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The Franchise Lawyer

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Message from the Chair

Will K. Woods, Baker & McKenzie, LLP

WILL K. WOODS
Baker & McKenzie, LLP

I know we all had a very different holiday season than normal in 2020, but I hope you all enjoyed some time to relax and connect (one way or the other) with friends and loved ones. In addition to spending lots of time with my wife and boys at home over an extended school break, I took the opportunity to reflect on the Forum's 43rd annual meeting. As the nature of the meeting evolved throughout the spring and summer of 2020, our guiding principle was to ensure that the substantive "product" that the annual meeting delivered met the Forum's very high standards—not an easy task in a virtual environment. I believe (and the formal and informal input that we have received on the meeting confirms) that we accomplished this objective.

More than 630 loyal Forum members attended our 2020 meeting, which was a significantly higher turnout than we expected under the circumstances. This level of attendance, along with prudent management by the 2020 meeting planning committee, preserves the Forum's strong financial position going into 2021.

A big thank you again to the 2020 meeting Co-Chairs, Elizabeth Weldon and Gary Batenhorst, as well as to the rest of the planning committee and the Governing Committee for all of their hard work in developing and executing the meeting so well in a very challenging environment. We owe a huge debt of gratitude to our tremendous speakers, all of whom worked very hard to develop top-notch papers and presentations. Finally, thank you to all of you for attending and for doing your part in making the meeting successful.

If you didn't make it to the Forum, we will be offering some of the programs for viewing (and CLE credit) at your leisure. Check out the Forum's website for more information.

As we turn the page on 2020 and move into what we all hope will be a more normal 2021, we are looking forward to reconvening in person in Atlanta in October! Our 2021 meeting Co-Chairs, Beata Krakus and Rob Lauer, have been hard at work for months, so

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Keep an Eye Out for Biometrics Laws

By Dawn M. Johnson, Greensfelder, Hemker & Gale, P.C.

The emerging use of technology that relies on biometric data such as facial geometry, vein patterns, voiceprints, retina scans, and fingerprints is beneficial to many businesses, including franchise systems, to facilitate consumer transactions. More recently, biometrics is increasingly important as customers and employees demand a move toward a contactless society in light of COVID-19. Examples include:

- Self-order kiosks that capture facial features to recognize customers and expedite orders.
- Facial scans to determine a customer's age, gender, or other characteristics to suggest possible purchases or to combat shoplifting.
- Fingerprint scans to identify a customer buying or using a company's services or to verify an employee's identity while clocking in or out of work or accessing a point-of-sale system.
- Facial recognition and thermal imaging to detect individuals infected with COVID-19 such as through temperature checks.
- Integration of technology into a "smart card" or credentials on a mobile device to eliminate multi-person biometric touchpoints.

Those using or considering using this technology need to be aware of the risk of liability. There is an increasing number of local, state, and federal laws that have been enacted or are being considered, some with considerable consequences, to regulate what some see as an invasion of privacy and discrimination amid threats of data breaches and hacking. These laws generally seek to prevent private entities from collecting biometric data from individuals without disclosure and consent. In Illinois, which has the oldest and strictest biometrics-specific law and had the first private right of action, 740 ILCS 14/1–14/25, plaintiffs do not need to show they were actually harmed by a violation. *Rosenbach v. Six Flags Entertainment Corp.*, 129 N.E.3d 1197 (Ill. 2019). As a result, class action lawsuits are multiplying. In one case, the plaintiffs sought a class of "tens of thousands, if not hundreds of thousands" of people who entered a retail store that used facial recognition technology. *Antonacci v. Target Corp.*, Case No. 2019L-000276 (Sangamon County, Ill. Cir. Ct. Dec. 18, 2019).

The objection to the use of biometrics-based technology and the premise for such legislation, as the Illinois law states, is that biometrics are unlike other unique identifiers that are used to access finances or other sensitive information. For example, a person can change sensitive information such as Social Security numbers. Biometrics, however, are biologically unique to each individual and, "once compromised, the individual has no recourse, is at heightened risk for identity theft, and is likely to withdraw from biometric facilitated transactions." 740 ILCS 14/5. Unlike a stolen credit card number, the laws' proponents argue, one cannot simply replace his or her facial features or fingerprints.

Franchisors, franchisees, and their counsel should be aware of the latest wave of class action lawsuits and the ever-increasing legislative efforts to enact laws that threaten to cripple companies using the latest technology to authenticate or monitor customers and employees. Some of the largest companies—including Apple, Amazon, Facebook, Google, Snapchat, TikTok, Target, and hotel chains, among others—have been sued for allegedly violating laws that govern the use of biometric data. Such suits reflect the tension between the intersection of emerging technology and data privacy. Plaintiffs are also suing individuals who are responsible for selling and supporting this technology, as well as smaller companies, including franchises such as L.A. Tan and Palm Beach Tan. Franchisors and franchisees have both been the subject of class action lawsuits under the Telephone Consumer Protection Act (faxes and text messages) and the Americans with Disabilities Act (website and physical franchise location accessibility). Biometrics class action litigation could surpass those in both number and potential damages. Recent lawsuits demonstrate the potential threat to companies based on the substantial penalties for the failure to follow statutory requirements for collecting, using and storing biometric data.

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The Status of Laws That Regulate Biometric Data

Three states have specific biometric privacy laws: Illinois, 740 ILCS 14/1–14/25; Texas, Tex. Bus. & Com. Code § 503.001 *et seq*.; and Washington, Wash. Rev. Stat. § 19.375.020 *et seq*. The Illinois law has a private right of action; the laws of the other two states are enforceable only through the state attorney general. California includes biometric data under its newly effective California Consumer Privacy Act ("CCPA"), which includes a private right of action. Other states have revised their existing data breach laws to include biometric data: Arkansas, Colorado, Iowa, Louisiana, Nebraska, New York, North Carolina, Ohio, Oklahoma, Oregon, South Dakota, Vermont, Wisconsin, and Wyoming. Many states have proposed legislation for regulating the use of biometric data, including Alaska, Arizona, Connecticut, Delaware, Florida, Hawaii, Maryland, Massachusetts, Michigan, Mississippi, Montana, New Hampshire, New Jersey, New Mexico, North Dakota, and Rhode Island. Cities are also enacting measures aimed at regulating biometrics. Effective January 1, 2021, Portland, Oregon, banned the private-sector use of facial recognition technology in any place of public accommodation, including wherever goods and services are sold, citing gender and racial basis as a reason. The ordinance provides a private right of action for damages sustained for a "material" violation or $1,000 per day for each day of violation, whichever amount is greater. *See* www.portland.gov. Other cities are reportedly considering similar bans.

The Illinois Biometric Information Privacy Act ("BIPA"), enacted in 2008, regulates the entire cycle of biometric data from capture and collection to use and disclosure. Before collecting or storing biometric data, a private entity must first: (1) provide written notice to individuals that collection will occur as well as the purpose and length of the collection; and (2) receive informed written consent from the individual to proceed with the collection. Private entities also cannot sell, lease, trade, or otherwise profit from a person's or customer's biometric information. Entities must use the reasonable standard of care in their industry to protect the data from disclosure and they must have a publicly available written retention policy that provides for permanent destruction of the data. Any person "aggrieved" by a BIPA violation can sue and recover "for each violation" the greater of $1,000 or actual damages for a negligent violation, and the greater of $5,000 or actual damages for an intentional or reckless violation, plus attorneys' fees, costs, and injunctive relief. 740 ILCS 14/15, 14/20. In *Rosenbach*, the Illinois Supreme Court held that a plaintiff does not need to show any actual harm or damage and that a mere procedural violation of BIPA is sufficient to support a cause of action. 129 N.E.3d at 1205. That ruling further opened the floodgates for class action lawsuits.

Lawsuits Alleging Violations of Biometrics Laws

As of January 2021, litigants filed more than 940 biometrics lawsuits in Illinois since 2008, according to the Courthouse News Service. Many others have filed lawsuits elsewhere in the country alleging BIPA violations. Generally, the lawsuits are class actions and claim that businesses have failed to notify and obtain consent before collecting biometric identifying information. The first reported BIPA class action settlement was $1.5 million with the L.A. Tan franchise system in December 2016 for a class of people who provided their fingerprints to access franchised salons in Illinois. The plaintiff alleged that the company obtained customers' fingerprints without obtaining their informed written consent.

In the *Antonacci* case, Target faces a putative class action lawsuit for its use of facial recognition technology for fraud and theft prevention and security. The lawsuit alleges that facial-recognition technology repeatedly re-maps a customer's facial geometry and compares it against faceprints stored in its database. This system allegedly allows stores to identify and track shoppers and identify suspicious shopping activity. The plaintiffs allege that Target collected a new faceprint from them each time they appeared on store security cameras, several times per store visit, without their permission. The class seeks $5,000 per violation, plus attorneys' fees and costs. Four companies that allegedly collected or stored the plaintiffs' biometrics are also respondents in discovery, pursuant to a process in Illinois that allows plaintiffs to conduct discovery to identify potential additional defendants (which would likely be those companies). Lowe's and Home Depot are also defendants in lawsuits over similar technology used for loss-prevention measures. *See Brunson v. Lowe's Home Centers, LLC*, Case No. 2019CH10251 (Cook County, Ill. Cir. Ct. Sept. 4, 2019); *Brunson v. The Home Depot, Inc.*, Case No. 1:19-cv-03970 (N.D. Ga. Sept. 4, 2019).

The Illinois law does not define what constitutes a "violation" of BIPA. *See Fernandez v. Kerry, Inc.*, Case No. 17 C 8971, 2020 WL 1820521, at *4 (N.D. Ill. April 10, 2020) ("The law is not clear as to whether, under BIPA, a plaintiff can recover for every fingerprint scan."); *Peatry v. Bimbo Bakeries USA, Inc.*, 393 F. Supp.3d 766, 769-770 (N.D. Ill. 2019) (noting undecided interpretation of BIPA's damages provision of treating

each scan as a separate violation in denying plaintiff's motion to remand a putative class action to state courts based on the amount in controversy). If a violation means each time a store camera captures a person's face, for example, defendants could face multiple violations for each individual on whom defendants collected biometric data. Numerous bills introduced in the Illinois Legislature would limit damages, provide a statute of limitations (BIPA has none and some courts have applied the five-year default limitations period rather than a shorter invasion of privacy or personal injury limitations), eliminate the private right of action, and delete the language that a party can recover for each negligent violation and instead provide that a party may recover only for a single collection of a person's biometric data. Unless the Illinois Legislature passes those bills, however, the potential damages under BIPA could be crippling to any company.

In February 2020, Facebook agreed to pay $550 million in a California case consolidating multiple class actions alleging BIPA violations for its photo tagging feature. *In re Facebook Biometric Information Privacy Litigation*, Master File No. 3:15-CV-03747 (N.D. Calif. Aug, 17, 2015). The court rejected that amount as insufficient but approved a $650 million settlement in August 2020. Shortly thereafter, a class action lawsuit with a potential class of millions accused Google of violating BIPA by using facial recognition technology to scan photos uploaded to its cloud-based "Google Photos" service, without consent, to identify people and their gender, age and location. *Molander v. Google, Inc.*, Case No. 5:20-cv-00918 (N.D. Cal. Feb. 6, 2020).

Burger King Corporation faces accusations that it used biometric scanning and time-tracking devices and technology to monitor and manage its employees' time and work performance and gave it to third parties, such as data storage vendors and payroll services. *See Huerta v. Burger King Corp.*, Case No. 2019CH09351 (Cook County, Ill. Cir. Ct. Aug. 14, 2019). Restaurant chain Wow Bao, which QSR magazine says has revolutionized the way diners interact with restaurants by incorporating innovative technology, is a defendant in a putative class action for allegedly violating BIPA. The plaintiff claims that Wow Bao's self-order kiosks use facial biometrics to authenticate food and beverage purchases in an effort to provide faster checkouts and higher sales volumes, but it failed to obtain customers' informed consent, even though customers had the option of whether to use facial biometrics. *Morris v. Wow Bao LLC*, Case No. 2017-CH-12029 (Cook County, Ill. Cir. Ct. Sept. 5, 2017). Speedway LLC, a gas station and convenience store chain, is a defendant in a putative class action for allegedly violating BIPA by collecting employees' fingerprints without obtaining their written consent and following the other legal requirements, and by improperly sharing the data with a third-party vendor of fingerprint-operated time clocks. *Howe v. Speedway, LLC*, Case No. 2017-CH-11992 (Cook County, Ill. Cir. Ct. Sept. 1, 2017); *see also Howe v. Speedway LLC*, Case No. 1:17-cv-07303 (N.D. Ill. Oct. 10, 2017); *Howe v. Speedway LLC*, Case No. 1:19-cv-01374 (N.D. Ill. Feb. 25. 2019).

In August 2020, two U.S. senators introduced the National Biometric Information Privacy Act of 2020 (S. 4400) to regulate the "collection, retention, disclosure, and destruction of biometric information." The Act is nearly identical to BIPA and contains a private right of action for any person "aggrieved by a violation" to bring a civil suit. A critical difference is that the proposed bill addresses the standing issue. The federal bill states that "Any such violation constitutes an injury-in-fact and a harm to any affected individual," such that a technical violation would suffice. The bill also includes a right-to-know provision that would require companies to disclose, upon request, the data that companies collect and how the companies intend to use it (similar to the CCPA). If enacted, the Act would substantially increase the number of biometrics cases nationwide and expose all companies using biometrics to liability.

Challenges to the Lawsuits

Some defendants alleged to have violated biometrics laws are attempting to shift some or all of the liability to vendors who supplied or supported the technology. After Hyatt Corporation faced a class action complaint, it brought a third-party complaint against the vendor that supplied the biometric time clocks for employee fingerprint scans and supported the technology. *See Rapai v. Hyatt Corp.*, Case No. 2017CH14483 (Cook County, Ill. Cir. Ct. Oct. 30, 2017). Based on the parties' contract, Hyatt claims that the vendor was the entity that collected, stored, used, and disclosed the data at issue in the lawsuit, and thus breached the contract by failing to comply with BIPA, and that the vendor had rejected Hyatt's tender of defense and indemnity. The plaintiffs are also suing the vendors. *See, e.g., Figueroa v. Kronos, Inc.*, Case No. 19 C 1306, 2020 WL 1848206 (N.D. Ill. Apr. 13, 2020); *Namuwonge v. Kronos, Inc.*, 418 F. Supp.3d 279 (N.D. Ill. 2019).

Other potential legal challenges have included: invocation of the statute of limitations (*see, e.g., Burlinski v. Top Golf USA Inc.*, Case No. 19-cv-06700,

2020 WL 5253150, at *6 (N.D. Ill. Sept. 3, 2020) (noting that BIPA does not specify a limitations period, is an unsettled area and rejecting statute of limitations arguments at the pleadings stage); personal jurisdiction challenges; claims that the actions fall outside the scope of the law; preemption arguments; constitutional challenges (such as damages being excessive and disproportionate in light of the absence of actual harm or the law violates the Dormant Commerce Clause); and arguments that plaintiffs have failed to allege that they have suffered any actual harm. As defendants seek to keep cases in federal court under the Class Action Fairness Act, the United States Court of Appeals for the Seventh Circuit held on a question of first impression that a person aggrieved by a violation of BIPA's disclosure and informed consent requirements has suffered a concrete injury-in-fact for Article III standing. *Bryant v. Compass Group USA*, 958 F.3d 617, 620-627 (7th Cir. 2020) (reversing in part district court's remand order in the case against a company that owned and operated vending machines accessed only by users' fingerprints), opinion amended on denial of rehearing en banc, No. 20-1443, 2020 WL 6534581 (7th Cir. June 30, 2020). *See also Fox v. Dakkota Integrated Systems, LLC*, Case No. 20-2782, 2020 WL 67381112, at *6-8 (7th Cir. Nov. 17, 2020) (reversing remand order and finding plaintiff had standing to litigate her failure to develop, disclose and comply with a data-retention policy claim).

Practice Pointers

This is a rapidly evolving area of law and technology. The patchwork of state laws, city ordinances and possible federal legislation means that franchisors and franchisees must be careful when adopting new technology. For franchisors, the cases illustrate the importance of language in the franchise agreement that franchisees are required to comply with all applicable laws. To the extent that franchisors have mandated the use of the technology, they could face claims of vicarious liability, if not direct liability. Franchisors should also be cautious when requiring all franchisees use this technology, as the legality of doing so may differ significantly by city or state. Furthermore, franchisors should include indemnification provisions in their franchise agreements in case they face lawsuits for violations at a franchisee's location, as well as indemnification provisions in vendor contracts. Franchisors will also want to consider making sure arbitration provisions in their agreements contain class action waivers. Franchisees, in turn, should be aware of any city or state laws relating to this technology, and alert their franchisors of the same if they seek to require that the franchisee implement such technology.

Insurer Chubb has said that state biometrics laws are among the recent trends in cyber risks, according to the Insurance Journal. Therefore, it is important for franchisors and franchisees to evaluate insurance coverage. An Illinois appeals court upheld a lower court ruling that an insurance company had a duty to defend an L.A. Tan franchisee in a BIPA class action lawsuit. The court found that the lawsuit allegations potentially fell under a policy's "personal injury" coverage provision and that a "violation of statutes" exclusion did not apply, so that it did not need to address whether a data compromise endorsement would also provide coverage. *West Bend Mut. Ins. Co. v. Krishna Schaumburg Tan, Inc.*, 2020 IL App. (1st) 191834, 2020 WL 1330494 (Mar. 20, 2020). The Illinois Supreme Court granted leave to appeal. 154 N.E.3d 804 (Sept. 30, 2020) (table).

At least one court has noted that allegations that a defendant made no effort to comply with BIPA, even though the law had been in effect for more than 10 years, was enough at the pleading stage to make a claim of recklessness, an element required for heightened statutory damages. *Hazlitt v. Apple, Inc.*, Case No. 3:20-CV-421-NJR, 2020 WL 6681374, at *10 (S.D. Ill. Nov. 12, 2020). Thus, in order to reduce the risk of litigation or regulatory action and increased damages, companies should:

1. Conduct an assessment or audit to determine whether, to what extent, and the type of biometric data they use, and where it is stored and who has access to it;
2. Develop policies that address state and local requirements;
3. Train employees on the policies;
4. Conduct regular audits to ensure compliance; and
5. Review contracts with vendors and service providers to determine whether they address biometric data and meet legal requirements.■

Nothing To See Here…Literally — Three Years of Section 558B of the Australian Fair Work Act 2009

By Iain Irvine, Vardon Legal

The principal employment statute in Australia is the Fair Work Act 2009 ("FWA"). In 2017 the FWA was amended to introduce new provisions to hold franchisors and holding companies directly liable if they knew, or could reasonably have been expected to know, contraventions would occur in their business networks and failed to take reasonable steps to manage the risk. The amendments followed an investigation that revealed widespread FWA non-compliance within the 7-Eleven franchise network. According to the Explanatory Memorandum for the amending bill, the reforms addressed increasing community concern about the exploitation of vulnerable workers (including migrant workers) by unscrupulous employers, and responded to a growing body of evidence showing a need to strengthen the laws.

Beginning on October 27, 2017, the Fair Work Ombudsman ("FWO"), under the new Section 558B, has the power to seek remedies, including civil penalties, against responsible franchisor entities where they have failed to take reasonable steps to prevent certain breaches of the FWA by their franchisees if they reasonably should have anticipated such breaches. The FWO has engaged in extensive enforcement activity in relation to failures to pay employee entitlements against business owners, including franchisees, since those amendments came into force, and some formal action seeking access to documents for the purposes of assessing whether the new provisions have been breached. However, there is yet to be a publicized action or judgement against a franchisor for breach of these laws.

The FWA contains a separate accessorial liability provision. Section 550 imposes liability on persons "involved in" (e.g., directly or indirectly, knowingly concerned in) contraventions. There has been only one judgement under this section against a franchisor for being involved in breaches by its franchisee. The significance of that decision, which occurred prior to the introduction of Section 558B, is limited, particularly as the relevant master franchisee admitted involvement in contraventions by its franchisee and the master franchisee and franchisee had a common owner and director. It would appear the FWO will be more willing to enforce breaches of Section 558B relative to taking action under Section 550. However, formal proceedings to date have been limited.

Responsible Franchisor Entity

A franchisor will be a "responsible franchisor entity" and have potential liability under Section 558B of the FWA if it has a significant degree of influence or control over the franchisee entity's affairs. In most franchise systems, it is likely that the franchisee/franchisor relationship will satisfy this test. However, it is less clear whether this would be the case where the relationship is indirect. For example, where a franchisor has granted a master franchise, that franchisor may be able to argue it is not a responsible franchisor entity with respect to sub-franchisees. That indirect relationship may also reduce the risk of a finding that the franchisor should have anticipated a breach of the FWA by a subfranchisee.

The definition of a responsible franchisor entity is also relevant when assessing whether Section 558B will apply to an intellectual property license other than a franchise agreement. The amendments to the FWA adopt the *Corporations Act* 2001 definition of franchise rather than that under the *Franchising Code of Conduct*. The former is a wider definition that captures any grant of rights to use intellectual property in connection with the supply of goods or services. If the grantor exerts a significant degree of influence or control over the grantee's affairs such a grant will be subject to Section 558B.

The Explanatory Memorandum published with the FWA amendments includes the following statement:

> The Fair Work Act does not extend to impose franchisor obligations on corporations operating completely outside Australia. That is, companies that do not have any operations in Australia and have simply entered into a master

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franchisor relationship with an Australian company (even if the Australian company is a subsidiary of the foreign company).

However, the FWA does not expressly exclude liability of foreign franchisors, and the basis for this statement is unclear. It is likely that such franchisors are at risk of liability under Section 558B as the grant of franchise rights in Australia may establish the necessary "appropriate connection" with the jurisdiction.

Anticipated Breach

A responsible franchisor entity will be liable for certain FWA breaches by its franchisee if it or any of its officers knew or could reasonably be expected to have known:

- The breach would occur; or
- A breach of the same or a similar character was likely to occur.

However, the franchisor will not be liable if it had taken reasonable steps to prevent a violation of the same or a similar character.

Reasonable Steps

What steps are reasonable for the purposes of preventing a breach will vary depending on the circumstances. The FWA lists a number of factors that may be relevant to determining what steps are reasonable. Some measures that may be reasonable include the following:

- Encouraging franchisees to undertake due diligence on the franchise offering, particularly the likely labor and other costs;
- Ensuring franchisees will have sufficient financial resources to pay correct employee entitlements;
- Recommending franchisees use FWO educational resources;
- Requiring the franchisee to comply with the FWA under the franchise agreement;
- Requiring franchisees to obtain independent professional advice on FWA compliance;
- Requiring franchisees to notify the franchisor if they become aware of any notice to, or action by, the FWO;
- Providing franchisees with training on FWA compliance;
- Recommending or prescribing workplace management systems or software;
- Ensuring franchisees direct employees to contact the franchisor if their complaint is not resolved; and
- Conducting compliance audits and/or requiring franchisees to self-audit.

Penalties

The maximum civil penalties for breach of Section 558B are AU$13,320 for natural persons and AU$66,600 for corporations. In addition to monetary penalties, the FWO may also issue compliance notices, require enforceable undertakings from franchisors to remedy breaches, and require payment to employees who have suffered loss as a result of the breach.

Where a franchisor incurs a civil penalty, it may have a right of action against its franchisee if the terms of the franchise agreement require the franchisee to comply with applicable laws and indemnify the franchisor. Irrespective of the terms of the franchise agreement, Section 558C of the FWA provides a franchisor a right of indemnity against the franchisee where a franchisor must compensate franchisee employees.

Enforcement Activity

In the years leading up to enactment of Section 558B, the FWO was investigating underpayment of employee benefits in franchise networks. Any resulting formal action generally focused on franchisees as the direct employers. In many cases, franchisees found in breach provided court enforceable undertakings to correct the relevant conduct.

Although these investigations have generally not resulted in formal action against franchisors, a number of franchisors have agreed to enter into Proactive Compliance Deeds with the FWO under which they have made commitments to take measures to ensure FWA compliance by franchisees. Certain franchisors have approached the FWO and entered into these arrangements prior to compliance issues arising. Other franchisors have done so in response to FWO investigations revealing FWA breaches within their systems or in response to issues revealed by their own internal audits. Brands that have made such commitments include: 7-Eleven, McDonalds, Domino's, La Porchetta, Chemist Warehouse, Retail Zoo (owner of Boost Juice, Salsa's Fresh Mex Grill, and Cibo Espresso), Foodco Group (owner of Muffin Break and Jamaica Blue), and Minor DKL Food Group (owner of the Coffee Club,

Ribs & Rumps, Coffee Hit, and Veneziano Coffee Roasters). *See* Fair Work Ombudsman, Australian Government, List of Proactive Compliance Deed at https://www.fairwork.gov.au/about-us/our-role/enforcing-the-legislation/compliance-partnerships/list-of-proactive-compliance-deeds.

In some instances, franchisors of non-compliant franchisees have not made these commitments. For example, in 2016 the FWO reported on its investigation of 11 United Petroleum franchisees. The investigation revealed breaches of the FWA and resulted in two franchisees giving enforceable undertakings. The FWO urged the franchisor to enter into a Proactive Compliance Deed. To date, it has not done so. Similarly, in 2017 the FWO reported outcomes of audits of 24 Pizza Hut franchisees, in which it found 246 of them to be in breach of their obligations under the FWA. Actions taken by the FWO included accepting enforceable undertakings from franchisees. However, the FWO took no formal action against the franchisor, and it did not enter into a Proactive Compliance Deed.

Since the enactment of Section 558B, the FWO has continued to actively investigate franchise networks. Reported formal action has still been largely franchisee focussed. Where the FWO has taken formal action against franchisors, this has generally been in relation to their employees rather than those of their franchisees. The FWO has not reported commencement of any proceedings for breach of Section 558B.

In September 2018, the FWO reported that it would be conducting further investigation of compliance within the Domino's franchise network with a view to assessing whether the franchisor had "taken reasonable steps to prevent, detect and address non-compliance within its network." The FWO has reported no further action to date.

In September 2019, the FWO reported a further investigation into liability of the United Petroleum franchisor for breach of the FWA by one of its franchisees. The FWO commenced proceedings against the franchisor for failing to produce documents relevant to that investigation. In *Fair Work Ombudsman v. United Petroleum Pty Ltd* [2020] FCA 590, the court found the relevant notice to produce records and documents failed to provide the necessary details or particulars as to the nature of the primary contraventions and documents required. Had the FWO been successful, the content of the documents sought may have been relevant to whether the FWO ultimately proceeded with action against United Petroleum for breach of Section 558B.

In 85 *Degrees Coffee Australia Pty Ltd v. Fair Work Inspector Rodwell* [2020] FCA 1190, the court found that a notice seeking records and documents for the purpose of investigating breach of Section 558B was not invalid by virtue of the fact that the relevant records and documents came into existence before the commencement of that section. The relevant notice stated that one of the purposes for seeking the information was to determine whether the franchisor was a responsible franchisor entity.

It is not clear yet the extent to which the FWO will enforce the new provisions against franchisors, however, these actions relating to access to records suggest the willingness to do so where sufficient evidence is obtainable.

One factor delaying the enforcement of Section 558B may be the time necessary for the FWO to complete investigations of potential franchisor contraventions of the new laws and commence action in relation to the same. However, in May 2019, the FWO reported taking its first action under other provisions introduced by the same bill that introduced Section 558B. Those other provisions, which came into force around the same time as Section 558B, increased civil penalties tenfold for "serious contraventions" defined as breaches of civil remedy provisions where:

- the defendant knowingly contravened the provision; and
- the defendant's conduct constituting the contravention was part of a systematic pattern of conduct.

These increased penalties do not apply to a breach of Section 558B.

By January 2020, the FWO had reported two further actions to enforce serious contraventions.

Another factor that may be delaying any enforcement of Section 558B is the response from the franchise sector. Many Australian franchisors have responded to the reform by reviewing, and where appropriate modifying, their workplace policies and systems. This has occurred outside of as well as under Proactive Compliance Deeds. Such actions are prudent following the introduction of the new laws. The steps that a franchisor should reasonably take to prevent FWA breaches will vary depending on the circumstances, however, examples of steps which may be appropriate are set out above.

For now, it remains unclear how active the FWO will be in investigating and enforcing breaches of Section 558B. ■

Franchisor v. Franchisor: Asserting Tortious Interference Claims after Losing a Franchisee to a Competing System

By Anne Horn Baroody, Parker, Hudson, Rainer & Dobbs, LLP

The stakes can be high when franchise systems compete for franchisees. For instance, in 2007, the franchisor for Popeyes Chicken & Biscuits sued Church's Chicken and a former Popeyes franchisee, seeking $20 million, after Church's acquired several Popeyes restaurants and transformed them into Church's restaurants. *See* https://www.qsrmagazine.com/news/afc-files-suit-against-churchs-chicken-and-former-franchisee. Other aggrieved franchisors have also sought damages and injunctive relief after losing valuable franchisees to a competing system, asserting claims for unfair competition, tortious interference, breach of contract, or other claims. This article examines how franchisors can leverage tortious interference theories against other franchisors when their franchisees have been lured away to join another system.

Elements of a Claim

Tortious interference theories come in two forms: tortious interference with contract and tortious interference with prospective or existing business relations. The elements of these common law torts vary by state, and parties should always consult applicable state law when evaluating a claim. Generally, however, the elements of tortious interference with contract include: (i) the existence of a contract between the plaintiff and the third party; (ii) the defendant's knowledge of the existing contract; (iii) the intentional interference with the existing contract; (iv) a breach of that contract as a result of the interference; and (v) resulting damages to the plaintiff. *See, e.g., Maxim Integrated Prods., Inc. v. Analog Devices, Inc.*, 79 F.3d 1153, *2 (9th Cir. 1996) (describing California law).

Tortious interference with business relations or expectancy generally requires the plaintiff to show: (i) the existence of a valid business expectancy; (ii) knowledge of the expectancy by the defendant; (iii) intentional interference by the defendant that induces breach of the expectancy; (iv) absence of justification; and (v) damages. *See, e.g., Briner Elec. Co. v. Sachs Elec. Co.*, 680 S.W. 2d 737, 740 (Mo. Ct. App. 1984). The plaintiff usually must also show that the defendant used some improper means to interfere with the plaintiff's business relationship. *Id.* at 743; *Rendon, Inc. v. Liberty Real Estate Ltd. P'ship III*, 444 S.E.2d 814, 817 (Ga. Ct. App. 1994).

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Breach of Presently Existing Contract

The strongest basis to recover against a competitor when a franchisor loses a franchisee is to show that the competitor induced a breach of an existing contract not terminable at will. Courts often protect existing contracts against even otherwise legitimate competition. *See Heavener, Ogier Servs., Inc. v. R.W. Fla. Region, Inc.*, 418 So. 2d 1074, 1077 (Fla 5th D.C.A. 1982). In *Heavener*, a Florida trial court enjoined competing real estate franchisors from soliciting each other's franchisees during the term of their franchise agreements and restricted each franchisor's ability to respond to inquiries from the other's franchisees, even if the franchisee voluntarily initiated contact. *Id.* The Florida appellate court found the injunction appropriate because "competition and free enterprise must give way to the existing contract and the party's right to rely on that contract." *Id.*

A franchisor that can show the breach of an existing contract often need not show any separate wrongful conduct to support a claim. *See, e.g., Prudential Real Estate Affiliates, Inc. v. Long & Foster Real Estate Inc.*, 208 F.3d 210 (Table), 2000 WL 248170, at *3 (4th Cir. 2000) ("Because the contract at issue in this case is not terminable at will, Prudential is not required to separately establish the fifth element of its interference claim by demonstrating that Long & Foster's interference was wrongful or without justification.").

The aggrieved franchisor must show more than a breaching franchisee who later accepted a franchise with a competitor. The franchisor typically must establish that the competitor induced the breach. *See* Restatement (Second) Torts § 766 cmt. n. Often it is not difficult, however, to establish at least a fact issue on this point. Even absent direct evidence, courts may infer inducement when the competitor offers

the franchisee favorable deal terms. *See* Restatement (Second) Torts § 766 cmt. m (discussing inducement by offer of better terms). For instance, the defendant in *Prudential Real Estate Affiliates* offered more than book value for the franchisee's equipment, assumed the franchisee's lease, and advanced the franchisee a substantial amount of cash to put toward the franchisee's debts. The district court found that those favorable terms tended to show inducement. 2000 WL 248170, at *6. Inducement might also be shown if the competitor offers to indemnify the departing franchisee for claims based on the existing franchise agreement. *See, e.g., Anesthesia Assocs. of Mount Kisco, LLP v. N. Westchester Hosp*. Ctr., 873 N.Y.S.2d 679, 683 (N.Y. App. Div. 2009) (triable issue existed when defendant offered to indemnify physician for claims arising from contract with former medical partnership); *but see Nat'l Econ. Research Assocs., Inc. v. Evans*, 24 Mass. L. Rptr. 436 (Mass. Super. Ct. Sept. 10, 2008) (offer of indemnification insufficient to recover for tortious interference with contract under Massachusetts law).

A plaintiff must also show the defendant's knowledge of the existing contract, though that too has presented a relatively low bar in franchise disputes. Some courts have not required the defendant to know the specific terms of the plaintiff's agreement. Instead, competing franchisors have been charged with knowledge of a competitor's franchise agreement terms if they used similar terms in their own franchise agreements or if the breached term was common in the industry. *See Wallace Oil Co. v. Michaels*, 839 F. Supp. 1041, 1045 (S.D.N.Y. 1993) (denying summary judgment to defendant on issue of knowledge when competing gasoline supplier used the same type of exclusive dealing contracts with its own dealers); *Prudential Real Estate Affiliates, Inc.*, 2000 WL 248170, at *4-5 (denying summary judgment to defendant on issue of knowledge when evidence showed that many, though not all, real estate brokerage franchisors restricted the franchisee's sale or transfer of the franchise).

Interference with At-Will Contracts or Other Business Relations

Absent an existing contract, an aggrieved franchisor may recover for tortious interference with business relations if it can overcome the defendant's privilege for legitimate competition. Competing franchise systems are generally privileged to compete for franchisees. The Restatement (Second) Torts § 768 articulates the privilege as follows:

> One who intentionally causes a third person not to enter into a prospective contractual relation with another who is his competitor or not to continue an existing contract terminable at will does not interfere improperly with the other's relation if:
>
> (a) the relation concerns a matter involved in the competition between the actor and the other; and
> (b) the actor does not employ wrongful means; and
> (c) his action does not create or continue an unlawful restraint of trade; and
> (d) his purpose is at least in part to advance his interest in competing with the other.

Restatement (Second) Torts § 768.
Several real-world scenarios implicate the competitor's privilege. A prospective franchisee might be about to execute a franchise agreement when a competitor persuades her to change course and join another system. Or a franchisee might change systems after the expiration of an existing franchise agreement. Even a franchisee's early termination of an existing agreement might fall within the competitor's privilege if the agreement was terminable at will. The Ninth Circuit has defined an "at-will" contract in the context of dealership arrangements as one "which either party may terminate without breaching the agreement." *Maxim Integrated Prods., Inc. v. Analog Devices, Inc.*, 79 F.3d 1153, at *3 (9th Cir. 1996).

In each of those scenarios, the plaintiff must be prepared to show that the competitor's conduct fell short of the four requirements set out in the Restatement. Significantly, many jurisdictions require the plaintiff to establish some separately wrongful conduct by which the competitor interfered with the at-will contract or business relationship. The tortious interference theory thus loses significant power as a stand-alone tort.

For instance, in *Maxim Integrated Products, Inc. v. Analog Devices, Inc.*, the dismissal of a manufacturer's antitrust claims was fatal to its tortious interference claim against a competitor who persuaded several distributors to terminate their at-will contracts with Maxim and enter into exclusive dealing arrangements with the competitor. 79 F.3d 1153 (9th Cir. 1996). The distributors' contracts with Maxim were at will because the distributors could terminate them, upon 30 days' notice, without breaching the agreement. *Id*. at *3. "At any time, Maxim had no legal assurance that its relationship with the independent distributors would continue longer than the 30 day notice period required by the contracts for termination." *Id*. at

*3. Because Maxim's antitrust allegations were its only claim against the competitor for independently wrongful conduct, its tortious interference theory fell along with the antitrust claims.

To avoid Maxim's fate, aggrieved franchisors should examine every basis to assert separate wrongful conduct against the interfering franchisor. Misappropriation of trade secrets, trademark infringement, false advertising, fraud, misrepresentation, trade libel, and antitrust violations are all potential avenues to establish separate wrongful means. Consider, for instance:

- If the departing franchisee retains any manuals, recipes, customer/contact lists, or other trade secret materials, the franchisor should investigate whether the competing system is using or threatens to use those materials in violation of state and federal trade secret laws. *See, e.g.*, *Handel's Enters., Inc. v. Schulenburg*, 765 F. App'x 117 (6th Cir. 2019) (granting preliminary injunction against the franchisee who retained trade secrets when starting competing business).
- If the franchisee does not fully de-identify or continues to offer the plaintiff's products after opening its doors as a competing unit, the aggrieved franchisor might assert direct or vicarious trademark violations against the competitor. *See Wallace Oil Co. v. Michaels*, 839 F. Supp. 1041, 1045 (S.D.N.Y. 1993) (indicating that changing the signs before fully shifting over the source of supply might be grounds for damages or injunctive relief under the Lanham Act).
- If the competitor is approaching monopoly power in the relevant market in violation of federal or state antitrust laws, the aggrieved franchisor might assert antitrust violations rendering otherwise non-actionable competitive conduct wrongful under the Restatement rule.

Breach of Post-Term Restrictive Covenants

Given the additional hurdles to recover for interference with at-will contracts and business relations, plaintiffs should identify any and all grounds to assert breach of an *existing* agreement with the departed franchisee. Even when the franchise agreement has or will expire by its own terms, courts may enjoin a competitor's interference with post-term covenants in the agreement. In one instance, a distributor obtained a preliminary injunction against a competitor when the competitor induced the (non-party) manufacturer to breach post-term noncompete obligations in its exclusive supply agreement with the plaintiff. *Engine Specialties, Inc. v. Bombardier Limited*, 330 F. Supp. 762 (D. Mass 1971). The manufacturer had supplied certain recreational vehicles exclusively to the plaintiff and had agreed not to market or sell those products for, variously, one or two years after termination of the relationship. When the manufacturer broke off the arrangement and agreed to supply recreational vehicles to the defendant, the court enjoined the defendant dealer from marketing any products in violation of the restrictive covenants. *Id.* at 769. The plaintiff was not required to show any separate wrongful conduct to obtain that relief.

Other post-term covenants may provide the same basis to assert breach of an existing contract even after the franchise agreement expires. Consider whether the franchisee has disclosed, or must inevitably disclose, the plaintiff's confidential information in order to obtain or manage a competing franchise unit. If the franchise agreement contains non-disclosure or confidentiality obligations, the franchisor might recover for interference with those obligations without showing any independent wrongful conduct. Under cases like *Engine Specialties,* competitors may not benefit from the departing franchisee's breach of post-term restrictive covenants.

Conclusion

A tortious interference plaintiff can recover powerful remedies against a competitor. Franchisors should evaluate these potential claims when a competitor entices its franchisees to abandon one system and open a competing unit. On the other hand, franchisors should train their business teams to tread carefully with potential franchisees who are under contract with a competing system. The strong protection for existing contracts should inform all franchisors looking to add new franchisees to their systems. ■

The Trademark Modernization Act of 2020: What Will Its Impact Be on Franchising?

By Christopher P. Bussert, Kilpatrick Townsend & Stockton LLP

The final months of 2020 were punctuated by a well-publicized debate between the executive and congressional branches on legislation involving COVID-19 related stimulus funding and the Consolidated Appropriations Act, 2021, which included funding necessary for the federal government to operate into 2021. Much of the Consolidated Appropriations Act was the result of months of bipartisan negotiation. Indeed, certain components of that legislation were not controversial at all and had substantial bipartisan support. One component receiving little attention by major media outlets, either before or after the passage and signature into law of the Consolidated Appropriations Act, was the Trademark Modernization Act of 2020 ("TMA 2020").

Most portions of TMA 2020 will become effective December 27, 2021. Despite the lack of fanfare, many in the trademark community view it as perhaps the most significant trademark legislation since the landmark Trademark Law Revision Act of 1988. More importantly, several of its provisions will be of great interest to the franchise community, and one in particular will have a significant impact in trademark law infringement matters between franchisors and franchisees or unrelated third parties. A discussion of the key changes embodied in TMA 2020 follows.

Restoration of the Presumption of Irreparable Harm in Trademark Litigation

Many litigation matters between franchisors and franchisees arise from "holdover scenarios" where a franchisee continues to use the franchisor's trademarks after expiration or termination of the franchise relationship in connection with a competing venture, often from the same location as the former franchised business. The Lanham Act provides franchisors with a robust weapon to secure preliminary and ultimately permanent injunctive relief to address these scenarios. To obtain injunctive relief, franchisors typically must demonstrate: (1) a likelihood of success; (2) irreparable injury; (3) the threatened injury to the movant outweighs the harm the relief sought would inflict on the opposing party; and (4) the injunction would not be adverse to the public interest. Prior to 2006, courts routinely held that a movant was entitled to injunctive relief merely by demonstrating a likelihood of success on the merits of a trademark infringement claim. The reason for this was judicial recognition of a "presumption" of irreparable harm to the movant because of the infringement. However, this changed in 2006 because of the United States Supreme Court's decisions in *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006) and *Winter v. Natural Resources Defense Counsel*, Inc., 555 U.S. 7 (2008), which eliminated similar presumptions in litigation brought under patent and environmental law.

After *eBay and Winter*, there has been a substantial debate over whether those holdings should be limited to their respective subject matters or given broader application to other areas of the law, such as trademark infringement and other Lanham Act matters. Over the past 14 years, court decisions have been decidedly mixed on the issue of whether a presumption of irreparable harm continues to apply in trademark infringement matters. The extent of the split of authority in such matters has been well documented in two excellent *Franchise Law Journal* articles, which discussed the evolution of this authority five and ten years post *eBay and Winter*. *See* Ronald T. Coleman, Jr., Trishanda Treadwell, & Elizabeth A. Loyd, *Applicability of the Presumption of Irreparable Harm After eBay*, 32 Franchise L. J. 3 (2012); Scott McIntosh & Jonathan Labakus, *To Presume Or Not To Presume, Irreparable Injury in Trademark Disputes Involving Franchisees Following eBay and Winter*, 36 Franchise L. J. 43 (2016). TMA 2020 has resolved the split of authority by providing that in trademark infringement matters the trademark owner enjoys a rebuttable presumption of irreparable harm upon establishing infringement at the proof stage, or showing a likelihood of success in proving

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infringement in the context of motions for temporary restraining orders or preliminary injunctions.

What will this mean for franchisor trademark owners going forward? Reinstitution or confirmation (depending on the jurisdiction) of the presumption of irreparable harm theoretically makes it easier to obtain injunctive relief in trademark infringement litigation. However, franchisor trademark owners are well advised not to ignore the importance of submitting any available evidence of actual irreparable harm in trademark infringement matters rather than relying solely on the presumption. Doing so is particularly important in matters where the opposing party seeks to rebut the presumption in its responsive pleadings. The submission of palpable evidence of harm may also be particularly advantageous in jurisdictions that abandoned the application of the presumption immediately following eBay and Winter and which may, at least initially, respond in a tepid manner to its reapplication.

New Ex Parte Challenges to Registration

Much of the impetus behind the Trademark Law Revision Act of 1988 ("TLRA") was to address perceived advantages foreign-based businesses had over their U.S. counterparts in obtaining registrations of their marks. For example, to counter the advantage foreign-based businesses had in filing applications based solely on ownership of a registration of their trademarks for the same goods and services outside of the United States, the TLRA added a prospective use registration basis under Section 1(b) of the Lanham Act. The TLRA also addressed another unfair advantage accorded to foreign-based entities relating to priority of rights. Before the TLRA's enactment, at least one court had held that a foreign-based business could establish constructive nationwide use for purposes of registration of its mark in the United States merely upon applying to register the mark in its home country. To level the playing field for U.S.- based businesses, the TLRA established constructive use rights effective from the filing date of an application upon issuance of a federal registration based on that application.

A significant portion of TMA 2020 addresses a new perceived threat primarily posed by foreign-based businesses and, in particular, those from China who obtain or maintain registrations based on false or inaccurate use claims and/or submission of fake or digitally altered specimens not actually showing use of the mark in U.S. commerce. TMA 2020 provides two new mechanisms for challenging registrations where substantial questions exist whether the subject mark was ever used in commerce. The first is a procedure for ex parte reexamination that permits challenges to use-based registrations issued under Section 1(a) of the Lanham Act on the ground that the subject mark was not used in commerce at the time the application was filed (if use was averred there) or, alternatively, as part of the amendment to allege use or statement of use submitted during prosecution of an application originally filed under Section 1(b). The second is a procedure for ex parte expungement, which permits challenges to registrations covering marks that have never been used in commerce. The primary purpose of the expungement option is to target registrations obtained by foreign-based businesses under either Section 44(e) or Section 66(a) of the Lanham Act. Nevertheless, the two proceedings are not mutually exclusive, and, at least in theory, a challenger could bring both against the same registration.

Although TMA 2020 makes clear that numerous regulations will be needed to enable the reexamination and expungement mechanisms, the following can be gleaned now from the Act.

- Who can institute these proceedings? Unlike inter partes opposition and cancellation proceedings, there is no standing requirement. Any person therefore can petition the Director of the United States Patent and Trademark Office ("Director") to institute a reexamination or expungement proceeding. Alternatively, the Director can institute either proceeding sua sponte.
- How does one institute these proceedings? One could potentially institute either proceeding by the filing of a Petition with the Director that identifies the registration(s) at issue and the challenged goods and/or services. The Petition must include a verified statement of the "reasonable investigation" of the merits of the challenge conducted by the Petitioner, any supporting evidence, and any fee prescribed by the Director. The Director will review the Petitioner's submission and determine if it establishes a prima facie case of nonuse. If so, the Director will institute the proceeding and notify the Registrant, who will have the opportunity to submit documentary evidence of use.

In the case of expungement, the Registrant alternatively may provide evidence that any nonuse is due to special circumstances excusing such nonuse. The Director will render a final decision on the Petition

- When must one institute the proceedings? A Petition for expungement may be filed only between the third and the tenth anniversaries of the subject registration, although for a limited period of three years after the TMA's effective date, petitions to initiate expungements may be brought against registrations at any time after their third anniversaries. A Petition for reexamination may be filed at any time within the first five years of the subject registration's issuance.
- Can there be multiple expungement/reexamination challenges against a particular registration?
  There can only be one Petition for expungement or reexamination as to a particular registration. If any or all of the subject registration survives the proceeding, there can be no further such proceedings to that registration by any party. However, this preclusion will not prohibit any party with standing from later instituting an inter parties cancellation proceeding.
- Can one appeal the Director's decision on expungement or reexamination?
  One can appeal the Director's decision to invalidate all or a portion of a challenged registration to the Trademark Trial and Appeal Board. In contrast, however, a determination by the Director whether or not the Petitioner has established a prima facie case of nonuse is not appealable.

Third-Party Challenges to Applications During Examination

TMA 2020 codifies existing letter of protest procedures, which allow third parties to raise certain challenges to pending applications during examination. Under TMA 2020, third parties may submit for consideration evidence relevant to a ground for the refusal of particular applications. Within two months after the date on which a third party files a submission, the Director will determine whether to include that evidence in the record of the application. Any determination by the Director of whether to forward that evidence to the examiner assigned to an application is final and nonreviewable, but it will not prejudice any party's right to raise any issue and rely on that or any other evidence in any other proceeding.

Timing of Responses to Office Actions

Under TMA 2020, the Director will provide by regulation flexibility to examining attorneys in establishing deadlines to Office Actions. Currently, applicants receive a rigid six-month period to respond to any Office Actions, regardless of the issue presented. TMA 2020 authorizes the Director to establish shorter deadlines of not less than 60 days, which the Director may extend at the request of the applicant for an aggregate of up to six months from the issuance of the original Office Action, upon payment of a fee prescribed by the Director. The practical effect of this change is the potential issuance of a registration more quickly, assuming the applicant responds substantively by the shorter deadline.

Conclusion

Upon promulgation of all regulations envisioned by its drafters, TMA 2020 should benefit trademark owners and the consuming public in numerous respects. Among other things, the Act provides welcome clarity on the applicability of the presumption of irreparable harm in trademark litigation and new or clarified procedures for challenging questionable registrations and applications, as well as a means for expediting the prosecution of applications. Taken together, TMA 2020's reforms may result in greater and more cost-effective protection for trademark owners seeking injunctive relief and a registration system that more accurately reflects the reality of the marketplace.■

New Rules on Online Platforms in the European Union—How They May Affect Franchisors

By Silvia Bortolotti, Buffa, Bortolotti & Mathis

Online platforms are becoming an increasingly important part of all business operations. Although there is not a clear and generally shared definition of online platforms, it is commonly accepted that they include a wide range of entities, such as: online marketplaces, social media, app stores, price comparison websites, platforms for the collaborative economy, food-delivery platforms, and search engines, among others.

While various regulatory bodies in the European Union ("EU") acknowledge and appreciate the positive effects of online platforms in the digital market, they also see the need to regulate their competitive position and commercial transactions, in order to protect both consumers and companies, particularly small and medium enterprises. Franchisors with EU operations need to understand the ways in which EU institutions consider and regulate these platforms, including the regulations that went into effect in July 2020, and how the rules regarding online platforms relate to existing EU antitrust and competition laws.

The European Approach toward Online Platforms

In its 2016 Communication (Online Platforms and the Digital Single Market Opportunities and Challenges for Europe, COM/2016/0288 final, § 4), the EU Commission indicated some key objectives in its regulatory approach, aimed at creating a "balanced regulatory framework for online platforms in the Digital Single Market," namely to:

- create harmonized rules at the EU level, in order to avoid uncertainty and confusion among the economic operators;
- guarantee compliance with the existing EU rules in areas such as competition, consumer protection, protection of personal data and single market freedoms by online platforms, considering their cross-border nature, through a good cooperation between the relevant authorities (see, Regulation (EU) 2006/2004 on Consumer Protection Cooperation);
- address clearly identified problems relating to a specific type for activity of online platforms in any future regulatory measures proposed at the EU level, starting by evaluating whether the existing framework is still appropriate; and
- elaborate responses to issues related to online platforms.

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The EU Commission has implemented such strategy with several rules, aimed at:

- guaranteeing transparency in the relations between platforms and companies (Regulation 2019/1150 on promoting fairness and transparency for business users of online intermediation services ("Regulation P2B"));
- guaranteeing transparency in the relations between platforms and end-users/consumers (Directive 2019/2161, as regards the better enforcement and modernization of Union consumer protection rules);
- extending existing rules protecting consumers also to platforms (e.g., Directive 2019/770 on certain aspects concerning contracts for the supply of digital content and digital services); and
- evaluating the specific characteristics and position of online platforms from an antitrust perspective, in the framework of the revision of Regulation 330/2010 on vertical restraints ("VBER").

The Perspective of Non-EU Entities Either Contracting with or Creating and Using Online Platforms

From the perspective of companies that sell their products through distribution and franchise networks, the use of third parties' online platforms can be an opportunity to reach more customers. However, this can also be a competitive risk, especially when those making sales through the platforms are free riders (i.e., third parties not pertaining to the distribution or franchise network) or even their distributors or franchisees.

Manufacturers and franchisors clearly would

like to benefit from the advantages of selling through internet platforms, but want to limit as much as possible sales made through online platforms by free riders. In the franchise context particularly, such free riders do not have the same investment in the franchisor's brand development and reputation as does the franchisor. Similarly, franchisors also wish to curtail online platform sales by the members of their network, if not made in accordance with the franchisor's omnichannel strategy and standards.

This competitive risk is particularly critical for manufacturers and franchisors to manage in their contractual relations with members of their own network, since European antitrust rules also prohibit manufacturers and franchisors from imposing required resale prices on the members of their distribution network, and to a certain extent from imposing restrictions on territory and customers.

The P2B Regulation

Regulation P2B was adopted on June 20, 2019 and entered into force on July 12, 2020. It aims primarily to ensure transparency and equal treatment within the European market for online intermediation services, regulating the relations between the service providers and online search engines on the one hand, and companies on the other, particularly small and medium enterprises.

The definition of online service providers (Art. 2) is very wide and includes not only e-commerce marketplaces, but also social media, home delivery platforms, app stores, and price comparison tools. In this respect, Regulation P2B may apply to possible online platforms created and managed by manufacturers/franchisors for the members of their distribution or franchise network.

From a territorial perspective, the provisions of Regulation P2B apply regardless of the place of establishment or residence of the service provider, as long as: (i) the services are provided or offered to business users and corporate website holders who have their place of establishment or residence in the European Union; and (ii) who, through these services, offer goods and/or services to EU consumers. In addition, the provisions apply even if the actual transaction is ultimately not performed online.

This means that Regulation P2B does not apply to franchisors based outside the EU, even if they sell to EU consumers through online platforms. However, it would apply to members of such franchisor's network (e.g., master franchisees, area developers, direct franchisees) based in an EU Member State who use online platforms such as social media or online search engines for selling their products or services to EU consumers.

In order to ensure equal treatment and fairness to business users, with reference to contractual terms and conditions ("T&C"), providers must ensure that T&C are drafted in a simple and understandable language, that they are easily available to business users at all stages of their commercial relationship, and that they include specific provisions provided therein, under penalty of nullity. Regulation P2B also subjects actions such as the restriction, suspension, and termination of the provision of services to strict procedural rules. Regulation P2B further regulates rankings on research engines, differentiated treatments, specific contractual provisions to be included in the T&C, and access to data.

Moreover, the provider must implement appropriate procedures and an internal complaint handling system, which must ensure compliance with the principles of transparency and fairness and must ensure, free of charge for business users, a reasonable time to handle disputes in relation to the complexity of individual issues. In addition, they must provide the possibility of extra-judicial dispute resolution through mediation. However, the right of providers and users to take legal action at any time before, during, or after the mediation shall remain unaffected.

Since Regulation P2B only entered into force on July 12, 2020, it has yet to be seen how national courts in EU Members States will implement and apply these rules.

Competition (VBER)

The last version (Regulation 330/2010) of the VBER, which applies to distribution and franchise agreements, is currently under revision, given that it will expire on May 31, 2022. Pursuant to the current VBER and the Commission Guidelines on Vertical Restraints, franchisees and distributors must remain free to make internet sales (which are included in the notion of "passive sales," or unsolicited sales) to customers of other territories. The position of online platforms is not clear under the current antitrust rules.

During the public consultation organized by the EU Commission, stakeholders of both platforms and manufacturers and the legal community involved in international distribution and franchise agreements (including several law firms, the International Bar Association,

EuroFranchise Lawyers, and the International Distribution Institute) expressed positions with respect to antitrust issues related to online platforms and internet sales.

Most organizations highlighted the need to introduce specific rules related to online platforms, which clearly do not fall under the scope of the existing rules on intermediaries and on distributors. (See the Staff Working Document Evaluation published by the EU Commission on September 8, 2020, in the framework of the Revision's process of the VBER). However, the position of the EU Commission on the contents of the future text is not yet available; a first draft of the new Regulation is expected to be published and circulated in 2021.

Online Restrictions Imposed by Selective Distribution Agreements

As far as the internal relations among the franchise and distribution networks are concerned, the framework of the revision of the VBER does address the possibility for manufacturers/franchisors to impose restrictions upon members of their distribution/franchise networks with respect to online marketing and online sales, following some recent decisions of the EU Court of Justice and of the EU Commission issued with reference to selective distribution agreements. *See*, e.g., C-230/16, Coty Germany GmbH v Parfümerie Akzente GmbH, CELEX LEXIS 62016CJ0230 (Dec. 6, 2017)

The concept of "Selective Distribution Agreements" only exists in the European Union, invented in the framework of the EU antitrust rules, particularly in the context of multi-brand retail sales. The only existing definition can be currently found in Article 1.1(e), of the VBER, which provides: "*... a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorized distributors.*"

Manufacturers of certain types of products (especially in the luxury, cosmetics, and perfumes sectors, but also in other fields) distribute their products through multi-brand retailers, by using selective distribution agreements. More specifically, through selective distribution contracts, a producer establishes a preferential relationship with a number of retail outlets, selected based on such characteristics as the producer considers necessary for the optimal sale of its products. Since the purpose of a selective network is that the products are only sold in the selected outlets, the establishment of such a network by its very nature implies that the members of the network must undertake not to sell the products to traders who do not belong to the selective distribution network, but only to end-users or to other members of the network. The EU antitrust rules on selective distribution agreements also apply to franchising agreements to the extent that the members of the franchise network undertake not to sell the products to traders who do not belong to the franchise network, but only to end-users or to other members of the network.

Selective distribution agreements have been used by manufacturers more often in the last decade, due to the strong competition of internet sales. These agreements are popular because the manufacturer can create a selective (multi-brand or mono-brand/franchise) network covering the EU territory and allow only sales among the members of the network and to end-users, but preventing the retailers/franchisees from selling to resellers/distributors outside the network, therefore indirectly limiting free riding. In addition, within this framework, the VBER and the associated guidelines in their current versions allow manufacturers/franchisors to restrict—under certain condition—the distributors/franchisees' sales through internet and online platforms to end-users/consumers.

Last but not least, based on the application of some principles established by the EU Court of Justice in application of the rules on trademarks, domestic courts in some EU Member States (e.g., Italy and Germany) have recently started to grant protection to manufacturers against free riders selling their products on the internet, even where such products had been legally purchased and were not counterfeited. The legal grounds for such protection are the existence of a selective distribution network and circumstances confirming the damage of the manufacturer's image and reputation through such sales (aspect, of course, to be evaluated on a case-by-case basis).

Therefore, integrating the elements of selective distribution in mono-brand retail systems such as franchising is becoming a valuable solution for challenging the competition of internet sales and internet platforms. This solution must be carefully adopted in compliance with the applicable antitrust rules, also taking into account the different approaches followed by Antitrust Authorities and domestic courts of the various EU countries.

It will be important to see if and how the revised text of the VBER to be issued by 2022 addresses these issues.■

Message from the Chair

Continued from page 1

the planning for our substantive programming and terrific social and networking events is well underway for our meeting, which will be held October 13–15 at the Hilton Atlanta Hotel in downtown Atlanta.

During the 2020 annual Forum meeting, the Forum membership elected three new Governing Committee members (John Holland of Dady & Gardner P.A., Earsa Jackson of Clark Hill PLC, and Heather Perkins of Faegre Drinker Biddle & Reath LLP) and elected Elizabeth Weldon of Snell & Wilmer, P.A. for a second three-year term on the Governing Committee. Additionally, Ron Coleman of Parker Hudson Rainer & Dobb LLP was elected as the Forum's new Chair. Each of these individuals' terms will commence on August 1, 2021. I look forward to working with our new Governing Committee members, and, in particular, with my good friend Ron Coleman as he transitions into his role as the next Chair.

Thank you again for your loyalty to, and engagement and participation in, the Forum.

As always, feel free to contact me at will. woods@bakermckenzie.com or 214-978-3022 or any other Governing Committee member (a list of the current Governing Committee members and Senior Appointed Leadership can be found here: https://www.americanbar.org/content/dam/aba/events/franchising/2020/fr_leadership10_12_20.pdf) if we can be of service to you.■

Message from the Editor-in-Chief

Erin C. Johnsen, Garner, Ginsburg & Johnsen, P.A

I'm honored to be taking over as the Editor-in-Chief of *The Franchise Lawyer* from Karen Marchiano. Karen has left this publication in wonderful shape, though we will miss her intellectual and friendly presence on the editorial board. I'm so appreciative for my time as an associate editor under Karen, and Heather Perkins before her, both of whom have set a very high bar for me as Editors-in-Chief. Thanks also to our three experienced associate editors—Keri McWilliams, Justin Sallis, and Paul Russell—and to our newest associate editor, Dawn Johnson. This publication is in exceptional hands with this team of editors.

In the winter issue, we are happy to bring you two articles providing international perspectives into franchising issues, from Australia to the European Union. This issue also contains insight for franchise attorneys on biometrics laws, tortious interference claims among franchisors, and a timely analysis of the impact of the Trademark Modernization Act of 2020 on franchising. Thanks to all our winter authors for their contributions to this issue.

If you're interested in writing for a future issue of *The Franchise Lawyer* or have a topic idea that you'd like to see covered, please do not hesitate to reach out to me directly at ecjohnsen@yourfranchiselawyer.com or 612-259-4807.■

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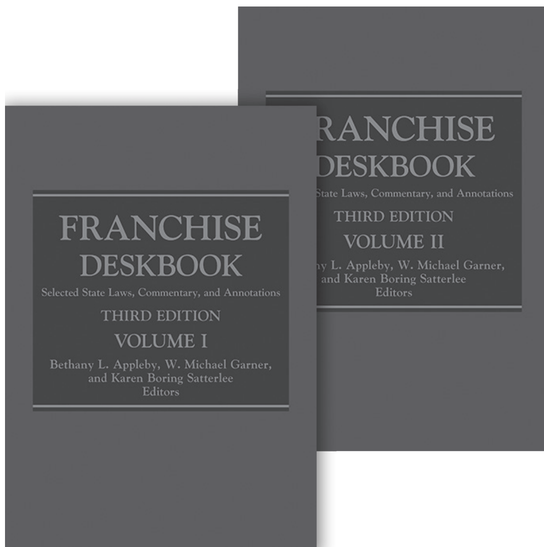

An essential reference to the text of generally applicable franchise registration, disclosure and relationship statutes and the accompanying regulations, this updated edition also includes annotations of reported and unreported cases arranged and keyed to important topics such as franchise fees, exemptions from registration, and more. The unique annotation system designed especially for franchise lawyers helps put your finger on cases that focus upon the issues that matter most.

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