannot be done because the plaintiff failed to present evidence sufficient to permit analysis.[88] Probably the most thorough discussion of the economic risks and rewards of individual versus class litigation is the Second Circuit's decision in *In re American Express Merchants' Litigation*, in which the court relied on extensive evidence from a Ph.D. economist retained by plaintiffs to conclude that because plaintiffs' likely out-of-pocket expenses would range between several hundred thousand and $1 million and the likely maximum damages (after trebling under the Clayton Act) of an average class member would be a little over $5,000, upholding the contractual class action prohibition would effectively negate defendant ever being held accountable, even if it was guilty of antitrust violations.[89] But too often, the courts fail to explain how and why they have concluded that the ceiling for so-called small damages is $5,000, or that stakes of $25,000 or even $75,000 provide sufficient incentive to litigate individually when weighed against the expenses of litigation and the potential for adverse results. These questions are amenable to empirical analysis, and there is extensive literature on risk aversion and risk tolerance[90] that courts can use to illustrate the facts that litigants present.

Another trend in some recent unconscionability decisions has been a focus on the process of contract formation. In particular, the presence or absence of coercive, high-pressure sales tactics has been the subject of judicial focus in evaluating whether a clause is procedurally unconscionable.[91] In this context, courts and litigators alike must be careful not to confuse this aspect of unconscionability with an argument that the entire contract was fraudulently induced. In addition, counsel should separately analyze sales tactics used to induce prospective franchisees to investigate opportunities and those employed to induce prospects to sign the agreements after the required ten-day review period. When a franchisor has strictly complied with the ten-day waiting period and refrained from high-pressure sales tactics at the actual time of signature, the authors believe that courts will be less likely to attribute any significance to the franchisor's behavior at earlier stages of the process.

A final trend regarding the decision of whether to enforce a class action prohibition is identifying the potential for retaliation against putative class members, as several California courts have done in the employment context.[92] In particular, the continuing relationship between the employer and the employee may discourage employees who fear retaliation from stepping forward to pursue individual claims.[93] The continuing relationship between the franchisor and the franchisee may warrant a similar analysis.

CONCLUSION

Although a class action might seem well suited to resolving many disputes that arise out of the standardized aspects of a franchise system, many franchise agreements contain clauses that prohibit franchisees from invoking the class action mechanism. The courts have upheld and rejected class action prohibitions, but case law in the franchise context is limited.

In evaluating whether to enforce contract provisions that bar class actions, courts have focused primarily on whether individual lawsuits make economic sense, although the decisions feature more speculation than application of actual facts. Recently, courts have raised the issue of whether class action prohibitions impermissibly intrude upon the power of the courts to control their own dockets. This inquiry will undoubtedly merit further consideration by courts in future cases regarding the enforceability of contractual class action waiver provisions.

ENDNOTES

1. Siemer v. Quizno's Franchise Co., LLC, No. 07-C-2170, 2010 WL 3238840 (N.D. Ill. Aug. 13, 2010).

2. Bonanno v. Quizno's Franchise Co., LLC, No. 06-cv-02358-CMA-KLM, 2009 WL 1068744 (D. Colo. Apr. 20, 2009).

3. Martrano v. Quizno's Franchise Co., LLC, No. 08-0932, 2009 WL 1704469 (E.D. Pa. June 15, 2009).

4. GTE Sylvania, Inc. v. Cont'l T.V., Inc., 537 F.2d 980, 999 (9th Cir. 1976) (quoting Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962)).

5. Murphy v. Holiday Inns, Inc., 219 S.E. 2d 874, 877–78 (Va. 1975), *quoted in* Hunter v. Ramada Worldwide, Inc., No. 1:04CV00062ERW, 2005 WL 1490053, at *6 (E.D. Mo. June 23, 2005).

6. Pub. L. No. 109-2, 119 Stat. 4 (2005).

7. Barbara J. Rothstein & Thomas E. Willging, Managing Class Action Litigation: A Pocket Guide for Judges 1 (Fed. Judicial Ctr. 2d ed. 2009).

8. *Id.*

9. *Id.*

10. *In re* Am. Express Merchants' Litig., 554 F.3d 300, 312 (2d Cir. 2009), *vacated and remanded sub nom.*, Am. Express Co. v. Italian Colors Rest., 130 S. Ct. 2401 (2010).

11. Mace v. Van Ru Credit Corp., 109 F.3d 338, 344 (7th Cir. 1997).

12. Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997).

13. Fed. R. Civ. P. 23(b).

14. Most states provide a mechanism for class action treatment as well. Many of them mirror the procedure used in the Federal Rules of Civil Procedure, while others depart dramatically from it. Although state court class action practice is far from dead, the enactment of the CAFA markedly altered the landscape for state court class action practice, primarily by enabling defendants to more easily remove cases filed in state court. Because the model on which most class actions proceed is the one used in federal court, we focus our discussion in this article on Rule 23. Practitioners are advised to be cognizant of the differences between state and federal class action practice.

15. Fed. R. Civ. P. 23(a).

16. Daigle v. Shell Oil Co., 133 F.R.D. 600, 603 (D. Colo. 1990).

17. Colo. Cross-Disability Coal. v. Taco Bell Corp., 184 F.R.D. 354, 357 (D. Colo. 1999).

18. Cook v. Rockwell Int'l Corp., 181 F.R.D. 473, 480 (D. Colo. 1998).

19. *Id.*

20. J.B. v. Valdez, 186 F.3d 1280, 1288 (10th Cir. 1999).

21. Realmonte v. Reeves, 169 F.3d 1280, 1285 (10th Cir. 1999) (quoting DeBoer v. Mellon Mortgage Co., 64 F.3d 1171, 1174 (8th Cir. 1995)).

22. *E.g.*, *J.B.*, 186 F.3d at 1288 (citing K.L. v. Valdez, 167 F.R.D. 688, 690 (D.N.M. 1996)); *see also In Re* Am. Med. Sys., Inc. 75 F.3d 1069, 1080 (6th Cir. 1996); Baby Neal v. Casey, 43 F.3d 48, 56 (3d Cir. 1994).

23. *E.g.*, *Cook*, 181 F.R.D. at 481.

24. Joseph v. Gen. Motors Corp., 109 F.R.D. 635, 637 (D. Colo. 1986) (quoting Kornberg v. Carnival Cruise Lines, Inc., 741 F.2d 1332, 1337 (11th Cir. 1984)).

25. *E.g.*, Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 625–26 (1997) (citing E. Tex. Motor Freight Sys., Inc. v. Rodriquez, 431 U.S. 395, 403 (1977)); *see also* Schlesinger v. Reservists Comm. to Stop War, 418 U.S. 208, 216 (1974).

26. Rutter & Wilbanks Corp. v. Shell Oil Co., 314 F.3d 1180, 1187–88 (10th Cir. 2002).

27. Fed. R. Civ. P. 23(b)(1).

28. Fed. R. Civ. P. 23(b)(2).

29. Fed. R. Civ. P. 23(b)(3).

30. *E.g.*, Joseph v. Gen. Motors Corp., 109 F.R.D. 635, 641 (D. Colo. 1986) (quoting 7A C. Wright & A. Miller, Federal Practice and Procedure § 1778, at 53).

31. *E.g.*, *id.* at 641.

32. Blades v. Monsanto Co., 400 F.3d 562, 566 (8th Cir. 2005).

33. Fed. R. Civ. P. 23(b)(3)(A).

34. Fed. R. Civ. P. 23(b)(3)(B).

35. Fed. R. Civ. P. 23(b)(3)(C).

36. Fed. R. Civ. P. 23(b)(3)(D).

37. *Joseph*, 109 F.R.D. at 642 ("The individual questions presented can be resolved in separate proceedings."); Cook v. Rockwell Int'l Corp., 181 F.R.D. 473, 481–82 (D. Colo. 1998) (Despite facts suggesting individual issues concerning liability and damages, "resolution of the common issues will materially advance the resolution of the case itself.").

38. 155 F.3d 331, 334 (4th Cir. 1998).

39. *Id.* at 333.

40. Bird Hotel Corp. v. Super 8 Motels, Inc., 246 F.R.D. 603, 608 (D.S.D. 2007).

41. *Id.* at 607–08.

42. Bird Hotel Corp. v. Super 8 Motels, Inc., No. CIV06-4073, 2010 WL 572741 (D.S.D. Feb. 16, 2010).

43. Fed. R. Civ. P. 1.

44. Bonanno v. Quizno's Franchise Co., LLC, No. 06-cv-02358-CMA-KLM, 2009 WL 1068744, at *24 (D. Colo. Apr. 20, 2009).

45. *Id.* at *1.

46. Among them is the district court in *Bonanno*. 2009 WL 1068744, at *12.

47. Cicle v. Chase Bank USA, 583 F.3d 549, 554 (8th Cir. 2009).

48. Thibodeau v. Comcast Corp., 912 A.2d 874, 886 (Pa. Super. 2006).

49. An arbitration clause was struck down and a class action allowed to proceed in *Powertel, Inc. v. Bexley*, 743 So. 2d 570 (Fla. Dist. Ct. App. 1999), while an arbitration clause prohibiting class proceedings was enforced in *Fonte v. AT&T Wireless Servs., Inc.*, 903 So. 2d 1019 (Fla. Dist. Ct. App. 2005). The decisions can be reconciled based on their reasoning; in *Powertel*, the clause was found procedurally unconscionable because it was imposed unilaterally by the service provider during the term of customers' agreements, thus giving customers the untenable choice between switching providers and being subjected to the arbitration provision. 743 So. 2d at 574–75. In contrast, the service provider in *Fonte* included the class prohibition in an arbitration clause in the original service agreement signed by plaintiff, thus affording her a meaningful opportunity to reject the provision at no cost to her. 903 So. 2d at 1026–27.

50. Kinkel v. Cingular Wireless LLC, 857 N.E.2d 250, 274 (Ill. 2006). Several recent decisions enforce class arbitration prohibitions under the "meaningful opportunity to reject" analysis when

the terms of the agreements allowed plaintiffs to opt out of mandatory arbitration by providing notice within a certain period after the agreement went into effect. Fluke v. Cashcall, Inc., No. 08-5776, 2009 WL 1437593, at *7–8 (E.D. Pa., May 21, 2009); Honig v. Comcast of Ga. I, LLC, 537 F. Supp. 2d 1277, 1288–89 (N.D. Ga. 2008).

51. 446 F.3d 25 (1st Cir. 2006).

52. *Id*. at 58.

53. *Id*. at 59.

54. 130 S. Ct. 1758 (2010).

55. *Id*. at 1775–76.

56. *E.g.*, Bonanno v. Quizno's Franchise Co., LLC, No. 06-cv-02358-CMA-KLM, 2009 WL 1068744, at *9 (D. Colo. Apr. 20, 2009).

57. *Id.* at *11 (citing Ortiz v. Fibreboard Corp., 527 U.S. 815, 846 (1999)).

58. *Id*.

59. *Id.* at *15.

60. *Id.* at *16.

61. *Id.* at *18.

62. *Id*. at *19.

63. *Id.* at *20.

64. *Id*. at *21.

65. *Id.* at *23.

66. *Id*.

67. *Id*.

68. *Id.*

69. *E.g.*, Martrano v. Quizno's Franchise Co., LLC, No. 08-0932, 2009 WL 1704469, at *21 (E.D. Pa. June 15, 2009).

70. *Id.* at *20 (citing Stewart Org. v. Ricoh Corp., 487 U.S. 22 (1988)).

71. *Id*.

72. *Id*.

73. *E.g*., *Bonanno*, 2009 WL 1068744, at *22.

74. Professor Rosenbloom's central notion of countervailing power is itself derived from the work of John Kenneth Galbraith. *See, e.g.*, John Kenneth Galbraith, American Capitalism (1956).

75. Bert Rosenbloom, Marketing Channels: A Management View 127 (7th ed. 2004).

76. *Id*. at 133–34.

77. *Id*. at 137.

78. *Id*. at 279.

79. Compare discussion of small damages, *infra* notes 80–88 and accompanying text.

80. Under the rule of *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996), "generally applicable" state law contract defenses may be used to defeat arbitration provisions, while state law specifically targeting the enforcement of arbitration clauses cannot be given effect without violating the Federal Arbitration Act. Unconscionability is well established as one of the generally applicable defenses that can prevent enforcement of an arbitration clause containing a class action waiver or prohibition. Ting v. AT&T, 319 F.3d 1126, 1150 n.15 (9th Cir. 2003); Kinkel v. Cingular Wireless LLC, 857 N.E.2d 250, 261–62 (Ill. 2006).

81. Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004) (emphasis in original).

82. 113 P.3d 1100 (Cal. 2005).

83. *Id*. at 1110.

84. Smith v. Americredit Fin. Servs., Inc., No. 09cv1076 DMS (BLM), 2009 WL 4895280, at *7 (S.D. Cal. Dec. 11, 2009).

85. *E.g.*, Bonanno v. Quizno's Franchise Co., LLC, No. 06-cv-02358-CMA-KLM, 2009 WL 1068744, at *15 (D. Colo. Apr. 20, 2009).

86. Banus v. Citigroup Global Markets, Inc., No. 09 Civ. 7128 (LAK), 2010 WL 1643780, at *10 (S.D.N.Y. Apr. 23, 2010).

87. Schultz v. AT&T Wireless Servs., Inc., 376 F. Supp. 2d 685, 690–91 (N.D. W. Va. 2005).

88. Reid v. Supershuttle Int'l, Inc., No. 08-cv-4854 (JG) (WP), 2010 WL 1049613, at *3–4 (E.D.N.Y. Mar. 22, 2010).

89. *E.g.*, *In re* Am. Express Merchants' Litig., 554 F.3d 300, 318–20 (2d Cir. 2009). In May 2010, the Supreme Court granted certiorari and summarily vacated the court's decision, remanding for further consideration in light of *Stolt-Nielsen*. Am. Express Co. v. Italian Colors Rest., 130 S. Ct. 2401 (2010). The one-paragraph summary remand does not specify why the appellate decision was vacated; the Supreme Court held in *Stolt-Nielsen* that under Federal Arbitration Act principles, when an arbitration agreement is allowed, it is impermissible for an arbitration panel to impose class-based arbitration. Stolt-Nielsen, S.A. v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1775–76 (2010). Because the Second Circuit based its decision on "the federal substantive law of arbitrability" rather than unconscionability principles, 554 F.3d at 312, it appears that the Supreme Court believes the Second Circuit's approach resulting in the invalidation of the bar to class arbitration is inconsistent with the reasoning of *Stolt-Nielsen*. The Supreme Court has now expressed interest in reviewing courts' efforts to allow class actions to proceed in the face of arbitration agreements that prohibit class proceedings. In *AT&T Mobility LLC v. Concepcion*, 2010 WL 303962 (U.S. May 24, 2010), the Court accepted certiorari to determine whether the FAA preempts the State of California from conditioning enforcement of an arbitration clause on the availability of classwide arbitration. The Ninth Circuit did exactly that in *Laster v. AT&T Mobility*, 584 F.3d 849 (9th Cir. 2009), and the holding from *Laster* is now under attack.

90. Particularly significant in this context is the so-called endowment effect first explored by Kahneman and Tversky, in which a prospective loss of *X* amount is given substantially more weight by an individual than a prospective gain of equal magnitude. D. Kahneman & A. Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 Econometrica 263 (1979); William Poundstone, Priceless 98–101 (2010). There is extensive literature concerning the economics of contingent fee litigation, much of which would seem to be relevant to whether the stakes of victory for plaintiffs and their counsel will warrant individual lawsuits, e.g., Richard Posner, Economic Analysis of Law § 21.9, at 624–32 (5th ed. 1998), but this literature is rarely cited by courts analyzing the enforcement of class action prohibitions.

91. *E.g*., Cicle v. Chase Bank USA, 583 F.3d 549, 555 (8th Cir. 2009) (no unconscionability where plaintiff presented no evidence of high-pressure sales tactics); Fonte v. AT&T Wireless Servs., Inc., 903 So. 2d 1019, 1026 (Fla. Dist. Ct. App. 2005).

92. *See, e.g.*, Gentry v. Superior Court, 165 P.3d 556, 568 (Cal. 2007); Franco v. Athens Disposal Co., Inc., 171 Cal. App. 4th 1277, 1296 (Cal. Ct. App. 2009). Notably, both *Gentry* and *Franco* involved nonwaivable statutory claims relating to employee wages.

93. *E.g.*, *Franco*, 171 Cal. App. 4th at 1296.

Yes to Arbitration, but Did I Also Agree to Class Action and Consolidated Arbitration?

Joel D. Rosen and James B. Shrimp

In a recent franchise matter brought in state court involving multiple franchisee plaintiffs with nine separate franchise agreements, the authors sought to enforce the arbitration provisions within those agreements on behalf of the franchisor.[1] After arbitration was compelled, franchisee–plaintiffs filed a single arbitration demand, in essence consolidating all nine cases into a single arbitration. The authors objected to the ad hoc consolidation of the claims and requested that the American Arbitration Association (AAA) sever the claims administratively. However, the AAA required the appointment of a provisional arbitrator and briefing to determine the viability of the consolidation.

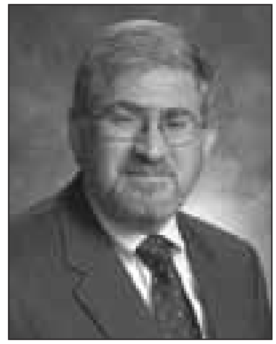
Flash back to *Green Tree Financial Corp. v. Bazzle*.[2] Until that 2003 U.S. Supreme Court decision, many standard arbitration provisions utilized in franchise agreements did not include any reference to consolidated arbitration or class action arbitration. It was presumed, at least by the franchisor, that the absence of any reference meant that consolidated or class action arbitrations were not permitted. However, due to six years of misguided court and arbitration decisions following *Bazzle*, many franchisors and other commercial entities have incorporated language into their arbitration provisions that seek to exclude the possibility of class action or consolidated arbitration.

Now flash forward to *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*,[3] in which the Supreme Court confirmed the presumption that consolidated or class action arbitrations were not permitted if not specifically referenced in a franchise agreement. The *Stolt-Nielsen* decision was limited, however, to a fact pattern in which the arbitration provision was silent as to class action arbitration, and the Court did not reach the issue of consolidation.

In the aftermath of the *Stolt-Nielsen* decision, this article examines the history of this area of the law and considers what language, if any, should be included or removed in an arbitration provision to prevent class action and/or consolidated arbitration.

CONSOLIDATED/CLASS ACTION ARBITRATIONS

In deciding whether to agree to an arbitration provision in commercial contracts, including franchise agreements, the parties to the contract weigh the benefits and disadvantages of arbitration. For the franchisor, the benefits of arbitration are (1) decreased attorney fees and other costs of litigation; (2) less intrusive discovery of franchisor records and limited depositions of franchisor representatives; (3) the streamlined procedure of arbitration, which results in quick resolution of claims; (4) the availability of knowledgeable arbitrators in the specific fields at issue; (5) no precedential value; and (6) the confidentiality of the proceeding and the filings versus the public nature of a court litigation. The disadvantages of arbitration are (1) the limited rights to appeal an adverse ruling or decision by the arbitrator and (2) the lack of any right to a jury trial. Most franchisors (and franchisees) find that the benefits of arbitration outweigh the disadvantages, thus explaining the wide incorporation of arbitration provisions in franchise agreements. Importantly, in incorporating an arbitration provision, the parties to the franchise agreement are, as a rule, only considering individual arbitration, i.e., arbitrating claims against each other.



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Consolidated arbitration and class action arbitration significantly alter the benefits and disadvantages of arbitration. A consolidated arbitration permits multiple plaintiffs (typically fewer than twenty) to bring all of their claims in a single arbitration against a defendant. In the franchise context, a consolidated arbitration permits multiple franchisees to bring all of their claims against the franchisor in a single arbitration. For example, if a group of franchisees in the same region believes that its contributions to a national advertising fund are not being spent properly, a consolidated arbitration would permit that group of franchisees to file a single arbitration against the franchisor.

A class action arbitration permits a single plaintiff to bring its claims and all of the claims of similarly situated parties in a single arbitration against a defendant. In the franchise context, a class action arbitration permits a single franchisee to bring its claims and the claims of all other franchisees against the franchisor in a single arbitration. For example, if one franchisee believes its contributions to a national advertising fund are not being spent properly, the franchisee could bring a class action arbitration on behalf of all franchisees in the system.

Obviously, the benefits of individual arbitration are greatly

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compromised in class action arbitrations and, to some extent, in consolidated arbitrations. A franchisor might opt for the streamlined procedures and limited review of arbitration for a single dispute with a franchisee that involves limited monetary exposure; however, the franchisor might not opt for the streamlined procedures and limited review of the arbitration of dozens, if not hundreds or thousands, of claims brought in a consolidated or class action arbitration with millions of dollars at stake. When drafting its franchise agreement, a franchisor probably is unaware and, as a result, does not consider that silence on this issue could create significant monetary exposure in damages and counsel fees.

Given the ever-changing developments in the law and its application, franchisors should consider including specific language prohibiting consolidated and class action arbitrations in a franchise agreement's arbitration provision.

FEDERAL ARBITRATION ACT

The Federal Arbitration Act (FAA) ensures the enforcement of arbitration provisions in contracts involving interstate commerce.[4] The U.S. Congress passed the FAA in response to some state courts' refusal to enforce arbitration provisions contained in contracts from other states. Arbitration is a matter of consent, and the FAA leaves it to the parties to establish the nature and scope of their arbitration.[5] It is in the discretion of the parties to craft arbitration provisions to specifically determine and state explicitly (1) where the arbitration will take place, (2) how many arbitrators there will be, (3) what rules and procedures will apply to the arbitration, and (4) what issues may be resolved in the arbitration.

The FAA provides that "a contract evidencing a transaction involving commerce" that contains a written provision to settle a controversy "arising out of such contract or transaction" by arbitration "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[6] *Commerce* in the FAA means "commerce among the several States or with foreign nations, or in any Territory of the United States."[7] "The term 'involving commerce' is not to be narrowly construed, and courts have found the requisite involvement where contractual activity facilitates interstate commercial transactions or where it affects commerce."[8] The Supreme Court later concluded that the FAA's reach extended to the full limits of Congress's Commerce Clause power.[9]

There can be no argument that a franchise system that is in multiple states and/or requires the delivery of materials from vendors in another state involves interstate commerce. For instance, the creation of a franchise relationship between a Pennsylvania franchisor and franchisees in New Jersey would clearly implicate interstate commerce "and creates significantly more than the 'slightest nexus' with interstate commerce that the [FAA] requires."[10]

The FAA applies even if the franchisee is in the same state as the franchisor, and the parties did not contemplate an interstate commerce connection.[11] In *Allied-Bruce Terminix Cos. v. Dobson*, a resident of Alabama purchased a lifetime termite maintenance agreement from an Alabama franchisee of Terminix.[12] Although the maintenance agreement was entered into between two Alabama parties, the *Allied-Bruce* Court held that interstate commerce was involved, in large part because the material used by the local franchisee was from out of state.[13]

If the arbitration provision is not governed by the FAA, a different analysis comes into play. In those instances, state law regarding contract interpretation and procedural rules regarding class actions and consolidation would apply. In such cases, whether an arbitration provision permits class action or consolidated arbitration would be determined on a state-by-state, contract-by-contract basis.

PRE-*BAZZLE*

Prior to 2003, consolidated or class action arbitration was generally not permitted by the FAA unless the arbitration provision explicitly provided for such arbitration. Although the FAA does not directly address the issue of consolidated or class action arbitration, the U.S. Supreme Court characterized the goal of federal arbitration legislation as the enforcement of arbitration agreements as intended by the parties, not the most expeditious dispute resolution. The Court held that

> [t]he legislative history of the [FAA] establishes that the purpose behind its passage was to ensure judicial enforcement of privately made agreements to arbitrate. We therefore reject the suggestion that the overriding goal of the [FAA] was to promote the expeditious resolution of claims. . . . The preeminent concern of Congress in passing the [FAA] was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate, even if the result is "piecemeal" litigation.[14]

Thereafter, the majority of the federal circuit courts determined that when an arbitration provision is silent as to whether claims are subject to class action or consolidation, the courts are without power to compel consolidation or class action arbitration. To compel consolidated or class action arbitration, express language in the arbitration provision is required.[15]

THE *BAZZLE* DECISION

In 2003, the Supreme Court opined on the limited question of "whether the Federal Arbitration Act, 9 U.S.C. § 1, *et seq*., prohibits class-action procedures from being superimposed onto an arbitration agreement that does not provide for class-action arbitration."[16] The *Bazzle* Court limited its review to class action arbitration and did not consider consolidated arbitration. After deciding to hear the case, however, the Court determined that it could not reach the question of whether the FAA prohibited class action arbitration because the arbitrator, not a court, had to make the initial decision about whether the arbitration provision explicitly provided for class action arbitration.[17] After hearing the case, the Court simply remanded for further proceedings consistent with the opinion.

POST-*BAZZLE*

Although the *Bazzle* decision never addressed whether the FAA prevented class action arbitration, a few federal appellate courts have subsequently misinterpreted the *Bazzle* decision and concluded that it overruled the previous decisions interpreting the FAA. However, a close look at the *Bazzle* decision does not suggest any departure from the Supreme Court's consistent holdings that the scope of the arbitrator's authority under the FAA is determined solely by the parties' agreement.[18] The *Bazzle* Court at most concluded only that it is for the arbitrator to determine, in the first instance, whether the arbitration provision at issue is or is not silent on the issue of class arbitration. The *Bazzle* Court engaged in no discussion regarding the permissibility of class or consolidated proceedings if the arbitration provision is silent, and did not reference any of the cases that previously addressed consolidated and class action arbitration in a absence of a specific arbitration provision.

What many arbitrators failed to do was to take a close look at the *Bazzle* decision to note its inherent limitations.

AAA RESPONDS TO *BAZZLE*

After the *Bazzle* decision, the AAA, "in response to the ruling of the United States Supreme Court in *Green Tree Financial Corp. v. Bazzle*," issued Supplementary Rules of Class Arbitrations "to govern proceedings brought as class arbitration."[19] These rules provide, inter alia, that the arbitrator, as a threshold matter, must determine "whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class."[20] In addition, the rules eliminate the presumption of confidentiality, making the arbitration hearings and the decisions (and certain filings, including the demand and the award) public.[21] The rules also provide that the AAA will administer demands for class arbitration if the underlying agreement provides for arbitration via the AAA and if the agreement is silent with respect to class claims, consolidation, or joinder of claims.[22]

In *Bazzle*'s aftermath, a number of arbitrators have determined that class action arbitration is permitted under arbitration provisions when the arbitration provision is silent as to the permissibility of class action arbitration. In making these determinations, the arbitrators relied upon a number of rationales. Because the AAA rules specifically provide for class arbitration, arbitrators determined, in some instances, that class arbitration should be permitted if the arbitration provision was silent.[23] Other arbitrators looked to the law of the state where the arbitration was brought to determine whether class action arbitration was permissible.[24] Still others held that if the arbitration clause encompassed any and all claims and disputes, the clause in and of itself was sufficiently broad to allow for class arbitration.[25] Many arbitrators concluded that the *Bazzle* decision indirectly permitted class action arbitration under the FAA when the arbitration provision was silent as to that issue because otherwise the *Bazzle* Court would have issued a bright-line rule prohibiting class action arbitration instead of leaving it up to arbitrators to decide.[26]

What many arbitrators failed to do was to take a close look at the *Bazzle* decision to note its inherent limitations. Namely, the *Bazzle* Court never reached a determination whether class action arbitration was permitted under the FAA. The Supreme Court cleared up this misinterpretation in the *Stolt-Nielsen* decision.

STOLT-NIELSEN

The Supreme Court granted certiorari in the *Stolt-Nielsen* case to decide "whether imposing class arbitration on parties whose arbitration clauses are 'silent' on that issue is consistent with the Federal Arbitration Act (FAA)."[27] The *Stolt-Nielsen* case involved a dispute between maritime shipping companies and their customers. Specifically, the customers alleged that the shipping companies were engaging in anticompetitive behavior that led to overcharging.[28] The agreements between the parties contained an arbitration provision that was silent as to whether class action arbitration was permitted.[29] Although a number of separate cases were brought by customers in different federal district courts, the Judicial Panel on Multidistrict Litigation consolidated the pending actions, and arbitration was ordered.[30] Thereafter, a customer, AnimalFeeds, served Stolt-Nielsen with a demand for class arbitration. The parties agreed to submit the issue of class arbitration to a provisional panel.[31]

The provisional panel determined that although the arbitration provision was silent as to class action arbitration, class action arbitration was permitted.[32] The *Stolt-Nielsen* Court noted that "the provisional panel thought that *Bazzle* controlled the resolution of the question whether the arbitration provision permitted the arbitration to proceed on behalf of a class."[33] The provisional panel's decision was appealed to the U.S. District Court for the Southern District of New York, which reversed, holding that the decision was in manifest disregard of maritime law because the provisional panel failed to engage in a choice of law analysis.[34] AnimalFeeds appealed to the Second Circuit, which reversed the decision of the Southern District and reinstated the provisional panel's decision, finding no manifest disregard of any maritime law.[35]

The Supreme Court concluded that imposing class action arbitration on parties that have not agreed to authorize class arbitration is inconsistent with the FAA, and that a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so. The *Stolt-Nielsen* Court further held that the mere existence of an agreement to arbitrate cannot be inferred to permit class action arbitration.

Initially, the Court noted that the provisional panel's reliance on the *Bazzle* decision was misplaced. Justice Alito noted that "when *Bazzle* reached this Court, no single rationale commanded a majority. . . . [T]he plurality opinion decided only the first question, concluded that the arbitrator and not a court should decide whether the contracts were indeed 'silent' on the issue of class arbitration."[36] The *Bazzle* plurality did not decide what standard was appropriate in determining whether an arbitration provision allows class arbitration. Although the concurrence addressed this issue, *Bazzle* did not yield a majority decision on this issue.[37]

The *Stolt-Nielsen* decision casts doubt as to whether the *Bazzle* decision even requires an arbitrator, rather than a court, to decide whether an arbitration provision permits class arbitration.[38] More importantly, however, the Court ruled clearly that "*Bazzle* did not establish the rule to be applied in deciding whether class arbitration is permitted. The decision in *Bazzle* left that question open."[39] The Court reasoned that the FAA's purpose in enforcing agreements to arbitrate, while keeping in mind the tenet "that arbitration 'is a matter of consent, not coercion,'"[40] is the preeminent concern in making this determination. And, therefore, the Court determined that if the arbitration provision is silent as to class action arbitration, class action arbitration is not permitted under the FAA.[41] In reaching this decision, the Court observed that there can be no implicit agreement to permit class action arbitration because "class action arbitration changes that nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an arbitrator."[42]

Stolt-Nielsen has brought some clarity as to when class action arbitration is permitted under the FAA.

This is the extent of the *Stolt-Nielsen* decision. The Court did not decide "what contractual basis may support a finding that the parties agreed to authorize class-action arbitration."[43] Thus, at least two questions are left open by *Stolt-Nielsen*: (1) what language in an arbitration provision would permit class action arbitration and (2) whether the analysis is the same for consolidated arbitration.

As to both questions, one should anticipate that the Supreme Court will require an express agreement within an arbitration provision to engage in class action arbitration. Whether the Court would require an express agreement to permit consolidated arbitration is an open question, one that is beginning to be debated by the lower federal courts. Notably, the *Stolt-Nielsen* Court emphasized the prior decisions of the Supreme Court, which held that the FAA's central purpose is to ensure that private agreements to arbitrate are enforced according to their terms. Moreover, the *Stolt-Nielsen* Court emphasized that the parties are generally free to structure their arbitration agreements as they see fit and that the parties may "specify with whom they choose to arbitrate."[44]

POST–*STOLT-NIELSEN*

In the last several months, a number of federal courts have considered the *Stolt-Nielsen* decision. Three cases are of particular note.

In *Anwar v. Fairfield Greenwich Ltd.*, the Southern District of New York considered whether the *Stolt-Nielsen* decision prevents consolidated arbitration when the arbitration agreement is silent.[45] In *Anwar*, a number of overseas investors who were caught up in the Bernie Madoff Ponzi scheme brought suit to recover their investment in one of the scheme's feeder funds, Fairfield Sentry. The overseas investors had twenty-four separate investment accounts with a company named Standard Chartered and used these accounts to purchase shares of Fairfield Sentry. The Standard Chartered accounts were governed by brokerage client agreements requiring arbitration. The arbitration provision provided that "no person shall bring a putative or certified class action to arbitration."[46]

In the aftermath of Madoff's admission, the overseas investors brought a consolidated arbitration alleging that no due diligence was performed prior to recommending investment in Fairfield Sentry.[47] Then, shortly after the *Stolt-Nielsen* decision, the AAA entered a partial award permitting the consolidated arbitration to continue, reasoning that the arbitration agreement was ambiguous because the arbitration explicitly prohibited class arbitration but did not mention consolidated arbitration. After analysis of state law and industry practice, the partial award permitted the consolidated arbitration to move forward. The Southern District of New York agreed with the partial award. The *Anwar* court determined that the *Stolt-Nielsen* decision was limited to class action arbitrations, in large part because the changes in the arbitral bargain caused by class action arbitration are not similarly wrought in a consolidated proceeding.[48] Specifically, confidentiality is maintained in a consolidated arbitration, and there are not an overwhelming number of plaintiffs that would cause issues relating to discovery and the arbitration proceeding itself. Therefore, the *Anwar* court permitted consolidated arbitration to proceed even though the arbitration provision did not address consolidated arbitration.

In two other cases, the federal court for the Western District of Washington and the Second Circuit (applying California law) expressed concern over whether the *Stolt-Nielsen* decision runs afoul of state law prohibiting class action waivers. The Western District of Washington in *Mansker v. Farmers Insurance Co. of Washington* discussed this issue, although ultimately it did not rule upon the apparent conflict between *Stolt-Nielsen* and the state's common law.[49] In *Mansker*, class action plaintiff argued that the *Stolt-Nielsen* decision prohibiting class action arbitration when the arbitration agreement is silent acts as a de facto class action waiver.[50] The *Mansker* court never reached a determination on this issue but did note that it raised troubling issues under Washington law.[51]

In *Fensterstock v. Education Finance Partners*, the Second Circuit considered whether a class action waiver within an arbitration provision in a student loan agreement was unconscionable and whether *Stolt-Nielsen* figured into the decision.[52] There, plaintiff brought an action on behalf of himself and others similarly situated, alleging that certain student loan providers and servicers engaged in fraudulent and deceptive practices. Defendants filed a motion to compel individual arbitration in accordance with the terms of plaintiff's loan agreement. The district court denied defendants' motion, holding that the arbitration clause was unconscionable under California law.[53] On appeal, the Second Circuit agreed with the district court. The court concluded that under California law, the class action arbitration waiver clause found within the student loan agreement was unconscionable and therefore unenforceable.[54] In doing so, the court emphasized that the student loan agreement was a consumer contract of adhesion and not a contract bargained for by equal parties.[55]

THE CONSEQUENCES

"Unexpected and involuntary [consolidated or] class action arbitration fundamentally alters the risks and benefits of the original arbitration" provision. Such a change can transform an individual arbitration of a limited franchise dispute into a "sprawling, high-stakes" arbitration without the safeguards of actual litigation (such as full appellate review).[56]

Although there is now some certainty regarding arbitration provisions that are silent as to class action arbitration, franchisors would be prudent to take steps to remove this determination from the hands of the arbitrators/courts by reviewing and, if necessary, redrafting arbitration provisions in their franchise agreements. Otherwise, franchisees may be successful in exploiting the void in Supreme Court jurisprudence regarding consolidated arbitration. Until that void is filled, franchisors should include language specifically forbidding consolidated arbitration in the franchise agreement, as well as language prohibiting class action arbitration. In drafting and entering into such a waiver, however, the franchisor must consider applicable state common law (and perhaps statutory law) regarding class action/consolidation waivers and whether such provisions are considered an unconscionable contract provision, thus invalidating the waiver.

As an example, the arbitration provision that led to the attempted consolidation of nine franchisees' arbitrations in which the authors are involved made no mention of consolidated or class action arbitration:

> Except as specifically otherwise provided in this Agreement, and in the event that Franchisee or Franchisor seeks injunctive relief under this Agreement, each of us agree that any and all disputes between us, and any claims by either of us that cannot be amicably settled, will be determined solely and exclusively by arbitration in accordance with the then existing rules of the American Arbitration Association at its nearest Pennsylvania office, subject to the following:
>
> Franchisee and Franchisor will select one arbitrator, and the two so designated will select a third arbitrator. If either of us fails to designate an arbitrator within 7 days after arbitration is requested, then a single arbitrator will be selected by the American Arbitration Association upon application of either you or Franchisor. Arbitration proceedings will be conducted in accordance with the rules then prevailing of the American Arbitration Association at its Yardley, Pennsylvania, office. Judgment upon an award of the majority of the arbitrators will be binding, and will be entered in a court of competent jurisdiction.
>
> Nothing herein contained will bar the right of Franchisee or Franchisor to obtain injunctive relief against threatened conduct that would violate this Agreement or cause loss of damages.[57]

Although under *Stolt-Nielsen* the absence of any mention of class action arbitration is sufficient to prevent class action arbitration, there are still issues such as consolidated arbitration and state laws regarding, inter alia, class action waivers. Therefore, the prudent practice is to include a provision that explicitly prohibits class action and consolidated arbitration, such as "Franchisee agrees that it will not file any arbitration claim as a class action, seek class action status, or permit its claim to be joined or made part of any class action filed by another. Franchisee further agrees that it will not file or join in any consolidated arbitration." If a given state has a statute relating to class action waivers, additional language may be mandated by statute.

CONCLUSION

For franchisors, class action arbitration and consolidated arbitration create uncertainty in their relations with franchisees. The *Stolt-Nielsen* decision has brought some clarity as to when class action arbitration is permitted under the FAA. This clarity will assist franchisors in drafting and enforcing arbitration provisions related to both class action and consolidated arbitration. The careful draftsman will be certain to clearly exclude class actions and consolidation of claims from the franchise agreement's arbitration provision. However, franchisors and their counsel must keep an eye on future developments in this area, especially related to consolidated arbitration, as it is likely that this area of the law will continue to evolve.

ENDNOTES

1. Biffle v. Slim & Tone, LLC, C.A. No. 2008-07157-19 (Pa. C.C.P. 2010).

2. 539 U.S. 444 (2003).

3. 130 S. Ct. 1758 (U.S. 2010).

4. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 54 (1995).

5. 9 U.S.C. § 2.

6. 9 U.S.C. § 2.

7. 9 U.S.C. § 1.

8. Seltzer v. Klein, 1989 WL 41288, at *3 (E.D. Pa. Apr. 20, 1989) (citing Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 401–02, n.7 (1967)).

9. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 274–75 (1995).

10. B.G. Balmer & Co., Inc. v. U.S. Fid. & Guar. Co., 1998 WL 764669, at *3 (E.D. Pa. Oct. 30, 1998) (interstate commerce involved regarding an agreement creating an agency relationship between Maryland corporation and a Pennsylvania corporation); *see also* Allison v. Medicab Int'l, Inc., 597 P.2d 380 (Wash. 1979) (franchise agreement between New York corporation and Washington resident was in interstate commerce).

11. *Allied-Bruce*, 513 U.S. at 281.

12. *Id.* at 268.

13. *Id.* at 282; *see also* Troshak v. Terminix Int'l Co., 1998 WL 401693, at *1 (E.D. Pa. July 2, 1998); Feinberg v. Ass'n of Trial Lawyers Assurance, 2002 WL 31478866, at *1 (E.D. Pa. Nov. 4, 2002).

14. Dean Witter Reynolds, Inc. v. Boyd, 470 U.S. 213, 219–21 (1985).

15. *See* Am. Centennial Ins. Co. v. Nat'l Cas. Co., 951 F.2d 107 (6th Cir. 1991); Baesler v. Cont'l Grain Co., 900 F.2d 1193 (8th Cir. 1990); Protective Life Ins. Corp. v. Lincoln Nat'l Life Ins. Corp., 873 F.2d 281 (11th Cir. 1989); Weyerhaeuser Co v. W. Seas Shipping Co., 743 F.2d 635 (9th Cir. 1984); Phila. Reins. Corp. v. Emp'rs Ins. of Wausau, 61 F. App'x 816, 820 (3d Cir. 2003) (citing Champ v. Siegel Trading Co., 55 F.3d 269, 274–75 (7th Cir. 1995)); *see also* Certain Underwriters at Lloyd's v. Century Indem. Co., 2005 WL 1941652, at *2 (E.D. Pa. Aug. 1, 2005).

16. Green Tree Fin. Corp. v. Bazzle, 2002 WL 32101094 (U.S. 2002); *see also* Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444, 447 (2003).

17. *Bazzle*, 539 U.S. at 447.

18. *See, e.g.*, UPS v. Int'l Bhd. of Teamsters, 55 F.3d 138, 141 (3d Cir. 1995); *see also* ReliaStar Life Ins. Co. of N.Y. v. EMC Nat'l Life Co., 564 F.3d 81, 85 (2d Cir. 2009).

19. *See* AAA Policy on Class Arbitrations (July 14, 2005).

20. *See id.* Rule No. 3.

21. *See id.* Rule Nos. 9, 10.

22. *See id.* Rule No. 18.

23. *See* Bess v. DIRECTV, Inc., AAA No. 11-140-02228-08 (Sept. 17, 2009).

24. *See* Cable Connection, Inc. v. DIRECTV, Inc., AAA No. 11-145-00752-04 (Feb. 8, 2005). In his thoughtful dissent, arbitrator Richard Chernick noted that the procedural law that applied to the arbitrator was the Federal Arbitration Act, not California procedural law; and, as a result, California procedural law is not pertinent to determining whether class action arbitration is permissible. Instead, Mr. Chernick looked to the plain meaning of the arbitration provision, which did not contemplate or permit class action arbitration.

25. *See* Herbert Kirsh v. Finova Group, AAA No. 11-148-Y-01381-07 (Sept. 26, 2008); Champion Ford Lincoln Mercury, Inc. v. Dealer Computer Servs., Inc., AAA No. 11-117-01935-06 (June 5, 2007).

26. *See e.g.*, *Champion Ford*, AAA No. 11-117-01935-06, at 7.

27. Stolt-Nielsen v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1764 (2010).

28. *Id.* at 1765.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.* at 1766.

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.* at 1771.

37. *Id.*

38. *Id.* at 1772 ("Unfortunately, the opinions in *Bazzle* appear to have baffled the parties in this case at the time of the arbitration proceeding. For one thing, the parties appear to have believed that the judgment in *Bazzle* requires an arbitrator, not a court, to decide whether a contract permits class arbitration.").

39. *Id.*

40. *Id.* (quoting Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989)).

41. *Id.* at 1775.

42. *Id.* at 1776.

43. *Id*.

44. *Id.*

45. *See* Anwar v. Fairfield Greenwich Ltd., 2010 WL 3431126, at *12–13 (S.D.N.Y. Aug. 20, 2010).

46. *Id.* at *1.

47. *Id.* at *4.

48. *Id.* at *12.

49. Mansker v. Farmers Ins. Co. of Wash., 2010 WL 3699847 (W.D. Wash. Sept. 14, 2010).

50. *Id.* at *2.

51. *Id.*

52. Fensterstock v. Educ. Fin. Partners, 611 F.3d 124 (2d Cir. 2010).

53. *Id.* at 127.

54. *Id.* at 140.

55. *Id.* at 139–40.

56. Stolt-Nielsen v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1764 (2010).

57. Biffle v. Slim & Tone, LLC, C.A. No. 2008-07157-19 (Pa. C.C.P. 2010).

The New Federal Gift Card Regulations

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Spending on gift cards for the 2010 holiday season was expected to reach $24.78 billion, with the average American spending approximately $146 on gift cards.[1] The amount that holiday shoppers were expected to spend in 2010 was almost $6 more than the previous year.[2] Given the obvious popularity of gift cards, most retailers likely feel obligated to offer gift cards to their customers. But retailers that sell or intend to start selling gift cards should proceed cautiously because more than forty states have consumer protection laws that govern them. Additionally, the federal government recently enacted a new law that establishes new minimum standards for gift card disclosures, expiration dates, service fees, and dormancy charges. Simply stated, a franchisor that currently sells or wishes to sell gift cards to its system's customers must become very familiar with the new federal gift card law and the many state laws that apply to the sale of gift cards.

This article provides a detailed description of the new federal gift card law and a basic road map of the various state laws. It also suggests steps that a franchisor can take to comply with the new federal gift card law and highlights issues that a franchisor should consider before establishing a gift card program. It is also important that franchisees become familiar with gift card laws because potential liability exists for sellers of gift cards as well as issuers under the new federal law. Franchisees also are typically obligated to comply with applicable law under their franchise agreements and should ensure that their implementation of any gift card program complies with state gift card regulations and unclaimed property laws.

NEW FEDERAL REGULATIONS

On May 22, 2009, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) was signed into law.[3] The Credit CARD Act amended the Electronic Fund Transfer Act (EFT Act);[4] imposed new requirements for expiration dates and dormancy, inactivity, and service fees associated with gift cards; and granted authority to the Board of Governors of the Federal Reserve System (Board) to promulgate regulations to implement these new requirements (federal gift card regulations).[5] Pursuant to § 403 of the Credit CARD Act, the federal gift card regulations were to become effective on August 22, 2010. However, on July 27, 2010, Congress passed legislation amending § 403 of the Credit CARD Act to delay the effective date for certain gift card disclosure provisions[6] to January 31, 2011, as long as certain conditions are satisfied.[7]

The federal gift card regulations apply to store gift cards, gift certificates, and general use prepaid cards.[8] A store gift card is a card, code, or other device issued to a consumer in a specified amount that can be increased or reloaded by the consumer and that can be redeemed for goods and services at a single merchant or an affiliated group of merchants.[9] An affiliated group of merchants is defined as "two or more affiliated merchants or other persons that are related by common ownership or corporate control . . . and that share the same name, mark, or logo."[10] In the franchise context, "the term includes franchisees that are subject to a common set of corporate policies or practices" pursuant to their franchise agreements.[11] Unless excluded under the federal gift card regulations, so-called closed loop cards are generally considered to be gift certificates or store gift cards. A gift certificate is basically a store gift card except that a gift certificate's value cannot be increased or reloaded.

A general use prepaid card is essentially the same as a store gift card except that it can be redeemed for goods and services at multiple unaffiliated merchants or used at ATMs.[12] Unless excluded under the federal gift card regulations, open loop cards are generally considered to be general use prepaid cards.[13] One common example of a general use prepaid card is an open loop card issued by a bank that can be used at any retailer that accepts that card brand (e.g., VISA or MasterCard).[14]

The federal gift card regulations apply to both issuers and sellers of gift cards. Because franchisors usually manage or control the establishment of a franchise system's gift card program and franchisees sell the program's gift cards

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to consumers, the federal gift card regulations apply to both franchisors and franchisees.

DISCLOSURES

The federal gift card regulations contain a complex array of disclosure requirements that may apply differently depending on the circumstances, e.g., whether a consumer purchases an instrument such as a card, code, or device in person or over the telephone. As noted below, certain disclosures must appear on the face of the gift card; others can be made on packaging, electronically, or verbally. If certain disclosures are made on accompanying contract documents rather than on the card itself, the disclosures will not comply with the "clear and conspicuous" disclosure requirements.[15] Certain important disclosure requirements are summarized below:

- Dormancy, inactivity,[16] and service fees[17] must be disclosed on the card and be visible to the consumer without the need to remove packaging or other materials at the time of sale. The amount of such fees, how often fees may be assessed, and the fact that fees may be assessed for inactivity must be disclosed prior to purchase, regardless of whether a gift card is purchased in person, via the Internet, or by phone.[18]
- A toll-free phone number and a web address, if one is maintained, where consumers may obtain fee information or a replacement gift card must be disclosed.[19]
- Information regarding whether funds underlying a gift card may expire must be disclosed on the gift card.[20]
- Electronic disclosures cannot be given through a hyperlink or in a manner where the purchaser can easily bypass the disclosure.[21]
- In situations where oral disclosures are allowed, written or electronic disclosures must also be made on or with the gift card.[22]

EXPIRATION DATES

Under the federal gift card regulations, gift cards may not be sold or issued unless the expiration date of the underlying funds is at least five years after the date of issuance (for a gift certificate) or five years after the date funds were last loaded (for a store gift card or general use prepaid card).[23] This requirement can present complications because, in certain instances, the expiration date for the underlying funds can be different from the printed expiration date on the card. For example, if a consumer loads additional funds on a card with a printed expiration date that is less than five years after the date the funds are loaded, that card would violate the federal regulations. To address the possibility of consumer confusion regarding differences between the gift card expiration date and the expiration date for the underlying funds, the Board adopted an approach to ensure that consumers have an adequate period of time to spend gift card funds.[24] Specifically, policies and procedures must be in place to give consumers a reasonable opportunity to purchase a gift card with at least five years remaining until the gift card expiration date.[25] The Board explained that consumers are deemed to have a reasonable opportunity to purchase a gift card with at least five years remaining until the gift card expiration date if (1) policies and procedures are in place to prevent the sale of a gift card that does not have an expiration date during the five years after the date that the gift card was sold or initially issued to a consumer, or (2) a gift card is available to consumers to purchase five years and six months before the gift card expiration date.[26]

DORMANCY, INACTIVITY, AND SERVICE FEES

The federal gift card regulations prohibit dormancy, inactivity, or service fees on gift cards unless three conditions are satisfied.[27] First, there must be no activity on the card or certificate during the one-year period before the fee is imposed.[28] For purposes of this condition, the term activity relates to any action by the consumer to use the funds on the card or certificate (i.e., increasing, decreasing, or otherwise using the funds).[29] If a fee is imposed because one year has passed with no activity and the consumer then uses the card or certificate the following month, another fee cannot be imposed until another year of inactivity passes. Second, only one dormancy, inactivity, or service fee can be imposed in any given calendar month.[30] For example, if a dormancy, inactivity, or service fee is imposed on February 24, the next such fee could not be imposed until March 1 at the earliest. Finally, dormancy, inactivity, and service fees must be disclosed "clearly and conspicuously" on the card or certificate, and such disclosures must be provided to the consumer prior to purchase.[31] Although the federal gift card regulations regulate the frequency of fees and require certain disclosures, they do not mandate or limit the amount of any fees imposed.

EXCLUSIONS

The federal gift card regulations exclude certain card products, including an electronic promise, plastic card, or payment code or device that falls into one of the following six categories:[32]

- cards usable solely for telephone services;
- reloadable cards not marketed or labeled as a gift card;
- loyalty, award, or promotional gift cards;
- cards not marketed to the general public;
- cards issued in paper form only; and
- cards redeemable solely for admission to events or venues.

FEDERAL PREEMPTION

The federal gift card regulations do not preempt state laws if state laws provide greater consumer protection than the federal gift card regulations.[33] In the approximately ten states without gift card regulations, the federal gift card regulations establish a minimum standard for expiration dates and dormancy, inactivity, and service charges. But for the states with their own gift card regulations, the analysis is more complex. Franchisors should carefully evaluate the differences between the federal gift card regulations and the applicable state regulations because many state regulations provide greater protection to consumers. The impact of the federal gift card regulations in these states will depend on the extent to which the state regulations address disclosures, the fees that can be charged in a given month, and the length of inactivity required before service fees can be charged. In other instances, it may be unclear whether the state or the federal regulatory system provides the greater consumer protection and therefore trumps the other.

One potential preemption issue involves the expiration date restrictions under federal . . . gift card regulations and state escheat laws.

One potential preemption issue involves the expiration date restrictions under the federal gift card regulations and the obligations under state unclaimed property, or escheat, laws. Escheat laws in many states require issuers of unused gift cards (or cards with unused balances) to transfer, or escheat, any remaining funds after a certain period of time to the state where the cardholder resides or the issuer is incorporated. Although time periods vary, funds typically must be transferred to the state either three or five years following the sale or the last use of the card.[34] As noted above, the expiration date requirements under the federal gift card regulations do not allow the funds to expire for at least five years. Thus, it is possible that issuers will be obligated to transfer unspent funds to certain states after three years while simultaneously being required to maintain adequate funds to cover the five-year expiration period required by the federal gift card regulations.[35]

Because state escheat laws vary, the Board decided that it was not feasible or prudent to make a preemption determination that applied generally to all states. Upon request for a preemption determination with respect to a particular state's escheat law, the Board will apply the general preemption standards discussed previously to determine whether the state law is inconsistent with the federal gift card regulations.[36] In this scenario, the Board's analysis would be published for notice and comment; and, if the Board were to determine that the state law is preempted, the final determination would be published in the commentary. Franchisors should monitor the Board's activity and be prepared to act in response to a Board ruling if necessary. State escheat laws are discussed below in the section on state gift card regulations, and a reference chart is also provided on pages 189–90 that includes references to the various state escheat laws.[37]

ENFORCEMENT ACTIONS

Failure to comply with the federal gift card regulations is a violation of the EFT Act. A merchant found liable for a violation of the federal gift card regulations is liable to the consumer for (1) actual damages; (2) statutory damages of \$100 to \$1,000 for an individual action or up to \$500,000 or 1 percent of the merchant's net worth in a class action; and (3) the costs of the action, including reasonable attorney fees.[38] The Federal Trade Commission (FTC) has the authority to enforce compliance with the requirements of the EFT Act.[39] If a violation of the federal gift card regulations occurs, it will be considered a violation of the FTC Act.[40] The FTC has the authority to commence a civil action to recover penalties for violations of the federal gift card regulations under the FTC Act.[41]

Prior to enactment of the federal gift card regulations, FTC law enforcement actions regarding gift cards focused on violations of the FTC Act. In its first gift card enforcement action in 2007, the FTC alleged that Kmart Corporation engaged in deceptive or unfair practices in the advertisement and sale of its Kmart gift cards.[42] In particular, the FTC claimed that Kmart advertised its Kmart gift cards as cash equivalents, even though dormancy fees were charged after two years of nonuse; misrepresented that the gift cards would never expire; and failed to include proper disclosures. The problems with Kmart's gift card program included disclosures in legalese located in fine print on the back of the gift card, failure to make presale disclosures for online sales, and packaging of gift cards in a manner that completely concealed the disclosures until the packaging was removed. Kmart and the FTC settled the matter in 2007 with Kmart agreeing (1) to disclose clearly and prominently any expiration dates and fees in all advertising and on the front of the gift card; (2) to disclose clearly and prominently, at the point of sale and prior to purchase, all material terms and conditions of any expiration dates and fees; (3) not to misrepresent any material terms and conditions of the gift card; (4) not to collect dormancy fees on any cards sold prior to the date the proposed order was issued; (5) to refund all dormancy fees for consumers who provide the number for the affected gift card; and (6) to publicize the refund program on its website.[43]

In its second enforcement action, also initiated in 2007, the FTC alleged that Darden Restaurants, Inc. failed to adequately disclose its dormancy fees.[44] Specifically, the FTC argued that the following fee disclosure practices were inadequate: (1) disclosing the fee in fine print on the back of gift cards that was obscured by other information; (2) marketing transparent gift cards with a red lobster on the front that hid the disclosure; (3) marketing cards to consumers in restaurants without notifying them of the fee; and (4) selling cards on the company websites without disclosing prior to purchase that a fee may apply.[45] Darden Restaurants, which owns the Olive Garden, Red Lobster, Smokey Bones, and Bahama Breeze chains, eventually settled the matter and agreed to disclose clearly and prominently all automatic fees and expiration dates in its advertising, at the point of sale, and on the actual card.[46] Darden was also required to restore all dormancy fees and publicize the restoration program on its website for a two-year period.[47]

STATE GIFT CARD REGULATIONS

Depending on the wording of the state statute and the state attorney general's attention to gift card matters, franchisors and franchisees may both be liable for violations of state gift card regulations. Approximately forty states have gift card regulations, and many have escheat laws that will impact a franchise system's gift card program. Similar to the federal gift card regulations, but in many cases more restrictive, state gift card laws focus on disclosures, expiration dates, and fees. At issue are fees that decrease the balance of the gift card, such as dormancy fees, replacement card fees, and other service fees. Because the federal gift card regulations may not preempt state law in many instances, franchisors that intend to establish a gift card program should carefully analyze all applicable state gift card regulations, many of which contain disclosure requirements that are different than the federal gift card regulations, as well as additional expiration date restrictions and fee restrictions. This exercise is critical if the franchisor intends to impose expiration dates or charge fees. State gift card regulations may also provide an additional set of exemptions and exclusions and allow the customers to redeem the balance of their gift cards for cash under certain circumstances. An in-depth discussion of state gift card regulations and escheat laws, which vary greatly from state to state, is beyond the scope of this article, but the following summarizes certain important topics and highlights issues of which franchisors and franchisees should be aware.

Depending on the wording of the state statute, . . . franchisors and franchisees may both be liable for violations of state gift card regulations.

The gift card regulations vary greatly on the issue of expiration dates. California, Connecticut, Florida, Maine, Minnesota, Montana, New Hampshire, Rhode Island, and Washington all prohibit expiration dates on gift cards.[48] Of the many states that allow expiration dates, Arizona, Georgia, Nebraska, Nevada, New York, North Carolina, Oregon, South Dakota, Texas, Utah, and Virginia all require that the expiration date be disclosed.[49] Further adding to the complexity regarding expiration dates, many states allow for expiration dates but require that the gift card remain valid for a certain minimum time period.[50]

Many states have regulations that govern the fees that a gift card issuer can charge. Connecticut, Florida, Illinois, Kentucky, Massachusetts, Michigan, Minnesota, Montana, New Hampshire, New Mexico, North Dakota, Oregon, Rhode Island, and Vermont are examples of states that prohibit a gift card issuer from charging service fees.[51] Although other states allow a gift card issuer to charge fees, these fees often must be disclosed to the customer.[52] In the states that allow a gift card issuer to charge fees, a number provide that fees cannot be charged for a specified period of time after the card is purchased,[53] and others allow fees only in very limited circumstances.[54]

ESCHEAT LAWS

Escheat of funds associated with gift cards, discussed above in the context of preemption, poses several challenges for franchisors either operating or considering a gift card program. In addition to imposing varying time periods in which they require unclaimed property to be escheated, many states have instituted reporting obligations with respect to unclaimed property. These requirements vary from state to state. The first step of ensuring compliance with escheat laws is to identify which laws among the fifty states (as well as the District of Columbia) are applicable.[55] Factors that impact that assessment, among others, include the unclaimed property holder's domicile (i.e., the state of incorporation or formation of the franchisor, not its principal place of business), the gift card owner's residence, and the state in which the gift card was purchased. As a general rule, priority between states with respect to the right to escheat gift card funds is determined by a trilogy of U.S. Supreme Court cases. Under the primary rule, the state of the creditor/owner's last known address as shown on the debtor's record has the first right to escheat.[56] If the primary rule does not apply because this information does not appear on the debtor's records or that state does not require escheat, then the secondary rule provides that the state of incorporation of the debtor has priority to escheat the unclaimed property.[57] The third rule, frequently referred to as the "state of transaction" rule, applies when the first two rules are not applicable.[58] Notably, many gift card issuers seek to avoid the escheat of gift card funds by relying on the secondary rule and incorporating in a state that does not escheat gift card funds. In this scenario, the primary rule is avoided by not collecting any information on the owner or purchaser of the gift card. However, some states have amended or are amending their laws to impose new or additional reporting obligations in an effort to collect additional unused gift card funds.[59] Notably, states are also continuing to amend or propose amendments to their escheat statutes to exempt gift card funds, bringing the total number of such states to approximately thirty, as long as the gift cards associated with such funds do not have expiration dates.[60]

As a general rule, once funds from unclaimed gift cards are escheated to a state, they are likely to remain with that state indefinitely. However, it is conceivable that a customer with an unused balance may attempt to redeem the balance, in which case the holder of the previously escheated funds would have a legitimate basis for reclaiming such funds from the state. As the foregoing makes clear, franchisors (or the entity holding gift card funds) should consider using technology that permits tracking balances so that any previously escheated funds may be netted out of the amount due with ensuing filings. Although a complete discussion of escheat laws is beyond the scope of this article, a list of escheat law citations are included in the reference chart on pages 189–90.

REDEMPTION FOR CASH

A minority of state statutes include provisions that require merchants to redeem a customer's gift card for cash. In California, a gift card is redeemable for cash if the cash value on the card is less than $10.[61] In Colorado, a gift card is redeemable for cash if the amount remaining on the card is $5 or less.[62] In Maine, Montana, and Washington, a gift card is redeemable for cash if the amount remaining on the card is less than $5.[63] In Massachusetts, a customer has the option to redeem the remaining balance in cash (1) if the gift card is nonreloadable and 90 percent of the value has been redeemed or (2) if the gift card is reloadable and the balance is $5 or less.[64] In Rhode Island and Vermont, a gift card is redeemable for cash if the remaining balance is less than $1.[65] Interestingly, a merchant is not required to redeem a gift card for cash in Kansas.[66]

CONSIDERATIONS FOR FRANCHISORS

The impact of federal and state gift card laws depends on the reach of the franchise system's gift card program. With the enactment of the federal gift card regulations, now is a good time for franchisors to update their existing gift card program. If franchisors intend to design a new gift card program, they should assess a number of considerations in the planning stages to establish a successful and compliant program. This section highlights important items that franchisors should consider and address when updating or designing a gift card program.

CORPORATE STRUCTURE AND TAX ISSUES

Franchisors should give serious consideration to corporate structure and tax issues. For instance, many companies form a subsidiary to manage their gift card program and administer the intake and payout of gift card funds. In this approach, the company will want to ensure that the structure it chooses for its gift card program allows it to obtain favorable tax treatment for the gift card entity. In recent years, the IRS has issued advice to some gift card companies, concluding that they did not qualify for income deferral on gift card revenue where the gift card company did not itself sell or provide the goods for which the cards were sold. Although this advice is not binding on other taxpayers, it is instructive. Various tax professionals have urged the IRS to reconsider its position that gift card receipts are payments over which the taxpayer exercises complete control and instead to treat gift card receipts as deposits.[67] Deposits are generally not taxable because they are subject to being refunded. Franchisors are well advised to explore these issues with their attorneys, accountants, and tax advisers to determine the best approach.

CENTRAL GIFT CARD ACCOUNT

Another important consideration is to determine how the franchisor will hold the gift card funds. Although it may seem obvious, franchisors would be well advised to require all gift card funds be held in a central gift card account that the franchisor (or an affiliate) controls. When a gift card is sold by a franchisee, those funds would not be treated as the franchisee's revenue. Rather, the funds would be regularly transferred from the franchisee's account into the central gift card account. There are many reasons to adopt this approach. When a gift card is redeemed by the customer, it may not be redeemed at the same location where it was purchased. To ensure that the location providing the products or services receives payment, the appropriate funds would be transferred from the central gift card account to the appropriate franchisee's account soon after the gift card was used. Another important reason to set up a central gift card account is to place the gift card funds out of reach from financially troubled franchisees that may misuse the funds or later file for bankruptcy. Keeping those funds separate from franchisees until the redeeming purchase is made eliminates the risk to customers if franchisees were to hold gift card funds individually.

EVALUATION OF PREVIOUS GIFT CARD PROGRAMS

Finally, it is important to look at the gift cards offered in the past, both with and without the franchisor's authorization. Perhaps an old gift card has not been removed from some stores despite a request to discontinue it. Some franchisees may be offering store promotions through social media that the franchisor has not approved. The types of cards to be included in any franchisor's program could include a mixture of promotional gift certificates, to be used only at a specific store during its grand opening, for example, and reloadable gift cards redeemable at any store in the system. What works in one system may not work in another; it is important to examine what has worked in the past when planning for the future.

REVISING DOCUMENTS FOR SYSTEMWIDE PARTICIPATION

As a general rule, franchisors should require mandatory systemwide participation in gift card programs rather than permit voluntary participation by franchisees.[68] For a franchisor that is considering implementing a new gift card program, the first step is to review prior franchise agreements and disclosure documents to determine whether they contain language that permits mandatory participation. If these documents do not contain appropriate language, franchisors should consider creating incentives for franchisees to participate in the program. For example, franchisees will be more likely to participate in the program if the franchisor can make a convincing case for the economic benefit and the increased customer loyalty that the program will create. In addition, franchisors should consider giving franchisees financial incentives to buy new equipment or software if expenditures are necessary to participate in the program. Of note, franchisors are likely to benefit from franchisees' purchase of new equipment in the long run, such as new point-of-sale terminals, because these types of equipment will likely make it easier to monitor gift card use and other sales activities. Creating a rewards program for stores selling the most cards is another incentive worth considering.

In addition to reviewing previous franchise agreements and disclosure documents, franchisors considering implementing a gift card program should evaluate whether they will need to incorporate additional disclosures into their disclosure documents, whether franchise agreements need to be revised, whether additional policies and procedures need to be incorporated into their operations manuals, and whether separate agreements need to be drafted to address franchisee responsibilities and obligations as well as the costs and expenses associated with such a program. Many operations manuals, disclosure documents, and franchise agreements currently in effect were written before gift cards became so prevalent in retail stores. If participation is not currently mandatory, franchisors should revise their disclosure documents and template agreements by including broadly worded disclosures about possible gift card programs and expenses related to them in order to reserve the right to require gift card program participation in the future. Of significance, disclosing that there may be required expenditures for a future gift card program can avoid later claims of inadequate disclosure by franchisees, as happened in the Coffee Beanery system.[69] In addition, franchisors should reserve the right to use national advertising funds to implement a gift card program in both the disclosure document and the franchise agreement.

TRAINING FRANCHISEES

Franchisors should determine how best to train franchisees and their employees to ensure compliance with the federal gift card regulations. For example, franchisors should anticipate establishing sales and marketing procedures to ensure that cards are not sold with a stated expiration date that violates the federal gift card regulations. Franchisees need training in advance to be sure that gift cards are marketed and displayed properly. If applicable, franchisors (and their franchisees) should stop selling paper gift certificates, develop a deadline for redeeming paper gift certificates, and publicize the new card program with website and in-store information. At a minimum, a franchisee's employees will require training on the sale, redemption, and reloading of gift cards. If a franchisee distributes reloadable cards that are not intended to be marketed as gift cards, the franchisee must be careful about how the cards are displayed to the customer to eliminate confusion regarding whether the cards are gift cards.

Store employees should be prepared to answer questions from customers related to applicable state regulations and the federal gift card regulations. For example, in a 2009 action against Starbucks Corporation to enforce California's gift card laws, the district attorneys of three California counties (Monterey, Sonoma, and Shasta) alleged that Starbucks retail stores had failed upon request to pay customers cash for the remaining value of gift cards worth less than ten dollars. The district attorneys sought civil penalties of $2,500 for each violation in addition to the costs of investigation and restitution. Starbucks was required to pay a civil penalty of $195,000, plus $20,000 in investigation costs and $10,000 to the state's Consumer Protection Prosecution Trust Fund. Additionally, Starbucks was required to implement a compliance program for its company-owned California stores to instruct its employees to redeem gift cards with less than ten dollars in remaining value for cash or a check.[70]

DESIGNING A NEW GIFT CARD

Franchisors should consider what the actual gift card will look like after the new disclosures are added. Much of the limited space on a standard gift card is already occupied by items such as the magnetic strip, the franchise system logo, state-specific consumer protection disclosures, and the card number. The federal gift card regulations include many specific requirements about what must be included on the face of a plastic gift card and how such information must be displayed. As such, franchisors should consult the regulations to get a head start on designing gift cards that comply with the new federal gift card regulations. In addition to considering the gift card's appearance, franchisors should evaluate whether any disclosures that are not on the face of the card are adequate. As discussed above, the federal gift card regulations clearly specify that electronic disclosures cannot be given through a hyperlink or in a manner where the purchaser can easily bypass the disclosure. If a franchisor decides not to impose fees and expiration dates, however, some of the new disclosures will not be required. Many franchisors have chosen to eliminate fees and expiration dates to avoid disclosures and to simplify use of the gift card by consumers and franchisees.

WHICH STATE LAWS APPLY?

If the franchisor only has locations in a handful of states, it may initially be necessary only to become familiar with the laws of those states in addition to federal law. But if a franchisor has locations in many states or anticipates expanding, it should design the gift card program to comply with the laws of each state where stores are now or will be located in the near future. In addition to the gift card and escheat laws discussed above, other laws may come into play. For instance, if customers are asked to register their gift cards online or otherwise, they are likely to provide personal information that must be maintained in accordance with applicable privacy laws. Further, franchisors and franchisees must be prepared to comply with advertising, sales and use taxes, and other laws.

HIRING A VENDOR

Franchisors should consider hiring a third-party vendor to handle the funds paid for gift cards and to transfer those funds out of franchisee accounts frequently. In that case, they should retain an established, reputable third-party vendor that has experience with multistate franchise systems. Many vendors offer a wide range of services and exercise varying degrees of control over gift card programs in keeping with the desires of the franchisor, and good vendors may provide training materials or assistance to educate franchisors and franchisees on displaying, selling, and redeeming gift cards. A vendor that manages the gift card funds and takes more responsibility for administering the program may have a greater stake in complying with the law and making sure that franchisees and their employees receive appropriate training. Additionally, a reputable vendor can assist franchisors with detecting and preventing fraud by identifying and flagging unusual activity on cards or potential purchases of gift cards made with stolen credit cards.

CONCLUSION

Without question, operating a gift card program and complying with the various regulations is difficult and complicated, and the level of difficulty and risk increases if a franchisor desires to impose expiration dates and fees. For these very reasons, in addition to concerns related to customer satisfaction, many companies have decided not to use expiration dates or impose fees. But smaller systems operating in a limited number of states with gift card regulations and escheat laws that are not overly restrictive may decide to use expiration dates and impose fees. Regardless of the approach taken, it remains important for franchisors and franchisees to understand the legal framework that governs their system's gift card program.

ENDNOTES

1. Press Release, Nat'l Retail Fed'n, Gift Givers Listening to Recipients as Gift Card Spending Expected to Rise (Nov. 17, 2010), *available at* www.nrf.com.

2. *Id.*

3. Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734–66.

4. Electronic Fund Transfer Act, 15 U.S.C. § 1693 et seq.

5. 12 C.F.R. § 205 et seq.

6. Provided certain conditions are satisfied, the final rule delays the effective date of the following provisions until January 31, 2011: (1) the requirement that a certificate or card must contain on its face a disclosure about any dormancy, inactivity, or services fees; (2) the required disclosure of the expiration date for the underlying funds or the fact that such funds do not expire; (3) the requirement for policies and procedures to ensure that a consumer will have a reasonable opportunity to purchase a certificate or card with at least five years remaining until the expiration date; and (4) the required disclosures of information about expiration, replacement cards, and fees, and of toll-free numbers and website information for obtaining replacement certificates or cards and fee information. The July 27, 2010, legislation was implemented by a Board rule issued on October 19, 2010, that finalized the Board's interim rule published in the *Federal Register* on August 17, 2010.

7. To take advantage of the delayed effective date, a certificate or card issuer must meet certain conditions: (1) complying with Regulation E's substantive restrictions on fees; (2) not imposing an expiration date for underlying funds; and (3) making certain alternative disclosures through in-store signage, messages during customer service calls, websites, and general advertising.

8. 12 C.F.R. § 205.20 et seq, *available at* www.federalreserve.gov/newsevents/press/bcreg/bcreg20100811a1.pdf.

9. *Id.* § 205.20(a)(2).

10. Supplement I to Part 205–Official Staff Interpretations, § 205.2–Definitions ¶ 20(a)(2)–Store Gift Card [hereinafter Official Staff Interpretations].

11. *Id*.

12. 12 C.F.R. § 205.20(a)(3).

13. *Id*.

14. For further discussion of open and closed loop gift cards, please see the official commentary to the federal gift card regulations. Electronic Fund Transfers, 75 Fed. Reg. 16,580 (Mar. 23, 2010).

15. 12 C.F.R. § 205.20(c)(1).

16. Dormancy fees and inactivity fees are fees for the nonuse of or inactivity on a gift card. *Id.* § 205.20(a)(5).

17. Service fees are periodic fees for holding or use of a gift card. *Id.* § 205.20(a)(6).

18. *Id.* § 205.20(d).

19. *Id.* § 205.20(e).

20. *Id.*

21. Official Staff Interpretations, *supra* note 10, ¶ 20(c)(2).

22. 12 C.F.R. § 205.20(c)(4).

23. *See id.* § 205.20(e)(2). "Expiration" of the funds, for these purposes, means that the funds are no longer available for redemption by the holder of the gift card. Depending on the applicable state laws, the holder of the funds may keep those funds itself or may escheat them to one or more states as unclaimed property.

24. *Id.*

25. *Id.*

26. The Board initially proposed two alternatives, entitled Alternative A and Alternative B, for determining whether the expiration date restrictions were satisfied. *See* 74 Fed. Reg. 60,986 (Nov. 20, 2009). The Alternative B approach was incorporated into the federal gift card regulations. *See* 12 C.F.R. § 205.20(e)(2); *see also* Official Staff Interpretations, *supra* note 10, ¶ 20(e)(1).

27. 12 C.F.R. § 205.20(d).

28. *Id.* § 205.20(d)(1).

29. *Id.* § 205.20(a)(7).

30. *Id.* § 205.20(d)(3).

31. *Id.* § 205.20(d)(2).

32. *Id.* § 205.20(b).

33. *See id.* § 205.12(b).

34. A number of states have abandonment periods that may be shorter than five years, including, for example, Montana, Nebraska, New Mexico, and North Carolina. In addition, a number of states expressly exempt gift certificates from the applicable escheat

provisions, including, for example, Maryland and Minnesota; however the express exemption language is not applicable to standard gift cards.

35. *See, e.g.*, Comment Letter from Network Branded Prepared Card Association to Jennifer J. Johnson, Bd. of Governors of the Fed. Reserve Sys. (Dec. 15, 2009).

36. *See also* 12 C.F.R. § 205.12(b)(2).

37. In addition, a helpful summary of the relevant provisions for each state can be found on the National Conference of State Legislature's website, *available at* www.ncsl.org.

38. 15 U.S.C. § 1693m(a).

39. *Id*. § 1693o(c). Note, however, that violations of the federal gift card regulations by banks are enforced by other governmental agencies. *Id*. § 1693m(a).

40. 15 U.S.C. § 1693o(c).

41. 15 U.S.C. § 45(m). The FTC also has the ability to issue cease-and-desist orders against a merchant for potential violations. *Id.* § 45(b).

42. *In re* Kmart Corp., Kmart Servs. Corp. & Kmart Promotions, LLC, FTC File No. 062 3088, *available at* http://www.ftc.gov/os/caselist/0623088/0623088do.pdf.

43. *Id.*

44. *In re* Darden Rests., Inc., GMRI Inc. & Darden GC Corp., FTC File No. 062 3112 (2007), *available at* www.ftc.gov/os/caselist/0623112/index.shtm.

45. *Id.*

46. *Id.*

47. *Id.*

48. Cal. Civ. Code § 1749.5(a)(1); Conn. Gen. Stat. § 42-460(a); Fla. Stat. § 501.95(2)(a); Me. Rev. Stat. Ann. tit. 33, § 1953.1.G; Minn. Stat. § 325G.53.2; Mont. Code Ann. § 30-14-108(1); N.H. Rev. Stat. Ann. § 358-a:2, XIII; R.I. Gen. Laws § 6-13-12; Wash. Rev. Code § 19.240.020(1)(a).

49. Ariz. Rev. Stat. Ann. § 44-7402; Ga. Code Ann. § 10-1-393(b)(33(A)(ii); Neb. Rev. Stat. § 69-1305.03(e); Nev. Rev. Stat. § 598.0921(1)(a); N.Y. Gen. Bus. Law § 396i; N.C. Gen. Stat. § 66-67.5(a); Or. Rev. Stat. § 646A.278; S.D. Codified Laws § 39-1-55(B); Tex. Bus. & Com. Code Ann. § 35.42; Utah Code Ann. § 13-11-4; Va. Code Ann. § 59.1-531.A.

50. *See* Ark. Code Ann. § 4-88-703; Haw. Rev. Stat. § 481B-13; 815 Ill. Comp. Stat. 505/2SS(b); Kan. Stat. Ann. § 50-6108; Ky. Rev. Stat. § 367.890; La. Rev. Stat. Ann. § 51:1423(B)(1); Md. Code Ann., Com. Law § 14-1319; Mass. Gen. Laws Ann. ch. 200A, § 5D; Mich. Comp. Laws § 445.903g; N.M. Stat. Ann. § 57-12-26(B); N.J. Stat. Ann. § 56:8-110, 1.a(1); N.D. Cent. Code § 51-29-02; Okla. Stat. tit. 15, § 797, A.1; Ohio Rev. Code Ann. § 1349.61(A)(1); S.D. Codified Laws § 39-1-55(B) (cannot expire before the first anniversary of the date the card was sold unless the expiration date is disclosed as required); Tenn. Code Ann. § 47-18-127(a); Vt. Stat. Ann. tit. 8, § 2702.

51. Conn. Gen. Stat. § 3-65c; Fla. Stat. § 501.95; 815 Ill. Comp. Stat. 505/2SS; Ky. Rev. Stat. Ann. § 367.890; Mass. Gen. Laws Ann. ch. 200A, § 5D; Mich. Comp. Laws § 445.903f; Minn. Stat. § 325G.53; Mont. Code Ann. § 30-14-108(3); N.H. Rev. Stat. Ann. § 358-a:2, XIII; N.M. Stat. Ann. § 57-12-26(C); N.D. Cent. Code § 51-29-02; Or. Rev. Stat. § 646A.276; R.I. Gen. Laws § 6-13-12; Vt. Stat. Ann. tit. 8, § 2703.

52. *See, e.g.*, Ga. Code Ann. § 10-1-393(33)(A); N.J. Stat. Ann. § 56:8-110, 1.b; N.M. Stat. Ann. § 57-12-26(B); S.D. Codified Laws § 39-1-55(C); Tex. Bus. & Com. Code § 35.42; Utah Code Ann. § 13-11-4; Va. Code Ann. § 59.1-531.B.

53. *See, e.g.*, Ark. Code Ann. § 4-88-703; Kan. Stat. Ann. § 50-6108; Md. Code Ann., Com. Law § 14-1319; Nev. Rev. Stat. § 598.0921, 1(c)(2); N.J. Stat. Ann. § 56:8-110, 1.a.(2); N.Y. Gen. Bus. Law § 396i; N.C. Gen. Stat. § 66-67.5(a); Ohio Rev. Code Ann. § 1349.61(A)(2); Tenn. Code Ann. § 47-18-127(b).

54. *See, e.g.*, Iowa Code § 556.9; Okla. Stat. tit. 15, § 797.D; Wash. Rev. Code § 19.240.040.

55. *See* Texas v. New Jersey, 379 U.S. 674 (1965) (setting the applicable precedent for determining which state has priority in receiving unclaimed property).

56. *Id.*

57. *See* Pennsylvania v. New York, 407 U.S. 206 (1972).

58. *See* Delaware v. New York, 507 U.S. 490 (1993).

59. For example, in July 2010, New Jersey amended its unclaimed property law, N.J. Stat. Ann. §§ 46:30B-1 et seq., to impose information collecting and reporting obligations and to provide for the custodial escheat of stored value cards. The proposed amendment contained the following language: "If the issuer of a stored value card does not have the name and address of the purchaser or owner of the stored value card, the address of the owner or purchaser of the stored value card shall assume the address of the place where the stored value card was purchased or issued and shall be reported to New Jersey if the place of business where the stored value card was sold or issued is located in New Jersey." 2010 N.J. Laws ch. 25c; N.J. Stat. Ann. § 46:30B-42.1c. Among others, the New Jersey Retail Merchants Association challenged the law. On November 13, 2010, two days before the law was to become effective, the court issued an injunction, holding that plaintiffs were likely to succeed on the merits because of the priority rules set forth in *Texas v. New Jersey*, 379 U.S. 674 (1965). *See* Am. Express Travel Related Servs. Co., Inc. v. Sidamon-Eristoff, Civil No. 10-4890 (FLW) (D.N.J. Nov. 13, 2010).

60. *See, e.g.*, Ariz. Rev. Stat. § 44-301.15; Utah Code Ann. § 67-4a-211 (effective July 1, 2011).

61. Cal. Civ. Code § 1749.5(b).

62. 2010 Colo. Sess. Laws ch. 180.

63. Me. Rev. Stat. Ann. tit. 33, § 1953(G); Mont. Code Ann. § 30-14-108(4); Wash. Rev. Code § 19.240.020(3).

64. Mass. Gen. Laws Ann. ch. 200A, § 5D.

65. R.I. Gen. Laws § 6-13-12; Vt. Stat. Ann. tit. 8, § 2704.

66. Kan. Stat. Ann. § 50-6108(b).

67. *See, e.g.*, Paul C. Lau, *Tackling Taxes—Tackling Gift Card Sales: Current or Deferred Revenue?* (pts. 1, 2), Taxes (Feb. 1, 2010; Apr. 1, 2010).

68. For example, if a gift card cannot be used at all locations in the franchise system, it is important to clearly communicate this fact to the consumer to help protect against a potential claim under a state's consumer protection law.

69. Coffee Beanery Ltd. v. WW LLC, 501 F. Supp. 2d 955 (E.D. Mich. 2007), *rev'd*, No. 07-1830 (6th Cir. Aug. 18, 2008), *cert. denied*, No. 08-1396 (U.S. Oct. 5, 2009).

70. People v. Starbucks Corp., No. 166948 (Cal. Super. Ct. Aug. 13, 2009) (final judgment and injunction per stipulation).

STATE GIFT CARD STATUTES AND STATE ESCHEAT LAWS		
State	**Laws Addressing Expiration Dates and Fees***	**Escheat Laws**
Alabama	N/A	Ala. Code § 35-12-72(a)(17), (b)
Alaska	N/A	Alaska Stat. § 34.45.240
Arizona	Ariz. Rev. Stat. Ann. § 44-7402	Ariz. Rev. Stat. Ann. § 44-301(15)
Arkansas	Ark. Code Ann. § 4-88-703	Ark. Code Ann. § 18-28-201(13)(B)(i)
California	Cal. Civ. Code § 1749.5	Cal. Civ. Proc. Code § 1520.5
Colorado	Colo. Rev. Stat. § 6-1-722	Colo. Rev. Stat. § 38-13-108.4
Connecticut	Conn. Gen. Stat. §§ 42-460, 3-65c	Conn. Gen. Stat. § 3-73a
Delaware	N/A	Del. Code Ann. tit. 12, § 1197; tit. 67, § 1212
District of Columbia	N/A	D.C. Code Ann. § 41-114
Florida	Fla. Stat. § 501.95	Fla. Stat. § 717.1045
Georgia	Ga. Code Ann. § 10-1-393(b)(33)(A)(ii)	Ga. Code Ann. § 44-12-205
Hawaii	Haw. Rev. Stat. § 481B-13	Haw. Rev. Stat. §§ 523A-14, 523A-3
Idaho	Idaho Code Ann. § 14-514	Idaho Code Ann. §§ 14-501(10)(b), 14-502(2)
Illinois	815 Ill. Comp. Stat. 505/2SS	765 Ill. Comp. Stat. 1025/10.6
Indiana	N/A	Ind. Code § 32-34-1-1
Iowa	Iowa Code § 556.9.2	Iowa Code § 556.9
Kansas	Kan. Stat. Ann. § 50-6108	Kan. Stat. Ann. § 58-3934
Kentucky	Ky. Rev. Stat. Ann. § 367.890	Ky. Rev. Stat. Ann. § 393.010
Louisiana	La. Rev. Stat. Ann. § 51:1423	La. Rev. Stat. Ann. §§ 9:151 et seq.
Maine	Me. Rev. Stat. Ann. tit. 33, § 1953(G)	Me. Rev. Stat. Ann. tit. 33, § 1953(G), (G-1)
Maryland	Md. Code Ann., Com. Law §§ 14-1319, 1320	Md. Code Ann., Com. Law § 17-101(m)
Massachusetts	Mass. Gen. Laws Ann. ch. 200A, § 5D; ch. 266, §§ 75C, 75D, 75E	N/A
Michigan	Mich. Comp. Laws § 445.903e, f, g	Mich. Comp. Laws § 567.235
Minnesota	Minn. Stat. § 325G.53	Minn. Stat. § 345.39
Mississippi	N/A	Miss. Code Ann. § 89-12-15
Missouri	N/A	Mo. Rev. Stat. §§ 447.500 et seq.

STATE GIFT CARD STATUTES AND STATE ESCHEAT LAWS		
State	**Laws Addressing Expiration Dates and Fees***	**Escheat Laws**
Montana	Mont. Code Ann. § 30-14-108(1), (3)	Mont. Code Ann. § 70-9-803(g)
Nebraska	Neb. Rev. Stat. § 69-1305.03(e), (f)	Neb. Rev. Stat. § 69-1305.03
Nevada	Nev. Rev. Stat. § 598.0921(1)(a), (b)	Nev. Rev. Stat. Ann. §§ 120A.010 et seq.
New Hampshire	N.H. Rev. Stat. Ann. § 358-a:2, XIII	N.H. Rev. Stat. Ann. §§ 358-A:2, 471-C:1 et seq.
New Jersey	N.J. Rev. Stat. § 56:8-110(1)	N.J. Rev. Stat. §§ 46:30B-1 et seq.
New Mexico	N.M. Stat. Ann. § 57-12-26(B), (C)	N.M. Stat. Ann. § 7-8A-2(A)(7)
New York	N.Y. Gen. Bus. Law § 396-i(3), 5(b)	N.Y. Aband. Prop. Law § 1315
North Carolina	N.C. Gen. Stat. § 66-67.5(a)	N.C. Gen. Stat. §§ 116B-53(c)(8), -54(b)
North Dakota	N.D. Cent. Code § 51-29-02	N.D. Cent. Code §§ 47-30.1-01 et seq.
Ohio	Ohio Rev. Code Ann. § 1349.61	Ohio Rev. Code Ann. § 169.01(B)(2)(d)
Oklahoma	Okla. Stat. tit. 15, § 797	Okla. Stat. tit. 60, §§ 651 et seq.
Oregon	Or. Rev. Stat. §§ 646A.276, .278	Or. Rev. Stat. §§ 98.302 et seq.
Pennsylvania	N/A	72 Pa. Cons. Stat. §§ 1301 et seq.
Rhode Island	R.I. Gen. Laws § 6-13-12	R.I. Gen Laws §§ 33-21.1-1 et seq.
South Carolina	N/A	S.C. Code Ann. §§ 27-18-10 et seq.
South Dakota	S.D. Codified Laws § 39-1-55(B), (C)	S.D. Codified Laws § 43-41B-15
Tennessee	Tenn. Code Ann. § 47-18-127	Tenn. Code. Ann. § 66-29-135
Texas	Tex. Bus. & Com. Code Ann. § 35.42	Tex. Prop. Code Ann. § 72.1016
Utah	Utah Code Ann. § 13-11-4	Utah Code Ann. § 67-4a-211
Vermont	Vt. Stat. Ann. tit. 8, §§ 2702, 2703	Vt. Stat. Ann. tit. 27, §§ 1241 et seq.
Virginia	Va. Code Ann. § 59.1-531	Va. Code Ann. § 55-210.8:1
Washington	Wash. Rev. Code §§ 19.240.020(1)(a), 19.240.030, 19.240.040	Wash. Rev. Code §§ 63.29.140, 19.240.005 et seq.
West Virginia	N/A	W. Va. Code § 36-8-2(a)(7)
Wisconsin	N/A	Wis. Stat. §§ 177.01 et seq.
Wyoming	N/A	Wyo. Stat. Ann. § 34-24-114

* For information about pending legislation, see National Conference of State Legislature website, *available at* www.ncsl.org.

Franchising (& Distribution) Currents

Bethany L. Appleby, Marcus A. Banks, and Amy Cheng

ANTITRUST

***Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc.*, No. 09-3013, Bus. Franchise Guide (CCH) ¶ 14,412 (3d Cir. July 7, 2010)**

Distributor Toledo Mack Sales & Service, Inc. (TMSS) appealed a judgment against it after a jury trial with manufacturer Mack Trucks, Inc. (Mack). TMSS had claimed at trial that, among other things, Mack had conspired "to restrain trade unreasonably in violation of § 1 of the Antitrust Act ('Sherman Act')." The jury disagreed. On appeal, TMSS argued that the trial court erred in instructing the jury on the type of evidence it could consider. The U.S. Court of Appeals for the Third Circuit affirmed the judgment.

Before trial, TMSS had moved to exclude evidence that (1) TMSS's reduced sales were "caused by the fact that it was embroiled in several lawsuits," (2) TMSS's top salesperson "had been convicted of receiving stolen auto parts," and (3) TMSS's dealership was terminated "for misappropriation of trade secrets." The trial court denied the motion. Because the "proffered evidence had a tendency to demonstrate that it was probable that [TMSS's] loss of sales was caused by poor management rather than Mack Trucks' alleged violation of § 1 of the Sherman Act," the trial court did not abuse its "broad discretion" in evidentiary rulings. However, because the trial court had not expressly addressed whether, under Federal Rule of Evidence 403, the evidence's probative value outweighed its prejudicial effect, the Third Circuit "elected to examine the record and perform the required balancing" itself and concluded that the "evidence had great probative value that was essential to [Mack's] defense and was not substantially outweighed by the danger of unfair prejudice."

The court similarly rejected a challenge to the trial court's exclusion of depositions taken in another lawsuit because they "were irrelevant and inadmissible under [Federal Rule of Evidence] 403." It also affirmed the trial court's decision to admit letters that other dealers sent to Mack because they were not hearsay as they were not offered for the truth of the matter asserted.

TMSS also challenged a jury instruction that TMSS claimed instructed "the jury to limit its consideration of the circumstantial evidence of [Mack's] conspiracy." The Third Circuit noted that "[u]nless a trial judge misstates the law, the judge's rulings on points for charge may be reversed only if the judge committed an abuse of discretion." The Third Circuit found no error in the trial court's instructions.

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ARBITRATION

***Binder v. Med. Shoppe Int'l*, No. 09-14046, 2010 U.S. Dist. LEXIS 72614, Bus. Franchise Guide (CCH) ¶ 14,432 (E.D. Mich. July 20, 2010)**

The U.S. District Court for the Eastern District of Michigan granted defendant franchisor Medicine Shoppe's motion to compel arbitration on the condition that the pending arbitration in Missouri be transferred to Michigan. Plaintiffs executed a license agreement to operate a Medicine Shoppe store in Michigan. The agreement contained an arbitration clause requiring arbitration in Missouri. Plaintiffs executed a guaranty agreement to be personally bound by the license agreement and operated their franchise for many years until defendant initiated arbitration proceedings in Missouri. Plaintiffs "filed an answering statement and asked to transfer [the] arbitration" to Michigan, but the request was denied. After the parties participated in a preliminary scheduling conference in the arbitration, plaintiffs sued Medicine Shoppe in Michigan state court on breach of contract and other related grounds, and Medicine Shoppe removed to federal court. Medicine Shoppe offered to relocate the pending arbitration to Michigan in exchange for plaintiffs' dismissal of the lawsuit, but plaintiffs refused. Medicine Shoppe then moved to compel arbitration of plaintiffs' claims in Missouri.

Before addressing the merits, the court decided two preliminary issues.

First, it found that plaintiffs did not waive their right to oppose arbitration even though they participated in arbitration proceedings before filing suit. Noting that cases provide "no bright line that delineates when waiver occurs," the court held that because the arbitration proceeding was still in its early stages, plaintiffs did not waive their right to object. Moreover, Medicine Shoppe did "not allege any significant prejudice from [p]laintiffs' attempt to terminate arbitration."

Second, the court found that plaintiffs were personally bound to arbitrate pursuant to the guaranty agreement even though they did not personally sign one of the agreements at issue. The court determined that a nonsignatory can be bound by an agreement to arbitrate under several theories, including incorporation by reference, assumption, and estoppel. Here, the full title of the guaranty (Owner's Guaranty and Assumption of Licensee's Obligations) and wording of the agreement ("personally . . . bound by, and personally liable for breach of, each and every provision [in the license agreement]") left no doubt as to the guaranty's purpose and effect of assuming obligations under the license agreement. In addition, because plaintiffs derived a direct benefit from the contract, "they [were] estopped from disclaiming the obligation to arbitrate."

On the merits, the court held that the license agreement was voidable, "but only to the extent that it require[d] arbitration to take place in . . . Missouri." Plaintiffs argued that they were fraudulently induced into believing that Medicine Shoppe would not try to arbitrate disputes. Medicine Shoppe gave plaintiffs a franchise disclosure document, "which state[d] that Michigan law prohibit[ed] franchise agreements from requiring out-of-state arbitration, and that any provision to that effect [was] void." "Plaintiffs [argued] that they relied on the [disclosure document] as . . . the parties' agreement to forego arbitration if the [l]icense [a]greement included a requirement to arbitrate in [Missouri]."

The court determined that the disclosure document "misrepresented [Medicine Shoppe]'s future conduct by implying that it would not resort to arbitration. At the very least, the inconsistency between the [disclosure document] and the license agreement created an ambiguity" to be construed against Medicine Shoppe as the agreement's drafter. The court further determined that plaintiffs relied on the disclosure document, "but only to the extent that they would not have to arbitrate outside of Michigan." The court found evidence of limited reliance in that, when Medicine Shoppe initiated arbitration, "plaintiffs did not object to the procedure itself, but simply asked to transfer venue to Michigan. When their request was denied, [p]laintiffs filed suit in state court, again without objecting to arbitration." Finding that the venue provision was void, the court severed the venue requirement and compelled arbitration consistent with the rest of the agreement because "[r]emoving the venue provision did not affect the rest of the license agreement, or alter the parties' rights and obligations."

***Med. Shoppe Int'l, Inc. v. Turner Invs.*, No. 09-2179, 2010 U.S. App. LEXIS 14960, Bus. Franchise Guide (CCH) ¶ 14,433 (8th Cir. July 21, 2010)**

The U.S. Court of Appeals for the Eighth Circuit affirmed the district court's confirmation of an arbitration award. In 1994, the appellant franchisees entered into a twenty-year license agreement with the Medicine Shoppe franchisor. In 2007, the franchisees closed their franchise, which Medicine Shoppe alleged breached the franchise agreement. Medicine Shoppe then filed an arbitration demand with the American Arbitration Association, seeking past due license fees and future continuing license fees for the remainder of the agreement's twenty-year term, as well as attorney fees and costs. The arbitrator granted Medicine Shoppe all of its requested damages, and the district court confirmed the award. The franchisees appealed, arguing that the district court erred because the arbitrator manifestly disregarded Missouri law, which requires that future fees be ascertained with reasonable certainty.

The Eighth Circuit affirmed confirmation of the award, following U.S. Supreme Court precedent in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008), which held that an arbitration award may be vacated only for the reasons enumerated in the Federal Arbitration Act (FAA). The enumerated grounds for vacating an arbitrator's order include corruption, fraud, impartiality, or an abuse of power. The court found that the franchisees' claim was not among the specifically enumerated grounds for vacating an arbitration award under the FAA and that the district court therefore did not err in confirming the award.

***Next Step Med. Co., Inc. v. Johnson & Johnson Int'l*, No. 09-2077, Bus. Franchise Guide (CCH) ¶ 14,457 (1st Cir. Aug. 30, 2010)**

Next Step Medical Co., Inc. (Next Step) entered into a contract with Johnson & Johnson International (JJI) under which JJI made Next Step its exclusive distributor in Puerto Rico. After JJI sent Next Step a letter terminating its exclusive distributorship, Next Step and its president, Jorge Iván Dávila-Nieves, sued JJI seeking, among other things, a preliminary injunction. "Dávila also sought damages in tort for the pain and suffering."

The federal district court "referred the case to a magistrate to make a report and recommendation on the requested preliminary injunction and to resolve 'all non-dispositive motions.'" After a hearing, the magistrate "recommended that a preliminary injunction be denied." The magistrate also went on to grant a JJI motion to compel the parties to arbitrate all of Next Step's claims, including the preliminary injunction request and Dávila's tort claim. On that same day, citing the magistrate's order compelling arbitration, the district court dismissed all of Next Step's claims with prejudice. The federal district court denied Next Step's motion for reconsideration, and Next Step appealed, contesting (1) the district court's failure to consider the merits of the magistrate's recommended denial of preliminary injunctive relief; and (2) the dismissal of Dávila's tort claim with prejudice, arguing that it was not arbitrable.

The U.S. Court of Appeals for the First Circuit held that the district court did not err in failing to consider the merits of the magistrate's recommended denial of injunctive relief. The court found that the district court was correct in concluding that the magistrate's order of arbitration effectively superseded its previously recommended denial of injunctive relief. Because the arbitrator was empowered "'to take whatever interim measures [it] deem[ed] necessary,'" including injunctive relief, the First Circuit reasoned that the district court was correct in holding that it was up to the arbitrator to determine preliminary relief. The court further held that the district court did not err because (1) the parties' conduct did not suggest to the court that arbitration would be abandoned upon an order of preliminary relief, and (2) interim emergency preliminary injunctive relief was inappropriate because a year had passed since the initial complaint and Next Step had made no effort to seek injunctive relief from the arbitrator. The First Circuit also held that the federal district court did not err in dismissing the Dávila tort claim with prejudice in light of the magistrate's order compelling arbitration of all claims. It noted that a federal "district court can, in its discretion, choose to dismiss [a] lawsuit, if all claims asserted in the case are found arbitrable."

The First Circuit also held that the Dávila tort claim was arbitrable. Although the arbitration provision only referenced JJI and Next Step, the court observed that a separate provision entitled "Disputes and Arbitration" specified that Dávila was a party to the distributorship agreement. The court also noted that the arbitration clause covered "any dispute, controversy or claim . . . arising out of or relating in any way to the business relationship between JJI and Next Step." Thus, "Dávila's tort claim—a claim arising out of and relating to the breakdown in the business relationships between JJI and Next Step—was covered by" the broad language of the arbitration provision. Finally, the fact that Dávila signed the distributorship agreement not only as executive of Next Step but also in his personal capacity persuaded the court that Dávila should be bound personally.

***Paul Green Sch. of Rock Music Franchising, LLC v. Smith*, Case No. 09-2718, Bus. Franchise Guide (CCH) ¶ 14,424 (3d Cir. Aug. 2, 2010)**

This dispute arose out of a music franchise that defendant purchased from the School of Rock. The franchise agreement contained an arbitration clause providing that any disputes relating to the agreement would be settled by binding arbitration in Pennsylvania and that the agreement would be interpreted under Pennsylvania law. The franchisor submitted a demand for arbitration in Pennsylvania, claiming that the franchisee did not properly report royalties. The franchisee moved to compel arbitration in California, claiming that the forum selection and choice of law provisions in the agreement were unenforceable and unconscionable. The California court denied the franchisee's motion, holding that the provisions were enforceable contingent upon the franchisee's ability to pursue its California Franchise Investment Law rights and remedies in the Pennsylvania forum. Following the arbitration's conclusion in Pennsylvania in favor of the franchisor, the U.S. District Court for the Eastern District of Pennsylvania confirmed the arbitrator's award.

On appeal, the U.S. Court of Appeals for the Third Circuit found that the arbitrator did not manifestly disregard the law in dismissing the franchisee's counterclaims under the California Franchise Investment Law and enforcing the post-termination noncompete covenant contained in the parties' agreement. Rather, the court held that the arbitrator was aware of those claims and the arguments on both sides and found no evidence that the arbitrator consciously chose to ignore the merits of those claims. The Third Circuit held that the district court correctly determined that the arbitrator's holding was not a willful flouting of known governing law.

BANKRUPTCY

***Doctor's Assocs., Inc. v. Desai*, No. 10-575, 2010 U.S. Dist. LEXIS 86454, Bus. Franchise Guide (CCH) ¶ 14,451 (D.N.J. Aug. 23, 2010)**

The franchisor of Subway sandwich shops entered into arbitration proceedings with one of its franchisees for failure to pay royalties. The arbitrator found in favor of the franchisor, terminated the franchise agreements, and awarded the franchisor damages. The franchisor applied in the U.S. District Court for the District of New Jersey to confirm the arbitration award and sought relief for franchisee's continued use of the franchisor's trademarks. The franchisee filed for bankruptcy and, after the automatic stay was lifted, moved to refer the pending matters before the district court to the bankruptcy court. The district court granted the motion. The franchisor then moved the district court to withdraw the bankruptcy referral under 28 U.S.C. § 175(d). The court denied the franchisor's motion.

Under 28 U.S.C. § 175(d), both permissive and mandatory withdrawal of a case referred to bankruptcy court are allowed. The court noted that under the statute, mandatory withdrawal is appropriate only when a proceeding involves both Title 11 bankruptcy law and other federal law that impacts interstate commerce. Following the lead of other courts in the U.S. Court of Appeals for the Third Circuit, the court adopted a narrow reading of the statute and held that withdrawal is mandated only when "the matter involves the 'substantial and material' consideration of federal law outside the Bankruptcy Code rather than the routine application of such law." (quoting *Wile v. Household Bank, F.S.B.*, No. 04-32, 2004 U.S. Dist. LEXIS 9141, at *6–7 (E.D. Pa. 2004)). The court held that because the franchisor was simply asking the court to confirm an arbitration award and grant it relief under the Lanham Act based on the validity of that award, the bankruptcy court would only need to engage in a routine application of federal statutes, and withdrawal was thus not mandated.

The court next evaluated whether permissive withdrawal of the referral was appropriate. The court explained that this evaluation involved two steps. First, it must be determined "whether each claim is or is not core to the bankruptcy proceedings under 28 U.S.C. § 157(b)-(c)." If the claims are noncore, the court then considers "the goals of promoting uniformity in bankruptcy administration, reducing forum shopping and confusion, fostering the economical use of the debtors' and creditors' resources, and expediting the bankruptcy process." (quoting *In re Pruitt*, 910 F.2d 1160, 1168 (3rd Cir. 1990)). The court assumed, for the sake of judicial efficiency, that the claims were noncore to the bankruptcy and went on to determine that withdrawing the referral would not help meet the goals of uniformity, economy, or efficiency. The district court held that allowing the withdrawal would actually promote forum shopping and noted that "securing a more friendly forum . . . is not a valid reason for a district court to withdraw reference of a proceeding properly pending before the bankruptcy court." (quoting *Travelers Cas. & Sur. Co. v. Skinner Engine Co.*, 325 B.R. 372, 378–79 (W.D. Pa. 2005)). Having found that neither permissive nor mandatory withdrawal of the referral to bankruptcy court was warranted, the district court denied the franchisor's motion to withdraw.

***In re Rescuecom Corp. v. Mohamed E. Khafaga*, Case No. 06-43018-608, Bus. Franchise Guide (CCH) ¶ 14,422 (Bankr. E.D.N.Y. July 9, 2010)**
A nationwide computer services franchisor executed two franchise agreements with a franchisee for the purchase and operation of two Rescuecom franchises. These "[a]greements prohibited the [franchisee] from competing with [the franchisor] and from diverting business away . . . during [both] the term of the [a]greements and for a period of time after . . . termination of the [a]greements." The franchisor commenced an adversary proceeding seeking a declaration that the debt owed to it by the franchisee was nondischargeable. The franchisor later amended its claims alleging different operative facts and conduct not set forth in the original complaint. The franchisee sought to dismiss the amended complaint, contending that those new claims were time-barred.

The court found that the franchisor's amended complaint was time-barred because it was filed more than sixty days after the date set for the meeting of creditors. The franchisor argued "that the [c]ourt should equitably toll the statute of limitations." However, the court determined that the franchisor made no showing of fraudulent concealment on the franchisee's part that would justify equitable tolling. The court ruled that the amended complaint did not relate back to the date of the original claim because the franchisee did not receive notice from the original allegations that the claims asserted in the amended complaint might be made. Further, as a result of the factual discrepancies between the two pleadings, there was no sufficient factual nexus to permit relation back.

***In re Shreyas Hospitality, LLC, Debtor*, Case No. 09-70523, Bus. Franchise Guide (CCH) ¶ 14,427 (Bankr. C.D. Ill. July 15, 2010)**
At issue was a motion to allow an administrative expense claim filed by Super 8 Worldwide, Inc., the franchisor of Super 8 guest lodging facilities. The court permitted Super 8's administrative expense claim for a debtor franchisee's use of the Super 8 franchise system, service marks, trademarks, and national reservation system during the pendency of the franchisee's Chapter 11 bankruptcy case. In bankruptcy, "an administrative expense claim may be allowed for the actual and necessary costs and expenses of preserving an estate. . . . Generally, an allowed administrative expense must arise from a transaction with the debtor-in-possession [that] conferred some benefit on the estate."

Here, it was undisputed that during the pendency of the case and until Super 8 obtained stay relief, the debtor franchisee continued to operate the hotel as part of Super 8's franchise system and retained all benefits of the parties' franchise agreement. Super 8 asserted that its trademarks were used by the debtor franchisee in, inter alia, signage, phone books, and Internet advertising, as well as by its participation in Super 8's national reservation system.

As a result, the court ruled that "[t]he amounts due pursuant to the terms of the [f]ranchise [a]greement for the period of time" in which the debtor-franchisee continued to operate the hotel in the Super 8 franchise system under Chapter 11 was "the proper measure of the amount [to] be allowed as [Super 8]'s administrative expense claim." The court further ruled that Super 8 "need not prove that the [debtor franchisee] actually profited from use of the [f]ranchise [a]greement."

BREACH OF CONTRACT

***Stucchi USA, Inc. v. Hyquip, Inc.*, Case No. 09-cv-732, Bus. Franchise Guide (CCH) ¶ 14,437 (E.D. Wis. July 28, 2010)**
A hydraulic equipment distributor failed to allege adequately that an Italian manufacturer and its American subsidiary breached the parties' alleged contract when, from all indications, there was no binding contract between the parties. The distributor argued that the parties entered into an oral distributor agreement. The distributor brought suit for breach of contract against the Italian manufacturer and its American subsidiary after the subsidiary informed the distributor that it would not be using it as an intermediary and instead would be selling its product directly to one of the distributor's customers.

The only written document produced by the distributor was a Notice of Open Account that the subsidiary gave the distributor after formation of the alleged oral agreement. "The contracts[,] [it appeared][,] would have come in the form of purchase orders contemplated by the 'Notice of Open Account.'" On review of a motion to dismiss the breach of contract claim, the U.S. District Court for the Eastern District of Wisconsin found that even assuming the alleged distributor agreement was a binding and enforceable contract, the breach of contract claim would still fail because the agreement was not exclusive. Thus, even if the distributor's customer ordered products directly from the subsidiary, as alleged, the subsidiary was still free to fill that order, and doing so would not violate any contract with the distributor. The court added that there was no community of interest, and therefore the distributor was not entitled to the protections given to a dealer under the Wisconsin Fair Dealership Law.

CHOICE OF FORUM

***Big O Tires, LLC v. Felix Bros., Inc.*, Case No. 10-cv-00362, Bus. Franchise Guide (CCH) ¶ 14,420 (D. Colo. July 12, 2010)**
This matter was before the court on plaintiff's motion for preliminary injunction and defendants' motion to dismiss, to transfer venue, or, in the alternative, to stay the proceedings.

Plaintiff, a Colorado retail tire franchisor, entered into three franchise agreements with a California franchisee in which the parties consented to venue in Denver. After the franchisee gave notice that it did not intend to renew one of its three franchises, the franchisor sued in the U.S. District Court for the District of Colorado to enforce the noncompete covenants contained in the franchisee's two remaining agreements. The franchisor sought to prohibit the franchisee from continuing to operate a competing tire store out of the location of the nonrenewed franchise. The franchisee argued that venue was improper because there was no allegation that any defendant resided or could be found in the district.

On review, the court held that the clause in question was "one of 'geographic' rather than 'sovereign' distinction." As such, the clause acted as a prospective contractual waiver of the franchisee's right to contest venue and thereby precluded it from arguing that venue in Colorado was improper. Accordingly, the court found that Colorado was "a permissible venue to which [the franchisee] consented."

The court further ruled that the franchisor would not be irreparably harmed if its request for a preliminary injunction enforcing the terms of a noncompete agreement was denied. The court found no evidence that the franchisee (1) violated the noncompete covenants in its two current franchise agreements by diverting customers to its third, competing store; and (2) was using its access to marketing strategy and promotional information to gain a competitive advantage. The court concluded that the franchisor failed to show any evidence of harm it was actually suffering but instead only proffered evidence of harm that it could theoretically suffer.

***Dunlap Enters. v. Roly Poly Franchise Sys., L.L.C.*, 2010 WL 2880179, Bus. Franchise Guide (CCH) ¶ 14,436 (Tex. Ct. App. July 23, 2010)**

Appellant franchisees appealed the trial court's decision dismissing their complaints without prejudice based on forum selection clauses in their franchise agreements with Roly Poly Franchise Systems, L.L.C. requiring suit in Georgia.

Under Texas law, forum selection clauses are enforceable unless the party opposing enforcement can show that "(1) enforcement would be unreasonable and unjust, (2) the clause is invalid for such reasons as fraud or overreaching, (3) enforcement would contravene a strong public policy of [the] state, or (4) the selected forum would be seriously inconvenient for trial." When the reason asserted is inconvenience and inconvenience was "foreseeable at the time of contracting, the challenger must show that trial in the contractual forum [would] be so gravely difficult and inconvenient that he will for all practical purposes be deprived of his day in court."

The franchisees argued that the clause was unreasonable and unjust because they could not secure personal jurisdiction over a co-defendant (a servicing company for Roly Poly) in Georgia. The franchisees' argument was based on the fact that Roly Poly sued the co-defendant in Georgia earlier, but the suit was dismissed for lack of personal jurisdiction over the co-defendant. The franchisees claimed that the prior decision was res judicata and would also prevent them from suing the co-defendant in Georgia. The court rejected the franchisees' claims as speculative and noted that res judicata is only binding when the exact same parties are subject to the previous judgment. Here, the franchisees were not parties to the case involving Roly Poly and the co-defendant. In addition, the subject of Roly Poly's dispute with the co-defendant was a Master Development Agreement that did not contain a Georgia forum selection clause. Finally, the court found that even if the franchisees were unable to secure personal jurisdiction over the codefendant in Georgia, they failed to establish that this would cause a hardship sufficient to find the forum selection clause to be unreasonable or unjust. Even though suing Roly Poly and the co-defendant in different courts could result in the "'empty-chair'" defense, where each defendant points to the other for liability, the hardship was not so grave as to amount to a denial of the franchisees' day in court.

***Pierce Mfg. Inc. v. First In Inc.*, Case No. 10-C-393, Bus. Franchise Guide (CCH) ¶ 14,429 (E.D. Wis. July 19, 2010)**

This dispute arose as a result of the desire of plaintiffs, manufacturers of emergency vehicles, to terminate a relationship with a dealer of its products. When the dealer learned of the manufacturers' effort to terminate its dealership, it sued in the U.S. District Court for the District of Arizona, seeking a temporary and preliminary injunction prohibiting termination. "In response, the manufacturers moved to dismiss . . . on the grounds that the . . . dealership agreements contained arbitration clauses mandating arbitration of disputes in . . . Wisconsin." The court "found that the dispute was not arbitrable because the arbitration clause was barred by the Motor Vehicle Franchise Contract Arbitration Fairness Act."

One week after the dealer's filing of suit in Arizona, one of the manufacturers filed suit in the U.S. District Court for the Eastern District of Wisconsin, seeking to enforce the arbitration clause and compel arbitration. The Wisconsin district court found that the manufacturer was not entitled to compel arbitration in Wisconsin because the Arizona court previously determined that the dispute was not arbitrable. The court determined that dismissal was required because co-equal federal courts in different states could not entertain parallel cases. Because the parallel action was filed in Arizona first, that court was therefore the proper court to determine the propriety of its jurisdiction and venue. The Wisconsin court noted that such a rule did not reward a "race to the courthouse" because the first-filed court could always decide to transfer the case or dismiss it. The rule merely afforded the first-filed court the ability to make a ruling as to which court should ultimately hear the case.

***RM Yogurt Haw. LLC v. Red Mango Franchising Co.*, Case No. 10-00157, Bus. Franchise Guide (CCH) ¶ 14,405 (D. Haw. June 29, 2010)**

The parties entered into an Area Development Agreement (ADA), Guaranty, and Release, which granted plaintiff the right to develop and operate defendant franchisor's Red Mango stores in Hawaii. In exchange, plaintiff paid defendant $125,000. Thereafter, plaintiff began to experience various difficulties with defendant and filed suit in Hawaii

State Court for, inter alia, breach of contract and misrepresentation. Defendant removed the matter to federal court and subsequently moved to dismiss for improper venue. Defendant claimed the action was governed by a binding forum selection clause contained in the ADA, Guaranty, and Release. Plaintiff then requested that the court transfer venue to federal court in Texas.

Upon review, the U.S. District Court for the District of Hawaii held that the ADA contained a forum selection clause requiring any disputes to be brought in the state of Red Mango's principal place of business at the time of institution of suit. Plaintiff claimed that all three exceptions contained in *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 12, 15 (1972), were applicable to the instant matter in that (1) the forum selection clause was included as a result of fraud or overreaching, (2) the party seeking to avoid the clause would be deprived of its day in court, and (3) enforcement of the clause would contravene strong public policy in the forum in which the suit was brought. The court found that plaintiff failed to prove any of these elements and held the ADA's forum selection clause to be valid. The court further ruled that the forum selection clause contained mandatory language specifying that venue was to lie exclusively in the judicial district in which Red Mango had its principal place of business when suit was instituted, i.e., Texas. Moreover, removal did not foreclose the removing party from claiming that venue was improper if the parties were bound by a valid and mandatory forum selection clause. Accordingly, the court concluded that transfer, rather than dismissal, was appropriate and instructed that the action be transferred.

***S.K.I. Beer Corp. v. Baltika Brewery*, Case No. 06-3501, Bus. Franchise Guide (CCH) ¶ 14,430 (2d Cir. July 20, 2010)**
Russia-based brewer Baltika Brewery designated wholesaler S.K.I. Beer Corp. as its exclusive brand agent in New York State. The brewer and wholesaler subsequently entered into an agreement for the purchase and sale of Baltika products, which provided that all disputes would be subject to binding arbitration in Russia. Thereafter, SKI brought suit in the U.S. District of the Eastern District of New York claiming that Baltika had stopped performing under the agreement. Baltika moved to dismiss, arguing that the forum selection clause in the agreement mandated dismissal. In opposition, SKI claimed that the forum selection clause contravened New York public policy interest in protecting its licensed beer wholesalers. The district court granted the motion to dismiss based on the mandatory forum selection clause.

In affirming the district court's ruling, the U.S. Court of Appeals for the Second Circuit found that even if the New York beer laws applied to the agreement, it would not bar the mandatory forum selection clause. Further, the wholesaler offered only speculation that the New York beer law would not be applied if the mandatory Russian forum selection clause was enforced and that it would not have a substantive remedy in the Russian forum. The Second Circuit found that mere speculation as to what rights the wholesaler would or would not have in the Russian forum was "not sufficient to rebut the presumption of validity of the forum selection clause."

CLASS ACTIONS

***Castaneda v. Burger King Corp.*, 264 F.R.D. 557, Bus. Franchise Guide (CCH) ¶ 14,238 (N.D. Cal. July 12, 2010)**
In this case, a putative class attempted to certify a class of all "mobility impaired patrons" against the Burger King franchisor for alleged Americans with Disabilities Act (ADA) violations at ninety-two Burger King franchises in California. The putative class members sought to require Burger King

> to adopt policies that would ensure access for customers who use wheelchairs and scooters and to bring the leased restaurants into compliance with [the ADA], Section 51 of the California Civil Code (the Unruh Civil Rights Act), and Section 54 of the California Civil Code (the California Disabled Persons Act ["CDPA"]).

They also requested "the minimum statutory damages under the Unruh Act and the CDPA."

One of the problems with certifying one large class was that there was no common Burger King store blueprint, meaning that "the physical differences among the 92 locations would predominate over the common issues." Although Burger King required its franchisees to design and construct stores in compliance with federal and state accessibility requirements, it left the design and construction specifics to the franchisees. The court noted that "[w]hether or not any store was ever out of ADA compliance would have to be determined store by store, feature by feature, before turning to the easier question of whether defendants as the franchisor/lessor, would have a duty to force the franchisees to remediate." Therefore, there were no "questions of law or fact common to the class," a class action prerequisite under Federal Rule of Civil Procedure 23(a)(2).

Another problem was that the class members sought certification under Rule 23(b)(2), which requires that defendant "acted or refused to act on grounds that apply generally to the class, so that final injunctive relief . . . is appropriate respecting the class as a whole." Here, injunctive relief would be appropriate only for those stores that were in fact in violation of the ADA. Due to the lack of a common blueprint, it was "highly unlikely" that all ninety-two stores were in violation. Even then, the specific injunctive relief to be granted would vary store by store. In addition, class certification under Rule 23(b)(2) generally requires that "the primary relief sought be declaratory or injunctive." Here, any injunctive relief would likely be subordinate in value to the monetary damages sought under the state statutes.

As a result, the court certified ten separate classes under Rule 23(b)(3) against only those ten of the ninety-two franchises "where a named plaintiff encountered alleged access barriers." A class may be certified under Rule 23(b)(3) if "questions of law or fact common to class members predominate over any questions affecting only individual members." For plaintiffs who visited the same location, common questions as to whether and how that location was in violation would predominate; it would be irrelevant whether monetary damages would predominate over injunctive relief.

***Ilene Siemer v. Quizno's Franchise Co. LLC*, No. 07-CV-2170, Bus. Franchise Guide (CCH) ¶ 14,440 (N.D. Ill. Aug. 13, 2010)**
On August 13, 2010, the U.S. District Court for the Northern District of Illinois approved a settlement agreement between two nationwide classes of franchisees and the Quizno's Franchise Company LLC and its related entities (Quizno's). The parties reached the settlement agreement on October 27, 2009, and it was preliminarily approved by the court on November 20, 2009. The court gave final approval to the settlement agreement on August 13.

The two classes of franchisees in the settlement agreement consisted of (1) a class of franchisees that had executed franchise agreements with Quizno's prior to July 2, 2009, for the operation of a Quizno's restaurant in the United States, the District of Columbia, or Puerto Rico but had not opened restaurants prior to that date (the sold but not opened, or SNO, Class); and (2) a class of franchisees that operated Quizno's restaurants in the United States, the District of Columbia, or Puerto Rico prior to November 20, 2009 (Franchise Operator Class). The two classes were further divided into subclasses based on several factors, including, among others, the time of closing of the franchisee's Quizno's restaurant, status as current or former franchise operators, prior releases executed, and previous refunds of franchise fees.

Notice was provided to potential class members, and class members were required to submit claim forms in order to receive compensation. Class members that elected not to be bound by the settlement agreement could opt out by submitting a timely opt-out form. After considering the notice given, the papers submitted in support of and in opposition to the settlement agreement, and the objection of the sole objector, and after conducting a final fairness hearing on June 30, 2010, the court issued its August 13, 2010, order granting final approval of the settlement agreement.

In approving the settlement, the court found that the settlement agreement satisfied the elements of Federal Rule of Civil Procedure 23 in that (a) the number of class members was so numerous that joinder was impracticable, (b) there were questions of law and fact common to each settlement class that predominated over any individual questions, (c) the claims of the SNO and Franchise Operator representative plaintiffs were typical of the claims of their respective settlement classes, (d) the SNO and Franchise Operator representative plaintiffs fairly and adequately represented and protected the interests of the SNO and Franchise Operator Settlement Classes, and (e) a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

The court held that the settlement "is, in all respects, fair, reasonable and adequate" to all class members "in light of the complexity, expense, possible duration of the further litigation, the discovery and investigation conducted, and the risk and difficulty of establishing liability, causation and damages." The court further found that the settlement "is the result of good faith, arm's length negotiations between experienced counsel representing the interests of the" class members and defendants.

The court's order affirmed all aspects of the settlement agreement entered into between the parties, including the class notices procedures, claim procedures, opt-out procedures, and mutual releases of the parties from all present and future claims. The court dismissed the action with prejudice and on the merits and "retain[ed] jurisdiction to adjudicate any disputes over the interpretation and/or full and effective implementation of the [settlement] [a]greement."

*Ms. Cheng and her firm represented defendant in this matter.

***Ilene Siemer v. Quizno's Franchise Co. LLC*, No. 07-CV-2170, Bus. Franchise Guide (CCH) ¶ 14,446 (N.D. Ill. Aug. 13, 2010)**
In a decision issued the same day as the court's order approving the settlement agreement in *Siemer v. Quizno's Franchise Co., LLC*, discussed above, the court also issued an opinion overruling the objection of the sole objector to the settlement agreement.

Jill and Gary Gevaart and their Wisconsin business, Globe Food Services LLC, former Quizno's franchisees, raised an objection to the settlement agreement and filed a motion to intervene in the case and a request to conduct discovery. The court granted their motion to intervene, denied their request for discovery, and overruled their objection. The Gevaarts were classified as Franchise Operator Class III, a subgroup of the Franchise Operator Class, consisting of class members who purchased and operated Quizno's restaurants but had closed them as of November 20, 2009.

The Gevaarts' primary objection to the settlement was that because they had paid their financial obligations to Quizno's when they closed their store, they would not benefit from the settlement provision that releases the Quizno's claims against franchisees for past due royalties. The court rejected this argument, observing that the Gevaarts' position ignored the additional financial benefit that the Gevaarts would receive from the release provision whereby Quizno's released its claims for future royalties against class members that, like the Gevaarts, failed to operate their Quizno's restaurant for the full fifteen-year term of the franchise agreement. In fact, "[t]he Gevaarts terminated their franchise agreement less than three years after they signed the agreement." The court further recognized that in reviewing the terms of a class settlement, it was "not called upon to determine whether the parties have struck the best possible deal." The court also noted that the Gevaarts were free to opt out of the settlement agreement, but they chose not to do so.

The court also overruled the Gevaarts' objection to the incentive awards for representative plaintiffs. The court recognized that representative plaintiffs devoted substantive time and effort to the litigation, that the settlement generated benefits for the class, and that courts have approved incentive awards in similar and much larger amounts.

Finally, the court rejected the Gevaarts' request for discovery into "whether other Franchise Operator Class III members incurred additional, personal debt, like the Gevaarts, to stay current on [their obligations to Quizno's]." The court recognized that although the Gevaarts are likely not alone in having incurred personal debt to make payments to Quizno's under their franchise agreement, out of the 8,468 franchisees to whom notice was sent, only one (the Gevaarts) filed an objection to the proposed settlement. The court stated that it "has little inclination to permit discovery when as in this case, objectors represent only a small percentage of the class." Moreover, the court held, the fact that the Gevaarts or other Class III members incurred substantial personal debt to pay Quizno's

> does not satisfy the court that the settlement agreement accords disparate treatment to them. Whether a class member suffered loss as a result of Quizno's purportedly unfair practices does not turn on whether he or she had substantial personal wealth on the one hand, or was required to incur substantial personal debt on the other.

The court also noted that at the final fairness hearing, Quizno's called an expert witness who testified that the value of the Quizno's release of its future royalty claims against the Gevaarts was at least $174,000, and "[t]he Gevaarts offered nothing to rebut that testimony and did not even appear at the fairness hearing to cross-examine the witness."

*Ms. Cheng and her firm represented defendant in this matter.

CONTRACT ISSUES

***Ramada Worldwide, Inc. v. Hotel of Grayling, Inc.*, No. 08-3845, 2010 U.S. Dist. LEXIS 65186, Bus. Franchise Guide (CCH) ¶ 14,409 (D.N.J. June 30, 2010)**

In this case, the U.S. District Court for the District of New Jersey granted the Ramada franchisor's motion for summary judgment on its complaint and defendant franchisees' counterclaims. Ramada sued defendants, primarily for past due amounts owed. Defendants counterclaimed, alleging that they were not obligated to pay because of Ramada's breach of contract and fraud. Defendants argued that Ramada materially breached by failing to (1) provide signage, (2) install a computer and software management system, (3) place the hotel on third-party reservation system websites, and (4) provide training. Ramada moved for summary judgment, including on defendants' counterclaims.

The court excluded certain evidence of the parties' communications pursuant to the parol evidence rule. Although applicable New Jersey law recognizes "an exception to the parol evidence rule where oral communications would constitute proof of fraud," the exception did not apply because the alleged misrepresentations related to matters expressly addressed in a wholly integrated contract. The court noted that both parties were experienced hotel operators who negotiated explicit statements in the franchise agreement's integration clause. The court also applied the "sham affidavit rule" and did not consider defendants' affidavit in opposition to summary judgment because the affidavit, created after plaintiff moved for summary judgment, directly contradicted defendants' prior deposition testimony.

The court granted summary judgment on Ramada's claims and rejected defendants' defense to nonpayment (that Ramada breached the franchise agreement by denying services) because defendants continued to receive the franchise agreement's benefits without paying the required fees. The court also granted summary judgment on Ramada's claim of default under the parties' guaranty agreement.

The court further granted summary judgment for Ramada on defendants' counterclaims, finding that (1) Ramada was not required to provide signage under the agreement, and defendants were barred from relying on testimony that Ramada made representations regarding signage before they executed the agreement; (2) the agreement did not require plaintiff to install a computer and software management system, and defendants could not otherwise establish how plaintiff materially breached the agreement; (3) defendants could not dispute that their hotel was placed on third-party reservation websites as the agreement required; and (4) defendants failed to provide evidence, other than contradictory testimony in the sham affidavit, to establish that Ramada breached the agreement by failing to provide training. Finally, defendants failed to create a material issue of fact on their fraud counterclaim, and the court did not consider evidence of alleged oral misrepresentations because that evidence was barred by the parol evidence rule.

***Dry Dock, L.L.C. v. Godfrey Conveyor Co., Inc.*, Case No. 09-cv-396, Bus. Franchise Guide (CCH) ¶ 14,403 (W.D. Wis. June 7, 2010)**

A boat dealer/distributor brought suit against a manufacturer alleging that twenty-four of the twenty-seven boat-and-trailer combinations it purchased from the manufacturer were defective and unfit for sale. The distributor alleged that the manufacturer breached the implied warranty of merchantability under Wisconsin law by selling defective products and breached an express warranty by failing to reimburse the distributor for warranty repairs that it was required to perform. Each purchase was covered by an express written warranty, which insulated the manufacturer from responsibility for incidental or consequential damages. The U.S. District Court for the Western District of Wisconsin found such a warranty to be valid and not unconscionable under Wisconsin law. The manufacturer further argued that it did not breach the express warranties because the distributor failed to follow the warranty procedures it had implemented for defect repairs. The court found that the manufacturer's express warranties did not disclaim the implied warranty of merchantability contained in each purchase. Noting the valid limitation on damages contained in the express written warranty, the court ordered the matter to proceed to trial on the issue of the distributor's claim that the manufacturer breached the implied warranty of merchantability.

DAMAGES

***Cole v. Homier Distrib. Co.*, 599 F.3d 856, Bus. Franchise Guide (CCH) ¶ 14,414 (8th Cir. Mar. 29, 2010)**

Distributor Cole's Tractor & Equipment, Inc. and Gregory M. Cole (collectively, Cole's) sued supplier Homier Distributing

Company (Homier) for breach of contract, violation of Missouri Revised Statutes § 407.405, tortious interference with contracts and business expectancies, and fraud stemming from Homier's termination of its distribution agreement with Cole's. The trial court granted Homier's motion to dismiss the tortious interference and fraud claims for failure to state a claim and also granted Homier's motion for summary judgment on the remaining counts because Cole's was unable to prove damages. The U.S. Court of Appeals for the Eighth Circuit affirmed the summary judgment decision in favor of Homier. Cole's alleged, inter alia, that Homier's breach caused Cole's to lose expected profits. The court stated that to establish lost profit damages, a plaintiff must "provide an adequate basis for estimating lost profits with reasonable certainty." Here, Cole's submitted expert testimony to establish lost profit damages. The court found that the expert report was factually flawed and speculative because the expert made the false assumption that Cole's would lose profits from no longer being a dealer for Homier. The termination letter that Homier sent to Cole's, however, explicitly stated that Homier hoped that Cole's would continue dealing its products. The expert used a twenty-five-year computation period based on the retirement age of the sole owner of Cole's and his qualification for government benefits. The court stated that the notion that this contract would have continued for twenty-five years was too speculative and that the trial court had not abused its discretion in awarding summary judgment for failure to establish damages.

***Med. Shoppe Int'l v. TLC Pharmacy, Inc.*, Bus. Franchise Guide (CCH) ¶ 14,416 (E.D. Mo. July 12, 2010)**

In this case, the U.S. District Court for the Eastern District of Missouri determined whether a franchisor may recover future license fees after franchise agreement termination. A pharmacy franchisor sued a franchisee that ceased operations and its personal guarantor. After obtaining summary judgment against the guarantor on the issue of liability, the franchisor sought summary judgment on the issue of damages, submitting affidavits showing past due license fees, future license fees, and attorney fees. The court concluded that the past due license fees were proper due to the franchise agreement's clause allowing for "all amounts due to [plaintiff] and any interest due thereon." Although Missouri courts had never considered whether franchisors were entitled to future fees, the court determined that they would likely decide that the franchisor was not entitled to such fees. Under Missouri law, lost profits are recoverable only if the parties contemplated recovery when the contract was formed. Here, the agreement did not demonstrate that either party contemplated recovery of future license fees. The agreement specified that obligations that "expressly or by their nature" survive termination would be recoverable after termination. However, the agreement did not expressly provide that the obligation to pay license fees survived termination. The court added that such an obligation does not "by its nature" survive termination. Accordingly, it concluded that recovery of future license fees was improper.

***Moran Indus. v. Mr. Transmission of Chattanooga, Inc.*, 2010 U.S. Dist. LEXIS 71753, Bus. Franchise Guide (CCH) ¶ 14,428 (E.D. Tenn. July 15, 2010)**

A franchisor (Moran) sued one of its franchisees (Mr. Transmission). The franchisee moved to dismiss the portion of the complaint that attempted to recover lost future royalties and marketing fund payments from the franchisee.

Pursuant to the parties' franchise agreement, Mr. Transmission was required to pay a weekly royalty fee along with a monthly marketing fund contribution. After twenty-seven years of operation, Mr. Transmission's owner retired and transferred all of his assets to his son. In response, Moran terminated the franchise agreement. The owner's son continued to operate the transmission service center under a different name, but using the same assets and equipment. Moran then sued, claiming over $250,000 in lost future royalty payments.

The franchisee's two main arguments in support of its motion to dismiss were that (1) the plain, unambiguous language of the franchise agreement provided that royalty payments would be made only for the agreement's first five years; and (2) as a matter of law, a franchisor that terminates a franchise agreement, even where the franchisee is in breach, is not entitled to future royalty payments because the franchisee's breach is not the proximate cause of the loss of future royalties.

The court first addressed whether the franchise agreement provided for royalties only for the first five years of the agreement. Although the franchise agreement only provided the royalty percentage that would be paid for the first five years, it also contained a parenthetical that the royalty payment could be increased for each subsequent five-year period. The parties had entered into an addendum seven years after the original agreement, which provided that certain work undertaken by the franchisee was afforded a lower royalty percentage payment. The court reasoned that the parenthetical and the addendum would make no sense if the agreement required royalty payments for only the first five years. The court found that the language in the franchise agreement was inherently ambiguous and, accordingly, parol evidence would be necessary to determine the parties' intent.

The court also addressed the franchisee's argument that franchisors are not entitled to future lost royalty payments as a matter of law where the franchisor terminated the franchise agreement due to the franchisee's breach. The court discussed various cases that the parties cited and noted that the variety of outcomes demonstrated the importance of the facts of each particular case and that courts disagree on how to analyze proximate cause and the significance of whether the franchisor terminated or simply sued the franchisee for breach. The court found that the franchisor's alleged facts "raised its claim to lost future royalties above the speculative level as required by *Twombly*." The court added that existing case law did not preclude future lost royalty damages where a franchisee has clearly abandoned the franchise.

Finally, the court held that a dismissal of the lost future royalty claim would be premature and that more factual evidence was needed to clarify the circumstances surrounding termination. Accordingly, the court denied the motion to dismiss.

DEFINITION OF FRANCHISE

***Engines, Inc. v. MAN Engines & Components, Inc.*, Case No. 10-277, Bus. Franchise Guide (CCH) ¶ 14,431 (D.N.J. July 29, 2010)**

In this matter, an engine manufacturer and its authorized dealer entered into a nonexclusive dealer agreement for the manufacturer's products. Thereafter, the dealer moved for a preliminary injunction seeking to enjoin the manufacturer from terminating the agreement. The parties agreed that resolution of the dispute turned on whether their relationship constituted a "franchise" under the New Jersey Franchise Practices Act. In granting the dealer's motion for a preliminary injunction, the U.S. District Court for the District of New Jersey determined that the dealer would be successful in establishing that it was a franchise of the manufacturer based on the likelihood that the parties shared a community of interest. New Jersey case law provided that a community of interest exists "when the terms of the agreement between the parties or the nature of the franchise business requires the licensee, in the interest of the licensed business's success, to make a substantial investment in goods or skills that will be of minimal utility outside the franchise."

The court found that the relationship of the parties had the indicia of control that were the hallmark of a community of interest. The court also noted that the dealer stood to lose multiple tangible and intangible indicia of control if terminated, including signage, advertisements, development of a customer base, investments in employee training, parts inventory, special tools, and computer systems to service businesses related to the manufacturer; and the mastery of those tools and systems. Following precedent, the court concluded that the dealer and manufacturer shared a financial interest evidenced by interdependence of the parties, including the degree to which they cooperated, coordinated activities, and shared common goals. Accordingly, the court held that the dealer established that the parties likely shared a community of interest and that the dealer was a franchisee.

***Water Quality Store, LLC v. Dynasty Spas, Inc.*, Case No. 2009AP1731, Bus. Franchise Guide (CCH) ¶ 14,426 (Wis. Ct. App. Dist. IV July 15, 2010)**

In this action, plaintiff, a spa dealer, claimed that defendant, a spa manufacturer and distributor, violated the Wisconsin Fair Dealership Law (WFDL) when the manufacturer terminated an agreement under which the dealer sold and serviced the spas it manufactured. The parties' relationship began upon entry into a "letter of intent/dealer agreement." At trial, the court instructed the jury that in order to determine if a dealership existed, it had to find there was a contract between the manufacturer and the dealer, as well as a community of interest between the parties. The court explained that a community of interest meant that "the parties shared a continuing financial interest in which [they] cooperated and coordinated their activities in operating the dealership business or marketing the dealership's goods and shared in common goals in their business relationship."

The jury found that a dealership in fact existed that was covered by the WFDL and awarded the dealer damages for termination of that dealership. On appeal, the manufacturer contended that the dealer failed to establish a community of interest as required under the WFDL to support a showing of a dealership. The manufacturer's primary argument was that the dealer "was not dependent on [the manufacturer] for its economic livelihood because [it] was able to find other sources of spas to sell" following termination. The manufacturer relied on a U.S. Court of Appeals for the Seventh Circuit case in support of this proposition.

The Wisconsin appellate court affirmed the jury's verdict and rejected the manufacturer's contentions. In doing so, the appellate court noted that federal courts applying Wisconsin law were not precedential authority for Wisconsin courts. The court therefore rejected the Seventh Circuit analysis because it could not be reconciled with the Wisconsin Supreme Court's most recent application of the community of interest standard. Significant factors in supporting a determination that there was a community of interest were that between 60 percent and 70 percent of the dealer's business was in spa sales and that, with the exception of only five spas, the dealer sold only spas made by the manufacturer. Additionally, there was no doubt that the dealer derived substantial revenues from its sales of the manufacturer's spas as a percentage of its total business. As a result, it was clear that the dealer was highly dependent on its relationship with the manufacturer for its economic health, and a reasonable fact finder could find the dealer had an exclusive territory. For these reasons, the court found evidence to support the jury's determination that a dealership existed sufficient to show there was a community of interest under the WFDL.

FRAUD

***Fed. Trade Comm'n v. Network Servs. Depot, Inc.*, 617 F.3d 1127, Bus. Franchise Guide (CCH) ¶ 14,447 (9th Cir. 2010)**

This case involved an enforcement action by the Federal Trade Commission (FTC) against Network Services Depot, Inc. (NSD), its owner Charles Castro, and its senior executive Gregory High for engaging in deceptive business practices in violation of § 5(a) of the Federal Trade Commission Act (FTC Act) and the FTC's Franchise Rule. NSD was in the business of selling Internet kiosk business opportunities, in which an investor would buy the rights to operate an Internet kiosk in a public space, such as an airport or hotel lobby, and revenues generated from the kiosk would be paid to the investor. Customers paid NSD and its affiliates more than $18 million dollars to participate in the kiosk program. Unfortunately for the customers, almost all of the thousands of business opportunities sold by NSD were a sham and described by the FTC as "a classic Ponzi scheme." NSD engaged a third party, Bikini Vending Corp. (BVC), to install and operate Internet kiosks for customers on its behalf. However, BVC did not install a vast majority of the kiosks. Instead it used money received from NSD's new customers to pay existing customers their minimum monthly payments.

Castro and High claimed that they did not investigate customer complaints or visit the kiosk sites to verify that machines had been installed. Instead Castro and High relied on BVC to install, maintain, and service the kiosks and to remit payments to customers. After the FTC began its investigation, Castro retained an attorney and paid him a lump sum of $375,000 for representation during the FTC litigation. One month later, the FTC filed suit against NSD, Castro, and High in the U.S. District Court for the District of Nevada. Prior to trial, the FTC and defendants filed cross-motions for summary judgment. The district court granted the FTC's motion and denied defendants' motion. The court found that "Castro and High were personally liable for equitable monetary relief" under § 5 of the FTC Act, "that the NSD kiosk venture satisfied the criteria for being a traditional services franchise[,] and that [defendants] violated the FTC's Franchise Rule by making misleading statements in the disclosure agreement circular provided to customers." The court further found that legal fees paid to Castro's attorney came from fraudulent kiosk sales; it imposed a constructive trust on $238,300 of the attorney fees and ordered the attorney to return that amount to the FTC. Defendants appealed the district court's finding on summary judgment that Castro and High were personally liable for equitable monetary relief.

The U.S. Court of Appeals for the Ninth Circuit affirmed the district court's decision and found that Castro and High were individually liable to make equitable restitution under § 5 of the FTC Act. The court reasoned that the district court properly entered summary judgment on the claim for individual liability under the FTC Act because the undisputed facts established that Castro and High "acted with either (1) actual knowledge, (2) reckless indifference to truth or falsity, or (3) an awareness of a high probability of fraud and an intentional avoidance of the truth" when they made representations to customers regarding the Internet kiosk business opportunities. The court held that the FTC was not required to show that Castro and High had actually intended to defraud the customers.

The court also affirmed the district court's grant of summary judgment in favor of the FTC on the issue of whether Castro and High had personal knowledge. The court concluded that Castro and High's deliberate construction of a "Chinese wall" between NSD and BVC rose to "the level of reckless indifference," and they could not turn "a blind eye" to the problems that customers were complaining about and continue to sell the fraudulent business opportunities.

The court also concluded that the FTC presented substantial evidence that Castro's attorney received payment attributable to defendants' statutory violations, and, therefore, the district court did not err in fashioning equitable relief in the form of a constructive trust on $238,300 of the attorney fees. The court further held that the bona fide purchaser rule did not apply because Castro's attorney failed to make a good faith inquiry into the source of the fees. Finally, the court noted that the attorney was allowed to keep a reasonable fee of $136,700 based on hours of services performed before the FTC froze Castro's assets.

***Heyser v. Noble Roman's, Inc.*, 933 N.E.2d 16, Bus. Franchise Guide (CCH) ¶ 14,450 (Ind. Ct. App. 2010)**

Several franchisees sued the franchisor, Noble Roman's, Inc., and two banks after the franchisees' Noble Roman's Pizza Restaurants failed, claiming actual and constructive fraud. The banks each filed a motion to dismiss the fraud claims because they were based solely on allegedly fraudulent representations by Noble Roman's. The trial court granted the banks' motions and dismissed these claims from the case with prejudice. Noble Roman's then filed a motion for partial summary judgment, arguing that franchisees were not alleging constructive fraud and were instead alleging actual fraud only. The trial court found that in a hearing in March 2009 on the banks' motions to dismiss, franchisees' counsel stated to the court, "[W]e have not plead [*sic*] constructive fraud." The court found this statement binding and held that franchisees were estopped from now asserting constructive fraud. The franchisees appealed the trial court's grant of partial summary judgment.

The Indiana Court of Appeals opined that an attorney can make an admission to a trial court that binds his client. The court then turned to the present case and held that franchisees' counsel unequivocally stated in the March 2009 hearing that the franchisees were pleading only actual fraud and not constructive fraud. That admission bound the franchisees throughout the lawsuit; and, as a result, Noble Roman's was entitled to partial summary judgment on the constructive fraud claims.

***Zantum, LLC v. Wencel*, No. H034533, 2010 Cal. App. Unpub. LEXIS 4954, Bus. Franchise Guide (CCH) ¶ 14,410 (Cal. Ct. App. June 30, 2010)**

In this case, the California Court of Appeal affirmed the trial court's finding of negligent misrepresentation by an ink cartridge franchisor. Plaintiff purchased an area directorship from defendants, which gave it the exclusive right to sell Caboodle Cartridge franchises in a specified area. When defendants suddenly ceased operations, plaintiff sued, alleging, inter alia, negligent misrepresentation. The trial court found that defendants made negligent misrepresentations about franchise operations to induce the purchase of a valueless area directorship.

The only issue on appeal was the individual liability of Caboodle's president and founder (corporate defendants were defunct). The court affirmed the trial court's decision, rejecting the president's argument that there was no evidence of negligent misrepresentation because the representations were reasonable at the time that they were made. The court found that before plaintiff purchased the area directorship, the president made misrepresentations through a marketing scheme that included statements either written or approved by him. These representations included that (1) Caboodle cartridge products would be remanufactured in Caboodle's own manufacturing facility utilizing advanced and specialized equipment and that 100 percent of the remanufactured cartridges were tested, (2) that Caboodle's remanufactured ink cartridges met or exceeded original equipment manufacturer quality and specifications, (3) Caboodle invested in a state-of-the-art recharging facility that did not compromise quality but offered substantial savings, and (4) Caboodle supplied a sufficient quantity of Caboodle remanufactured ink cartridges to support a large number of franchised stores.

The court noted that there was evidence that the president did not have reasonable grounds to believe the truth of any of those representations before plaintiff purchased the area directorship. To the contrary, evidence showed that there were known problems with the quality of Caboodle's remanufactured cartridges and that it struggled to supply even a small number of existing franchises with enough products. In connection with quality and quantity issues, the president had fired Caboodle's director of manufacturing as well as several employees in the manufacturing facility. There were records of refunds made because of defects and quality problems. E-mails indicated concerns that existing franchises were losing customers because orders could not be filled. Caboodle employees also testified that Caboodle eventually purchased cartridges from outside vendors to fill orders and did not individually test them. The court therefore determined that substantial evidence supported the trial court's finding that a reasonable person with the information available to the president would not have represented Caboodle as a functional, valuable franchise that could be sold with an exclusive area directorship.

GOOD FAITH AND FAIR DEALING

***Miller Auto. Corp. v. Jaguar Land Rover N. Am.*, No. 3:09-CV-1291, 2010 U.S. Dist. LEXIS 81654, Bus. Franchise Guide (CCH) ¶ 14,444 (D. Conn. Aug. 11, 2010)**

A motor vehicle dealer brought six claims for relief against its franchisor, Jaguar Land Rover North America, as well as two claims against its predecessor franchisor, Ford Motor Company. The dealer's claims against Ford for breach of the implied covenant of good faith and fair dealing and promissory estoppel related to the dealer's allegations that it spent money to expand its facilities based on Ford's representation of substantial sales growth, but the additional sales never materialized. Ford moved to dismiss both claims.

Ford argued that the dealer's claim for breach of the implied covenant of good faith should be dismissed because the claim was time-barred by a three-year statute of limitations, not tied to any specific contract term between the parties, and failed sufficiently to allege that Ford had acted in bad faith. The U.S. District Court for the District of Connecticut found that the applicable statute of limitations for claims for breach of the implied covenant in Connecticut was six years. Because all of the acts complained of occurred within six years of commencement of the action, the claim was not time-barred. However, the court agreed with Ford's remaining arguments. The court held that the dealer failed to assert a claim closely tied to a "discretionary application or interpretation of a contract term" as required by Connecticut law. The court further held that the dealer failed to allege adequately any bad faith on Ford's part, as "altering business plans—especially when the right to do so is reserved by contract to the party who alters them—is not an action done in bad faith, even if it occurs to the detriment of another." The court therefore granted Ford's motion to dismiss the claim for breach of the implied covenant of good faith and fair dealing.

The court also granted Ford's motion to dismiss the dealer's promissory estoppel claim. Ford argued that the claim was precluded because there was a valid contract between the parties. The court agreed, noting that a contract is not void as a matter of law simply because the dealer "would have been at a competitive disadvantage vis-à-vis other Jaguar dealers" if the dealer had decided not to sign the contract. The dealer also failed to provide evidence, or even allege, that disproportionate bargaining power of the parties rendered the terms of the contract unconscionable. Although the court dismissed the promissory estoppel claim, it did so without prejudice and granted the dealer leave to file a second amended complaint.

***Miller Auto. Corp. v. Jaguar Land Rover N. Am.*, No. 3:09-CV-1291, 2010 U.S. Dist. LEXIS 87594, Bus. Franchise Guide (CCH) ¶ 14,452 (D. Conn. Aug. 24, 2010)**

A motor vehicle dealer brought six claims for relief against its franchisor, Jaguar Land Rover North America (JLRNA), as well as two claims against its former franchisor, Ford Motor Company. JLRNA moved to dismiss the dealer's claims for breach of the implied covenant of good faith and fair dealing and for violation of the Connecticut motor vehicle dealer law that prohibits a manufacturer from unreasonably denying a relocation request. Both claims arose out of JLRNA's denial of the dealer's multiple requests for relocation.

Similar to its earlier decision in favor of JLRNA's codefendant Ford, the U.S. District Court for the District of Connecticut found that the dealer failed to state a claim for breach of the implied covenant of good faith and fair dealing against JLRNA because the dealer had not adequately alleged the required element of bad faith. The dealer claimed that JLRNA imposed "excessive and onerous" facility requirements as a condition of approving relocation, but the court reasoned that even if true, this did not show that JLRNA acted with "dishonest purpose or moral obliquity." (quoting Buckman v. People Express, Inc., 205 Conn. 166, 171 (1987)). The dealer's allegations only established a legitimate business dispute over the relocation and did not show how JLRNA acted in bad faith.

The court also dismissed the dealer's claims for violation of a provision of the Connecticut motor vehicle dealer law that prohibited a manufacturer from unreasonably denying a dealer's relocation request as long as the dealer complied with certain notice requirements. The court found that this provision had only prospective applicability and should not be applied to a franchise agreement signed prior to the amendment that added this provision. The court found that the introductory language of the amendment was ambiguous with respect to retroactive applicability, and legislative history was silent on the issue of retroactivity as well. Therefore, the court followed the general rule under Connecticut law that applies legislation prospectively only unless the legislative history "clearly and unequivocably" expressed the intent to apply the legislation retroactively. Having dismissed two of the dealer's six claims against JLRNA, the court granted leave for the dealer to file a second amended complaint.

INJUNCTIVE RELIEF

***Dunkin' Donuts Franchising, LLC v. Panzar Boston Post*, No. 10-CV-4188, Bus. Franchise Guide (CCH) ¶ 14,445 (S.D.N.Y. Aug. 16, 2010)**

Franchisors of the Dunkin' Donuts and Baskin-Robbins franchises and their affiliates sued franchisees for breach of contract, trademark infringement, unfair competition, and trade dress infringement arising out of franchisees' alleged breach of their franchise agreements and for continuing to operate their Dunkin' Donuts franchises. Franchisors moved for a preliminary injunction. The U.S. District Court for the Southern District of New York was not persuaded that franchisors made a clear showing of irreparable harm as a result of franchisees' alleged misconduct. Specifically, the court held that there was no evidence of abuse of the trademark, violations of franchisors' industry standards, or customer confusion. Moreover, the court found that franchisees raised substantial issues concerning the franchisors' role in causing the franchisees' financial difficulties, which resulted in franchisees' default under the franchise agreements. Accordingly, the franchisors' motion for a preliminary injunction was denied.

JURISDICTION

***Bauer v. Douglas Aquatics, Inc.*, No. COA 10-47, Bus. Franchise Guide (CCH) ¶ 14,459 (N.C. Ct. App. Sept. 7, 2010)**

Defendant and appellant Douglas Aquatics, Inc. is a Virginia corporation that franchises pool management and construction companies in Virginia and North Carolina. Plaintiff is a North Carolina resident who entered into a swimming pool construction agreement with defendant Douglas Aquatics Charlotte, LLC (DA Charlotte), a franchisee of appellant located in North Carolina. Plaintiff sued both DA Charlotte and appellant for breach of warranties, breach of contract, negligence, fraud, unfair and deceptive trade practices, and agency in North Carolina state court arising from the alleged faulty construction of plaintiff's swimming pool. Appellant brought a motion to dismiss for lack of personal jurisdiction and failure to state a claim, which the trial court denied. Appellant appealed the trial court's denial of its motion to dismiss for lack of personal jurisdiction, and the appellate court affirmed.

The court determined that the sole issue for appeal was whether plaintiff's assertion of jurisdiction over appellant comported with due process of law. It recognized that to satisfy the due process component of the personal jurisdiction inquiry, there must be sufficient "minimum contacts" between the nonresident and the forum state "such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" The court held that the record did not support a finding of general jurisdiction over appellant and limited its inquiry to whether specific jurisdiction existed.

The court recognized that "vicarious liability of a franchisor for the acts of its franchisee . . . depends upon the existence of an agency relationship." Here, it held that plaintiff failed to prove an actual agency relationship between appellant and DA Charlotte, but that vicarious liability may still exist where there is "apparent agency" or "agency by estoppel."

The court found that an apparent agency relationship existed between appellant and DA Charlotte and reasoned that the trial court's findings were sufficient to support the conclusion that appellant held DA Charlotte out as its apparent agent to the citizens of North Carolina through affirmative representations on appellant's website. Specifically, appellant described DA Charlotte as one of appellant's locations that provides pool construction needs in the Charlotte, North Carolina, area. The court rejected appellant's argument that no apparent authority existed due to the franchise agreement between itself and DA Charlotte, which "unequivocally defines the relationship between franchisee [DA Charlotte] and itself as independent" and specifically prohibits DA Charlotte from representing itself as appellant's agent or engaging in any activity that would purport to bind appellant. The court recognized that plaintiff was not privy to the franchise agreement defining the relationship between defendants. Therefore, the court concluded that

> [i]t was Appellant's statement on its website that "[DA Charlotte] is one of five [of] Douglas [Aquatics], Inc.'s locations throughout Virginia and North Carolina and that Douglas [Aquatics], Inc. opened its fifth location in Charlotte, North Carolina in 2005 trading as Douglas Aquatics Charlotte" that constituted words or conduct representing or permitting it to be represented that DA Charlotte is Appellant's agent.

Such statements, the court held, "can easily be construed as a manifestation by Appellant to citizens in the Charlotte area that DA Charlotte was its agent." In addition, the court noted that the contract between DA Charlotte and plaintiff provided that appellant would perform the pool construction work. Although the contractual provision itself would not have supported a reasonable belief that appellant and DA Charlotte were the same entity, the representations on appellant's website "justified Plaintiff's belief in the agency intimated by DA Charlotte, and his reliance thereon in entering the construction contract was consistent with ordinary care and prudence." The court concluded that "the elements of apparent agency are met, and Appellant can be considered legally responsible for the acts of its apparent agent, DA Charlotte, for purposes of personal jurisdiction."

***Smallbizpros, Inc. v. MacDonald*, 618 F.3d 458, Bus. Franchise Guide (CCH) ¶ 14,454 (5th Cir. 2010)**

Smallbizpros, Inc. (d/b/a Padgett Business Services), a franchisor, sued MacDonald, a franchisee, over termination of its franchise agreement. The parties agreed to settle the case and filed a stipulated settlement order with the U.S. District Court for the Western District of Texas. The order contained a stipulation of dismissal and attached the terms of the parties' settlement agreement. At the parties' request, the district court signed and entered the order. MacDonald later refused to comply with the settlement agreement, and the district court issued a contempt order against MacDonald for his noncompliance. MacDonald appealed, arguing that the district court did not have jurisdiction to enforce the terms of the settlement agreement. The U.S. Court of Appeals for the Fifth Circuit agreed.

The Fifth Circuit held that under Federal Rule of Civil Procedure 41(a)(1)(A)(ii) and Supreme Court precedent, the district court's jurisdiction over the matter ended when the stipulation of dismissal was filed by the parties. The Fifth Circuit recognized that there are instances when a district court has ancillary jurisdiction even after a stipulation of dismissal is filed, but it held that this was not one of those instances. The dismissal order filed by the parties did not incorporate the terms of the settlement agreement (it merely attached the terms to it), and it did not expressly give the court ancillary jurisdiction to enforce the settlement agreement. The parties could have, but did not, make the dismissal "expressly contingent upon the district court's entry of the order." For these reasons, the Fifth Circuit determined that the district court did not have jurisdiction. The Fifth Circuit noted that even though "the parties and the district court likely intended for the district court to retain ancillary jurisdiction to enforce the terms of the settlement agreement . . . jurisdiction is a strict master and inexact compliance is no compliance." The Fifth Circuit vacated the contempt order entered against MacDonald and remanded to the district court with instructions to dismiss for lack of jurisdiction.

STATE DISCLOSURE/REGISTRATION LAWS

***Coyne's & Co., Inc. v. Enesco, LLC*, No. 07-4095 (MJD/SRN), 2010 U.S. Dist. LEXIS 83630, Bus. Franchise Guide (CCH) ¶ 14,449 (D. Minn. Aug. 16, 2010)**

Plaintiff Coyne's & Company, Inc. (Coyne's), a Minnesota giftware company, entered into a distributor agreement with defendant Country Artists, Ltd. (CA), in which CA granted Coyne's "'the exclusive right to sell, distribute, market, and advertise certain lines of [CA] [gift] product[s] . . . for the territory consisting of the United States and Mexico.'" The distributor agreement provided that Coyne's pay a 50 percent markup on CA products and meet a sales requirement of $5 million or 5 percent above the previous year's sales, whichever was greater. The distributor agreement also provided that "either party could serve upon the other written notice to terminate the agreement if the other party became insolvent, filed [for] bankruptcy . . ., made a general assignment for the benefit of its creditors, or had a receiver or trustee appointed for its business." In August 2007, receivers were appointed for CA. The receivers and defendant Enesco, LLC, an Illinois giftware company that competes directly with Coyne's, entered into an asset sale agreement in which CA transferred its business and assets to Enesco. The receivers then sent a letter to Coyne's terminating the distribution agreement between Coyne's and CA. Coyne's, in turn, contacted Enesco to request release of CA products that Coyne's had ordered before August 2007. Coyne's and Enesco eventually entered into a Mutual Nondisclosure Agreement (NDA) in which the parties agreed that any confidential information that was exchanged would be used only to evaluate the parties' wish to "explore a business opportunity of mutual interest." By the end of 2007, however, Enesco returned all information Coyne's provided under the NDA and began to distribute CA products in the United States.

Several months after entering into the NDA, Coyne's filed a multiple-count complaint against Enesco, CA, and the receivers, who were later dismissed as defendants. Enesco and Coyne's filed cross-motions for summary judgment. The U.S. District Court for the District of Minnesota granted Enesco's summary judgment motion on the following claims: (1) tortious interference with contractual relations, (2) tortious interference with prospective business relations, (3) promissory estoppel, (4) unfair competition under the Lanham Act, (5) alleged violation of the Minnesota Deceptive Trade Practices Act, and (6) alleged violation of the Minnesota Trade Secrets Act.

The court denied Enesco's motion for summary judgment on the Coyne's claim that Enesco assumed CA's role as franchisor under the distribution agreement and wrongfully terminated the agreement in violation of the Minnesota Franchise Act. The court found that there was a genuine question of material fact on whether the 50 percent markup, minimum sales requirement, and/or excess inventory requirement constituted indirect franchise fees. The court observed that "minimum volume sales requirements can constitute an indirect franchise fee if the prices exceeded bona fide wholesale prices or if the distributors were required to purchase amounts or items that they would not purchase otherwise." The court also observed that parties cannot waive the protections of the Minnesota Franchise Act, so the fact that the distributor agreement stated that no franchise relationship existed was immaterial. Because a genuine question existed as to whether Coyne's was a franchisee, the court also denied Enesco's motion for summary judgment on Coyne's claim that Enesco violated § 80C.14 of the Minnesota Franchise Act, which makes it "unfair or inequitable practice" to "compete with the franchisee in an exclusive territory."

STATUTORY CLAIMS

***Anheuser-Busch, Inc. v. Schnorf*, No. 10-cv-1601, Bus. Franchise Guide (CCH) ¶ 14,438 (N.D. Ill. Sept. 3, 2010)**

This lawsuit was spurred by the proposed acquisition by Wholesaler Equity Development Corporation (WEDCO), a subsidiary of Anheuser-Busch, Inc. (AB), of an ownership interest in City Beverages from SD of Illinois, Inc. (SDI) and Double Eagle Distributing Company (Double Eagle). WEDCO owned a 30 percent interest in City Beverages, so the proposed transaction would result in WEDCO becoming the sole owner of City Beverages. The Illinois Liquor Control Commission (Commission) informed plaintiffs that the acquisition would violate the Illinois Liquor Control Act, which prohibits an out-of-state brewer, such as AB, from directly distributing beer to in-state retailers. However, "in-state brewers are permitted to perform the distribution function in Illinois." Because of its nonresident status, AB could not possess an ownership interest in a licensed Illinois distributor.

WEDCO, AB, SDI, and Double Eagle brought suit challenging the Commission's construction of the Illinois Liquor Control Act as violating the Commerce Clause of the U.S. Constitution. The Commission informed plaintiffs that the acquisition would violate Illinois law. Under the Commission's interpretation of the Illinois Liquor Control Act, an out-of-state brewer, such as AB, must go through an in-state distributor to distribute beer to in-state retailers. Therefore, because of its nonresident status, AB may not possess an ownership interest in a licensed Illinois distributor. However, in-state brewers are permitted to perform the distribution function in Illinois.

The court recognized that under Commerce Clause jurisprudence, laws are subject to per se invalidation where they discriminate against interstate commerce, whether the discrimination is explicit, "has a discriminatory purpose, or has substantial discriminatory effects." The court first recognized that under the Commission's interpretation of the law, "the basis for determining whether a brewer can distribute beer in Illinois turns on the brewer's residency; an in-state brewer is eligible, while an out-of-state brewer is not." Thus, the court held, "by its own terms, this law explicitly discriminates against out-of-state brewers."

The court next determined whether the law, which discriminates by its own terms, meets the "very narrow exception" to the rule of per se invalidity by "advancing a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." The court recognized that under this inquiry, "[t]he burden is on the State to demonstrate that the *discrimination* is . . . justified" and that "the State must come forward with concrete record evidence, rather than mere speculation." The court held that the state failed to demonstrate the law met the exception despite the state's arguments to the contrary. The court rejected the state's argument that the in-state brewers that currently distribute in Illinois are so small and produce such a small amount of beer that "permitting them to self-distribute does not jeopardize the Act's goal of promoting temperance and competition": the argument failed to address the fact that the Liquor Control Act permits all in-state brewers, not just small ones, to distribute beer within the state and prohibits all out-of-state brewers, not just large ones, from distributing beer within the state. Similarly, the court rejected the state's argument that it is more difficult to exert control over out-of-state licensees and that "there is an increased risk of tax evasion when a producer and distributor affiliate." The court found that the argument did not justify the discrimination against out-of-state producers because the tax evasion would apply to brewers that act as distributors regardless of where they are located. The court held that the state failed to demonstrate any legitimate purpose that justifies the discrimination.

Having found that the law violated the Commerce Clause, the court next turned to the appropriate remedy, choosing between (1) nullification of the discriminatory provision, which would allow out-of-state brewers to distribute directly to retailers, or (2) extension of the provision, which would prohibit in-state brewers from distributing directly to retailers. The court concluded that the more appropriate remedy from a judicial perspective was to withdraw the self-distribution privilege from in-state brewers rather than to extend the privilege to out-of-state brewers. The court added that it would stay enforcement of its order until March 31, 2011, to allow the Illinois state legislature to act on the matter if it so desires. The court directed the parties "to file a joint status report [on] March 15, 2011, advising the court of any legislative efforts to address the constitutional defect identified in [its] opinion, after which time the [c]ourt [would] determine whether to lift or extend the stay."

***Bonus of Am., Inc. v. Angel Falls Servs., L.L.C.*, 2010 U.S. Dist. LEXIS 67079, Bus. Franchise Guide (CCH) ¶ 14,415 (D. Minn. July 6, 2010)**

In this case, the U.S. District Court for the District of Minnesota granted a cleaning and maintenance service franchisor's preliminary injunction motion against its franchisee and "Patron," a competing business that the franchisor alleged was being managed by one of the franchisee owners in violation of contractual noncompete provisions. Before entering into any agreements, the franchisor shared other franchisees' revenue information with the franchisee to induce the franchisee to enter into the agreement. The parties entered into the initial franchise agreement on an expedited basis with an agreement to modify the agreement following negotiations. The parties later entered into Master Franchisor Agreements that superseded the expedited agreement. The Master Franchisor Agreements contained a covenant not to compete during the term of the agreement and for two years afterward within a fifty-mile radius.

Patron was a competing cleaning services business incorporated by a separate individual but that solicited the franchisee's customers and used the same employees and contractors as the franchisee. The franchisor alleged that the franchisee's owner played an active role in Patron's day-to-day management and presented as evidence Patron documents with the franchisee owner's signature, including invoices and business proposals. The court granted the injunction after finding that Patron's competing business using the franchisor's system was likely to cause irreparable harm to the franchisor's goodwill and that the balance of the harms weighed in the franchisor's favor. The court reasoned that the harm to the franchisor's reputation and goodwill outweighed the harm resulting in preventing the franchisee and Patron from competing, especially since the franchisee had entered into a covenant not to compete. As for likelihood of success on the merits, the court evaluated whether the Master Franchisor Agreements and the covenant not to compete were enforceable. The franchisee and Patron argued that the franchise agreement was not enforceable because it was entered into before the franchisor was registered to sell franchises in Minnesota, as required by the Minnesota Franchise Act (MFA). The franchisor conceded that the expedited agreement had been entered into before registration but that the parties entered into the later Master Franchisor Agreements after registration. The court found that the registration violation was merely technical and did not make the agreements unenforceable. The franchisee also argued that the franchisor violated the MFA by providing revenue information and projections before the franchise sale. Under the MFA, a franchisor must include a public offering statement that "includes a copy of estimated or projected franchisee earnings" and "may not make statements contrary to a disclosure in the public offering statement." The franchisor denied that it had provided information contrary to the public offering statement. The court found that because there were conflicting self-interested statements regarding this issue, the franchisee and Patron had not shown that the Master Franchisor Agreements were unenforceable.

The court then focused on the enforceability of the covenants not to compete. Under Texas law, covenants not to compete are enforceable if they are ancillary to an otherwise enforceable agreement and contain limitations as to time, geographic area, and scope of activity to be restrained. The court noted that "[a] covenant is ancillary if (1) the consideration given in the otherwise-enforceable agreement create[d] the franchisor's interest in restraining the actions of its franchisees, and (2) the covenant [was] designed to enforce the franchisee's promises." In this case, the agreements were found to be otherwise enforceable because the franchisor promised to allow the use of its system and to disclose confidential information in exchange for promises not to compete. The court also found that the restraints of competition for a two-year period after the agreement and a fifty-mile radius were reasonable. Based on the court's findings that the Master Franchisor Agreements and covenants not to compete were enforceable, coupled with the evidence presented that Patron and the franchisee were violating the covenant, the court found that the franchisor was likely to succeed on the merits. The court also ruled that "[t]he public interest [factor] [did] not strongly favor one party over the other." Accordingly, the court held that the preliminary injunction was warranted.

***Franklin Park Lincoln-Mercury, Inc. v. Ford Motor Co.*, 2010 U.S. Dist. LEXIS 66732, Bus. Franchise Guide (CCH) ¶ 14,407 (N.D. Ohio July 2, 2010)**

A Ford dealer owned a Lincoln-Mercury dealership in Ohio. Without his knowledge, a buyer who also owned a Ford dealership bought a Lincoln-Mercury dealership located close to the dealer. The buyer operated the purchased dealership at its existing location for one day before moving it less than a mile away to integrate it with his established Ford dealership. The dealer protested the actions with the Ohio Motor Vehicle Dealers Board (Board), arguing that it was entitled to notice of these actions and an opportunity to protest. The Board dismissed the protest, and the court of common pleas affirmed the dismissal based on two exceptions within the notice requirements of the Ohio Motor Vehicle Dealers Act (Act): (1) relocations of existing dealerships of less than one mile, and (2) sales or transfers of existing dealerships where "the transferee proposes to engage in business at the same location." After the dealer appealed to the appellate court and lost, it sued Ford in the U.S. District Court for the Northern District of Ohio, alleging breach of fiduciary duty and violations of the Act and the federal Automobile Dealers Day in Court Act (ADDCA). Ford moved to dismiss.

The dealer argued that Ford owed fiduciary duties arising out of three sources of law: (1) the common law, (2) the Act, and (3) the ADDCA. The court found that neither the Act nor the ADDCA created a fiduciary relationship because neither contained any language to that effect, and the court did not find any case law supporting this proposition.

However, the court found that the dealer had stated a plausible claim for breach of fiduciary duty under Ohio common law. The existence of a franchisee/franchisor relationship does not give rise to a fiduciary relationship unless a special trust and confidence has been placed by the franchisee in the franchisor. The court noted that a recent case, *Manhattan Motorcars, Inc. v. Automobili Lamborghini, S.P.A.*, 244 F.R.D. 204, Bus. Franchise Guide (CCH) ¶ 13,669 (S.D.N.Y. 2007), held that a franchise relationship involving "exceptional circumstances" creates a fiduciary relationship and that such exceptional circumstances suffice to meet the "special trust" requirement of Ohio law. In *Manhattan Motorcars*, a fiduciary relationship was created when a franchise agreement granted the franchisor "the authority to exercise near life and death economic power" over the franchisee and required the franchisee to disclose confidential information. Because the dealer's complaint had tracked the exceptional circumstances of the *Manhattan Motorcars* case by alleging that the franchise agreement placed Ford "in a position of disproportionate power and dominance over" it, required the franchisee to disclose confidential information, and made the franchisee "dependent upon Ford for economic survival," the complaint was sufficient to demonstrate a special trust in the franchisor. Accepting those allegations as true, the court found that the franchisee stated a plausible breach of fiduciary duty claim.

***Saccucci Auto Group, Inc. v. Am. Honda Motor Co., Inc.*, 617 F.3d 14, Bus. Franchise Guide (CCH) ¶ 14,439 (1st Cir. 2010)**

Plaintiff Saccucci, a car dealer located in Rhode Island, sued defendant American Honda Motor Co., Inc. (Honda) after Honda prohibited its dealers from selling Honda Vehicle Service Contracts (VSCs) over the Internet. Saccucci claimed that the prohibition violated three provisions of the Rhode Island Fair Dealership Act: (1) one provision prohibiting car manufacturers from "coerc[ing]" a dealer into entering an agreement, (2) a second provision prohibiting manufacturers from engaging in "arbitrary" action that causes damage to a dealer, and (3) a third provision prohibiting manufacturers from engaging in any "predatory practice" against a dealer.

Saccucci also claimed that Honda violated Rhode Island's implied covenant of good faith and fair dealing.

A VSC is a vehicle protection package similar to an extended warranty. Honda does not sell its VSCs directly to customers; rather, Honda dealers pay Honda a fee for every Honda VSC they sell. Dealers are then free to charge their customers whatever price they wish, keeping the difference as profit. Honda also pays its dealers a "performance based allowance" for each VSC sold. Honda VSCs were initially sold at dealer locations only, but at some time in 1997 dealers began to sell VSCs over the Internet. In 2002, certain Honda dealers began to complain about the lower-priced VSCs sold online. Although Honda initially supported online VSC sales, in 2007 Honda's position began to change after it received more complaints from individual dealers and received a recommendation from a board comprised of dealers that Honda stop online sales of VSCs. Dealers pointed to dissatisfaction from customers who purchased VSCs in dealer stores and later discovered VSCs sold online at significantly lower prices. Honda's management considered this issue and announced a temporary prohibition on Internet sales of VSCs beginning in February 2008.

Saccucci sued Honda in Rhode Island state court shortly after Honda imposed the temporary prohibition on online VSC sales. Honda removed the case to federal district court and then moved for summary judgment. The U.S. District Court for the District of Rhode Island granted summary judgment for Honda. Saccucci appealed.

On appeal, Saccucci argued that the district court erred when it granted Honda summary judgment on Saccucci's dealer act claims and its claim that Honda breached the implied covenant of good faith and fair dealing. The U.S. Court of Appeals for the First Circuit affirmed the district court's decision. On the first dealer act claim for coercion, the First Circuit held that Honda's prohibition of online VSC sales did not constitute a wrongful demand. Although the court held that Honda read its rights under the relevant contracts too broadly, it rejected Saccucci's argument that the contracts were ambiguous with respect to Honda's ability to curb VSC sales on the Internet. According to the court, Honda made its decision based on its commercial judgment and concern that Internet VSC sales harmed brand image and loyalty and resulted in dealers promoting competing products. On the second dealer act claim for arbitrary action, the court held that Honda made its decision to prohibit online VSC sales only after thorough consideration and that, far from being without reason, Honda acted out of concern for its dealers. On the third dealer act claim for predatory practice, the court again held that rather than acting with the intent to harm dealers, Honda enacted the prohibition in order to protect brand image and loyalty, which were in the best interest of its dealers. Finally, the court, referencing its analysis under the coercion claim, concluded that the district court correctly granted Honda summary judgment on the implied covenant of good faith and fair dealing claim because Honda's actions did not interfere with any contractual objectives and lacked bad faith.

***Taylor v. 1-800-GOT-JUNK?, LLC*, No. 09-35661, 2010 U.S. App. LEXIS 14433, Bus. Franchise Guide (CCH) ¶ 14,423 (9th Cir. July 14, 2010)**

In this case, franchisee appealed the district court's grant of summary judgment in favor of the franchisor. After the parties entered into a settlement and release agreement, the franchisee sued the franchisor for allegedly violating the Washington Franchise Investment Protection Act (FIPA). Both parties moved for summary judgment. The franchisee argued that the settlement and release agreement did not bar its claims because it had not been represented by counsel and because the FIPA voids unrepresented parties' releases and waivers. The franchisor responded that the FIPA antiwaiver provision did not apply because the FIPA applied only to franchises sold in Washington, and the franchisee was in Oregon. Aside from the franchise agreement's Washington choice of law provision, the franchisee had no connection to Washington. The district court agreed. On appeal, the franchisee argued that the franchise agreement's choice of law provision permitted the action despite the FIPA's express territorial limitation; but it offered no supporting authority for its argument, and the argument contradicted an earlier U.S. Court of Appeals for the Ninth Circuit decision. The Ninth Circuit therefore affirmed.

***Warren Distrib. Co. v. Inbev USA, L.L.C.*, 2010 U.S. Dist. LEXIS 55542, Bus. Franchise Guide (CCH) ¶ 14,404 (D.N.J. June 7, 2010)**

Plaintiff beer distributors sued defendant beer brewers Inbev and AB for violations of the Malt Alcoholic Beverages Practices Act (Act). AB filed counterclaims for unjust enrichment, tortious interference with contract (two counts), and violations of the Act.

Distributors had individual distributing agreements with Inbev for several name-brand beers. AB ultimately purchased the brewing rights of several of those brands and chose to use its existing distributors. The Act requires a successor brewer to pay a distributor fair market value for the brand beers before terminating distributor rights. Accordingly, AB offered fair market value payments to each distributor based on what is known as the "market multiples" approach. The market multiples approach multiplies a distributor's gross profits from a prior year by "a multiple derived from purported comparable transactions." Here, AB offered a multiple of 3.3 for certain brands and 2.5 for others. AB also offered a premium payment for the distributors' cooperation during the termination process. The distributors refused to cooperate, believing that the calculations were unfair. Thus, AB terminated their rights and tendered payment to each distributor according to the market multiples calculations (minus the premium). Although the market multiples approach is not an uncommon approach in these circumstances, the distributors insisted that the "discounted cash flow" method be used. The distributors alleged that the market multiples approach undervalued their rights by $40 million.

The distributors also alleged that they were damaged because Inbev (1) actively negotiated with AB to transfer to it the import rights to certain brands and, in doing so, shared confidential, proprietary information with AB; and (2) induced the distributors to purchase large amounts of inventory when it knew that AB was taking over the brewing rights. AB's counterclaim asserted damages because the distributors allegedly sold terminated brands after termination and because one distributor actively engaged in a "duplicitous campaign" of representing itself as an authorized seller of certain brands while inducing retailers to stop selling those brands. The distributors as a group, AB, and Inbev each moved for summary judgment.

The distributors claimed that Inbev violated the Act by terminating the agreements without good cause and when AB was not acting in compliance with the Act. Inbev claimed that it did not violate the Act because AB was the successor brewer and thus responsible for acts taken thereafter. The court agreed that AB was a successor brewer but determined that Inbev was still responsible for whether AB paid the distributors fair market value before it could determine that the termination was with good cause. The court denied Inbev's summary judgment motion because there was a question of fact concerning whether AB paid fair market value to the distributors.

The court turned to AB's motion for summary judgment on claims of violations of the Act and tortious interference. AB argued that summary judgment was appropriate if it could show that a reasonable tender was paid. The court rejected this argument. The Act defines fair market value as "the price at which the asset would change hands between a willing seller and a willing buyer." The Act requires that a successor brewer pay a wholesaler "the fair market value." According to the court, the word *the* suggests that there is an objective fair market value that is not simply a reasonable tender and that must be determined by a jury.

One of AB's counterclaims concerned the distributors' alleged violations of the Act. The court stated that the Act does not provide for a cause of action by a brewer against a distributor. Thus, the court granted summary judgment in favor of the distributors on this claim.

TERMINATION AND NONRENEWAL

***Duncan Servs., Inc. v. ExxonMobil Oil Corp.*, 2010 U.S. Dist. LEXIS 69372, Bus. Franchise Guide (CCH) ¶ 14,421 (D. Md. July 12, 2010)**

In this case, the U.S. District Court for the District of Maryland reconsidered an earlier ruling on motions to dismiss and rejected ExxonMobil dealers' claims against ExxonMobil for constructive termination in violation of the Petroleum Marketing Practices Act and breach of contract. The court noted that the U.S. Supreme Court in the *Mac's Shell* case determined that a franchise is terminated only where one of the statutory elements of the franchise is terminated. Those elements include the use of the franchisor's trademark, the purchase of motor fuel, and the lease of the premises. None of the statutory elements had ended because the dealers could still use the trademark, purchase fuel, and lease the premises and still rented the property. The court also rejected the dealers' breach of contract claim because they had not alleged that ExxonMobil had actually violated any contract provisions.

***Krispy Kreme Doughnut Corp. v. Satellite Donuts, LLC*, Case No. 10-civ-4272, Bus. Franchise Guide (CCH) ¶ 14,434 (S.D.N.Y. July 21, 2010)**

Following multiple, uncured monetary defaults, a doughnut shop franchisor sent its franchisee a Notice to Cease and Desist, which effectively terminated the franchise agreement between the parties. Thereafter, the franchisor moved to enjoin the franchisee from operating the franchises and using the franchisor's trademarks and proprietary information. The U.S District Court for the Southern District of New York found that the franchisor had a clear and substantial likelihood of success on the merits of its claim that it properly terminated its franchisee and that the franchisee was infringing upon its trademarks in violation of the Lanham Act by continuing to operate its two doughnut shops.

The court further held that the franchisee's argument that the Notice to Cease and Desist was not called a Notice of Termination was of no merit. The notice mailed by the franchisor stated in substance that the agreements were terminated due to the franchisee's multiple failures to cure its defaults and that continued use of the franchisor's trademarks was unauthorized. The court found that the franchisee's receipt of the letter satisfied the franchise agreement's notice of termination requirements and that the franchisee's ongoing infringement of the trademarks constituted irreparable injury to the franchisor.

***Absolut Spirits Co. v. Monsieur Touton Selection, Ltd.*, Nos. A-3363-08T1, A-3680-08T1, 2010 N.J. Super. Unpub. LEXIS 1874, Bus. Franchise Guide (CCH) ¶ 14,443 (N.J. Super. Ct. App. Div. Aug. 3, 2010)**

Absolut, a manufacturer of vodka, sought to terminate Touton as a wholesaler by filing a petition with the Alcohol Beverage Commission (ABC). An administrative law judge (ALJ) recommended granting Absolut's petition to terminate Touton, and the ABC director accepted the ALJ's recommendation. Touton appealed the ABC director's order, and the New Jersey Superior Court remanded the matter to the ABC director to make findings of facts that supported his decision to allow Absolut to terminate Touton. The ABC director determined that the termination was supported by the fact that Touton disparaged Absolut's brand and committed unfair trade practices.

After hearing the evidence, the ABC director concluded that Absolut had met its burden of demonstrating that Touton had engaged in proscribed trade practices by (1) requesting reimbursement for participation in a sales program despite the fact that Touton was aware that it did not comply with the program requirements and was therefore not entitled to any reimbursement, (2) attempting to order brands of Absolut flavored vodka even though it knew that it was not authorized to sell such brands, and (3) selling Absolut products below cost even though the ABC director denied Touton's request to do so. The ABC director also concluded that Touton's conduct of undercutting the price and using Absolut products as a loss leader fell under the definition of *product disparagement*.

At the outset, the court noted its narrow scope of review in considering administrative decisions. The court then upheld the ABC director's findings as well-supported by the record and consistent with the governing law. The court, however, held that it need not determine whether Touton's conduct satisfied the definition of *product disparagement* because such conduct constituted unfair trade practices, which were more than sufficient to justify Absolut's termination of Touton as a wholesaler.

***Ultimate Ford Inc. v. Motor Vehicle Div. of the Tex. Dep't of Transp.*, No. 03-09-00548-CV, Bus. Franchise Guide (CCH) ¶ 14,174 (Tex. App. Aug. 27, 2010)**

In this case, Ford Motor Company, Inc. (Ford) sought to terminate two dealerships. In order to terminate such dealerships, Ford was required to comply with the Texas Occupations Code (TOC), which requires a franchisor to include, among other things, a statement required by the statute in its written notice of termination. However, Ford's written notices of termination to the dealerships did not precisely track the language specified in the TOC. Specifically, Ford misidentified the agency with which the dealerships could file protests and the governing statute. Despite the errors in Ford's notices of termination, the dealerships timely filed their protests with the Texas Department of Transportation (Division), the correct agency charged with enforcing the TOC.

After a hearing, a Division administrative law judge (ALJ) concluded that good cause had been established for terminating the dealerships and that the notices of termination failed to comply with the requirements of the TOC. Despite Ford's noncompliance with the TOC, the ALJ issued a proposed recommendation that the dealerships' franchise agreements be terminated, which the Division's director adopted. The dealerships sought judicial review of the Division's determination, asserting that (i) Ford's failure to comply with the TOC rendered the termination letters ineffective; and (ii) the Division's order violated the TOC, exceeded the Division's authority, resulted from "improper procedure," contained an error of law, was an abuse of the Division's discretion, and was not supported by substantial evidence. Specifically, the dealerships pointed to the language of the TOC providing that a termination notice "must" contain the specified statutory disclaimer. This *must* language, the dealerships asserted, made the specific disclaimer a condition precedent to termination of the dealerships' franchise agreements.

Although the court acknowledged that the *must* used in the TOC denoted a condition precedent, it noted that it did not follow that any noncompliance with the notice requirements by Ford must automatically invalidate the Division's good cause determination. Rather, to determine the consequences of a failure to satisfy a condition precedent, the court must look to the legislative intent of the statute. The court found that the legislative intent of the termination notice requirement of the TOC was to ensure that a dealer facing termination is notified of its statutory rights to protest the termination and to obtain a hearing and how to do so. The court found that the purpose of the notice requirement was satisfied. Even though the disclaimer included in Ford's termination notice did not precisely track the requirements of the TOC, the court reasoned that the termination letters did notify the dealerships of their rights to protest the terminations and how to do so. In fact, the court noted that the dealerships did file timely protests of the terminations with the correct agency and with citations to the correct governing statute, and the dealerships went on to participate in the ensuing contested-case hearing. Consequently, the court concluded that the Division's decision that any defect in Ford's notice of termination letter did not invalidate Ford's termination was reasonable and consistent with the statute.

TORTIOUS INTERFERENCE

***Minn. Deli Provisions, Inc. v. Boar's Head Provisions Co., Inc.*, Case No. 08-3607, Bus. Franchise Guide (CCH) ¶ 14,401 (8th Cir. May 27, 2010)**

Factual issues precluded a distributor's efforts to defeat, by summary judgment, claims that a manufacturer had breached an oral agreement and tortiously interfered with contractual and prospective relations. Boar's Head, a manufacturer of deli products, appointed Minnesota Deli Provisions, Inc. (Minnesota) as its distributor. Minnesota claimed that it was verbally assured that Boar's Head would not terminate the relationship or touch Minnesota's customer accounts as long as it performed adequately. After Boar's Head found multiple product deficiencies at Minnesota's retailers, Boar's Head stripped Minnesota of multiple customer accounts and reassigned those accounts without compensating Minnesota. Following Minnesota's institution of suit for breach of contract, breach of the implied covenant of good faith and fair dealing, promissory estoppel, and tortious interference, Boar's Head found additional product deficiencies at Minnesota's retailers and terminated the agreement.

The U.S. Court of Appeals for the Eighth Circuit affirmed the district court's grant of summary judgment in favor of Boar's Head, finding that, under Minnesota law, the verbal assurances made by Boar's Head contained nothing more than general statements too indefinite to create a legally enforceable offer for a durational term. The Eighth Circuit concluded that the contact between the parties was at will and thus that the relationship was terminable at will. Further, having found no evidence of a clear and definite promise or agreement between the parties, the Eighth Circuit could not conclude that Minnesota established a course of dealing between the parties regarding a contractual right to sell its customer accounts.

***Utility Trailer Sales of Kan. City, Inc. v. MAC Trailer Mfg., Inc.*, No. 09-2023-JPO, 2010 U.S. Dist. LEXIS 83142, Bus. Franchise Guide (CCH) ¶ 14,448 (D. Kan. Aug. 16, 2010)**

In 2000, Utility Trailer Sales of Kansas City, Inc. (Utility) and MAC Trailer Manufacturing, Inc. (MAC) "entered into a dealer agreement [that] grant[ed] Utility a non-exclusive license . . . to sell trailers and other products manufactured by MAC." The agreement "set a geographic area consisting of . . . eastern Kansas and western Missouri . . . in which Utility . . . would be the sole" authorized dealer of MAC products. Both Utility and MAC had the right to terminate the dealer agreement upon thirty days' notice. In 2008, MAC sent a letter to Utility purporting to terminate the dealership "'effective immediately.'" After Utility protested and filed an administrative complaint with the Kansas Director of Vehicles, MAC sent a letter revoking the termination. In 2008 MAC authorized Summit Truck Equipment, LLC (Summit) as a licensed dealer of MAC products in the Kansas City metropolitan area. Later that year, Utility filed suit against MAC and Summit in state court. After MAC and Summit timely removed the suit to federal court, "MAC sent a second termination letter to Utility," giving thirty days' notice of termination as required by the dealer agreement.

In its suit, Utility brought claims against MAC for breach of contract, tortious interference with a prospective business relationship, and violation of the Kansas Vehicle Dealer and Manufacturer Licensing Act (KDMLA). Utility also brought claims against Summit for tortious interference with an existing contract and tortious interference with a prospective business relationship. A jury returned a verdict in favor of Utility on the claims of tortious interference with a prospective business relationship against MAC and Summit and awarded actual damages. The jury rejected Utility's remaining claims and its request for punitive damages.

This decision involves the renewed motion of MAC and Summit for judgment as a matter of law on Utility's claim of tortious interference with a prospective business relationship, and Utility's renewed motion for judgment as a matter of law on its KDMLA claim and motion for new trial on its claims for breach of contract and tortious interference with existing contract. The U.S. District Court for the District of Kansas granted MAC and Summit's renewed motion for judgment as a matter of law and denied Utility's motions.

MAC and Summit argued that the evidence could not support a finding that defendants acted with malice and that a "competitor privilege" existed. The court found that although there was sufficient evidence for the jury to find that MAC and Summit acted with malice, there was no legally sufficient basis on which the jury could have found the absence of the business competitor privilege. Under the business competitor privilege, an actor cannot be liable for tortious interference with a prospective business relationship if "(1) the relation concerns competition between the actor and the plaintiff, (2) the actor does not employ wrongful means, (3) its actions do not create or continue an unlawful restraint of trade, and (4) its purpose is at least in part to advance competition." The court concluded that the standard for establishing "wrongful means" under the second prong is higher than the standard for establishing malicious action and required Utility to show that the alleged wrongful actions of MAC and Summit rose to the level of independently actionable conduct. Utility's failure to do so required the court to determine that a jury could not conclude that there was an absence of competitive privilege.

On the remaining claims, the court denied MAC and Summit's motion for judgment as a matter of law based on their argument that the conduct underlying Utility's tortious interference with a prospective business relationship was the same as the conduct underlying Utility's breach of contract claim. The court also rejected MAC and Summit's argument that Utility could not recover damages for lost profits beyond the thirty-day notice period for termination.

The court denied Utility's motion for judgment as a matter of law on the KDMLA claim and dismissed that claim. The court held that it lacked jurisdiction to consider the KDMLA claim because Utility failed to exhaust its administrative remedies as required by the statute. Finally, the court denied Utility's request for a new trial on its breach of contract and tortious interference with existing contract claims based on a discovery violation.

TRADEMARK INFRINGEMENT

***Pinzone v. Papa's Wings, Inc.*, Case No. 2090472, Bus. Franchise Guide (CCH) ¶ 14,418 (Ala. Civ. App. July 9, 2010)**

A divorce settlement agreement between a pizza restaurant franchisor and his ex-wife transferred the franchisor's interest in his Fairhope, Alabama, "Papa's Pizza" restaurant to his ex-wife. That agreement, however, did not grant the ex-wife exclusive use of the Papa's Pizza name in Fairhope. The ex-wife subsequently sold her Papa's Pizza restaurant to Papa's Wings, an entity that continued the operation of the restaurant and use of the Papa's Pizza name. That entity owned other Papa's Pizza locations under franchise agreements with the franchisor. The franchisor subsequently opened its own Papa's Pizza location in Fairhope. After Papa's Wings sued, the trial court enjoined the franchisor from operating pizza restaurants using the Papa's Pizza name and logo within the town of Fairhope and declared that the current owner had exclusive rights to use that name and logo within those limits.

On appeal, the court reversed the trial court's ruling, finding that it had erred in declaring that the current owner of the Fairhope restaurant had the exclusive right to use the Papa's Pizza name in Fairhope and enjoining Papa's Pizza from using that name in connection with another restaurant in Fairhope. The divorce settlement agreement did not contain language granting the ex-wife exclusive use of the Papa's Pizza name in Fairhope. Further, the contract by which the current owner of the Fairhope restaurant purchased the restaurant from the ex-wife stated that the ex-wife sold the right to use the Papa's Pizza name in Fairhope "only"; it did not state that the current owner had the exclusive right to use the name in Fairhope. As a result, the appellate court ruled there was "no evidence from which the trial court could have concluded that [the current owner of the ex-wife's restaurant] ha[d] the exclusive right to use the Papa's Pizza name . . . in Fairhope."

TRADE SECRETS

***Maaco Franchising, Inc. v. Augustin*, No. 09-4548, 2010 U.S. Dist. LEXIS 83895, Bus. Franchise Guide (CCH) ¶ 14,442 (E.D. Pa. Aug. 5, 2010)**

Franchisor Maaco Franchising, Inc. (Maaco) sued franchisees for breach of franchise agreement and improper disclosure of trade secrets. Maaco moved for a preliminary injunction to enforce the franchise agreement's covenant not to compete and enjoin the alleged misappropriation of purported trade secrets. After a two-day hearing on the preliminary injunction motion, Maaco requested that the entire transcript be withheld from the public or that almost all of the transcript be redacted. The U.S. District Court for the Eastern District of Pennsylvania held that Maaco "ha[d] not carried its burden to show a need for secrecy beyond 'broad allegations of harm.'" The court found that the evidence presented regarding the purported trade secrets constituted information that was available to the public at large. Accordingly, the court denied Maaco's request to withhold or redact the transcript from the preliminary injunction hearing.

*Ms. Appleby's firm represented Maaco in this case.

VICARIOUS LIABILITY

***Soto v. Superior Telecom, Inc.*, No. 10-CV-0135 (BLM), 2010 U.S. Dist. LEXIS 54327, Bus. Franchise Guide (CCH) ¶ 14,400 (S.D. Cal. June 2, 2010)**

In this case, the U.S. District Court for the Southern District of California refused to dismiss a vicarious liability claim against defendants 7-Eleven and its franchisee. Plaintiff alleged that "Bonita Señorita" phone cards purchased from a franchised location did not provide the full calling time they were supposed to due to undisclosed charges. Plaintiff sued in California state court with a request for class certification against the phone card maker, 7-Eleven, and its franchisee, alleging that he was unaware of the rates, charges, and fees associated with the phone cards because the information was not displayed on the cards or anywhere near the sales location in violation of California law. He also claimed that he would not have purchased the cards had he known about the undisclosed charges.

Defendants removed the case to federal court and moved to dismiss. Defendant 7-Eleven argued that it was not vicariously liable because the franchisee operated as an independent contractor, and plaintiff's conclusory allegations of joint venture and management of the sale of phone cards could not establish that 7-Eleven had actual control over the franchisee.

In denying the motion to dismiss, the court noted that under *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), it need not accept as true "conclusory," "bare assertions." However, plaintiff satisfied *Iqbal*'s pleading standard because plaintiff adequately alleged an agency relationship under California law by asserting that (1) under the Standard Franchise Agreement, 7-Eleven required franchisees "to offer and sell certain 'Categories of Inventory,'" including certain calling card brands; (2) 7-Eleven spent substantial resources to develop and market its "'Prepaid Card product category' by controlling which products the franchisees were required to sell, negotiating the purchase terms with the distributors of the cards . . . , and overseeing the installation and maintenance of electronic equipment used to activate and 'charge' the cards at the register"; and (3) 7-Eleven and the franchisee shared the profits and losses of the Bonita Señorita cards through their "joint management and control of the sale of the Bonita Señorita cards."

***Uninsured Employers' Fund v. Brown*, No. 2010-CA-000283-WC, 2010 Ky. App. Unpub. LEXIS 696, Bus. Franchise Guide (CCH) ¶ 14,453 (Ky. Ct. App. Sept. 3, 2010)**

"Tonda Michelle Brown sustained work-related injuries . . . while working at a Subway sandwich stop owned and operated by Watash, UBC." Because Watash did not carry workers' compensation insurance, Uninsured Employers' Fund (Fund) paid Brown's medical expenses and temporary disability benefits. The Fund, however, "reserved the right to seek indemnity from" Doctors' Associates, Inc. (DAI), the franchisor of the Subway sandwich shop operated by Watash, the franchisee, provided that DAI qualified as an up-the-ladder employer of Brown under Kentucky's Workers' Compensation Act (Act).

An administrative law judge (ALJ) held that the Act did not apply because franchise relationships fall outside its scope, and Watash should not be considered a "subcontractor" because Watash was paying DAI for the right to operate the Subway sandwich shop. The Kentucky Department of Workers' Claims affirmed the ALJ's opinion. The Fund appealed the decisions of the ALJ and Department of Workers' Claims.

The Kentucky Court of Appeals reversed and remanded for further findings. The court found no cases supporting the ALJ's conclusion that "a franchisor is always or even presumptively exempt from providing workers' compensation benefits for employees of its franchisees." The court further concluded that "[t]he question of whether a particular business opportunity or franchise relationship satisfies [the Act] must be answered on a case-by-case basis."

The court then held that the ALJ failed to make any findings of fact supporting its second conclusion that DAI and Watash did not have a contractor-subcontractor relationship simply because Watash made royalty payments to DAI and was not in turn "remunerated" by DAI. The court pointed to *R.O. Giles Enterprises, Inc. v. Mills*, 275 S.W.3d 211 (Ky. Ct. App. 2008), in which the court held that courts will look to the nature of parties' business arrangement in determining whether it constitutes a contractor-subcontractor relationship and will not defer to the label that parties' attach to the arrangement. Because the ALJ is the finder of fact in workers' compensation matters, the court reversed and remanded to allow the ALJ to make additional findings of fact regarding the nature of DAI's business that support a legal conclusion under the Act.

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