

The Franchise Lawyer

American Bar Association • Forum on Franchising

Message from the Chair

By Elizabeth M. Weldon, Haynes and Boone, LLP



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I hope all who attended the Forum on Franchising's 46th Annual Meeting in Dallas, Texas—about 800 of us, plus guests!—are still thinking about the excellent programs, the development of franchise law, and the good memories after time spent with friends and colleagues. We had especially excellent scholarship in our 24 programs, three intensives, and two plenaries, including one with Lois Greisman from the Federal Trade Commission, and we had high spirits as our members were happy to be together again in person and enjoying the wonderful social events.

Planning the Annual Meeting is a big task, and our deep thanks for the 46th Annual Meeting goes to Nicole Micklich and Heather Perkins, our Co-Chairs for the meeting. Nicole and Heather led the Annual Meeting Planning Committee, which included the 45th Annual Meeting Co-Chairs Jason Adler and Ben Reed and the 47th Annual Meeting Co-Chairs Earsa Jackson and Erin Johnsen, as well as Immediate Past Chair Ron Coleman, Past Chair Will Woods, and me. We owe thanks to each and every one of our speakers and program directors who prepared or aided in preparing the scholarly papers and presentations for the programs. Each year, it is thrilling to see the scholarship and creativity of our speakers, and we are grateful for the effort and care they put into continuing the Forum's tradition of being the preeminent forum for the study and discussion of the legal aspects of franchising. And likewise, the authors of the *Annual Developments* book take effort and care to new heights each year. Our 2023 authors, Annie Caiola and Chuck Marion, did it again, doing such a wonderful job authoring the book this year and presenting the developments to us in Dallas. Thank you for your great work!

We have a new ABA director working with us this year, Tiffany Goldston, and we welcome her to our Forum and are excited to work with her to continue our traditions and develop new paths and offerings for the Forum. Tiffany was previously an associate director with the Antitrust Law Section of the ABA and is especially skilled in the work necessary to operate our Forum. Tiffany jumped right into the Annual Meeting in Dallas,

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What Franchising Can Learn from Trademark Disputes Over Dog Toys

By Christopher P. Bussert, Kilpatrick Townsend & Stockton



Although the title at first glance may seem bizarre, dog toy subject matter has served as surprisingly fertile ground for assessing trademark infringement and potential defenses based on the First Amendment, including, most notably, parody. Indeed, because recent case law has arguably strayed beyond historic norms (particularly in the Ninth Circuit), the U.S. Supreme Court recently stepped in to set the record straight in *Jack Daniel's Properties, Inc. v. VIP Products, LLC*, 599 U.S. 140 (2023), a dog toy case that centered on the defense of parody.

The world of franchising has historically wrestled with the interplay of trademark infringement and the First Amendment, including parody defenses. Nearly 10 years ago, contributors to the *Franchise Law Journal* engaged in a vigorous debate exploring, more broadly, the extent to which franchisors could safely use the intellectual property of others. See David Gurnick & Tal Grinblad, *OPIP-When Is It Lawful To Use Other People's*

Intellectual Property in Franchising?, 33 *FRANCHISE L.J.* 481 (Spring 2014); and Marc A. Lieberstein & William M. Bryner, *Before You Use Others' Intellectual Property Without Permission, Consider This...*, 34 *FRANCHISE L.J.* 131 (Fall 2014).

This article will rekindle that debate and, more importantly, review where the law has landed for the time being in the evaluation of First Amendment and parody defenses to trademark infringement.

Ruff Day for the Trademark Owner

The authors of the aforementioned 2014 articles largely framed their First Amendment and parody discussion by reference to the Fourth Circuit's decision in *LouisVuitton Malletier v. Haute Diggity Dog, LLC*, 507 F.3d 252 (4th Cir. 2007), the first of the three dog toy cases discussed herein.

LouisVuitton involved a dispute between a manufacturer of luxury luggage, handbags, and



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accessories and a manufacturer of dog chew toys, including chew toys called “Chewy Vuitton,” designed to parody famous trademarks on luxury products. On cross-motions for summary judgment, the district court concluded as a matter of law that the Chewy Vuitton chew toys did not create a likelihood of confusion. Louis Vuitton appealed to the Fourth Circuit.

At the outset, the Fourth Circuit noted that the parties did not dispute the protectable nature of Louis Vuitton’s trademarks or that the defendant used colorful imitations of these trademarks. Rather, the parties disputed whether the Chewy Vuitton chew toys created a likelihood of confusion. Although the court noted the Fourth Circuit’s seven-factor analysis for trademark infringement applied to Louis Vuitton’s claim (*see Pizzeria Uno Corp. v. Temple*, 747 F.2d 1522, 1527 (4th Cir. 1984)), prior to applying those factors, the court first considered whether the Chewy Vuitton chew toy successfully constituted a parody. According to the court, a successful parody defense depends on whether the product at issue conveys two simultaneous yet contradictory messages: that the product is original, but also that it is not the original but instead a parody. *Louis Vuitton Malletier*, 507 F.3d at 260. The court found that the Chewy Vuitton chew toys clearly conveyed both of these messages.

However, the finding that the toy manufacturer successfully parodied the luxury bag brand did not conclude the court’s likelihood-of-confusion inquiry. Rather, the Chewy Vuitton chew toy’s parody status only influenced the application of the seven *Pizzeria Uno* factors by diminishing any likelihood of confusion. *Id.* at 261. In applying each of the factors through the parody filter, the court concluded that each was either neutral or favored the defendant. In particular, the court pointed to the lack of any evidence of actual confusion in the record.

Louis Vuitton also contended that the Chewy Vuitton chew toys constituted actionable dilution of Louis Vuitton’s trademarks. The court similarly found this contention lacking, finding that application of the multifactor analysis outlined in the Trademark Dilution Revision Act through the parody filter compelled the conclusion that the Chewy Vuitton chew toys neither constituted dilution by blurring nor dilution by tarnishment. In reaching that conclusion, the court noted that Louis Vuitton failed to submit any evidence, beyond the speculation of its attorneys, of any reputational harm as a result of the advertising, sale, or distribution of the Chewy Vuitton chew

toy. *Id.* at 268–69. Because of the absence of evidence of actual confusion or reputational harm, the Fourth Circuit affirmed the district court’s grant of summary judgment to the defendant.

When a Problem Comes Along, You Must Whippit

Anheuser-Busch, Inc. v. VIP Products, LLC, 666 F. Supp. 2d 974 (E.D. Mo. 2008) presented a second dog toy case. The case’s facts mirror those of *Louis Vuitton* in that they involve a dispute between a beverage manufacturer, which owned the famous Budweiser mark, and a manufacturer of dog chew toys that had introduced a toy called “Buttwiper.” Anheuser-Busch brought suit claiming that the Buttwiper chew toy constituted trademark infringement and moved for a preliminary injunction.

Like the court in *Louis Vuitton*, the court began its analysis by applying the six-factor likelihood-of-confusion test for trademark infringement utilized in the Eighth Circuit. *See SquirtCo. v. The Seven-Up Co.*, 628 F.2d 1086, 1091 (8th Cir. 1980). Significantly, of the six factors, the defendant conceded that only two were at issue: the degree of care exercised by consumers and evidence of actual confusion. As to the degree of care, the court found this factor arguably weighed in favor of Anheuser-Busch because of evidence in the record that Anheuser-Busch had licensed its Budweiser mark to manufacturers of pet items, and some of those products were comparable in price to the “Buttwiper” toy. More importantly, as to the issue of confusion, Anheuser-Busch, unlike *Louis Vuitton*, relied on survey evidence demonstrating a 30 percent confusion rate, nearly three times what courts in that circuit had found sufficient to establish actual confusion. As a result, the court concluded that the issue of likelihood of confusion fell considerably on Anheuser-Busch’s side of the ledger.

The court then turned to the defendant’s infringement defense based on parody. The court noted that although parody often plays a role in the court’s likelihood-of-confusion analysis, “a defendant’s cry of parody did not magically fend off otherwise legitimate claims of trademark infringement or dilution.” *Anheuser-Busch, Inc.*, 666 F. Supp. 2d at 985. In support of its parody defense, the defendant heavily relied upon the then-recent Fourth Circuit *Louis Vuitton* case. The court ultimately held that the defendant’s parody defense did not overcome Anheuser-Busch’s likelihood of confusion survey, evidence that some of the parties’ products were comparable in cost, and

Anheuser-Busch's licensing of its Budweiser mark in connection with pet items.

Ninth Circuit Found to be Paws-itively Barking up the Wrong Tree

A final case, *Jack Daniel's Properties, Inc. v. VIP Products, LLC*, 599 U.S. 140 (2023), concerns a subsequent effort by VIP to develop and sell a parody-themed dog chew toy. VIP marketed this chew toy under the name "Bad Spaniels" and featured a wide-eyed spaniel over the words "Bad Spaniels" and "The Old No. 2 on your Tennessee Carpet," with a product shape that resembled the Jack Daniel's No. 2 Tennessee Whiskey bottle. After VIP introduced the Bad Spaniels product, Jack Daniel's promptly demanded that VIP stop selling it. VIP responded by filing a complaint seeking a declaratory judgment that the Bad Spaniels dog toy did not infringe or dilute any trademark or trade dress rights owned by Jack Daniel's. Jack Daniel's then filed counterclaims asserting trademark infringement and trademark dilution.

The matter eventually proceeded to a bench trial on Jack Daniel's claims. Taking a page out of Anheuser-Busch's book, Jack Daniel's relied heavily on expert testimony and survey evidence in support of its claims. As to its dilution by tarnishment claim, Jack Daniel's relied on empirical marketing research studies that established the Bad Spaniels product was likely to tarnish the Jack Daniel's trademarks and trade dress by creating negative associations, either consciously or unconsciously, and undermining the pre-existing positive associations with its whiskey.

The court applied the Ninth Circuit's eight-factor likelihood-of-confusion test, *see AMF Inc. v. Sleekcraft Boats*, 599 F.2d 341 (9th Cir. 1979), to the trademark claim. It began its analysis by focusing on the actual confusion factor and Jack Daniel's survey evidence that 29 percent of the survey respondents were likely to be confused or deceived by the belief that Jack Daniel's manufactured or otherwise authorized or approved of the Bad Spaniels dog toy, a rate that was nearly double the threshold typically needed in the Ninth Circuit to establish trademark infringement.

As in the *Anheuser-Busch* case, VIP relied heavily on its defense of parody and the fact that its product packaging contained an express disclaimer of affiliation or association with Jack Daniel's. The district court was unmoved by both arguments. It ruled that a defendant cannot rely on the parody defense if it also seeks to capitalize on a famous mark's popularity for the defendant's own commercial purpose. The court also noted

the evidence of copying and discounted the defendant's disclaimer because the defendant displayed it in tiny font on the reverse side of the packaging. The court then assessed the remaining *Sleekcraft* likelihood-of-confusion factors and found that each favored Jack Daniel's. As a result, the court ruled that Jack Daniel's had prevailed on its trademark infringement and trademark dilution claims and granted a permanent injunction. VIP then appealed the district court's decision to the Ninth Circuit, and this is where the case got interesting (or in the view of some "off the rails").

The Ninth Circuit vacated the district court's finding of infringement and dilution, reasoning that the district court had neither properly analyzed the nature of the Bad Spaniels toy nor applied the correct legal standard. The Ninth Circuit held that the district court failed to account for the fact that the Bad Spaniels toy constituted an "expressive work," one designed to communicate a humorous message. Because of its expressive work status, the court added that the district court should have first required Jack Daniel's to demonstrate that the Bad Spaniels toy was either (1) not at all artistically relevant to the underlying work or (2) expressly misled consumers as to the source or contents of the work. Only if Jack Daniel's successfully navigated the Ninth Circuit's expressive work test would the application of the *Sleekcraft* factors apply. The court added that the commercial nature of the Bad Spaniels toy did not render it non-expressive. *VIP Prods., LLC v. Jack Daniel's Props., Inc.*, 953 F.3d 1170, 1175–76 (9th Cir. 2020), *vacated and remanded*, 599 U.S. 140 (2023).

The Ninth Circuit then turned to Jack Daniel's trademark dilution by tarnishment claim and reached a similar conclusion based on the non-commercial nature of the Bad Spaniels toy. According to the court, because the Bad Spaniels toy contained some protected expression in the form of a humorous message, the use of the Bad Spaniels mark was non-commercial despite its use in the sale of a product. *Id.* at 1176. After vacating both the district court's trademark infringement and trademark dilution judgments, the Ninth Circuit remanded the case to the district court for further proceedings consistent with its opinion.

On remand, the district court entered summary judgment of noninfringement based on its application of the Ninth Circuit's expressive work test, which the Ninth Circuit summarily affirmed. The Supreme Court then granted a petition for a writ of certiorari presenting two questions:

the first of which was whether humorous use of another's trademark as one's own on a commercial product is subject to the Lanham Act's traditional likelihood-of-confusion analysis, or, instead, receives heightened First Amendment protection from trademark infringement claims.

The Court responded by vacating the Ninth Circuit's opinion, holding that when an alleged infringer uses a trademark in the way the Lanham Act most cares about—as a designation of source for the infringer's own goods or services—the infringement claim rises or falls on the application of the traditional multifactor test for likelihood-of-confusion. *Jack Daniel's Props.*, 599 U.S. at 153. The Court added that the expressive work test articulated by the Ninth Circuit applied most appropriately in cases involving non-trademark uses, i.e., cases in which the defendant has used the mark at issue in a non-source-identifying way. *Id.* at 155–56.

As to the impact of parody in the likelihood-of-confusion analysis, the Court offered at least some guidance on how future inquiries should be conducted. According to the Court, a parody must conjure up “enough of an original to make the object of its critical wit recognizable.” *Id.* at 161. At the same time, however, the Court explained that a successful parody must so contrast with the plaintiff's own mark “that its message of ridicule or pointed humor comes clear without resulting in likely confusion.” *Id.* Consistent with the *Louis Vuitton* and *Anheuser-Busch* decisions, the Court concluded that courts could consider parody as part of the standard trademark infringement analysis. *Id.*

The second question presented by the *Jack Daniel's* petition was whether the humorous use of another's mark as one's own on a commercial product can be non-commercial, thus barring as a matter of law a claim of dilution by tarnishment under the Trademark Dilution Revision Act. The Court again disagreed with the Ninth Circuit's conclusion. The Ninth Circuit's conclusion, according to the Court, rested on the erroneous assumption that VIP could shield itself from dilution liability because of Section 43(c) of the Lanham Act's “fair use” exclusion, which excluded from liability “[a]ny noncommercial use of a mark.” *Id.* at 161. The Court held the Ninth Circuit erred in ignoring the statute's express exclusion to the fair use exclusion, namely that the fair use exclusion did not apply where a party's use is “as a designation of source for a person's own goods and services.” *Id.* at 162 (citing 15 U.S.C. § 1125(c)(3)(A)). The Court added that adoption of the Ninth Circuit's approach

would in effect reverse the result dictated by the statute. The Court further explained:

Given the fair-use provision's carve-out, parody (and criticism and commentary, humorous or otherwise) is exempt from liability only if not used to designate source. Whereas on the Ninth Circuit's view, parody (and so forth) is exempt always—regardless whether it designates source. The expansive view of the “noncommercial use” exclusion effectively nullifies Congress's express limit on the fair-use exclusion or parody, etc. Just consider how the Ninth Circuit's construction played out here. The District Court had rightly concluded that because VIP used the challenged marks as source identifiers, it could not benefit from the fair-use exclusion for parody. The Ninth Circuit took no issue with that ruling. But it shielded VIP's parodic uses anyway. In doing so, the court negated Congress's judgment about when—and when not—parody (and criticism and commentary) is excluded from dilution liability.

Id. at 162.

In view of its ruling that the non-commercial exclusion could not shield parody or other commentary from trademark infringement or dilution-based liability where the defendant's use was source-identifying, the Court vacated the Ninth Circuit's judgment and remanded the matter for further proceedings.

Conclusion: Parody Claims Are Back to Being on a Shorter Leash

The takeaway for trademark owners and would-be parodists: proceed with caution. Where the parody does not indicate the source or origin of a product or service, the parodist has a better chance of prevailing under the First Amendment ground. However, where the use at least in part serves as source identification, i.e., when the product or service trades on the goodwill of the trademark owner to market its own product or service, the product or service must meet an infringement claim on the usual battlefield of likely confusion. And because trademark owners have now learned the value of proving their cases through confusion surveys and other expert evidence establishing reputational harm, parodists would do well to move forward only if they can produce affirmative evidence effectively rebutting any such evidence presented by the trademark owner. ■

Canada Enacts New Competition Offense Relating to Employees: The Impact on Franchise Arrangements

By Mark Katz, Davies Ward Phillips Vineberg LLP, and Joseph Adler, Hoffer Adler LLP

On June 23, 2023, amendments to Canada's Competition Act took effect that make it a criminal offense for two or more unaffiliated employers to conspire, agree, or arrange to:

1. fix, maintain, decrease, or control wages, salaries, or terms and conditions of employment; or
2. not solicit or hire each other's employees.

R.S.C. 1985, ch. C-34, § 45(1.1).

By enacting this new offense, Canada joins other jurisdictions, most notably various jurisdictions in the United States, in placing new emphasis on protecting employees from allegedly anticompetitive conduct in labor markets. According to the Competition Bureau, which administers and enforces the Competition Act, maintaining and encouraging competition among employers will lead to higher wages and salaries, as well as better benefits and employment opportunities for employees.

As many saw when various U.S. attorneys general took action on this topic in recent years, this Canadian development has important implications for franchise systems operating in Canada. The legislation will impact existing franchise agreements and the drafting of future franchise agreements. Franchisors understandably have a need to protect the integrity, value, and investment of and in their brands, and they often attempt to do so, in part, by preventing departing franchisees from competing with their existing franchisees and corporate- and affiliate-owned units. Nonetheless, non-competition and non-solicitation covenants often found in franchise agreements face increasing scrutiny by courts, regulators, and legislative bodies. The recent amendments to the Competition Act serve as just another example of this trend.

Key Features of the New Offense

Key points about the new offense include:

1. The new offense applies not only to agreements made between employers on or after June 23, 2023, but also to conduct that reaffirms or implements agreements made before that date.
2. The new offense is per se, meaning that the law does not require the Competition Bureau to prove that the agreement in question had a negative impact on competition. The crime is in the agreement itself. In addition, circumstantial evidence can serve as the basis of an agreement, allowing a court to draw an inference that the parties had a "meeting of the minds" to engage in illegal conduct, even when lacking evidence of an explicit agreement.
3. The amendments impose severe penalties, with the potential for prison terms of up to 14 years and fines at the discretion of the court, with no maximum. Parties allegedly harmed by the conduct may also sue for damages.
4. The prohibition targets "employers" rather than "competitors," meaning that the offense does not depend on accused parties competing against each other (unlike many other competition offenses in Canada).
5. The offense targets individuals for prosecution, not just corporations. Directors, officers, agents, and employees could all face charges under the offense if implicated in illegal conduct. This includes human resources personnel.
6. The wage-fixing element of the offense applies not only to salaries but also to "terms and conditions" of employment, i.e., terms that could affect a person's decision to enter or remain in an employment contract.



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According to Competition Bureau guidelines, this can include allowances (such as per diem and mileage reimbursements), working hours, location, non-compete clauses, and even job descriptions. See Guidelines (<https://ised-isde.canada.ca/site/competition-bureau-canada/en/how-we-foster-competition/consultations/enforcement-guidance-wage-fixing-and-no-poaching-agreements>).

7. The no-poaching element of the offense only applies to agreements between employers not to hire each other's employees. Accordingly, the offense does not extend to a non-reciprocal agreement whereby only one party agrees not to hire away another's employees. The Competition Bureau offers the example in its guidelines of a consulting company embedding its employees with a client, which agrees not to hire the embedded employees for a certain period of time thereafter. Since the consulting company does not provide a reciprocal commitment to the client, this type of arrangement should not constitute an offense.
8. The new offense does not expressly prohibit the sharing of employee-related information with other employers, such as terms and conditions of employment. As such, at least to a certain extent, companies can continue to conduct benchmarking exercises with other employers. That said, exchanges of information could be used as evidence supporting the inference of an illegal agreement. Accordingly, companies should exercise particular caution when potentially sharing confidential information about the treatment of employees.
9. It may be possible to defend against an alleged violation of the new offense by relying on the Competition Act's "ancillary restraints defence" ("ARD"). To qualify for this defense, the allegedly illegal conduct must directly relate to, and be reasonably necessary for achieving the objective of, an otherwise legal broader or separate agreement. For example, the Competition Bureau will generally not assess wage-fixing or no-poaching clauses that are ancillary to merger transactions, joint ventures, or strategic alliances under the new offense. The Bureau also cautions, however, that the ARD will not necessarily provide protection for sham agreements or unnecessarily broad clauses in terms of direction, geography, or affected employees. Also, even if the new criminal

offense does not apply, the Bureau may choose to pursue civil action under different provisions of the Competition Act.

What This Means for Franchise Arrangements

Although the new offense is of general application and not specifically targeted at franchise arrangements, it does apply to franchisors and franchisees. For example, the fact that the new offense targets "employers" means that the prohibition would impact franchisor-franchisee relationships even though franchisors and franchisees do not typically view each other as competitors. Additionally, the new offense covers relationships between franchisees. In fact, the Competition Bureau's guidelines referenced above expressly recognize the potential application of the new offense to franchise arrangements. Guidelines, Section 3.1.

The guidelines acknowledge that labor-related restraints can play an important role in the franchise model and agreements between franchisors and franchisees. However, the Bureau also highlights that it may investigate situations where these restraints appear broader than necessary.

Given the foregoing, franchisors should consider the following:

1. Franchisors should identify any labor-related restraints in their agreements and assess for unnecessarily broad restraints. Franchisors should exercise particular caution when attempting to regulate wages and poaching, and they should also exercise caution with the duration and geography of restraints.
2. In some cases, franchisors may need to amend agreements, if not immediately then on renewal or transfer of the franchise agreements. Alternatively, at least as a temporary expedient, franchisors should make it clear that they will not enforce potentially violative provisions. Franchisors may wish to look at how franchisors in the United States responded proactively to state attorneys' general concerns over the last several years. Franchisors should also consider amending their franchise agreements by adding language to substantiate any potential ancillary restraints defense.
3. As part of their training programs, franchisors may also wish to recommend that their franchisees refrain from entering into agreements that potentially violate the Competition

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Lack of Personal Jurisdiction: An Oft-Neglected Initial Defense in Third-Party Actions Against Franchisors

By Jennifer A. Guy, Hilton Worldwide, and
Abbey A. Taylor, Plave Koch PLC

Many lawyers, including litigators, may have limited experience with personal jurisdiction arguments in their practice, often last encountering them during their first-year Civil Procedure class. However, when a plaintiff files a lawsuit against a franchisor due to an accident or actions involving guests or employees at a franchised location, asserting a defense of lack of personal jurisdiction can prove highly effective in removing the franchisor from the case, allowing the franchisee and their counsel to concentrate on resolving the claims without the added burden and costs of defending the franchisor. A hypothetical case illustrates this strategy:

Fish Inc. is a Virginia-based restaurant franchisor incorporated in Delaware with franchised locations in all states. Franny Franchisee owns and operates a Fish Inc. franchise in Indiana. Penny Plaintiff slipped and fell when she entered Franny's franchised restaurant. Penny files a lawsuit against Franny in Indiana and includes Fish Inc. as a defendant. The franchise agreement contains an indemnity clause that requires Franny to indemnify and defend Fish Inc. in the lawsuit.

In many cases like this, a franchisor delegates its defense to the franchisee and their appointed counsel, who in turn will typically file an answer and concentrate on removing the franchisor from the case through a dispositive motion on the merits, arguing against the franchisor's ownership and control of the franchise. However, the franchisee may be able to largely prevent the franchisor's involvement altogether (and reduce costs) by asserting a lack of personal jurisdiction argument on behalf of the franchisor at the beginning of the lawsuit. Whether through a motion to dismiss or preliminary discussions with the plaintiff's counsel, asserting that the court lacks jurisdiction over the

franchisor can swiftly and efficiently lead to the franchisor's dismissal from the case.

Personal Jurisdiction Jurisprudence

The principles of personal jurisdiction jurisprudence strongly support the argument that an out-of-state franchisor should not be subject to a court's jurisdiction in a third-party action filed in the state where a franchise is located solely because it is the franchisor. Personal jurisdiction exists when a defendant has "certain minimum contacts with [the State] such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). The U.S. Supreme Court has established two categories of personal jurisdiction: general jurisdiction and specific jurisdiction. *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915, 919 (2011). The nature of the defendant's contact with the forum state determines the applicable category of jurisdiction. It is also crucial to review the relevant state statute concerning the exercise of personal jurisdiction over a foreign defendant, known as a long-arm statute, although most such statutes align with federal law by allowing jurisdiction over nonresident defendants to the extent permitted by the Due Process Clause.

General jurisdiction arises when a defendant is essentially "at home" in the state. *Daimler AG v. Bauman*, 571 U.S. 117, 127 (2014). Corporate defendants are considered "at home" in the state of their incorporation and their principal place of business. In the hypothetical case above, Fish Inc. would be "at home" in both Virginia—the location of its headquarters—and Delaware—its place of incorporation. Consequently, a court in either jurisdiction could exercise general personal jurisdiction over the company in any case filed there. In addition, the Supreme Court in *Daimler* recognized that in exceptional circumstances, a defendant may be subject to general jurisdiction



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in a forum other than its place of incorporation or principal place of business if its activities in that forum are so substantial that it effectively becomes “at home” there. *Id.* at 139 n.19.

Plaintiffs’ attorneys often assume or argue that a franchisor’s registration to conduct business in the state is sufficient to establish general jurisdiction. However, mere registration is not enough to confer general jurisdiction. Assessing general jurisdiction necessitates an evaluation of a corporation’s activities on a national and global scale. A corporation operating in multiple places cannot be deemed “at home” in all of them. *Id.* at 139 n.20. Therefore, being registered to do business in a state does not automatically establish a franchisor as “at-home” there. *Fidrych v. Marriott Int’l, Inc.*, 952 F.3d 124, 134 (4th Cir. 2020).

A plaintiff’s attorney might also attempt to argue that a franchisor should be subject to general jurisdiction based on the extent of its operations in the forum state, the revenue derived from franchisees in that state, or the level of marketing directed at residents of the state. However, those contacts should be insufficient to establish general personal jurisdiction. *Id.* In *Chen v. Dunkin’ Brands, Inc.*, 954 F.3d 492 (2d Cir. 2020), the court found that it did not have jurisdiction over the franchisor defendant, despite the defendant being a franchisor with numerous retail establishments in the forum state and exerting control over nationwide product labeling and advertising. The court reasoned that the plaintiff had not demonstrated that Dunkin’s relationship with the forum state was “in any way significant or exceptional in relation to the company’s nationwide business activity.” *Chen*, 954 F.3d at 500. In short, personal jurisdiction jurisprudence, as shown by relevant case law, supports the contention that an out-of-state franchisor should generally not be subject to a court’s jurisdiction simply because it is registered in or advertises in the state of a franchised location.

If the defendant lacks sufficient contacts to be considered “at home” in the forum state, a court may exercise specific jurisdiction if the defendant has continuous and systematic contacts with the forum state that give rise to the claims in question. The defendant’s contacts with the forum state must be somehow connected to the underlying claim. In *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985), the Supreme Court stated that specific jurisdiction exists when the defendant has purposefully directed activities at residents of the forum and the litigation arises from alleged injuries related to those activities. Conversely, when there is no such connection,

specific jurisdiction is lacking, regardless of the extent of the defendant’s unrelated activities in the state. *Bristol-Myers Squibb Co. v. Superior Court of California*, 582 U.S. 256, 264 (2017).

For a franchisor, most, if not all, of its contacts with the forum state will be unrelated to the cause of the litigation. Taking the hypothetical case mentioned earlier as an example, Fish Inc.’s contacts with Indiana, such as being registered to do business in the state, having a contractual relationship with an Indiana entity, operating a website available in Indiana, and deriving revenue from a franchisee in Indiana, very arguably have no connection to Penny’s slip-and-fall accident at Franny’s franchised restaurant. In other words, Fish Inc. should not be subject to specific personal jurisdiction in Indiana because Penny’s claims do not arise from or relate to Fish Inc.’s contacts with the state, absent further evidence of a connection between Fish Inc. and Penny’s fall.

Under either test for personal jurisdiction, a franchisor can present several compelling arguments to establish a lack of personal jurisdiction. First, the franchisor is not “at home” in the forum state because its principal place of business is not located there, and it was not incorporated in the forum state (unless this is not true in the specific case). Second, there are insufficient minimum contacts with the state to justify jurisdiction, and any contacts are unrelated to the underlying litigation. However, counsel must review recent case law in the relevant jurisdiction because while the franchisor may have a strong argument for a lack of personal jurisdiction, courts have adopted different approaches, and the analysis is highly fact-specific.

Take for instance *Hankins v. Doubletree Management, LLC*, Case No. 19-cv-8698, 2022 WL 3013089 (D.N.J. July 29, 2022), where the court found that it did not have jurisdiction over the defendant because although the defendant’s website accepted bookings from the forum state for the hotel in question, the defendant did not specifically target customers from the forum state. And compare that case to *T.S. v. Intercontinental Hotels Group, PLC*, Case No. 19-cv-2970, 2020 WL 6392459 (S.D. Ohio Nov. 2, 2020), where the court found that the defendant (parent company to the franchisor) had sufficient minimum contacts to exercise specific personal jurisdiction through a vicarious liability analysis under state-specific law. In *Intercontinental Hotels*, the court pointed to the fact that the plaintiff alleged that the parent acted as “the principal” and “‘acknowledge[d] the third-party franchisee . . . ,

as the agent' to act on its behalf based on franchise agreements and the use of the IHG brand name and likeness." *Id.* at *3 (alteration in original). The court also found control over brand standards and the right to terminate a franchise agreement for non-compliance with brand standards to be persuasive. The court held that the defendant's actions constituted purposeful availment and could not be characterized as "random, fortuitous, or attenuated contacts." *Id.* (citation omitted). Finally, in *Nandjou v. Marriott International, Inc.*, Case No. 19-2189, 2021 WL 140775 (1st Cir. Jan. 15, 2021), where the underlying accident took place at a franchised hotel in Montreal, Canada, the First Circuit affirmed the trial court's finding of personal jurisdiction in Massachusetts over the Delaware- and Maryland-based franchisor because the franchisor sent marketing materials promoting the hotel to plaintiff's home in Massachusetts.

Thus, while a franchisor can present strong arguments for lack of personal jurisdiction, counsel must consider the specific case law and factual circumstances to determine the likelihood of success in asserting this defense.

Rule 12(b)(2) Motions

Rule 12(b)(2) of the Federal Rules of Civil Procedure grants defendants the right to challenge a federal court's personal jurisdiction. Similarly, each state has its own procedural rule that allows defendants to contest the validity of the state court's jurisdiction (often through a motion to quash service or a preliminary objection). However, if a defendant fails to raise the defense of lack of personal jurisdiction in its responsive pleading and instead responds to the allegations without contesting jurisdiction, it may waive its right to assert this defense. *See, e.g., Adams v. Unione Mediterranea Di Sicurtà*, 220 F.3d 659, 667 (5th Cir. 2000) ("Usually a party waives personal jurisdiction by failing to raise the issue when filing a responsive pleading or making a general appearance."); *Garza v. Forquest Ventures, Inc.*, 358 P.3d 189, 198 (Mont. 2015) (noting "a party waives a personal jurisdiction defense by failing to raise it in the party's initial response."). Therefore, it is important for counsel representing franchisors in these types of actions to ensure that the first responsive filing either includes a motion to dismiss for lack of personal jurisdiction or asserts the defense of lack of personal jurisdiction to avoid waiving this potentially successful defense.

In a motion to dismiss for lack of personal jurisdiction under Federal Rule of Civil Procedure

12(b)(2), the burden of proof rests with the plaintiff to demonstrate that the court has personal jurisdiction over the contesting defendant. *Daynard v. Ness, Motley, Loadholt, Richardson & Poole, P.A.*, 290 F.3d 42, 50 (1st Cir. 2002). When ruling on a Rule 12(b)(2) motion, the court is not limited to considering only the allegations in the complaint. This presents an opportunity for the franchisor's counsel to present additional evidence and arguments beyond the scope of the plaintiff's pleading. It is an opportunity to demonstrate to the court that the franchisor lacks ownership and control over the franchised location involved in the litigation. Indeed, courts may take judicial notice of public land records and the proper owner. *FED. R. EVID.* 201 (b)(2); *Deibler v. Quicken Loans, Inc.*, Case No. CV TDC-15-2286, 2016 WL 393308, at *1 (D. Md. Feb. 1, 2016); *Poseidon Dev., Inc. v. Woodland Lane Estates, LLC*, 152 Cal. App. 4th 1106, 1117 (2007). Because it is the plaintiff's burden to prove personal jurisdiction over the franchisor, a franchisor must provide information that highlights the absence of a relationship between the franchisor and its activity in the state on the one hand and the underlying claim on the other hand.

Presenting evidence of lack of control, ownership, or management over the franchised location in the context of a Rule 12(b)(2) motion has the added benefit of allowing a franchisor to preview the crucial "lack of control" argument that substantively supports the franchisor's exclusion from the case in a way that it likely could not under a different Rule 12 motion, such as for failure to state a claim. If the plaintiff erroneously alleges that the franchisor controls the operations of the franchised location, a Rule 12(b)(2) motion enables the franchisor to present evidence to refute that allegation.

To strengthen a motion to dismiss, it is vital to provide an affidavit or declaration stating that the franchisor does not own, manage, or control the franchised location, and does not employ or supervise the franchisee or its employees. The affidavit or declaration should also describe the extent of the franchisor's relationship with the forum state. *See Travelers Cas. & Sur. Co. of Am. v. Telstar Const. Co.*, 252 F. Supp.2d 917, 922 (D. Ariz. 2003) ("It is well established that the Court may consider affidavits and other materials when weighing a Motion to Dismiss for lack of personal jurisdiction under Rule 12(b)(2) without transforming the motion into a Motion for Summary Judgment."). Submitting such evidence compounds the plaintiff's burden to establish a jurisdictional basis.

If the court remains uncertain about personal jurisdiction after reviewing the motion and

supporting materials, it may opt for an evidentiary hearing or allow the plaintiff to conduct jurisdictional discovery. *Grayson v. Anderson*, 816 F.3d 262, 268 (4th Cir. 2016); *Trintec Indus., Inc. v. Pedre Promotional Prod., Inc.*, 395 F.3d 1275, 1283 (Fed. Cir. 2005).

Jurisdictional Discovery

Counsel must carefully draft a motion to dismiss to provide sufficient support for the court to either deny or limit a plaintiff's request for jurisdictional discovery. Jurisdictional discovery occurs before any discovery on the merits and serves the purpose of uncovering additional facts concerning the court's ability to exercise jurisdiction over a defendant. Jurisdictional discovery is highly discretionary and depends on the specific circumstances of the case. When a plaintiff offers mere speculation or conclusory assertions about contacts with a forum state, a court is within its discretion to deny jurisdictional discovery. *Carefirst of Maryland, Inc. v. Carefirst Pregnancy Centers, Inc.*, 334 F.3d 390, 402 (4th Cir. 2003). Jurisdictional discovery should not be used as a fishing expedition in the hope of discovering a basis for jurisdiction. *Base Metal Trading, Ltd. v. OJSC "Novokuznetsky*

Aluminum Factory," 283 F.3d 208, 216 n.3 (4th Cir. 2002). If the court does allow jurisdictional discovery, it may be beneficial to advocate for a short timeframe or limited scope of discovery.

Conclusion

When representing a franchisor defendant in a third-party lawsuit involving a franchised location, it is important not to overlook the defense of lack of personal jurisdiction. A well-crafted motion to dismiss can potentially remove the franchisor from the case without having to address the merits of the claims or engage in extensive discovery. If both the franchisee and the franchisor are named, an early joint defense agreement helps to streamline the litigation and properly focus the parties' time and resources. It may also be worthwhile to contact the plaintiff's counsel and explain the franchisor's position. In many instances, the plaintiff's counsel will agree to dismiss the franchisor or an unrelated entity to avoid the time and expense of opposing a planned motion to dismiss. While the lack of personal jurisdiction argument may not be applicable in every case, if the facts support it, it can be a highly effective defense strategy. ■

Canada Enacts New Competition Offense Relating to Employees

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Act. For example, franchisors may encourage franchisees to avoid sharing their confidential information about the treatment of employees and to not enter into no-poaching agreements with each other. Of course, franchisors should make it clear to their franchisees that such recommendations do not constitute legal advice and encourage their franchisees to seek their own independent legal advice.

4. Though franchise agreements seldom provide that franchisors are required to abide by a no-poaching provision, it would be useful for franchisors to explicitly state in their franchise agreements that the no-poaching obligation is not a reciprocal one both between the franchisors and each of their franchisees and among the franchisees themselves. Franchisors should also advise their personnel that they should not enforce no-poaching provisions if they are in fact reciprocal.
5. The Competition Bureau does not consider a franchisee's ability to recover training costs related to a "poached" employee problematic under the new amendments "where the compensation is reasonably related to the costs incurred for training and does not disadvantage

employees' opportunities relative to external candidates" (Guidelines, Example 4).

6. The Guidelines also clarify in Example 4 that a franchisee's mere awareness of parallel standard franchise agreements, which include no-poaching restraints, ordinarily will not raise concerns in the absence of evidence of an intention between franchisees to enter into a no-poaching agreement with each other. For example, the Bureau could regard steps taken by two or more franchisees to enforce a franchise agreement's no poaching restraint as evidence of a common consensus and potentially illegal "meeting of the minds."
7. Given that the new offense includes individual liability, franchisors should consider obtaining additional directors' and officers' insurance coverage.

Conclusion

Franchisors and franchisees operating in Canada must now closely consider the new wage-fixing/no-poaching offense in how they organize their treatment of employees. Failure to do so carries with it a significant risk for both franchisors and franchisees. ■

Time for a Single Source of Truth

By Darin Kraetsch, GSD Consultancy and FranDash®, and Bryan White, Baker McKenzie



In today's fast-paced, digital environment, franchisors generate vast amounts of data, reports, and other useful information—all of which can contribute to a franchise system's success. Unfortunately, in most cases, the information is not effectively organized at the point of collection and often ends up scattered across several different systems, platforms, or even physical filing cabinets, making it difficult to properly utilize. A franchisor may not realize its information is disorganized until an inconvenient time; whether a critical document is missing and needed in a dispute, or a strategic transaction is put on hold because the franchisor is not able to quickly and efficiently respond to basic information requests.

One strategy franchisors are increasingly utilizing to address these issues is adopting franchise management systems (the "single source of truth") where a franchisor's most important data, reports, and other useful information may be maintained. These programs are typically developed and operated using a Software as a Service product and allow the franchisor to collect data from different areas

of the business in a user-friendly manner that is then organized and readily available. Having a unified view of its system as a whole may enable the franchisor's key executives and operational personnel to make more informed decisions, improve collaboration, enhance productivity, and reduce risk. It can also help streamline workflows, reduce errors and inconsistencies, and ensure compliance with legal and regulatory requirements.

In this article, we explore the benefits of a single source of truth and the ways it may help franchisors remain competitive in today's dynamic business landscape. We also explore the ways a single source of truth may benefit franchisees.

The Need for a System Diet

In today's technology-driven world, franchisors rely heavily on software systems in nearly all aspects of their businesses, including franchise sales and administration, legal/compliance, real estate, store development, accounting, field operations, and marketing. However, most software systems are not capable of supporting all of these



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essential business functions or are not capable of consolidating vast amounts of information into a single database. As a result, many franchise systems still utilize multiple independent systems to manage different aspects of their business.

Some franchisors have attempted to cobble together franchise management solutions at great expense and with varying success. For example, each division of the franchisor's business may modify or develop separate solutions, resulting in vital information being distributed and stored in redundant and decentralized ways. These cobbled-together systems are typically not designed to communicate with each other and may result in fragmented and inconsistent data, miscommunication, errors, or an inefficient allocation of resources. Franchisors may consider eliminating unnecessary and redundant software systems and instead focus on using a franchise management system that is capable of supporting as many business functions as possible.

Some of the most important functions and capabilities of a franchise management system are:

- **Automation:** The system should be capable of electronically distributing, tracking, and facilitating the signature process for the franchise disclosure document, franchise agreement, and all other related agreements. The system should also alert the franchisor when a document is signed or that a document has been sent but is not signed within a certain period of time.
- **Tracking:** The system should have a mechanism for tracking and displaying negotiated terms with each franchisee as well as more basic information such as franchisee entity details and ownership structure information. The system should also track whether each franchised business is open, closed, or terminated, and alert the franchisor of upcoming expirations, renewals, and other important dates. Some franchise management systems can also track franchisee insurance compliance and support the real estate aspects of a franchisor's business with mapping functions and other useful tools.
- **Reporting and Analytics:** The system should have the ability to prepare reports using the franchisor's data in a variety of presentation styles that can be customized to fit the franchisor's business and the preferences of its personnel. Examples of some reports that franchisors regularly generate using

franchise management systems include sales cycle analysis, lead generation effectiveness, opening and delay reports, and unit compliance audits.

- **Integration with Other Systems:** Ideally, such software systems will also have the capability to integrate with other standalone systems that may be necessary for very specialized functions that are not supported by the primary software system. By connecting these different systems, a franchisor can help ensure that all of its data is current and consistent across its business units.

The Benefits of a Single Source of Truth

Having a single source of truth may result in both smaller benefits (e.g., time savings) and large-scale benefits (e.g., more informed decision-making) for franchise companies. Consider the following example: A franchisor's legal department uses an Excel spreadsheet to organize information about its franchisees and important dates and deadlines, while its operations team uses a smartsheet to track store opening timelines, and the system's store development team uses a project management system to track the same information. Each year, this franchisor prepares an updated Item 20 (Outlets and Franchisee Information) for its franchise disclosure document. Legal prepares an initial draft for review, and the business clients review against the information from their systems and flag multiple discrepancies, resulting in a flurry of email communication and hours of work reconciling the data and correcting the information from each separate division of the franchisor that tracks the same data.

A single source of truth may solve the above dilemma by organizing all data related to Item 20 disclosures in one place. The leading franchise management systems on the market also have mobile capabilities, allowing personnel to send a franchise disclosure document, map directions to a store, conduct a compliance visit, or review a summary of negotiated franchise documents from a mobile phone or tablet, increasing the likelihood that critical data will be recorded in a timely and accurate manner. These systems may be able to identify areas where costs and/or time can be reduced and can help mitigate legal risks and increase regulatory compliance by automating the disclosure process and related record-keeping and processes.

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Recent Decisions Provide Guidance on Drafting and Enforcing Indemnity Provisions in Franchise Contracts

By Abby L. Risner, UB Greensfelder LLP

The obligation to indemnify generally means an obligation to pay for another party's legal liabilities, damages, or losses. In the franchising world, it most often arises as a contract term. Contractual indemnity provisions are frequently overlooked until one party is threatened with unexpected liability. Then, suddenly, the provision becomes a crucial element of the bargain struck between the contracting parties.

In franchising, indemnification obligations are typically found in the franchise agreement itself and are frequently invoked by both franchisors and franchisees. *See, e.g., Burgers Bar Five Towns, LLC v. Burger Holdings Corp.*, 987 N.Y.S.2d 410, 412–13 (N.Y. App. Div. 2014) (holding the franchisor must indemnify the franchisee in connection with a trademark action filed by a third party). Additionally, both franchisors and franchisees often seek insurance coverage that turns on the applicability of an indemnity provision.

Transactional counsel drafting and negotiating indemnity provisions need to evaluate which risks can and should be allocated and must use precise language to ensure enforceability. Likewise, litigation counsel must understand the potential limitations on the enforcement of a right to indemnity.

This article highlights recent court decisions resolving disputes over indemnity provisions between franchisors, franchisees, and their insurers. For a more detailed background and discussion of considerations in drafting and evaluating indemnity provisions, see the paper from the 2022 Annual Forum on Franchising's *Preparing For and Dealing With Third Party Claims (W-24)* by Sally Dahlstrom, Brittany Johnson, and Tony Marks.

Limitations on Indemnification

Enforcement of an indemnity provision depends on the specific language in the provision within the context of the contract as a whole and under

the interpretive principles set forth by applicable state law. Although the contract's language and context are of prime importance, parties and counsel must be aware that the treatment of indemnity provisions—including when and how they are enforced—often varies by state. For example, courts disagree on the meaning of the phrase “hold harmless.” Many courts have found this duty redundant of the general duty to indemnify. *See, e.g., 1800 Ocotillo, LLC v. WLB Grp., Inc.*, 196 P.3d 222, 225 (Ariz. 2008). Other courts, however, differentiate “hold harmless” as a defensive right, protecting a party from having indemnity sought from it. *See, e.g., Queen Villas Homeowners Assn. v. TCB Prop. Mgmt.*, 56 Cal. Rptr. 3d 528, 534 (Cal. Ct. App. 2007).

Franchise lawyers should ask themselves the following questions when evaluating the enforceability and scope of indemnity provisions:

Does the obligation to indemnify include the indemnitee's own negligent conduct? In some cases, courts will reject the application of indemnity where it frustrates a public policy. This most often arises when courts refuse to enforce indemnity provisions that are silent on the enforcing parties' own negligence or intentional misconduct. *See, e.g., Dewitt v. London Rd. Rental Ctr., Inc.*, 910 N.W.2d 412, 417 (Minn. 2018). But indemnification for a party's own negligence may be enforced if the language is sufficiently specific by its express terms, so long as those terms do not conflict with applicable law.

For example, in *Mode v. S-L Distribution Co.*, Case No. 18-CV-00150, 2021 WL 3921344 (W.D.N.C. Sept. 1, 2021), a federal court in North Carolina considered misclassification claims brought by distributors against their manufacturer and the manufacturer's counterclaims for indemnification under the parties' distribution agreements. The distributors disputed that indemnification could apply to the manufacturer's own violation of the



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Fair Labor Standards Act (“FLSA”). Dismissing the indemnity claim, the court found that to award fees under an indemnity provision in such a scenario would be inconsistent with the FLSA’s fee-shifting provision and would chill potential FLSA plaintiffs from bringing claims. *Mode*, 2021 WL 3921344, at *17. The court also concluded that the claim at issue did not fall within the indemnity provision because it did not arise out of the distributor’s conduct, but instead was based on the manufacturer’s conduct. *Id.* at *18.

Of course, an indemnity provision can also expressly exclude coverage for a party’s own negligence, removing any uncertainty on the subject. See *Hanover Ins. Co. v. Retrofitness, LLC*, Case No. 16-CV-1751, 2017 WL 4330366, at *8 (D.N.J. Sept. 29, 2017) (refusing to find a duty to defend the franchisor in an underlying putative class action alleging violation of consumer protection laws because the class action complaint specifically alleged that the franchisor was negligent, and the insurance policy expressly excluded claims based on the franchisor’s negligence).

Does the indemnity provision clearly identify what it covers or is it vague? If an indemnity provision is ambiguous, it may not be enforceable, or not on the terms that were desired or intended. Contracting parties and their counsel should consider not only the ambiguity of the provision itself but any ambiguity in the context of the franchise agreement as a whole. For example, consider whether the indemnity provision’s treatment of attorney fees conflicts with the more general attorney fees provision in the franchise agreement. Similarly, review any damage limitations in the indemnity provision that conflict with damage limitations in the franchise agreement.

Clear and unambiguous indemnification language can pay dividends. For example, in *Pizza Hut, LLC v. Ronak Foods, LLC*, Case No. 21-CV-00089, 2022 WL 3544403 (E.D. Tex. June 17, 2022), the franchisor astutely included an indemnity provision in its franchise agreement that expressly applied to several specific categories of claims, including all claims brought by the franchisee’s employees or others related to the “franchisee’s employment practices.” The court concluded the robust indemnity provision was expansive and obligated franchisees to indemnify the franchisor under the franchise agreement. The court rejected the franchisee’s argument that the indemnity obligations were limited to worker’s compensation matters and awarded the franchisor

attorneys’ fees and damages. *Pizza Hut*, 2022 WL 3544403, at *13.

The breadth of indemnity provisions is also relevant in the insurance context. For example, *For Senior Help, LLC v. Westchester Fire Ins. Co.*, 451 F. Supp. 3d 837 (M.D. Tenn. 2020) involved a dispute over insurance coverage for an arbitration award in a franchisee’s favor in litigation between the franchisor and franchisee related to the franchise relationship. The franchisee sued the franchisor’s insurer arguing that it wrongfully denied payment of the arbitration award. The court rejected the insurer’s arguments that the policy did not cover the arbitration award against the franchisor. First, the court rejected the argument that a fraud exclusion barred recovery of the award because the arbitrator’s finding was based on a breach of the franchise agreement, not fraud. Second, the court found that the breach of contract claim was not excluded from coverage. *For Senior Help*, 451 F. Supp. 3d at 839.

Does the indemnity provision include a duty to defend? Although many indemnity clauses specifically include the term “defend,” the duty to indemnify and duty to defend impose different obligations. If litigation arises, those differences can be material to the costs that will be incurred defending litigation. Where the duty to defend is expressly part of the indemnity provision, it obligates a broader duty beyond indemnification—the duty to pay for or actually provide defense of a claim. The duty to defend arises regardless of the merit of any underlying claim. Some provisions expressly specify whether the indemnitee has the right to select counsel and control the defense.

Jurisdictions vary on whether the duty to defend must be expressly articulated. Generally, the obligation to defend only arises if specifically required by the terms of the provision. As a result, parties should not assume that the duty to defend exists merely because there is an indemnity provision.

Patel v. 7-Eleven, Inc., Case No. 17-CV-11414, 2023 WL 35357 (D. Mass. Jan. 4, 2023) exemplifies the risk of contractual vagueness on the duty to defend. That case involved a misclassification case brought by 7-Eleven franchisees in which 7-Eleven, the franchisor, counterclaimed. 7-Eleven’s counterclaim, which relied on the indemnity provision of the franchise agreement, sought damages in the form of its attorneys’ fees and costs incurred after the court denied the franchisees’ claims. The court rejected the claim for fees, finding that the indemnity provision made

no mention of defense fees or costs. *Patel*, 2023 WL 35357, at *4. Adding to its rationale, the court observed that the provision was limited to up to \$500,000, which it reasoned is inconsistent with an intent to include fees. Aside from litigation fees, the court did note that if 7-Eleven had sought reimbursement for other losses, such as replacing a franchisee, those losses may have been recoverable under the indemnity provision. *Id.*

On the other hand, in some states, even when the term “defend” is not explicitly included in the provision, the duty to defend may still be imposed so long as the contract does not expressly provide to the contrary. *See, e.g.*, CAL. CIV. CODE § 2778(4) (“The person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity, but the person indemnified has the right to conduct such defenses if he chooses to do so”); OKLA. STAT. ANN. tit. 15, § 427(4) (same).

Does the indemnity provision cover claims directly between the contracting parties?

Indemnity provisions are usually intended to provide protection against third-party claims and do not cover direct liability between the contracting parties. For example, in *Macedonia Distributing, Inc. v. S-L Distribution Co., LLC*, Case No. 17-CV-1692, 2019 WL 1002523, at *2 (C.D. Cal. Jan. 2, 2019), the court found that an indemnity provision that contained “indemnify,” “defend,” and “hold harmless” language only applied to third-party disputes, not intra-party disputes. The court construed the indemnity provision as a whole to conclude that the other provisions would be illogical if they also applied to intra-party disputes, and the court referenced a trend to narrowly interpret indemnity clauses. *Id.* at *3 (applying Pennsylvania law).

Similarly, in *Learning Experience Systems, LLC v. Collins*, Case No. 20-CV-2504, 2023 WL 5835034 (E.D.N.Y. Sept. 8, 2023), a franchisor and franchisee disputed whether an indemnity provision in a purchase and sale agreement applied to disputes between them. The court concluded that the indemnity provision did not include language clearly indicating that losses to each other would be covered. As a result, the indemnity provision did not apply to claims between the franchisor and franchisee. *Learning Experience*, 2023 WL 5835034, at *25.

Notwithstanding these decisions, an indemnity provision can always be drafted to expressly include disputes between the parties.

Is the franchisor covered by a franchisee’s insurance? Many recent decisions on the enforceability of indemnity provisions pertain to insurance coverage and often consider whether an indemnity provision in a franchisee’s insurance contract also protects the franchisor.

For example, in *Owners Insurance Co. v. MM Shivah LLC*, Case No. 20-CV-21, 2022 WL 668382 (E.D.N.C. Mar. 4, 2022), amended by, 2022 WL 18214255 (E.D.N.C. Apr. 5, 2022), a federal court in North Carolina considered whether the franchisee’s insurer had a duty to defend the franchisor, a named insured in the franchisee’s policy, in an employment case alleging sexual harassment and assault claims against the franchisee. The insurer argued it did not have a duty to defend because coverage was only for claims involving the franchisor’s role as a grantor of the franchise. The insurer argued that the allegations in the case were not premised on liability as a franchisor. The court rejected the insurer’s arguments, concluding that the underlying allegations encompassed the franchisor’s liability as a grantor of the franchise and, thus, the insurer owed the franchisor a defense. *MM Shivah*, 2022 WL 668382, at *11.

But a federal court in Pennsylvania reached a contrary result on distinguishable facts. In *Soft Pretzel Franchise Systems, Inc. v. Twin City Fire Insurance Co.*, Case No. 22-CV-1277, 2022 WL 3099770 (E.D. Pa. Aug. 4, 2022), a Pretzel Franchise franchisee’s employee sued the franchisor for injuries allegedly caused from a pretzel rolling machine. The plaintiff claimed that Pretzel Franchise was responsible for safety at the pretzel rolling facilities and had also designed and placed the machine. Because the claims against Pretzel Franchise were direct claims against the franchisor, not claims based on its role as the grantor of a franchise, and the franchisee’s insurance was limited to coverage over disputes concerning the granting of a franchise, the court found that the insurer had no duty to defend or indemnify under the insurance policy. *Soft Pretzel*, 2022 WL 3099770, at *2.

Takeaways for Drafting and Enforcing Indemnity Provisions

Although indemnity provisions in franchise agreements or other franchise system contracts are sometimes taken for granted, they can become central to disputes between franchisees and franchisors, or with third parties. Treating an indemnity provision as a nonessential boilerplate provision can be dangerous for both franchisees and franchisors. In light of the limitations

on enforcement of indemnity provisions, counsel should consider the following questions when evaluating an indemnity provision:

- When does the indemnity clause apply?
- To whom does it apply: Does it only apply to third-party claims or does it also apply to direct claims between the franchisee and franchisor?
- What does it apply to: Can you anticipate any types of claims you would like to expressly include or exclude from coverage?

- Does it expressly set forth a duty to defend?
- Is there any ambiguity or vagueness with respect to when the duty to indemnify (or to defend) is triggered, and is it consistent with other provisions in the franchise agreement?

The careful and appropriate use of indemnification language can provide significant protection to both franchisors and franchisees and bring more predictability and stability to a system. It is therefore worthwhile for franchisees and franchisors to give such provisions a closer look. ■

Time for a Single Source of Truth

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Franchise management systems may also benefit franchisees by providing access to an organized database for maintaining important operational records and other information, and having a single access point for all franchisor communications. A franchise management system may have a project management feature that allows the franchisor and franchisee to track and collaborate on a detailed step-by-step pre-opening and opening checklist, promoting consistency and timeliness with respect to the opening process across the entire franchise network. A good franchise management system will also allow franchisees to access (i) their franchise agreement and any related agreements or side letters; (ii) system training modules and support features; (iii) reporting and analytics tools; and (iv) correspondence from the franchisor related to system updates, marketing materials/promotions, and other important operational items. Having all of these features available through a franchise management system should ultimately save franchisees time and resources.

Manage the Business Like You Are Preparing to Sell It

Many franchisors seek to grow their system and potentially be acquired, whether through the sale of the company to a competitor, another company wishing to expand into the franchisor's line of business, or a private equity firm. Alternatively, the franchisor may wish to bring in institutional investors to finance and fuel rapid growth. Growing systems may benefit from implementing best

practices to create a business that is sustainable, profitable, and attractive to potential buyers or investors.

A franchise management system may benefit the franchisor during the due diligence stage of a strategic transaction. Information often must be provided extremely quickly, and the receiving party will expect it to be organized and easily reviewable. For franchisors, all franchise agreements, amendments, releases, and disclosure documentation for each of its franchisees should be readily accessible and organized. The acquiring or investing party will likely want to confirm, for example, that the franchisor has regularly followed best practices in selling franchises by following set processes, including, among other things, timely obtaining a signed franchise disclosure document acknowledgment of receipt before each franchise or development agreement was signed.

If a franchisor has not organized its information in a franchise management system, its attorneys and other advisors may spend time reviewing, scanning, and uploading relevant documents from a variety of electronic and non-electronic sources, and may risk being unable to provide evidence of franchise sales compliance or other documentation. Having the ability to quickly and efficiently satisfy the information demands of an acquiring party through the use of a franchise management system may be a great benefit to franchisors pursuing such a strategic transaction.

Having a single source of truth and properly utilizing a cutting-edge franchise management program may benefit a franchise system and even provide a competitive advantage for franchisors. ■

Message from the Chair

Continued from page 1

and we thank her, as well as Cheryl Whelan, Shelley Klein, and the staff at DCI, for all of the critical meeting planning details that made up the Dallas meeting.

As I mentioned in Dallas, one of the best duties as Chair of the Forum on Franchising is to give our Forum's awards at the Annual Meeting. This year, I was so pleased to award the following:

- Edward (Jack) Wood Dunham Rising Scholar Award: Melanie Kalmanson and Emily Plakon for their recent article in the *Franchise Law Journal*, *Atlantic Marine After 10 Years*, Summer 2023.
- Future Leader Award: Aaron-Michael Sapp
- Diversity Award: Joe Fittante
- Lewis G. Rudnick Award, honoring a member of the Forum who, over the course of a distinguished career as a franchise lawyer, has made substantial contributions to the development of the Forum and to franchise law: David Gurnick

At the Forum's annual business meeting in Dallas, we confirmed the work of the nominating committee and re-elected Earsa Jackson and Heather Perkins for their second three-year terms and newly elected Erin Johnsen and Max Schott to three-year terms on the Governing Committee. I am excited to work with each of these members

and am also excited to continue working with Ron Coleman as Immediate Past Chair and thank him for his exceptional work as Chair of the Forum on Franchising. He is a great friend and mentor to me, and our Forum remains fortunate to have him in leadership.

And now, we turn to planning the 47th Annual Meeting with Earsa and Erin. Please save the date for the 47th Annual Meeting that will take place October 16–18, 2024, in Phoenix, Arizona! Many of you submitted program ideas for the meeting—thank you for making these submissions. We have reviewed those ideas and are planning another exciting set of programs for Phoenix.

Seeing so many of you in Dallas was a heartening start to my term as Chair of the Forum. As I mentioned at the State of the Forum in Dallas, we have ambitious goals for our Forum, including in the areas of finance, membership, diversity, comradery and relationships, and scholarship. We will continue to work hard for our Forum. Please contact me with ideas on how we can improve service to our members or how you or your colleagues can be more involved with the Forum. My email address is Elizabeth.weldon@haynesboone.com, and my direct dial is 949.202.3011. Thank you for being a member of the Forum on Franchising and for making this organization the special, engaging, and welcoming place that it is. ■

Message from the Editor-in-Chief

By Justin L. Sallis, Lathrop GPM LLP



Echoing the sentiments of my predecessor, Erin Johnsen, in her last Message from the Editor-in-Chief, I find myself filled with gratitude and enthusiasm in assuming the role. I am grateful

to Erin for her exceptional stewardship of this publication and for the tremendous work that she continues to do for the Forum. I am also grateful for the excellent team of associate editors and ABA staff that—along with our indispensable authors—make this publication what it is. In

particular, thank you to Dawn Johnson and Paul Russell for agreeing to continue as editors for a second term, providing critical continuity in a time of transition. Also, a warm welcome to new editor Mackenzie Dimitri. I am grateful and enthused to work with the team and so many of you to continue *The Franchise Lawyer's* tradition of providing the Forum with a newsletter designed to give the latest developments in franchise law and Forum events.

If you're interested in writing for *The Franchise Lawyer* in a future issue or have a topic idea that you'd like to see covered, please reach out to me directly at Justin.Sallis@Lathropgpm.com or 202-295-2223. ■

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