STATEMENT OF OWNERSHIP

Franchise Law Journal (ISSN: 8756-7962) is published quarterly, by season, by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, Illinois 60654-7598. Franchise Law Journal seeks to inform and educate members of the bar by publishing articles, columns, and reviews concerning legal developments relevant to franchising as a method of distributing products and services. Franchise Law Journal is indexed in the Current Law Index under the citation FRANCHISING.

Requests for permission to reproduce or republish any material from the Franchise Law Journal should be sent to copyright@americanbar.org. Address corrections should be sent to coa@americanbar.org. The opinions expressed in the articles presented in Franchise Law Journal are those of the authors and shall not be construed to represent the policies of the American Bar Association and the Forum on Franchising. Copyright © 2015 American Bar Association. Produced by ABA Publishing.
**TABLE OF CONTENTS**

**EDITORIAL**

Forum Membership and Being the First to Know  
*Bethany L. Appleby*  

**ARTICLES**

A Billion Dollar Franchise Fee? Tesla Motors’ Battle for Direct Sales: State Dealer Franchise Law and Politics  
*Eric D. Stolze*  

A Canadian Perspective on the Independent Contractor-Employer Issue  
*Larry M. Weinberg*  

Statutory Constraints on Substantial Change to Dealers’ Competitive Circumstances Creates Substantial Compliance Confusion  
*James J. Long*  

Enforcing Arbitration Awards in International Franchising  
*Ronald A. Giller, Sarah L. Wieselgren, and Lynette Gladdis*  

**FEATURE**

Franchising (& Distribution) Currents  
*Amy Cheng, Jennifer Dolman, and Eliott R. Ginsburg*
One of the many benefits of Forum membership is being the first to know. When any important court decision issues, or when something otherwise newsworthy happens, your fellow members on the Forum’s Listserv will make sure you know immediately. For example, by the time the major news organizations got hold of it, it was old news on the Listserv that the National Labor Relations Board General Counsel determined that McDonald’s may be deemed a “joint employer” of its franchisees’ employees.

Another benefit of Forum membership, of course, is your automatic subscription to this publication. In the Franchise Law Journal, we can take that Listserv breaking news and put it in context and provide much deeper analysis and opinions. A perfect case in point is Larry Weinberg’s A Canadian Perspective on the Independent Contractor-Employer Issue.

We also celebrate the scholarly pursuits, energy, and involvement of our newer members. This issue salutes our 2014 Rising Scholar Award winner, Eric D. Stolze, and publishes his excellent winning article, A Billion Dollar Franchise Fee? Tesla Motors’ Battle for Direct Sales: State Dealer Franchise Law and Politics. We urge you to submit an article for consideration for the 2015 Rising Scholar Award if you qualify. Please also encourage newer lawyers in your office to participate. Submission details are provided below.

Rounding out this jam-packed issue are James Long’s Statutory Constraints on Substantial Change to Dealers’ Competitive Circumstances Creates Substantial Compliance Confusion, which discusses laws limiting a manufacturer’s ability to “substantially change the competitive circumstances” of a dealership, and Enforcing Arbitration Awards in International Franchising by Lynette Gladdis, Ronald A. Giller, and Sarah L. Wieselgren, which provides in-house and...
outside counsel perspectives on obstacles to enforcing international arbitration awards and how to surmount them.

* * *

The deadline for the 2015 Rising Scholar Award is July 13, 2015. To be eligible, entrants must be members of the ABA Forum on Franchising and zero to four years out of law school. Qualified participants should prepare articles according to the Franchise Law Journal’s author guidelines. The submissions will be judged by current and former members of the Franchise Law Journal and the Franchise Lawyer editorial boards. The current Forum chair will also be consulted and provide input on the selection of the winning article.

The author of the winning article will receive the following: (1) the article will be considered for publication in a future edition of Franchise Law Journal; (2) the author will be recognized and presented with a plaque at the Annual Forum on Franchising; (3) the author will receive a small financial award to reimburse in part expenses for traveling to the Annual Forum for the award presentation; and (4) the author’s registration fee for attending the Annual Forum will be waived.

Articles must be submitted to Bethany L. Appleby, the current editor-in-chief of the Franchise Law Journal, no later than Monday, July 13, 2015, to be considered in this year’s competition. All inquiries should be directed to: bappleby@wiggin.com.

We look forward to receiving the submissions!
A Billion Dollar Franchise Fee? Tesla Motors’ Battle for Direct Sales: State Dealer Franchise Law and Politics

Eric D. Stolze

The automobile industry’s impact on the nation’s economy is of undeniable significance. In 2013, dealers reported total revenues of $730 billion, and the 15.5 million new vehicles sold through the country’s franchised dealerships were the main engine driving that figure.1 A recent entrant into this sector, Tesla Motors, sold only 22,477 cars in 2013.2 Yet, Tesla has garnered attention, and opposition, to its comparably miniscule volume because of the exclusive method it employs in distributing its vehicles: direct-to-consumer sales. In a dramatic break from tradition and how virtually all vehicles are sold, Tesla has never utilized dealers to facilitate sales, relying exclusively on company-owned stores and its significant presence on the Internet.

Fueled by the nation’s automobile dealers, many preexisting state dealer franchise regimes outlaw Tesla’s sales model, and recent legislation in other states likewise aims to ban that practice. As an automobile manufacturer, Tesla faces a patchwork of state laws and regulations that are so restrictive, in some places, as to ban test drives and require a contrived run-around for warranty service. Despite this opposition, Tesla has entrenched itself with its direct sales approach in a battle against the status quo that


Eric D. Stolze (erictolze@paulhasting.com) is a mid-level associate in the Complex Litigation & Arbitration Practice Group in the Atlanta office of Paul Hastings LLP, where his practice focuses on representing corporate clients in high value disputes, with an emphasis on franchise dispute litigation and alternative dispute resolution.
has sparked aggressive lobbying, legal challenges, and even commentary by executives at the Federal Trade Commission. Tesla’s market capitalization, which surged to over $30 billion in February 2014, rivals that of other established manufacturers and is a reflection of its drive to see that it sells its own cars on its own terms.3

But Tesla’s resolve also raises a number of questions about the fundamental merits of arguably protectionist and competitively insulating state dealer franchise statutes. Should laws enacted to curb abusive practices by automobile manufacturers against preexisting dealers now be used to dictate the franchise model as the exclusive means of retailing new vehicles? What harms are states actually guarding against when preventing Tesla from shunning dealers altogether? How important are those safeguards, especially where states are unofficially, if not ostensibly, willing to jettison direct sales bans in exchange for Tesla’s multibillion dollar capital investment?

This article includes a brief recount of the history of the dealer franchise system and its protectionist legislation, which is needed to appreciate the conflicting interests of stakeholders in ongoing battles and the norm embedded in many states’ regulatory frameworks. Next, Tesla’s direct sales model and the philosophy behind it are pitted against the historical impetus for the existence of dealer franchise laws. The regimes of several states—including attempts at challenging them and Tesla’s workarounds—will be examined in detail. A specific focus will be in the states where Tesla had the greatest potential to leverage the allure of prospective capital investment and job growth accompanying its promised “gigafactory” project.

I. The Advent of Franchised Automotive Dealers

In the early history of automobiles and in the years following their invention, a host of selling formats were tested and discarded—factory stores, mail order, consignment, retail department stores, and salesmen.4 As the automobile became mainstream, the predecessor of today’s dealer franchise system emerged as commonplace: “wholesale distributors who operated within large exclusive territories.”5 The modern dealer franchise system was in place by the 1950s, requiring dealers to make substantial investments in property, equipment, and inventory as the industry evolved.6 As the franchised automotive dealer model became nearly ubiquitous so, too, did local dealer complaints about treatment by distant, out-of-state manufacturers.

6. Id.
The few major auto manufacturers amounted to an oligopoly, able to dictate the terms on which the sole supply of new automobiles would be available to dealers. Over time, dealership agreements became contracts of adhesion offered on increasingly onerous terms, which led to perceived abuses of power and opportunism that jeopardized both owners’ profitability and their businesses as a going concern.\(^7\) Dealer complaints ranged from minor issues, such as delays in payment for delivery and warranty work, to more serious ones, including disparate allocations of popular and sellable vehicles and dumping of undesirable heavily optioned or model year-end production.\(^8\)

The most egregious perceived abuses dealt not with the treatment of dealers during the term of the franchise, but when the franchise term was at its end. Manufacturers largely claimed that their agreements with dealers allowed for termination of or a refusal to renew a dealership, while restricting the right to sell or transfer the franchise.\(^9\) At the same time, manufacturers operated company stores selling directly to consumers, thereby engaging in direct competition with their franchised dealers.\(^10\) These perceived misgivings led to legislative action, both at the state and federal levels. Congress, for example, enacted the Automobile Dealers’ Day in Court Act in 1956 to (1) shift at least some power in the manufacturer-dealer relationship in favor of the dealers and (2) override dealership agreement provisions inhibiting a “judicial determination” of whether the manufacturer acted in good faith.\(^11\)

States have a significant interest in the protection of new automobile dealerships, which generate nearly 18 percent of all sales tax revenue, from overreaching and abuse by manufacturers.\(^12\) Today, a literal patchwork of laws enacted by all fifty states regulates, if not mandates, the automobile franchised dealer relationship. Wisconsin was the first state to adopt a law targeted to the automobile franchise relationship in 1937, and Alaska the last in 2002.\(^13\) Despite manufacturers’ previous attempts to defeat these laws in the courts, their general principles have been upheld as constitutional, namely, under Equal Protection\(^14\) and Commerce Clause\(^15\) challenges. The terms of these laws, and specifically their impact on Tesla, are discussed below.

\(^8\) Id. at 760–76.
\(^9\) Id. at 768.
\(^10\) Id. at 768–89.
\(^12\) Lafontaine & Morton, \textit{supra} note 5, at 234.
\(^14\) See, \textit{e.g.}, Ford Motor Co. v. Texas Dep’t of Transp., 264 F.3d 493, 502, 510 (5th Cir. 2001) (concluding that Texas’s dealer franchise statute, which “only prevents manufacturers, regardless of their domicile, from entering the retail market,” survives an equal protection challenge because it “bears a reasonable relationship to the State’s legitimate purpose in controlling the [automobile] retail market. . . .”).
\(^15\) See, \textit{e.g.}, Int’l Truck & Engine Corp. v. Bray, 372 F.3d 717, 726 (5th Cir. 2004) (upholding Texas’s dealer franchise statute against a dormant commerce clause challenge because it “did not discriminate against manufacturers based on out-of-state status; motor vehicle manufacturers,
II. Tesla’s Disruptive Market Entrance and Clash with State Regulation

Economic commentators have noted that state franchise laws “almost guarantee dealership profitability and survival.”16 Unsurprisingly, the dealer industry defends dealer franchise laws, claiming that they “promote a wide network of dealers across the state and create competition in vehicle prices and services that consumers can expect.”17 Tesla opened its first “store” in Los Angeles in May 2008, marking the beginning of its direct-to-consumer sales model driven by company-owned stores and Internet sales.18 Although existing dealers and many legislators would label Tesla as disruptive because of this break from tradition, Tesla’s vice president of business development, Diarmuid O’Connell disagrees, concluding that “[i]t's only disruptive from [the dealers’] point of view. It is logical and pragmatic from our point of view.”19 Claiming that “being forced to use franchise dealers would be highly detrimental to [its] mission,” Tesla raises a number of points in support of its sales practice:

- Gas-powered vehicles are the lifeblood of established automobile dealers, accounting for “virtually all” of their revenues;
- The sales process for electric vehicles requires consumer education and familiarization with a new powertrain, directly at odds with the “quick, high volume sales—incentivized by substantial sales commissions” of traditional dealers;
- Tesla stores are compact, deliberately located in high-traffic areas, and designed to invite potential customers inside, as opposed to the “large, out-of-the-way facilities” maintained by traditional dealers that are destinations in and of themselves;20
- Compared to established dealers that pervasively advertise, Tesla “has no advertising, no ad agency, no CMO . . .”21 Instead, it relies on
word-of-mouth from customers, media coverage and brand recognition, all of which require control of the buying experience;22 and

- Dealers profit handsomely from their service departments, not only from warranty work, but also from regular maintenance expenses that are often borne by the vehicle owner. Contrasted with gasoline vehicles requiring regular oil changes, brake pads, and other service at regular intervals, Tesla’s “Model S requires almost no maintenance.”23

The tension between Tesla’s sales model and state dealer franchise laws is explainable as a perversion of the original intent and purpose behind these laws. When enacted, states sought to protect existing dealers from unfair, abusive, and opportunistic behavior of the manufacturer that had granted that franchise. The reach of those laws today expands far beyond that premise in many states, mandating that all manufacturers, not just those with existing dealers already positioned in the state, must sell new vehicles exclusively through a franchised dealer. As applied to a new market entrant like Tesla, without any existing dealerships, these laws still mandate that the sole permissible conduit for selling new vehicles is through a franchised dealer. The difficulty of modifying that status quo, and the powerful interest groups at play, is best exhibited by the tumultuous saga in New Jersey—a battle involving Tesla; the governor; administrative boards; the legislature; and, of course, the powerful dealer lobby.

A. New Jersey Showdown

The clash of divergent interests and power of dealer trade groups is exhibited nowhere better than in New Jersey, where Tesla safely operated for years before that state’s licensing agency reversed course and succumbed to industry and political pressure. Tesla opened two stores in New Jersey in 2012, both of which were granted licenses to sell vehicles directly to consumers by the New Jersey Motor Vehicle Commission.24 Tesla contends that the existing New Jersey dealer franchise law “only restricts the ability of a franchisor to compete against its own franchisees; it does not prohibit a manufacturer with no franchisees from being a licensed dealer.”25 Tesla believes that the New Jersey Motor Vehicle Commission implicitly accepted this premise when it opted to license Tesla at the outset. While Tesla was attempting to renew its licenses for existing stores and obtain a third one for a new location, it encountered unexplained difficulties and administrative

22. New Jersey Appeal, supra note 20, at 5.
25. Id.
delays. As Tesla later learned, the New Jersey Coalition of Automotive Retailers allegedly was lobbying the New Jersey Motor Vehicle Commission to alter regulations to Tesla’s detriment.\textsuperscript{26} Clearly, that campaign was successful.

On March 11, 2014, the New Jersey Motor Vehicle Commission officially amended its administrative code to bar Tesla from continuing to operate any company stores in the state.\textsuperscript{27} Following the New Jersey Motor Vehicle Commission’s amendments, any party seeking a dealer license was required to “produce evidence that the applicant or licensee is a franchisee” as that term is defined in a New Jersey statute,\textsuperscript{28} including the production of the “franchise agreement(s) with the motor vehicle manufacturer.”\textsuperscript{29} The Commission justified its decision by citing to New Jersey’s Franchise Practices Act and claiming it was enacted “not only to protect franchisees in their relationships with franchisors, but also to establish a fair system for the sale of new motor vehicles, which system, in New Jersey, involves the sale of new motor vehicles through franchised dealers.”\textsuperscript{30}

After Governor Chris Christie punted responsibility for the actions of his appointees on the New Jersey Motor Vehicle Commission,\textsuperscript{31} the New Jersey State Assembly’s Consumer Affairs Committee answered unanimously. It sponsored a bill that, if ultimately enacted, would have legislatively reversed the Motor Vehicle Commission’s decision and allowed Tesla, once again, to sell vehicles directly to consumers from its stores in New Jersey. That bill, passed by a vote of 77-0,\textsuperscript{32} is special interest legislation in its own right. Its text is targeted to impact only “certain manufacturers” and “Tesla” by name, given that it is applicable only to a “motor vehicle franchisor licensed . . . on or prior to January 1, 2014 and exclusively manufacturing zero emission vehicles.”\textsuperscript{33}

Amid Tesla’s intermediate victory, the president of the New Jersey Coalition of Automotive Retailers (NJCAR) vowed to continue the pursuit of its long term agenda:

No one wants to see Tesla out-of-business in New Jersey and NJCAR is committed to working with members of the Legislature who are exploring options that
would allow a start-up electric car maker, like Tesla, a reasonable period of time to ramp up operations (or sales volume) before they conform their business operations to the franchise model.34

The proposed legislation is not without its limitations, still including certain protections for the automotive dealer franchise lobby. By allowing “no more than four places of business in the State” and requiring the maintenance of “at least one retail facility for the servicing, including warranty servicing, of vehicles sold . . . .”,35 this legislation is still only a compromise, stop-gap measure that postpones a larger debate about franchised dealers for another day. Nonetheless, clearing the way to comply with this legislative requirement, Tesla received local zoning approval in late June 2014 to open its first service center in the state.36 Until New Jersey’s state senate acts by passing similar legislation,37 Tesla will remain resigned to operating its former stores in the state exclusively under the restricted “gallery” model.

III. Tesla’s Gigafactory: A $5 Billion Bargaining Chip

Enter Tesla’s “gigafactory,” the moniker for what would be the largest lithium-ion battery production facility in the world, which Tesla intends to build in the southwestern United States. The planned facility involves up to a $5 billion total investment; brings with it a projected 6,500 jobs;38 and, when fully operational, would more than eclipse the current, worldwide production capacity for the type of batteries serving as the power store for Tesla vehicles.39 In early 2014, Tesla announced four finalists in its vetting process for the project’s ultimate 500- to 1,000-acre site: Arizona, Nevada, New Mexico, and Texas.40 These selections are notable for reasons beyond

---

35. N.J. Assemb. No. 3216 § 6(1)–(2).
their geographic convenience to Tesla’s vehicle assembly factory in Fremont, California, injecting a novel aspect into Tesla’s negotiations with these states.41

Several states continued to maintain restrictions or complete bans on sales of Tesla vehicles despite their advancement to the finalist stage for a massive Tesla component production facility. This puzzlement begs the question of how the “gigafactory” was leveraged by both sides in negotiations—and especially whether any finalist states attempted effectively to extract a “franchise fee” from Tesla: billions of investment and thousands of jobs in exchange for the ability to sell cars without involvement of a dealer. Tesla’s Vice President of Business Development O’Connell was less than coy in public remarks about the prospect of quid pro quo: “The issue of where we do business is in some ways inextricably linked to where we sell our cars. . . .”42 Commentators agreed that delaying announcement of its selection while states competed for the site was “an excellent way for the company to try to get as many incentives from all states involved, including its desire to change the franchise model for car sales.”43 Despite their attempts to woo Tesla’s investment, states continued to retain laws prohibiting Tesla—or any other manufacturer—from selling cars within their borders.

With dealer franchise laws obviously an issue in play along with other economic concessions, Tesla announced that it would delay its final site selection to “approach[] a down-select stage in the process, which will likely see two locations emerge” as final contenders for the “gigafactory.”44 Tesla intended to “break ground on these locations in parallel,”45 a move that has been coined a “bake off” to extract maximum benefits in a head-to-head competition between two states.46 Several of the competing states remained disadvantaged by their dealer franchise statutes.

A. Texas

Tesla’s founder and CEO, Elon Musk, has declared Texas’s dealer franchise law to be “very un-Texan.”47 The Texas law is among the nation’s

45. Id.
most restrictive, mandating that: “a manufacturer or distributor may not directly or indirectly: (1) own an interest in a franchised or nonfranchised dealer or dealership; (2) operate or control a franchised or nonfranchised dealer or dealership; or (3) act in the capacity of a franchised or nonfranchised dealer.” The law is so broad, in fact, that “the term ‘dealer’ . . . extends to all dealers, not just dealers of new vehicles,” and also impairs Tesla’s ability to provide service and maintenance or vehicles inside the state.

Though Tesla operates two “galleries” in Texas, to be distinguished from an actual store, any discussions of pricing, financing, leasing, or purchasing are forbidden, and test drives cannot be offered. If a Texas resident manages to purchase a Tesla vehicle despite these barricades, it is delivered by a third-party transport provider, and no Tesla employee can contact the buyer until forty-eight hours after delivery. For information about operating the vehicle, buyers are referred to online tutorials or instructed to telephone a Tesla service representative located outside of Texas. Similarly, buyers of Tesla vehicles must register their vehicles (because Tesla cannot) and pay sales tax at the time of registration, forcing some buyers to pay the tax as a lump-sum rather than roll it into the vehicle’s financing. Lastly, obtaining service for a Tesla vehicle in Texas must originate by contacting Tesla Service in California, which then arranges sub-contracted service work by a local subsidiary. The repair centers in Texas cannot advertise that they perform warranty repairs or discuss additional issues with the owner. Instead, the customer must again speak with a Tesla employee located in California—not communicating with anyone at the repair facility about the work actually being done to their vehicle.

Texas Governor Rick Perry has explicitly categorized the underlying law as “antiquated protections . . . for car dealers” and said that the state’s residents “don’t need to be protected.” Tesla’s O’Connell blatantly invited a change to Texas’s law as a factor in the “gigafactory” selection process, stating that “[i]f Texas wants to reconsider its position on Tesla selling directly in Texas, it certainly couldn’t hurt.” But, automobile dealers are “a pretty
powerful lobby” in the state, according to one Texas state representative—hardly a revelation given their degree of involvement in the political process.58 Dealer-interested campaign contributions topped $2.5 million for Texas’s 2012 election cycle, distributed to nearly 60 percent of elected legislators, and lobbyist spending amounted to $780,000 across twenty-six lobby contracts.59 Yet, Governor Perry’s efforts to woo Tesla to Texas included driving a Model S to political fundraisers and saying that it needs a “made-in-Texas bumper sticker.”60

B. Arizona

Arizona state law imposes similar restrictions on Tesla sales. Lawfully selling vehicles in Arizona requires a dealer’s license, which Tesla is not eligible for under Arizona statute:

A. A factory shall not directly or indirectly compete with or unfairly discriminate among its dealers.

B. Competing with or unfair discrimination includes any one of the following:

2. The factory selling, leasing or providing, or offering to sell, lease or provide, a vehicle or product, service or financing to any retail consumer or lead.61

Because of this law, Tesla’s Scottsdale location operates on the “gallery” model, with many of the same constraints and restrictions as those in Texas. Bobbi Sparrow, president of the Arizona Automobile Dealers Association, accused Tesla of “trying to buck the system” imposed by the law: “[a] manufacturer cannot be a dealer in this state. . . . We put that in law in 2000.”62

Arizona’s legislature, however, took at least some action in hopes of changing that law, likely making the state more attractive as a site for the “gigafactory” in the process. One state representative has admitted as much, stating “[w]e wanted to send a message that Arizona is open for business.”63 Two separate pieces of legislation were proposed that would have allowed Tesla to operate its “galleries” as actual “stores,” as it does in other states, where it could actually be permitted to sell a car to consumers.


61. A RIZ. STAT. ANN. § 28-4460.


The first proposed legislation, H.B. 2123, would have amended Arizona’s dealer franchise law specifically for electric vehicle manufacturers so that state law would no longer:

Prohibit a factory from selling, leasing or providing, or offering to sell, lease or provide, a vehicle or product, service or financing to any retail consumer if both of the following apply:

(i) The factory manufactures only electric vehicles.
(ii) The factory has a service center in this state to handle repair, warranty or recall issues regarding the vehicles.\(^{64}\)

Another bill, H.B. 2059, would have applied more generally, amending Arizona state law so that it would not “[p]rohibit a factory from selling, leasing or providing, or offering to sell, lease or provide, a vehicle or product, service or financing to any retail consumer or lead if a dealer is not located within sixty miles of the retail consumer or lead.”\(^{65}\)

Unfortunately for Tesla, and ultimately for Arizona, neither legislative charge resulted in any modifications to state law. Arizona’s legislature recessed in mid-April 2014 without the Senate ever voting on H.B. 2123, and H.B. 2059 “died early in the session in the face of opposition from car dealers.”\(^{66}\) Until next year, at least, Arizona’s ban on direct auto sales will stand, even while it continues to compete with states that allow Tesla to operate its stores as actual vehicle showrooms.

C. New Mexico

New Mexico maintains a similar ban on sales of new vehicles by manufacturers, precluding them from acting as dealers in the state. It also has even more restrictive provisions, like some other states, which prevent manufacturers from providing warranty service work:

It is unlawful for a manufacturer, distributor or representative to:

...  
V. be licensed as a dealer or perform warranty or other service or own an interest, directly or indirectly, in a person licensed as a dealer or performing warranty or other service; provided that a manufacturer or distributor may own a person licensed as a dealer for a reasonable time in order to dispose of an interest acquired as a secured party or as part of a dealer development program.\(^{68}\)

\(^{68}\) N.M. Stat. Ann. § 57-16-5.
Although a bill was introduced that would have allowed Tesla to conduct direct sales in New Mexico, it did not leave the legislature.69 Instead, New Mexico’s efforts to win the “gigafactory” site were directed toward economic incentives.70 New Mexico Governor Susana Martinez commented, “We are not going to jump ahead of ourselves, we’re still talking, we’re still having conversations, but of course we’d be very proud to have them.”71 Tesla has no stores or galleries in the state.72

D. Nevada

Tesla operates a full-fledged company store in Las Vegas and is able to sell cars directly to consumers consistent with its preferred business model.73 Tesla secured a license from Nevada to operate that store, despite objection from the dealer lobby and continuing claims that direct sales were outlawed by existing statutes.74 Coincidence or not, Nevada was regarded as the frontrunner for selection of the “gigafactory” site.75 While the legislatures of Nevada’s competitors were arguing over whether a Tesla vehicle could legally be sold directly to consumers in their states, Nevada’s officials and legislature were otherwise occupied preparing additional legislation to woo Tesla—sizeable economic incentives and streamlining the process for granting up to a 30 percent discount on electricity rates through its Office of Economic Development.76 Nevada’s competitive advantage led to Tesla’s September 2014 announcement that its gigafactory would be built at a site near Reno.77 Coupled with

71. Id.
73. Id.
74. Tesla’s $1.3 Billion Incentive Deal with Nevada Includes Direct Sales, AUTO. NEWS, Sept. 12, 2014 (“But Tesla had been able to obtain a license for a store in Las Vegas last year. Though dealers had maintained that store was operating in violation of the statute, the gigafactory project made the difference in turning around the association’s opposition.”), available at http://www.autonews.com/article/20140912/RETAIL07/140919949/teslas-$1.3-billion-incentive-deal-with-nevada-includes-direct-sales.
$1.25 billion in tax breaks over twenty years, the selection also halted efforts of the Nevada Franchised Automobile Dealers Association to stop Tesla’s direct sales through the state’s legislature and administrative agencies. The trade group’s executive director stated, “We took a big breath and tried to look at the big picture. We agreed to provide a carve-out in our franchise law for them.” As one of several pieces of legislation authorizing the complete incentives package, Tesla obtained formal codification of the right to operate its direct sales model in the state:

Chapter 482 of NRS is hereby amended by adding thereto a new section to read as follows: A manufacturer is not subject to the provisions of NRS 482.36311 to 482.36425, inclusive, if the manufacturer:

1. Only manufactures passenger cars powered solely by one or more electric motors;
2. Only sells at retail new or new and used passenger cars that it manufactures; and
3. Was selling such passenger cars at retail in this State on or before January 1, 2016.

IV. Economics of Dealer Franchises and Unlikely Bedfellows

The state dealer franchise laws that Tesla is wrangling have ramifications far beyond one company’s desire to challenge the present nationwide system of car distribution, but instead impact a substantial sector of the American economy. Dealer franchise laws not only established a status quo when first enacted by states, they now serve to perpetuate it and demand an Act of Congress, or at least a locally influenced state legislature, to allow change: “When the automakers decided to sell their cars through independent dealers, they did so based on what they judged was good for their industry at the time. They cannot now adjust this business decision, even if the market dictates that they should.” For example, “[t]hese franchise laws have insulated car dealers from much of the e-commerce revolution that has hammered other sectors from books to electronics.” The economic implications of dealer franchise laws, both for consumers and auto manufacturers, seemingly validate Tesla’s offered reasoning for its resolute commitment to direct sales.

81. Lafontaine & Morton, supra note 5, at 247.
The U.S. Government’s Troubled Asset Relief Program caused it to “invest” tens of billions of dollars into the American automotive industry.83 Years earlier, the costs of the domestic auto distribution system were estimated at “averaging up to 30 percent” of a vehicle’s price with dealer costs accounting for nearly half of that total.84 An even more dated study by the Federal Trade Commission concluded that dealer franchise laws accounted for nearly 6 percent of a new vehicle consumer’s cost, and that “the cost to all car buyers could run to well over $3 billion per year” in 1978 dollars.85 Little has changed in dealer franchise laws since then, although developing trends have eroded the bases that originally justified the enactment. Today, the country’s largest automotive dealer is a publicly traded company, operating “265 dealerships in 15 states selling 32 different brands,” with a total market capitalization exceeding $7 billion.86 The emergence of the “automotive group,” owning dozens of, if not more than a hundred, dealerships, is a far cry from the individual dealer that was once at the mercy of a single auto manufacturer.87

Despite the costs associated with intermediation in the car sales process, auto manufacturers seem to be rallying behind their dealers to halt the spread of Tesla’s sales model. Appearing at hearings on bills that would have allowed sales outside of the franchised dealer regime, lobbyists for the Auto Alliance—comprised of twelve vehicle manufacturers88—voiced their disapproval: “[w]hat we’re opposed to is allowing one of our competitors to go around the dealer network and sell directly to consumers. We think we should all be treated the same.”89 Some manufacturers have employed even more aggressive tactics. General Motors, for example, wrote a letter to Ohio Governor John Kasich about pending pro-Tesla legislation:

This exemption could allow Tesla to continue to sell vehicles directly to customers without utilizing a network of independent franchised dealers, which is prohib-

---

ited for other automakers. As a result, Tesla would gain a distinct competitive advantage by avoiding restrictions that all other manufacturers face. . . . This exemption . . . would essentially allow Tesla to compete under a completely different set of rules. Simply put, General Motors strongly believes there exists no justification for an individual auto manufacturer to receive such unique, favorable protection under Ohio law. . . .

Despite these contrived efforts to block another market entrant, the National Automobile Dealers Association (NADA) characterizes its industry as “robust and highly competitive.” Consistent with this theme, NADA recently launched a public relations campaign to tout the benefits of the exclusive, franchised dealer system “as the best and most efficient way to buy, sell, service, and finance cars in the marketplace.” Ironically, while reaping the economic benefits of state dealer franchise laws, an NADA-commissioned study laments the costs of complying with “61 major federal rules, resulting in higher prices for dealership customers and the loss of an estimated 10,500 dealership jobs.”

Economists and executives of the Federal Trade Commission are not buying the sales pitch offered by the franchised dealer industry. In an open letter to New Jersey Governor Chris Christie, over seventy economists lambasted the notion that state laws mandating vehicle sales exclusively through franchised dealers are warranted:

There is no justification on any rational economic or public policy grounds for such a restraint of commerce. Rather, the upshot of the regulation is to reduce competition in New Jersey’s automobile market for the benefit of auto dealers and to the detriment of its consumers. It is protectionism for auto dealers, pure and simple. . . . In sum, we have not heard a single argument for a direct distribution ban that makes any sense. To the contrary, these arguments simply bolster our belief that the regulations in question are motivated by economic protectionism that favors dealers at the expense of consumers and innovative technologies.

Several officials at the Federal Trade Commission are like-minded, authoring a rare commentary on state dealer franchise laws and suggesting the removal of these “regulatory impediments.” Andrew I. Gavil, director of the Office of Policy Planning; Deborah L. Feinstein, director of the Bureau of Competition; and Martin Gaynor, director of the Bureau of Economics,

---

91. DATA 2014, supra note 1, at 1.
view the dealer franchise law system requiring franchised automobile sales as a “bad policy” because it “protect[s] existing middlemen from new competition.” Like many other commentators, these FTC officials believe that state dealer franchise laws have exceeded their original purpose of “protecting” dealers to becoming “‘protectionist,’ perpetuating one way of selling cars—the independent dealer.”96 Instead, the market and competition should decide which processes and businesses are best:

Regulators should differentiate between regulations that truly protect consumers and those that protect the regulated. We hope lawmakers will recognize efforts by auto dealers and others to bar new sources of competition for what they are—expressions of a lack of confidence in the competitive process that can only make consumers worse off.97

The resistance of dealers, trade associations, and manufacturers alike is an implicit admission that an alternative distribution system could be superior and less costly. Pragmatically, the interests groups opposing Tesla’s direct sales approach otherwise would not fear inroads from the direct sales alternative.

V. Conclusion

The automobile dealer industry defends the state franchise laws it lobbies to protect with a variety of hollow talking points, the epitome of which is that “unlike virtually any other product, if a car is operated incorrectly, people can be hurt or killed.”98 The claimed consequences of product misuse are neither unique to automobiles nor mitigated by franchised vehicle sales. Countless products are equally, if not even more dangerous when misused, but are sold across America outside of an exclusive, franchised dealer regime—including those with four wheels, a gasoline engine, steering wheel, driver’s seat, and an accelerator. The lawnmower, replete with spinning blades, causes over 34,000 emergency room-worthy injuries and nearly 90 deaths each year, according to the Consumer Products Safety Commission.99 Yet, the level of regulation over their sales pales in comparison to the confines of the franchised-dealer-only sales regime legislated, or proposed, in many states.

Participants in the franchise business model already receive the protections of franchise agreements, common law, and perhaps even general franchise relationship statutes in many states. The problem is that many state franchise laws for automobile dealers go above and beyond those principles

96. Id.
97. Id.
to provide a nearly unmatched level of security and protection. Decades after these measures were first enacted, they remain on the books and perpetuate the insulation of an entire industry from new market entrants, technology, and distribution methods. Such laws are explainable only by reference to their historic roots, despite the larger industry’s undeniable advancement since those times. The efficacy of mandating vehicles sales exclusively through licensed dealers is dubious, given that vehicles purchased through alternative channels can still be driven, registered, and resold in the states with the most restrictive legislation.

The state dealer franchise laws at issue, and the legislation in play to strengthen their restrictions, are valuable to the dealers and trade associations, as evidenced by their political activity, legislative lobbying, and public relations campaigns. All of these efforts are aimed at prolonging the status quo and preserving the state mandate that virtually all new cars are sold through franchised dealers. Although Tesla’s success in changing unfavorable laws and resisting enactment of bans on direct sales has been mixed, each legislative cycle in the near term will almost assuredly cause the battle between Tesla and dealers to fester. So long as lawnmowers and chainsaws can be bought outside a legislatively mandated franchise regime, automobile dealers should prepare to compete with, add more value than, and differentiate themselves from the alternatives, whether emerging or available now. Tesla’s direct sales model is just one potential threat of many, but if defensive efforts are concentrated on extending market dominance through legislation, dealers may be caught flat-footed when those measures prove unsuccessful—just as the taxi industry’s longtime reliance on government regulation created massive inroads for alternatives. The legislation of dealer franchises as the exclusive source of new vehicles is nothing more than an anti-competitive mandate powered by lobbying and political pressures, producing results that are the antithesis of the democratic, free market system.

100. Mike Ramsey, Missouri: The New Front Line in Car Dealers’ War on Tesla, WALL ST. J. CORP. INTELLIGENCE, May 12, 2014 (“In most cases, Tesla has been successful in shooting down attempts to change laws that would prevent their operations, and unsuccessful in getting new legislation passed to allow it.”), available at http://blogs.wsj.com/corporate-intelligence/2014/05/12/missouri-the-new-front-line-in-car-dealers-war-on-tesla/.

101. Emily Badger, Taxi Medallions Have Been the Best Investment in America for Years. Now Uber May Be Changing That, WASH. POST, June 20, 2014, (“In exchange for all of this regulation, taxis have for decades held a government-backed monopoly. . . . Uber counters that medallions have created a cartel that operates for its own benefit—and not in the best interests of the public.”), available at http://www.washingtonpost.com/blogs/wonkblog/wp/2014/06/20/taxi-medallions-have-been-the-best-investment-in-america-for-years-now-uber-may-be-changing-that/.
A Canadian Perspective on the Independent Contractor-Employer Issue

Larry Weinberg

Recent developments in the world of franchising have frequently been reported as a threat to the very foundation and stability of franchising as a business model. In the United States, the National Labor Relations Board’s (NLRB) recent joint employer directive regarding McDonald’s has the potential for industry-wide consequences for franchisors across the country. Although U.S. franchisors have enjoyed generally consistent jurisprudence regarding the joint employer definition since the 1960s, recent political changes and judicial commentary may alter the nature of the franchisor-franchisee relationship. Cases like Juarez v. Jani-King of California, Inc.1 and Patterson v. Domino’s Pizza, LLC2 highlight the confusion in American jurisprudence regarding the determination of whether a franchisee, or an employee of a franchisee, is an employee of the franchisor. However, Americans are not alone in feeling the effects of the potentially changing franchise landscape. North of the border, Canadian franchisors and franchisees are dealing with similar issues. For Canadian franchisors, these issues are not only the aftershock effects of changes occurring in the United States, but they also reflect the tension that has long been an issue in the common law regarding the distinction between an employee and an independent contractor. Although these issues are new and fresh for many people engaged today in franchising, they are in fact issues that have always simmered just below the surface and have every once in a while boiled over.

Franchising has been a staple of business growth in Canada for over fifty years. It has generated an increase in consumer spending, job creation, and entrepreneurship opportunities. In Canada, the franchise industry accounts

---

2. 333 P.3d 723 (Cal. 2014).

---

Larry Weinberg (lweinberg@casselsbrock.com) is a partner at Cassels Brock & Blackwell LLP in Toronto. The author would like to thank Roey Fishman, student-at-law at Cassels Brock & Blackwell LLP, for his invaluable assistance in researching and writing this article.
for approximately $100 billion in sales annually, and consumers of goods and services spend one out of every five dollars at a franchise. In addition to the considerable sales figures, the franchising industry provides significant and stable employment opportunities. Retail franchises employ over one million Canadians, and 97 percent of all franchises opened in Canada in the last five years are still in business. In addition to a robust Canadian domestic franchise industry, franchisors based in the United States have successfully pursued Canada as a stable, predictable, and profitable expansion landscape that provides growth opportunities. With many U.S. franchisors already having a significant investment in the Canadian marketplace, it is just as important for them to know the current Canadian attitude to the issue of joint employment and what the future may hold for franchising.

But why is the joint employer determination so important? One of the hallmarks of franchising as a business model is that franchisors seek to ensure that their franchisees are seen and treated as independent contractors rather than as employees. Although franchisors have always had to be concerned with occasional findings of vicarious liability in favor of third parties in such areas as product liability and negligence, a determination of joint employment can expose franchisors to any number of claims alleging that they are always vicariously liable for the actions of their franchisees and the employees of their franchisees. In addition, there are significant potential negative outcomes in characterizing a franchisor as an employer of the franchisee, and in turn, as a joint employer of the franchisee’s employees, including:

- liability for notice under the provincial employment standards legislation, such as Ontario’s Employment Standards Act, 2000 (ESA); 5
- potential action for statutory and common law severance obligations, and in addition, wrongful dismissal claims under ESA;
- ability of employees to claim compensation under applicable workers compensation laws, such as Ontario’s Workplace Safety Insurance Act, 1997; 6
- liability under the federal Income Tax Act 7 for taxes that “employers” did not withhold at source because they did not treat the person as an employee;
- liability for other amounts typically withheld from employee paychecks, such as federal Employment Insurance premiums;
- liability for Canada Pension Plan contributions; and
- inconvenient and expensive audits.

4. Id.
5. S.O. 2000, c. 41. Although this article refers specifically to the laws of Ontario for ease of reference, but other provinces in Canada have similar legislation.
This article addresses how Canadian courts and tribunals have traditionally viewed the franchise relationship. The article then addresses the current trends in Canada among government agencies and even some courts to hold franchisors increasingly more liable for the wrongful acts and omissions of their franchisees, particularly in light of the recent activity in the United States on this issue. Finally, the article looks at the potential impact on both franchisors and franchisees of altering the franchise relationship.

I. Determination of Joint Employer

A. Background

Canadian common law has often struggled with the distinction between a true employee and independent contractor. As in the United States, the relevant body of case law is not insignificant, with several cases discussing the standard for the permissible level of control a franchisor may exert on a franchisee without being deemed an employer. The law in Canada has traditionally required more than simply applying a label to the relationship in determining whether it is a contract for services as opposed to being an employment agreement. Courts consider the totality of the commercial relationship between the parties and assign relatively little value to the name assigned to the governing agreement. The conduct, intention, and expectation of the parties transcend the label assigned.

A consideration of the issue of control needs to take into account that, by definition, a franchise involves a certain level of control by a franchisor over a franchisee. For example, Ontario’s franchise law (Arthur Wishart Act8) defines a feature of a “franchise” to be that “the franchisor or the franchisor’s associate exercises significant control over, or offers significant assistance in, the franchisee’s method of operation, including building design and furnishings, locations, business organization, marketing techniques or training.”9 This example serves to remind us that inherent in the franchise relationship is a degree of control that franchisors exert over franchisees. Canadian decisions have consistently held that the control a typical franchisor exerts over franchisees. Canadian decisions have consistently held that the control a typical franchisor exerts over franchisees is consistent with the franchise relationship and thus does not attract the designation of an employment relationship.10

In analyzing the issue of control, the court reviews the type of relationship that exists between the franchisor and the franchisee and determines whether this relationship is in fact that of an employer-employee or of an independent contractor. This analysis requires an examination of both the contractual terms of the franchise agreement and an observation of the day-to-day control the franchisor exercises over the franchisee’s operations. Moreover,

9. Id. at s.1(1).
determining whether a franchisor is liable as the employer of the franchisee’s employees requires a detailed analysis of the facts in every case. The “fundamental control test” set out by the Ontario Labour Relations Board in York Condominium Corp.\textsuperscript{11} is the most common judicial approach in assessing who the employer is. In applying the test, the Ontario Labour Relations Board held that the following indicia of day-to-day control must be considered in conjunction with the facts of each case to make a determination:

(a) The party exercising the direction and control over the worker performing the work;
(b) The party bearing the burden of remuneration;
(c) The party imposing the discipline;
(d) The party hiring the worker;
(e) The party with the authority to dismiss the worker;
(f) The party who is perceived to be the employer by the worker; and
(g) The existence of an intention to create the relationship of employer and employee.\textsuperscript{12}

B. Review of Case Law

Canadian courts have said that there is no universal test to determine if a person is an employee or independent contractor but have articulated several different analytical approaches. Central to all judicial decisions is the issue of control.\textsuperscript{13}

The Supreme Court of Canada, the highest appellate court in the country, has declared that there is no bright line test to be applied to determine whether an employment relationship or independent contractor relationship exists. Instead, the predominant question is whether the individual who has been engaged to perform services actually performs those services for his own account.\textsuperscript{14} In other words, was the individual carrying on business for himself, or was he carrying on the business of the organization from which he was receiving compensation? Canadian case law has been consistent with respect to the degree of control a franchisor may exert before being deemed a joint employer with the franchisee. Generally speaking, the more control that a company exerts over the individual, the more likely a court will find an employment relationship exists. In this sense, control includes the degree to which the company limits an individual’s autonomy with respect to the operation of his business. The Supreme Court of Canada made the following authoritative statement in 671122 Ontario Ltd. \textit{v} Sagaz Industries Canada Inc.:

The central question is whether the person who has been engaged to perform the services is performing them as a person in business on his own account. In making

\textsuperscript{12} \textit{Id.}
\textsuperscript{14} \textit{Id.} at para. 31.
this determination, the level of control the employer has over the worker’s activities will always be a factor. However, other factors to consider include whether the worker provides his or her own equipment, whether the worker hires his or her own helpers, the degree of financial risk taken by the worker, the degree of responsibility for investment and management held by the worker, and the worker’s opportunity for profit in the performance of his or her tasks.\textsuperscript{15}

Recognizing that the control test may be an oversimplification in determining if one is an independent contractor or an employee, courts will also look beyond simple control, having developed a further four-pronged test to do so. This so-called four-part test considers: (1) whether there is control by the company over the individual, (2) who owns the tools, (3) whether the individual has a chance of profit, and (4) whether the individual has a risk of loss. Courts have acknowledged that control should not be the only factor considered.\textsuperscript{16} Where an individual is the owner of the “tools” of his business, there is strong evidence that he is an independent contractor. Tools, in this sense, include not only hard goods and equipment but also the know-how, administrative functions, and other functions of the business. Chance of profit and risk of loss are connected, in the sense that an individual who has a guaranteed salary, no opportunity to make a profit, and no exposure to risk of loss is more likely to be an employee.

The following Canadian cases are examples of the fact-based approach in assessing control in the context of franchise and other relationships. Some of these cases are quite old now, reinforcing the point that the issue itself is not new.

1. 671122 Ontario Ltd. v Sagaz Industries Canada

\textit{Sagaz}, while not decided in the franchise context, applies to determination of the issue of control in general. In establishing the foundation for joint employment in Canada, the Supreme Court of Canada asserted that “the employer does not have the same control over an independent contractor as over an employee to reduce accidents and intentional wrongs by efficient organization and supervision.”\textsuperscript{17} The court provided a list of other relevant factors that a court could consider in determining whether an employer-employee relationship exists. These include whether the worker provides his or her own equipment, whether the worker hires his or her own helpers, the degree of financial risk taken by the worker, the degree of responsibility for investment and management held by the worker, and the worker’s opportunity for profit in the performance of his or her tasks.\textsuperscript{18} The court stressed that this is a nonexhaustive list, and there is no formula as to their

\begin{itemize}
\item \textsuperscript{15} \textit{Sagaz}, at para. 47.
\item \textsuperscript{16} Canadian Broadcasting Corp. (1982), 44 di 19; Nationair (Nolisair International Inc.) (1987), 70 di 44.
\item \textsuperscript{17} \textit{Id.} at 35.
\item \textsuperscript{18} \textit{Sagaz}, at para. 47.
\end{itemize}
application. Courts have typically referred to these factors after completing the control analysis in order to confirm and strengthen their decisions.

2. Toshi Enterprises Ltd. v Coffee Time Donuts Inc.

In Toshi, the Ontario Divisional Court reversed a decision of the Small Claims Court, in which the franchisor was held vicariously liable for the negligence of its franchisee because they were determined to be in an employment relationship. A fire at a Coffee Time restaurant spread to a neighboring restaurant, Toshi Enterprises, causing significant damage. Consequently, Toshi Enterprises claimed damages against the franchisor, Coffee Time. In finding that Coffee Time was not liable as the franchisee’s employer, the Ontario Divisional Court held that there was insufficient control by the franchisor. The court stated that in any franchise agreement, there are inevitably provisions that give the franchisor some control over the franchisee; “such provisions are regular and expected inclusions in a franchise agreement.”

In finding that the franchisor was not vicariously liable, the court succinctly articulated that the franchise agreement in this case was clear, and the franchisor abided by those terms:

[T]here is no agency relationship between the franchisor and the franchisee; the franchisee is an independent contractor completely separate from the franchisor; the franchisee hires and fires its own employees; handles its own finances; maintains its own accounting and business records, financial statements and tax returns; maintains its own insurance on the premises and the property; exercises its own business judgment in the operation of the business; and is the owner of assets.

As noted at the outset, franchisors have always had to be concerned with findings of vicarious liability. The Toshi case does not stand for the proposition that if there is no employment relationship between a franchisor and a franchisee, the franchisor will never be liable for the acts of a franchisee. “Rather, outside of the context of employment law, a franchisor may be liable to third parties for the acts of a franchisee if a third-party believed it was dealing with a franchisor.”

3. Youngblut v Jim & Jaklen Holdings Ltd

In Youngblut, the Saskatchewan Court of Queen’s Bench held that a franchisor was liable to the employees who had worked for the franchisee for pay

19. Id. at para. 48.
22. Id. at para. 15.
23. Id. at para. 16.
24. Nadine Cote, Canada: Franchisor or Franchisee: Who Is the Employer?, MONDAQ (Nov. 14, 2011), http://www.mondaq.com/canada/x/153358/Franchising/Franchisor+or+Franchisee+Who+is+the+Employer (last visited Dec. 7, 2014); For example, see Fraser v U-Need-A-Cab Ltd. (1985), 50 O.R. (2d) 281 (C.A.). In this case, a franchisor taxi company was held liable for the conduct of its franchisee, an independent driver, since the passenger called the taxi company for the car service not knowing that the driver was independent of that company.
25. 2002 SKQB 463.
in lieu of notice of termination under Saskatchewan’s Labour Standards Act. The case involved a franchisee of a financially failing Tomas Cook restaurant who notified the franchisor (Mr. Tomas) that it intended to shut down the restaurant. The franchisor sought to keep the restaurant open and find a new franchisee. The parties agreed that the franchisor would assume all management responsibilities over the restaurant and all future liabilities associated with finding a new franchisee. Despite the franchisor’s efforts, the restaurant failed before a new franchisee was found. In turn, the employees were terminated without the notice or pay in lieu of notice required under the Labour Standards Act.

The court recognized that franchise arrangements generally involve a certain degree of control by the franchisor over the franchisee, stating that “by their nature, franchise arrangements entail some degree of control by the franchisor, even though the franchisee is generally an independent business person operating the franchise.” Further, the court commented on the high level of involvement of the franchisor in this case, even before the franchisor assumed the management of the restaurant:

Thus, although the terms of the franchise agreement itself in this case reveal a high level of involvement and control by the franchisor Mr. Tomas, including franchisor approved management; display of promotional material in the restaurant approved by franchisor; frequent unannounced inspection by franchisor; compliance with standards, and provision of written monthly statements of account, these factors do not make Mr. Tomas anything but a franchisor with an interest in the business. Indeed, clause 23 of the agreement states clearly that “neither the Franchisee nor any person performing any duties or engaged in any work on the premises at the request of the Franchisee shall be deemed an employee or agent of the Franchisor.”

However, the court made note of how the relationship changed once the franchisor assumed the daily operations of the restaurant and stated: “The correct application of the law to the facts as found by the adjudicator in this case would suggest that Mr. Tomas’ increased management control changed his status from being merely an interested franchisor to also being that of employer after September 24, 2001.” Accordingly, the franchisor and the franchisee were held to be co-employers as soon as the franchisor assumed control over management and they were jointly and severally liable for the pay in lieu of notice of termination owing to the employees.

4. Mac’s Milk Ltd. v Workmen’s Compensation Board of Ontario

In Mac’s Milk, a now ancient 1977 decision, the Ontario Divisional Court upheld the ruling of the Workmen’s Compensation Board, which found that Mac’s Milk convenience store operators were employees of the franchisor,

---

26. Id. at 15.
27. Id. at 21.
28. Id. at 22.
Mac’s Milk Ltd. In this case, an agreement was signed between the franchisor and the franchisee, which stated that any operator of a Mac’s Milk location was an independent contractor. The agreement went further in explaining the role of the operator, noting that the operator was not obligated to provide any personal services for the company. The board held that, despite these contractual provisions, the relationship was effectively an employer-employee relationship. The board cited numerous other terms of the agreement which were found to be so restrictive and controlling over the operators that the operators ought to be considered employees of the franchisor. Some of the terms that the board found indicative of an employer-employee relationship included requirements of the operators to deposit daily earnings from sales, keep records of sales, permit company representatives to inspect the premises as well as review the accounts and merchandise of the location, and actively participate in Mac’s Milk advertising campaigns. The mere inclusion of a clause purporting to define the relationship that exists between a franchisor and a franchisee is only a part of the court’s analysis.

5. Head v Inter Tan Canada Ltd

Similar to Mac’s Milk, Head further highlights the Canadian courts’ willingness to look beyond the terms of an agreement in determining whether a franchisee is an employee or independent contractor. In the 1992 Head decision, the plaintiff Head had a joint venture agreement with Inter Tan Canada, operating as RadioShack, to operate one of the stores. When the defendant terminated the relationship, Head brought an action against the defendant claiming to be an employee of the business instead of a franchisee. The franchisee argued that it should be treated as an employee of RadioShack rather than as an independent contractor because it claimed eligibility for severance and other benefits under the Employment Standards Act. The court reviewed the various degrees of control that the franchisor had over the franchisee. In its analysis, the court most notably found the following:

- Head was subject to the extensive store operating manual;
- Head was “force-fed” as to how to stock the store from the corporate warehouse;
- RadioShack retained ownership of the place of business and the merchandise;
- The joint venture agreement prohibited Head from engaging in any other business without the consent of RadioShack;

30. Id. at para. 10.
31. Id. at para. 11.
32. Id. at para. 23.
33. Id. at para. 13.
35. R.S.O. 1980, c. 137.
• RadioShack conducted regular and irregular store visits; and
• Under the joint venture agreement, RadioShack had the same ability to terminate Head as if he were a company store manager.\textsuperscript{36}

In weighing the totality of the work arrangement, the court held that Head was acting as an employee under the \textit{Employment Standards Act}. “On the scale of franchise relationships generally, Head had very little influence as a franchisee. He certainly was much more like a company store manager who was on a somewhat different profit-sharing arrangement.”\textsuperscript{37}

6. \textit{Maycock v Canadian Tire Corp.}\textsuperscript{38}

In \textit{Maycock}, a 2004 decision of the British Columbia Human Rights Tribunal, a disabled man sued franchisor Canadian Tire Corp. (CTC) after being refused entry to a franchise location with his service dog. CTC claimed that its franchisees were not employees of CTC. Similar to the franchisor in \textit{Mac’s Milk}, CTC submitted that the franchise agreement stated that franchisees were independent contractors, and similarly the tribunal in \textit{Maycock} expanded its analysis beyond these contractual terms.\textsuperscript{39} The tribunal noted that the CTC had certain control over its franchisee to protect the Canadian Tire trademark, trade names, and private branded products.\textsuperscript{40} CTC, however, did not exercise direction or control over the franchisee on a day-to-day basis.\textsuperscript{41} Following the decision in \textit{Youngblut}, the tribunal confirmed that some franchisor control is inherent in a franchisor-franchisee relationship. In such circumstances, where there is no evidence of day-to-day control by the franchisor, a franchisee will not be held to be an employee of the franchisor.\textsuperscript{42}

The decision in \textit{Maycock} highlights that the mere presence of control by a franchisor over a franchisee does not, on its own, satisfy the level of control necessary to attract vicarious liability or the determination of joint employment. Courts take a fact-based approach in determining if the control exerted by a franchisor over a franchisee is above and beyond the norm regardless of the terms of the franchise agreement.

II. Current Changes

The cases discussed earlier and the general principles enunciated by the Supreme Court of Canada allowed for a general sense of predictability. Franchisors could generally understand that, in terms of control, there is a line over which they should not cross. For decades, case law supported franchisors’ exertion of a considerable level of control while escaping liability. More

\begin{itemize}
  \item \textsuperscript{36} \textit{Head, supra} note 34, at 215.
  \item \textsuperscript{37} \textit{Id.} at 216.
  \item \textsuperscript{38} 2004 BCHRT 33.
  \item \textsuperscript{39} \textit{Id.} at para. 47.
  \item \textsuperscript{40} \textit{Id.} at para. 54.
  \item \textsuperscript{41} \textit{Id.} at para. 53.
  \item \textsuperscript{42} \textit{Id.} at para. 46.
\end{itemize}
recently, however, courts, administrative tribunals, and government agencies are increasingly sensitive to the perceived vulnerability of employees and franchisees due to the unequal bargaining power between these parties and franchisors. In certain instances, whether intentionally or unwittingly, some franchisors have crossed the line.

A. Recent Determination by National Labor Relations Board

The general counsel of the U.S. National Labor Relations Board (NLRB) announced on July 29, 2014, that McDonald’s USA, LLC, the corporate franchisor, may be held liable as a joint employer of its franchisees’ employees in several pending complaints. In making this determination, the NLRB has reduced the control threshold in finding joint employment from “direct and immediate” control over the employees to significant control considered in the totality of the circumstances. In addition, in the recent NLRB case of Browning-Ferris Industries of California, Inc. v. Sanitary Truck Drivers and Helpers Local 350, the NLRB is currently considering on appeal whether Browning-Ferris Industries (BFI), its subcontractor Leadpoint, or both, employed certain workers at BFI’s facility. In making his recommendations to the NLRB, the general counsel urged the Board to modify its joint employer standard “to take into account the economic and industrial realities of employment relationships.” The general counsel argued that the Board’s current standard for determining joint-employer status is significantly narrower than the traditional standard and ignores Congress’s intent that the term “employer” be construed broadly. He further urged the Board to adopt a new standard that accounts for the totality of the circumstances, including how putative joint employers structure their commercial dealings.

The proposed joint-employer standard would find joint employer status whenever, “under the totality of the circumstances, including the way the separate entities have structured their commercial relationship, the putative joint employer wields sufficient influence over the working conditions of the other entity’s employees such that meaningful bargaining could not occur in its absence.” The potential NLRB decisions would erode the traditional distance and protection enjoyed by franchisors, altering the business model and exposing franchisors to a new degree of liability.

43. Cote, supra note 24.
46. Id. at 24.
47. Id. at 2.
B. Canadian Jurisprudence

Canadian courts, employment standards adjudicators, and human rights tribunals may not be far behind the United States on this issue. In *Lindsey v McDonald’s Restaurants of Canada Ltd.*, the Human Rights Tribunal of Ontario (HRTO) denied McDonald’s preliminary request that it be removed as a respondent to an application alleging discrimination by a former employee. Melanie Lindsey brought an application against McDonald’s Restaurants of Canada Ltd., the Canadian franchisor, and Manna Foods Inc., the franchisee, alleging that her former employer’s policy requiring part-time employees to be available for midnight shifts had an adverse effect on her due to her child care obligations. Lindsey argued that this constituted discrimination and a breach of the Human Rights Code as it was a failure to accommodate her family and marital status. McDonald’s sought an order from the HRTO to dismiss the application against it on the basis that Lindsey was an employee of Manna and that McDonald’s was simply a franchisor providing operational support to Manna.

HRTO did not accept McDonald’s argument that a lack of participation or control in the day-to-day operations of the franchisee constituted a basis for dismissal. Rather, the tribunal followed an existing approach of declining to dismiss applications against franchisors at a preliminary stage and held that the question of McDonald’s liability should be determined following evidence and argument at the hearing. HRTO has not issued a final determination addressing the merits of the complaint.

Another recent example of a possible policy change is the decision of the Manitoba Appeal Commission in the case known as *Cleaners*. The case involved a franchisor who sold janitorial cleaning licenses to franchisees. Under the franchise agreement, franchisees were responsible for registering with the workers’ compensation board and paying the required premiums. Following an audit by the workers’ compensation board, the Assessment Committee determined that franchisees with earnings below a minimum threshold were deemed to be workers of the franchisor such that the franchisor was required to remit the workers’ compensation premiums for them, notwithstanding the terms of the parties’ agreement.

On appeal, the Commission confirmed the holding, and consequently, the franchisor was required to remit workers’ compensation premiums on behalf of those franchisees. However, workers’ compensation premiums are generally calculated based on an employer’s payroll, and because they were not employees, these franchisees were not on the franchisor’s payroll. As a result, the Assessment Committee arbitrarily deemed the franchisees’ payroll to be a percentage of the net amount remitted by the franchisor to the franchisee. In addition, the Commission barred the franchisor from recovering these

---

premiums from its franchisees because such acts are prohibited under the Workers Compensation Act.\textsuperscript{50}

The Commission focused on whether the relationship was more akin to that of an employer-employee relationship, such that the franchisees were properly deemed to be workers for the purposes of assessment under the Workers Compensation Act. The Commission based its decision on factors not traditionally considered in determining which entity is the employer. For example, it placed little or no weight on the fact that the franchisees had significant autonomy, including responsibility for supervising their workers, responsibility for the scheduling and delivery of cleaning services, and the ability to accept the work that they wanted.\textsuperscript{51}

The Appeal Commission instead focused on various business controls the franchisor exerted over the franchisee—all of which are not that common in franchise arrangements but usually not determinative of whether an employment relationship exists. For example, the Commission considered that the janitorial contracts were between the franchisor and the end-user clients and that the franchisor handled the administration of the funds, such as sending invoices to clients, collecting the payments, and remitting the amounts owed to the franchisee pursuant to the franchise agreements. Moreover, it also contemplated how the franchise agreement provided the franchisor various other controls over a franchisee, such as the obligation to wear uniforms and the ban on use of equipment or supplies that are not preapproved by the franchisor. Historically, and as in \textit{York Condo}, these factors would not amount to control over employment matters.

The Commission also concluded that the franchisees were not truly in business for themselves. This conclusion, however, fails to recognize the business realities surrounding the operations of the business. Specifically, the Commission discounted the financial risk associated with operating the business and the risk of loss and opportunity for profit, which depended on how efficiently the franchisees ran their franchises.

Thus, the decision in \textit{Cleaners} adds confusion to the factors that ought to be considered when determining which entity is the employer. It is one of the recent judicial departures from the norm and the emerging trend towards the finding of employment in franchise relationships.

C. Government Agencies

The recent changes in Canada are not just part of a judicial overhaul. Government agencies are blurring the line between franchisor and franchisee for a variety of reasons, including reducing their own costs of administering programs. For example, in 2002, the Province of Ontario enacted legislation to introduce Blue Box recycling programs to be developed and administered by a stand-alone quasi-governmental body called Stewardship Ontario. The


\textsuperscript{51} \textit{Cleaners}, supra note 49.
The purpose of the program is to compensate the province for the cost of running recycling programs by requiring businesses that provide recyclable materials to consumers (food containers, pizza boxes, etc.) to pay for the handling of this recyclable waste. The legislation requires companies that meet certain conditions to file a steward’s report with Stewardship Ontario and pay a fee for the tonnage of waste they generate. The law deems franchisors to be the obligated steward for all of their Ontario franchisees. The province of Ontario is thereby actively blurring the distinction between franchisor and employer by not treating franchisees as independent business people responsible for their own costs. There is no justification for this approach, except that it is easier for the government to collect from fewer, large franchisors with deeper pockets, and presumably, franchisors can pass the cost to their franchisees. This administrative policy has invaded the franchise relationship in a way once thought unimaginable—in effect, requiring that one person be responsible for the tax imposed on another. Since then, other provinces have introduced similar programs.

Even more disturbing, Ontario has recently considered the introduction of restaurant menu labeling laws, mandating the display of certain caloric and other nutrition information regarding the food served. Although the value of these initiatives in combatting obesity can be debated, the relevant and more insidious feature of the bill last introduced into the Ontario legislature is that franchisors would be liable for significant monetary penalties if franchisees failed to abide by the signage and labeling requirements. It is expected that industry associations such as the Canadian Franchise Association will take proactive steps to keep this vicarious liability provision out of any final law. 52

III. What the Future Holds

Canadian cases decided twenty or more years ago appeared to make clear a predictable distinction between an employee and independent contractor, both generally and in the context of the franchise relationship. However, the issue has come to the forefront again as courts, administrative tribunals, and government agencies seek to blur the distinction. And although Canadians are not yet predicting the demise of the franchise business model, Canadian franchisors and franchisees will be monitoring the U.S. situation, as this fundamental characteristic of franchise relations comes under assault. The changing landscape of the franchise industry in the United States could have significant implications for the industry in Canada. Although the McDonald’s case is yet to be decided, it is quite evident that the industry, and more importantly those who adjudicate and dictate policy, are following a trend of finding franchisors that exert significant control over franchisees

52. Health Statute Law Amendment Act (Healthy Decisions Made Easy), Bill 149 (2014).
responsible for those franchisees under theories that explicitly or implicitly treat the franchisor as an employer.

So, similar to franchisors in the United States, franchisors in Canada should examine carefully every aspect of their involvement in their franchisees’ business. They should be proactive and consider the way they conduct business and provide oversight and support. Franchisors will always seek to maintain their brand equity through the control of certain business policies and procedures and must be permitted to do so. But franchisors must be far more wary of crossing that line of control and involvement that could expose them to tremendous liability as an employer of the franchisee and its direct employees.

A. Significance of Employer Status

There will be significant changes in the franchise relationship in the event that the threshold of control for finding joint employment continues to lower. Franchisors may act in a variety of ways if adjudicators and policymakers blur the line between the franchise relationship and employment relationship. These changes could result in significant and potentially detrimental effects on the franchise model, and likely, the economy as a whole.

On one hand, if franchisors—in response to the increased potential liability as a joint employer—begin to exert greater control over franchisees, franchisees lose the entrepreneurial spirit and benefit of small business ownership. Moreover, insurance premiums and fees may increase to offset the additional liability, which will increase the cost of a franchise for a potential franchisee.

On the other hand, franchisors may reduce the amount of support for franchisees in an attempt to eliminate the appearance of control. In such a case, one of the key benefits for acquiring a franchise is lost. Franchisees acquire franchises to operate their own businesses; however, franchisees purchase an existing brand with the expectation that they will receive sufficient training, guidance, and direction from the franchisor to increase their chances of success. Franchisees expect such help, and the intertwined success of the franchisee and franchisor has enabled the industry to flourish. It is in both parties’ best interest for the franchisor to keep intellectual property, trademarks, and operations under strict control. The franchisor is, in effect, promising the franchisee that it will maintain the franchise’s brand quality, which means that the franchisor must ensure that no franchisee does anything to tarnish the brand.

A third unfortunate consequence of treating franchisors as the employers of both their franchisees and their franchisees’ employees is that some systems may simply opt to forego franchising entirely.

B. What About the Franchisees?

It is not certain that franchisees would or should support this emerging trend. Many are happy to maintain their independence and have less control
exerted over their business operations. Franchising is by nature an entrepreneurial undertaking, so some franchisees would not want to be considered employees because it would destroy the features that made franchising an attractive business opportunity. On the other hand, some franchisees may want the benefits and protections provided to them as employees and may welcome the additional controls and franchisor involvement.

IV. How to Proceed

Franchisors must work to find the so-called middle ground of control without exposing themselves to liability while still protecting their brands. Franchisors must refrain from exerting excessive control or micromanaging their franchisees’ businesses. It is paramount for franchisors to maintain some distance from franchisees’ day-to-day operations, management, and employment and financial decisions. As discussed, there are important reasons why a franchisor may find it necessary to exercise control over its franchisees, such as the need to protect the brand and maximize franchise value. To minimize the possibility that a franchisor may attract liability as an employer of their franchisees, a franchisor should do at least two things: (1) revisit franchise agreements and (2) exercise control cautiously and strategically.

A. Revisit Franchise Agreements

Franchisors must, of course, abide by the terms of their existing agreements. However, a franchisor should consider how its business objectives can be achieved in a way that reduces the amount of control in their relationship with franchisees and consider if changes are warranted on a going-forward basis. There are many strategic, operational, financial, and other issues to consider—often depending on the nature of the franchised business. For example, does the franchisor need to collect payment from a customer of the franchisee? That is an unusual provision, but if it exists in the particular franchise model, it could have an impact on a finding that a franchisee is an independent contractor. Moreover, franchisors should include such standard clauses in franchise agreements that unequivocally state that by signing, the franchisee agrees to become an independent contractor and is in no way an agent or employee of the franchisor. Although the courts have been consistent in looking beyond these clauses, they can often be a factor in the decision, especially if they are missing.53

B. Exercise Control Cautiously and Strategically

If a franchisor deems it necessary to control certain functions of the franchisee, the right to do so should be clear and apply only to those functions.

53. Maycock, supra note 38, at para. 47.
Franchisors should avoid retaining the right to enforce standards in the agreement that the franchisor has no real intention of enforcing.

The risk of franchisor liability cannot be eliminated. However, in Canada, a consideration of the well-accepted features of the common law tests and structuring business models accordingly can reduce the potential of being found to be an employer or joint employer. Regardless of how courts may have treated franchising as a business model in the past, past precedent may not be able to halt this new trend of government agencies to treat franchisors as responsible for the acts and omissions of their franchisees. Changing that course will require a coordinated effort on the part of franchisors, franchisees, and relevant trade associations to educate the government and the public on the importance of the independent contractor known as the franchisee.
Statutory Constraints on Substantial Change to Dealers’ Competitive Circumstances Creates Substantial Compliance Confusion

James J. Long

Any attorney or businessperson with experience in franchising or motor vehicle dealerships understands that a number of states have laws that restrict, for example, a franchisor’s or car manufacturer’s ability to terminate, cancel, or fail to renew an agreement with a franchisee or car dealer. These laws often have the common elements of requiring “good cause” to take these actions and certain notice and opportunity to cure obligations. Although the specific requirements may vary slightly from state to state, the actions they constrain, i.e., termination, cancellation, and nonrenewal, are all easily understood and identified. A “termination” or “nonrenewal” generally will have the same meaning in Minnesota as in Texas.

At least thirty-one states, however, also statutorily constrain a manufacturer’s ability to “substantially change the competitive circumstances” of the dealership. At the end of this article is a substantial, although not exhaustive, appendix listing the statutes that contain this restriction. These statutes range in scope from generalized dealer acts such as the Wisconsin Fair Dealership Act (WFDL) to special industry dealer statutes such as agricultural equipment dealer acts and heavy and utility equipment dealer acts and contain substantial variation state to state in statutory language, scope, and meaning. Unlike terminations or nonrenewals, there is no readily recognized definition of “substantial change to competitive circumstances,” and unlike a “termination,” attorneys and business people do not necessarily know a “substantial change of competitive circumstances” when they see it. Moreover, the vast majority of these statutes do not define “substantial change of competitive circumstances” and often there is a dearth of case law interpreting
those statutes. There also are variations in the statutes’ specific language, all of which can mean that a “substantial change in competitive circumstances” under a Minnesota statute may not be one under a Texas statute, and vice versa.

The idea behind restricting substantial changes without good cause to a dealer’s competitive circumstances is a good one. These statutes can protect dealers from losing the benefits and value of the business for which they contracted through manufacturers’ actions taken without good cause. The lack of clarity in the language of the statutory prohibitions, however, presents real and substantial challenges for attorneys and businesspeople attempting to comply. It is important for manufacturers to be able to understand what their statutory obligations are concerning terminations or nonrenewals. There is little certainty, however, in what the laws require with respect to actions that “substantially change the competitive circumstances” of a dealership. Not only must a manufacturer determine what that phrase means under a specific state’s statute, but often there is also little or no guidance on its meaning. Thus decision makers are left in a quandary as to how to comply with the law, and whether they need statutorily defined “good cause” to take a certain action. Exacerbating the problem is the fact that a number of these statutes also impose a notice requirement. Before taking an action that will “substantially change the competitive circumstances,” the manufacturer first must give the dealer sixty or ninety days’ notice. As a result, a manufacturer must decide whether to give notice, without any clear guidance on whether the action triggers the notice requirement.

Very little has been written on this issue, even though every year additional dealer statutes of either industry specific or general scope containing this requirement are introduced in state legislatures across the country. This article attempts to address the issues created by statutes that restrict a manufacturer’s ability to “substantially change the competitive circumstances” of its dealerships and identify the situations in which those issues arise.

I. Statutory Language

This analysis begins with the specific statutory language. The most common wording found in these statutes is that a supplier or manufacturer may not “substantially change the competitive circumstances of the Dealer Agreement without cause.” At least thirty-three statutes listed in this article

1. In most instances the definition of “good cause” is the same as that required for “terminations” or “nonrenewals” under the Acts. An exception exists under the North Dakota Farm Equipment Dealership Practices Act which does not use the term “good cause” but rather provides that a manufacturer “may not . . . substantially change the competitive circumstances of the dealership contract for any reason other than failure of the farm equipment dealer to comply with the terms of the written contract . . .” N.D. CENT. CODE § 51-07-01.2.
contain this\textsuperscript{2} or very similar language.\textsuperscript{3} Significantly, in most instances the statute restricts substantial change not of the dealership in isolation, but the competitive circumstances of the \textit{dealership agreement}.\textsuperscript{4} This should make the terms of the dealership agreement itself crucial to determining what the competitive circumstances are.

Several statutes, however, do not utilize language that is this restrictive. In the following states’ statutes, the “dealer agreement” is not mentioned: (1) in Alabama, the prohibition is for a supplier to “substantially alter that dealer’s competitive circumstances without good cause”;\textsuperscript{5} (2) in Iowa, “a supplier shall terminate . . . by . . . a substantial change in competitive circumstances only with good cause and notice;\textsuperscript{6} (3) in Washington, a supplier may not “substantially change the dealer’s competitive circumstances” without good cause;\textsuperscript{7} and (4) in Idaho, a supplier must have good cause to make a “substantial change in competitive circumstances in the relationship with the distributor.”\textsuperscript{8} It is less likely that courts will address the limits on the relationship created by the express terms of the dealer agreements in these four states when determining if those competitive circumstances have been changed.

In several statutes, the prohibition that the manufacturer may not “substantially change the competitive circumstances of the dealer agreement” is limited to specified reasons causing the substantial change. The Arkansas Farm Equipment Retailer Franchise Protection Act, for example, precludes such changes when “based on the result of a natural disaster, including a

\textsuperscript{2} ARIZ. REV. STAT. ANN. § 44-6702(A)(3); ARK. CODE ANN. § 4-72-310(b)(4); CAL. BUS & PROF. CODE § 22902; COLO. REV. STAT. § 35-38-103; IDAHO CODE ANN. § 28-24-103; KAN. STAT. ANN. § 16-1203; KY. REV. STAT. ANN. § 365.831; LA. REV. STAT. ANN. § 51:482; MD. CODE ANN., COM. LAW §§ 19-103, 301; MICH. COMP. LAWS § 445.1457a; MINN. STAT. §§ 325E.0681, 325E.062; MISS. CODE ANN. § 75-77-2; MO. REV. STAT. § 407.840; MONT. CODE ANN. §§ 30-11-802, 30-11-902; NEV. REV. STAT. § 597.1143; N.C. GEN. STAT. § 66-182; N.D. CENT. CODE §§ 51-07-01.2; OKLA. STAT. tit. 15, § 245A.3, 245(22); OR. REV. STAT. § 646A.312; S.D. CODIFIED LAWS § 32-6B-45; TENN. CODE ANN. §§ 47-25-1302, 1903; TEX. BUS. & COM. CODE ANN. §§ 57.002(21), 153.202; VA. CODE ANN. § 59.1-352.3; WASH. REV. CODE § 19.98.120; WIS. STAT. § 135.03; WYO. STAT. ANN. §§ 40-20-116, 40-20-117.

3. There is some slight variation in language in the following state statutes: (1) In California, the prohibition is to “materially change the competitive circumstances of a dealer contract.” CAL. BUS & PROF. CODE § 22902 (emphasis added); (2) In Nevada, it is a violation to “substantially change \textit{the terms} of a dealer agreement. . . .” NEV. REV. STAT. § 597.1143 (emphasis added); (3) In Ohio, it is a violation to “substantially \textit{alter} the competitive circumstances of a dealer agreement.” OHIO REV. CODE ANN. § 1353.06 (emphasis added); (4) In Michigan, it is a violation to “substantially change the competitive circumstances of an \textit{agreement} without good cause.” MICH. COMP. LAWS § 445.1457a (emphasis added); and (5) In Nebraska, it is a violation to substantially change “the competitive circumstances \textit{intended} by the dealer agreement.” NEB. REV. STAT. § 87-704 (emphasis added).

4. See \textit{supra} note 2.


6. IOWA CODE § 322F.2.

7. WASH. REV. CODE § 19.98.120(4).

8. IDAHO CODE ANN. § 23-1328A. Interestingly, a different Idaho statute that regulates Suppliers and Dealers of Farm Equipment contains the standard language of “substantially change the competitive circumstances of the dealer agreement.” \textit{Id.} § 28-24-103.
sustained drought in the dealership market area, labor dispute, or other circumstances beyond the dealer’s control.” This language has been narrowly interpreted. In *Southern Implement Co., Inc. v. Deere & Co.*, a dealer alleged that John Deere violated the statute by substantially changing the competitive circumstances of its dealership agreement when Deere allowed another dealer to sell within the plaintiff’s territory. The Eighth Circuit affirmed summary judgment on the statutory claim, writing that the statute “requires a ‘natural disaster’ to trigger the law’s prohibition” and holding that “we do not believe that Deere’s relationship with [the second dealer] qualifies as a natural disaster for the purposes of the law.” Likewise, the Nebraska Equipment Act precludes “substantially changing the competitive circumstances intended by the dealer agreement due to the results of conditions beyond the dealer’s control, including drought, flood, labor disputes, or economic recession.” Neither statute has a good cause exception.

II. What Constitutes a “Substantial Change” in Competitive Circumstances?

Only two states actually statutorily define “substantial change in competitive circumstance.” The Washington Farm Implements, Machinery, and Parts Act defines a “change in competitive circumstances” as one that “materially impact[s] a specific dealer’s ability to compete with similarly situated dealers selling the same brand of equipment.” The definition in the Oregon Repurchase of Farm Implements Act is similar but with one possibly material difference: “change in competitive circumstances’ means a material
detrimental effect on a retailer’s ability to compete with another retailer who sells the same brand of farm implements.” Oregon requires material detriment to trigger the statute, whereas Washington has an arguably more liberal standard, requiring only material impact. Interestingly, neither statute defines “substantially,” but both statutes regulate only actions that “substantially change” competitive circumstances. Both statutory definitions do, however, make clear that the focus is on how the action affects competition with other dealers of the same brand. One question these two statutory definitions raise is whether the statutory restriction applies at all if a dealer has an exclusive territory and thus does not face any intra-brand competition.

While the Oregon and Washington statutes at least make clear that the focus is intra-brand competition and provide some type of standard for how substantial the change in competitive circumstance must be (material effect or material detriment), statutes in twenty-nine other states provide no such guidance. Thus, two basic questions are necessary to determine what a “substantial change in competitive circumstances” means. First, how significant must the change be to constitute “substantial change”? Second, what exactly is meant by the competitive circumstances of the dealer agreement? Case law addresses one or both of these questions in only a few jurisdictions. In most instances, however, attorneys are left to argue statutory interpretation or apply case law from other state courts addressing same or similar statutory language. This can result in great uncertainty as to whether an action falls within the statute’s scope.

III. How Substantial Must the Change Be?

There is a logical basis for requiring a very significant impact for an action to constitute substantial change in competitive circumstances based upon the other actions also prohibited in many of these statutes. In the vast majority of those statutes, the prohibition is to “terminate, cancel, fail to renew, or substantially change the competitive circumstances . . .” Defining “substantial change” in a way that equates that term to the three preceding ones (terminate, cancel, or fail to renew) makes some sense. In fact, four state laws define “terminate” to include materially or substantially “chang[ing] the competitive circumstances of a dealer contract.” Another statute, the Iowa Equipment Dealership Act, explicitly ties substantial change to termination by stating “a Supplier shall terminate a dealership agreement by . . . a substantial change in the competitive circumstances only upon good

14. OR. REV. STAT. § 646A.300(2).
cause.”¹⁶ This type of statutory language suggests that “substantial change in competitive circumstances” is meant to equate to termination or cancellation. Most case law interpreting other statutes that do not explicitly tie substantial change to termination, however, reject this restrictive definition.

In the first of several Seventh Circuit opinions interpreting the WFDL, Remus v. Amoco Oil Co.,¹⁷ Judge Posner addressed how significant the substantial change had to be to trigger protection of the Act, writing that “[t]he provision about not ‘substantially chang[ing] the competitive circumstances of the dealership’ may be intended simply to protect the dealer against ‘constructive termination,’ that is, against the franchisor’s making the dealer’s competitive circumstances so desperate that the dealer ‘voluntarily’ gives up the franchise.”¹十八 Judge Posner went on to posit that the “statute may go somewhat further than we have suggested and protect dealers against new competition that has substantially adverse although not lethal effects.”¹⁹ The court in Remus did not resolve this issue, because the plaintiff could not meet either standard.

What has evolved through a number of federal court decisions interpreting the WFDL is a dichotomy of two standards, depending upon the type of action claimed to constitute the “substantial change.” Federal courts have articulated a concern about inhibiting a manufacturer’s business judgment as it applies to all dealers in general. The Seventh Circuit has held that “even though a new policy may hurt the profitability of some dealers, the prohibition of substantial changes in competitive circumstances was not meant to prohibit nondiscriminatory system-wide changes.”²⁰ Therefore, federal courts interpreting the WFDL allow a case based upon a nondiscriminatory action to proceed only if it is “the equivalent of constructive termination.”²¹ It appears, however, that Wisconsin federal courts apply a “substantially adverse” standard for the level of harm required for discriminatory actions.²² This dual standard of substantiality, based upon the nature of the conduct at issue, does not exist in other jurisdictions.

The Minnesota Court of Appeals held in Astleford Equipment Co. v. Navistar International Transportation Corp.²³ that a de facto termination was required to satisfy this element of substantial change in the Minnesota

---

¹⁶. Iowa Code § 322F.2.
¹⁷. 794 F.2d 1238 (7th Cir. 1986).
¹⁸. Id. at 1240.
¹⁹. Id. at 1241.
²¹. Conrad's Sentry, Inc. v. Supervalu, Inc., 357 F. Supp. 2d 1086, 1100 (W.D. Wis. 2005) (“I conclude that Wisconsin law would allow plaintiffs to proceed with claims that they were subjected to changes in their competitive circumstances that were discriminatory or that were intended as constructive termination. They may not go forward with their claim that they suffered adverse consequences that were neither discriminatory nor the equivalent of constructive termination.”).
²². Id.; Remus, 794 F.2d at 1241 (“The statute may . . . protect dealers against new competition that has substantially adverse although not lethal effects.”).
²³. 611 N.W.2d 33 (Minn. Ct. App. 2000).
Heavy and Utility Equipment Dealers Act (HUEMDA). The Minnesota Supreme Court, however, expressly rejected the de facto termination standard on appeal. 24 The plaintiff claimed that Navistar violated HUEMDA by approving a competing dealership close to the plaintiff. After the trial court found for the manufacturer defendant, the court of appeals affirmed, holding “that the phrase ‘substantially change the competitive circumstances’ means ‘conduct amounting to a de facto or constructive termination of a dealership agreement.’” 25 The supreme court reversed, predominantly based upon applying the rule of statutory construction that “‘no word, phrase, or sentence should be deemed superfluous, void or insignificant.’” 26 The court concluded that to interpret “substantial change” to mean a de facto termination would render that phrase meaningless, since the statute also restricts “termination.” 27 The court ruled that “[a] plain reading of the word ‘terminate’ would include de facto termination. . . . In order to give the phrase substantially change the competitive circumstances of the dealership agreement any meaning, that phrase must be construed to mean something other than de facto termination.” 28

The Minnesota Supreme Court instructed that “a court should engage in a case-by-case factual inquiry in reaching its ultimate conclusion of whether there has been a substantial change in the competitive circumstances.” 29 The court reviewed the purpose and intent of the statute, emphasizing that “the statute cannot be read to protect a dealer from nearly all new competition that threatens a dealer’s profits.” 30 It established a standard

that a substantial change in competitive circumstances is a change that has a substantially adverse although not necessarily lethal effect on the dealership. It is a change that is material to the continued existence of the dealership, one that significantly diminishes its viability, its ability to maintain a reasonable profit over the long term or to stay in business. 31

This is an unspecific and multifaceted standard that leaves much room for argument based upon facts specific to the case and does not allow an attorney to provide a firm opinion on an initial counseling call as to whether the proposed action constitutes a “substantial change.”

Other than in Minnesota and Wisconsin, very few courts have addressed the required level or impact of the change. The decision of the Supreme Court of Montana in Van Riper v. Ford New Holland, Inc. 32 lists acts that violate the Montana statute that prohibits substantially changing a dealership’s

24. 632 N.W.2d 182 (Minn. 2001) (quoting Amaral v. Saint Cloud Hosp., 598 N.W.2d 379, 384 (Minn. 1999)).
25. Id. at 187.
26. Id. at 188.
27. Id. at 189.
28. Id. (emphasis in original).
29. Id. at 191.
30. Id.
31. Id.
32. 862 P.2d 47 (Mont. 1993).
competitive circumstances without good cause.\textsuperscript{33} In \textit{Van Riper}, the following actions were found to constitute substantial changes in the competitive circumstances of the dealer agreement: (1) “placing the dealer in attrition status without reasonable notice;” (2) without prior notice, “depriving the dealer of the possibility of transferring its dealership;” (3) threatening termination of plaintiff’s agreement on a pretext; (4) “establishing a second dealership in the area when it was aware that two dealers could not survive;” (5) “refusing to remove [the dealer] from stop ship status after receiving the payment it demanded;” (6) diverting orders of goods from [the plaintiff] and transferring them to the competing store without notice; and (7) continuing adverse credit terms . . . \textsuperscript{34} The court did not discuss the significance or impact of these acts on the dealer, leaving little guidance exists on how significant the conduct must be.

\section*{IV. Can a Change Allowed by the Dealer Agreement be Actionable Under the Statute?}

The second question considers what is meant by the statutory language of “competitive circumstances of the dealership agreement.” Definitions of this phrase in the Washington and Oregon statutes make clear that those statutes focus on a dealer’s ability to compete with similarly situated dealers selling the same brand of equipment. The Wisconsin federal courts, interpreting this language in the WFDL, also focus on the impact that the manufacturer’s discriminatory conduct has on the dealer’s ability to compete with other dealers of the same brand. In these three states, “a substantial change to competitive circumstances” requires an impact on intra-brand competition. Nothing in the language, however, suggests that these statutes in other states must be confined to issues of intra-brand competition. Competitive circumstances clearly could allow for consideration of actions that affect the dealer’s ability to compete in the marketplace as a whole, whether against the same brand or against other brands. Thus, significant room for dispute exists as to what competitive circumstances are covered under most of these statutes.

A recurring question is whether a change in circumstances that is allowed by a dealer’s agreement terms can ever constitute a change in competitive circumstances governed by these statutes. The argument that the answer is answered in the negative is based on the prohibition being of a substantial change of the competitive circumstances of the dealer agreement itself. If the dealership agreement allows a certain action, the argument is that the competitive circumstances of that dealership agreement cannot be changed by an action consistent with it. If the manufacturer does what it is allowed to do under the dealership agreement, nothing is changed concerning the

\textsuperscript{33} Mont. Code Ann. § 30-11-802.
\textsuperscript{34} Van Riper, 862 P.2d at 50.
dealership agreement. This argument is less persuasive if the statutory prohibition addresses the competitive circumstances of the dealer or of the dealership and does not mention the dealer agreement itself.

Some courts have adopted this rule, while others have rejected it. In *Cunningham Implement Co. v. Deere and Co.*, the plaintiff claimed that the defendant’s refusal to approve a transfer of a dealership violated the Minnesota Agricultural Equipment Dealer’s Act prohibition on “substantially chang[ing] the competitive circumstances of a dealership agreement without good cause.” The court rejected this argument, noting that “the dealership agreement here gave Deere the right to approve or deny transfers of its dealerships” and concluding that “exercising that contractual right is not a violation of the MAEDA.”

In a clear illustration of how difficult these laws containing the substantial change in competitive circumstances language are to navigate, two years later a federal court reached a different conclusion interpreting the same language found in a different Minnesota statute, the Minnesota Heavy and Utility Equipment Dealers Act. In *Midwest Great Dane Trailers, Inc. v. Great Dane Limited Partnership*, the defendant-manufacturer planned to appoint a second dealer in the State of Minnesota, when previously the plaintiff had been the only Great Dane dealer in the state throughout the term of its dealership agreement. The court dismissed the plaintiff’s breach of contract claim, finding “that the language of the agreement itself does not prohibit Great Dane from appointing an additional dealer within Midwest’s area of responsibility.” The defendant also sought dismissal of the plaintiff’s claim that addition of a second dealer violated the Act’s prohibition of “substantially change the competitive circumstances of a dealership agreement.” The defendant cited *Cunningham* in support of its argument “that a finding that the contract is unambiguous as to nonexclusivity and Great Dane’s right to appoint an additional dealer is dispositive of Plaintiff’s claim under the MHUEMDA.” The court, however, rejected this argument.

The court took issue with the meaning of the inclusion “of a dealership agreement” in the statute, explaining:

> On its face, it is evident that “of a dealership agreement” is intended to modify the phrase “substantially change the competitive circumstances.” However, had the legislature intended to limit causes of action under this part of the statute to changes in the agreement or contract itself, it would have had no need to include the phrase “competitive circumstances” and simply could have required good

---

35. No. C7-95-1148, 1995 WL 697555 (Minn. Ct. App. Nov. 28, 1995). This decision was designated as unpublished and thus has limited precedential value pursuant to MINN. STAT. § 480A.08(3).
36. MINN. STAT. § 325E.062.
38. MINN. STAT. § 325E.068.0684.
39. 977 F. Supp. 1386 (D. Minn. 1997). The author was counsel for defendant in this case.
40. *Id.* at 1390.
41. *Id.* at 1391.
cause by manufacturers to “substantially change a dealership agreement” or possibly, to “substantially change the competitive circumstances in a dealership agreement.”

The Court noted that “the manifest legislative intent of the statute . . . was undeniably designed to protect dealers and distributors,” concluding “that legislation implemented to protect dealers must protect more than the provisions of the written agreement.” It therefore found:

[A]n actionable claim exists under the statute when a dealer alleges that a manufacturer has effectuated a “substantial change in competitive circumstances” without good cause, even if the alleged “change” was contractually permitted. An allegation that the prevailing conditions, surroundings, or background of a dealership agreement have been substantially changed without good cause sufficiently states a claim upon which relief may be granted for the purposes of a motion to dismiss under Rule 12(b)(6).

The Minnesota Supreme Court subsequently cited this statutory construction with approval. Thus, an action allowed by the dealer agreement may still come within the restrictions of the MHUEMDA.

Of the states that have addressed this issue, Minnesota holds the minority view. Laws in Texas, Tennessee, and Wisconsin with essentially the same statutory language as the Minnesota Act have been interpreted to reach the opposite result. In Freightliner of Knoxville, Inc. v. Daimler-Chrysler Vans, LLC, the plaintiff entered into an agreement to distribute “Sprinter Vans” from DaimlerChrysler. As a condition of that agreement, the plaintiff spent $800,000 on upgrading its facility. Subsequently, the defendant dual branded the Sprinter vans under the Dodge trademark and allowed Dodge dealers to sell the same brand. The plaintiff claimed this violated the prohibition in the Tennessee Trade Practices Act (TTPA) that a supplier may not “substantially change the competitive circumstances of a retail agreement without good cause.” The Sixth Circuit found that the agreement “explicitly contemplates the sale of Sprinter vans through other dealers.” Based upon the language of the agreement, the court affirmed the dismissal of the TTPA claims because “a straightforward reading of the agreement belies FOK’s argument that DC Van’s business relationship with Dodge amounted to a change in the competitive circumstances of the retail agreement under the TTPA, as this relationship is explicitly anticipated in the agreement itself.”

42. Id. at 1391–92.
43. Id. at 1392.
44. Id. at 1394.
45. Id. at 1392.
47. 484 F.3d 865 (6th Cir. 2007).
48. TENN. CODE. ANN. § 47-25-1302.
49. Freightliner, 484 F.3d at 869.
50. Id. at 870.
those representations would “stand in stark contrast to the terms that were eventually included in the retail agreement.”51 The basis of this decision is that an action or event allowed by the agreement “is explicitly anticipated in the agreement itself” and thus cannot constitute a change in the competitive circumstances of the dealer agreement.

The confusion with the substantial change language is highlighted by the U.S. District Court for the Western District of Tennessee decision four years earlier under the same language of the TTPA in *Power & Telephone Supply Co. v. Harmonic, Inc.*52 The defendant had authorized the plaintiff to be the “non-exclusive reseller” to third party RCN, which was the plaintiff’s only authorized customer. Because of complaints on price from RCN, the defendant subsequently sold direct to RCN products covered by its agreement with the plaintiff. Despite the plaintiff being a “non-exclusive” reseller, the court found that “Harmonic terminated or substantially changed the competitive circumstances of the parties’ agreement” because “Harmonic’s actions circumvented P&T as the distributor of equipment. . . .”53 The court did not address whether a substantial change could occur for an action allowed by the dealer agreement, and the Sixth Circuit in *Freightliner* did not address this contrary decision.

In *Keizar Motors, Inc. v. Kubota Tractor Corp.*,54 a Texas Court of Appeals cited with approval the reasoning of the *Freightliner* court. Defendant Kubota placed a competing dealer twenty-five miles from the plaintiff’s location. The plaintiff claimed this violated the Texas Farm, Industrial and Outdoor Power Equipment Dealer Act,55 which provides “a supplier may not substantially change the competitive circumstances of a dealer agreement without cause.”56 The trial court denied the plaintiff’s request for a temporary injunction “because the Dealership Agreement, which has an entirety clause, unambiguously provides Eastex with no exclusive territory.”57 After concluding that the dealer agreement “gave Kubota the right to enter into a dealer agreement at any location,” the court held that Kubota’s right under the contract to add other dealers “is part of the competitive circumstances contemplated by the Dealer Agreement” and that the statute “cannot be used to alter the terms of the parties’ binding agreement.”58

51. Id.
52. 268 F. Supp. 2d 981 (W.D. Tenn. 2003).
53. Id. at 989.
55. This act was repealed in 2011 by 2011 Tex. Gen. Laws ch. 1039 § 3, but replaced with the Texas Fair Practices of Equipment Manufacturers, Distributors, Wholesalers, and Dealers Act, TEX. BUS. & COM. CODE ANN. §§57.153, .202. This new statute also requires good cause for any substantial change of competitive circumstances of the dealership; thus the analysis under the prior act in *Keizar* should apply to the current act.
56. TEX. BUS. & COM. CODE ANN. § 55.052.
57. Keizar, 334 S.W.3d at 354.
58. Id.
Every court that has interpreted the Wisconsin Fair Dealership Act’s language of “substantially changing the competitive circumstances of the dealership agreement” as requiring good cause has held that an action authorized by the dealership agreement cannot violate the statute. As summarized in *Wisconsin Compressed Air Corporation v. Gardner Denver, Inc.*, courts have repeatedly held that “when a dealership agreement provides for only ‘non-exclusive’ dealership rights in an area, a grantor may assign additional dealers to the area without violating § 135.03.”

Given the lack of case law interpreting most of these statutes, substantial uncertainty exists whether actions allowed by the dealer agreement can violate restrictions on substantial change in competitive circumstances. There are strong arguments for both interpretations. The minority view is that these statutes have a pro dealer bent and to interpret them as not covering anything allowed by the dealer agreement restricts their scope in a manner inconsistent with the purpose of the statute. Moreover, if all the statute does is prevent substantial changes not allowed by the dealer agreement, it has very little utility and is not much more than a statutory breach of contract claim that might provide for attorney fees. The majority view, however, is based upon the express language of the statute. It is difficult to logically explain how an action that is allowed by the dealership agreement could be held to constitute a substantial change of the competitive circumstances of that dealership agreement. The result is significant uncertainty under most of these statutes as to whether a very substantial change to the competitive circumstances faced by the dealer can violate the statute if that change is allowed by the dealer agreement.

V. Required Notice before Substantially Changing the Dealer Agreement’s Competitive Circumstances

Approximately half of the statutes reviewed in this article require notice before taking the action that would result in substantial change to the competitive circumstances. This places the manufacturer and its counsel in an

---

59. As discussed below, however, the Wisconsin Supreme Court came to the opposite conclusion in *Jungbluth v. Hometown, Inc.*, 548 N.W.2d 519 (Wis. 1996) when interpreting the notice requirement of the WFDL, which requires ninety days’ notice of “substantial change in competitive circumstances” without the qualifying phrase “of the dealership agreement.”
60. 571 F. Supp. 2d 992, 1001 (W.D. Wis. 2008).
even more difficult position because of the uncertainty of whether an action would be a substantial change in competitive circumstances. If no notice is provided, and if it is later determined that the manufacturer’s action was a substantial change, the failure to give notice itself constitutes an independent violation of the statute. Arguably the law would be violated even if the manufacturer had “good cause” to make the change but did not provide notice. On the other hand, if notice is provided, that could be construed as an admission that the contemplated action is indeed a “substantial change in competitive circumstances” and, thus, the manufacturer would need good cause to take this action. The manufacturer is placed in a no-win position.

A number of the statutes requiring good cause for a substantial change in competitive circumstances implicitly acknowledge the quandary created by a notice requirement. Of the state laws requiring good cause for terminations, nonrenewals, or substantial change, most require notice of termination or nonrenewal, but only half of them require notice for substantial change in competitive circumstances. For example, the Virginia Equipment Dealers Protection Act, which requires that “no supplier . . . may terminate, cancel, fail to renew or substantially change the competitive circumstances of an agreement without good cause,” mandates ninety days’ written notice of termination, but no corresponding notice of a substantial change. Likewise, the Minnesota Heavy and Utility Equipment Dealers Act requires good cause for termination, cancellation, nonrenewal, and substantial change of competitive circumstances, but requires notice only for termination, cancellation, and nonrenewal. The omission of a notice requirement for a substantial change in competitive circumstances most likely results from recognition of the problematic nature of such a requirement.

The requirement of WFDL § 135.04 that a dealership grantor must “provide a dealer at least ninety days’ prior written notice of . . . substantial change in competitive circumstances” perfectly illustrates how difficult these statutes can be to understand and apply and the importance of the exact statutory language. Section 135.03 provides that “no grantor . . .
may . . . substantially change the competitive circumstances of a dealership agreement without good cause.” The rule in Wisconsin is that if the dealership agreement allows an action, good cause is not required. In Jungbluth v. Hometown, Inc., the grantor had successfully argued to the Wisconsin Court of Appeals that the same rule should apply to the notice requirement under the WFDL.

The Wisconsin Supreme Court, however, reversed. The Jungbluth court pointed out the difference in statutory language, that although § 135.03 addresses substantial change “of the competitive circumstances of a dealership agreement,” the notice provision of § 135.04 requires notice of a substantial change “of the competitive circumstances” without the additional language “of the dealership agreement.” The court undertook a statutory construction analysis of this provision, concluding that “the statutory notice requirement provided in § 135.04 is designed to afford the dealership the opportunity to react and protect itself from the potentially devastating effects of an overreaching grantor with superior bargaining power, change the competitive circumstances, not of the dealership agreement, but rather the business itself.” As a result, a grantor does not require good cause under § 135.03 to substantially change competitive circumstances for a dealer if that action is allowed by the dealership agreement, but the grantor must still provide ninety days’ notice of that action.

VI. Conclusion

Statutes that restrict a manufacturer from making “substantial changes to the competitive circumstances of the dealership agreement” create counseling nightmares for manufacturers and their attorneys. A manufacturer in a given state must first determine if there is a relevant statute. If so, the manufacturer can hope for case law or statutory definitions that clarify application of the statute, but in most instances, no such clear guidance will exist. When no guiding case law exists, counsel first must focus on the explicit language of the statute and then identify favorable case law for analogous state statutes and argue for interpretation of the statute at issue in light of that case law. Ultimately the result is often substantial uncertainty as to how to comply with the statutory language in individual states. This uncertainty can result in increased disputes and litigation that could be avoided by statutory definitions and clearer judicial standards. If legislators who seek to add prohibitions on “substantial change to the competitive circumstances of the dealership” to their state’s dealer protection statutes would expressly address the issues raised in this article in their proposed bill’s language, it would increase statutory compliance and decrease costly, unnecessary disputes.

67. 548 N.W.2d 519 (Wis. 1996).
68. Id. at 525.
69. Id. at 524.
## APPENDIX

<table>
<thead>
<tr>
<th>STATE</th>
<th>ACT</th>
<th>LANGUAGE</th>
<th>NOTICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>1. Tractor, Lawn &amp; Garden &amp; Light Industrial Equipment Franchise Act. ALA. CODE § 8-21A-3(4)</td>
<td>1. “It shall be a violation . . . for a supplier to . . . substantially alter that dealer’s competitive circumstances without good cause.”</td>
<td>1. 90 days. § 8-21A-4</td>
</tr>
<tr>
<td></td>
<td>2. Tractor, Lawn &amp; Garden &amp; Light Industrial Equipment Franchise Act. ALA. CODE § 8-21A-4</td>
<td>2. “[E]xcept where grounds for . . . a change in his or her competitive position are contained in subdivisions . . . a supplier shall give a dealer [notice] of the supplier’s intent to . . . change the dealer’s competitive circumstances.”</td>
<td></td>
</tr>
<tr>
<td>Arizona</td>
<td>Equipment Dealer’s Act. ARIZ. REV. STAT. ANN. §§ 44-6702(A)(3), 44-6703</td>
<td>“It is a violation . . . for a supplier to . . . substantially change the competitive circumstances of the dealer agreement without cause.”</td>
<td>90 days’ notice of supplier’s intent. § 44-6703</td>
</tr>
<tr>
<td>Arkansas</td>
<td>Farm Equipment Retailer Franchise Protection Act. ARK. CODE ANN. § 4-72-310(b)(4)</td>
<td>“It is a violation . . . for a manufacturer to attempt or threaten to . . . substantially change the competitive circumstances of the dealership agreement based on the result of a natural disaster . . . or other circumstances beyond the dealer’s control.”</td>
<td>NONE</td>
</tr>
<tr>
<td>STATE</td>
<td>ACT</td>
<td>LANGUAGE</td>
<td>NOTICE</td>
</tr>
<tr>
<td>---------</td>
<td>----------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------</td>
<td>--------------</td>
</tr>
<tr>
<td>California</td>
<td>Fair Practices of Equipment Manufacturers, Distributors, Wholesalers and Dealers Act. CAL. BUS. &amp; PROF. CODE §§ 22903(c), 22902</td>
<td>“No supplier . . . may . . . materially change the competitive circumstances of a dealer contract without good cause.” NOTE: “‘Terminate’ means to . . . materially change the competitive circumstances of a dealer contract.” [defined in § 22901(w)]</td>
<td>180 days. § 22903</td>
</tr>
<tr>
<td>Colorado</td>
<td>Farm Equipment Fair Dealership Act. COLO. REV. STAT. §§ 35-38-103(1)(c), 104-106</td>
<td>“It is a violation . . . for a supplier . . . to substantially change the competitive circumstances of the dealer agreement without cause.”</td>
<td>180 days. § 35-38-104(1)(a)</td>
</tr>
<tr>
<td>Idaho</td>
<td>1. Agreements Between Suppliers and Dealers of Farm Equipment. IDAHO CODE ANN. §§ 28-24-103(4), 28-24-104; (“Equipment” includes ATVs, Outdoor Power Equip., Industrial &amp; Construction Equip., and Farm Equip.) 2. County Option Kitchen and Table Wine Act: Wineries, Importers or Dealers and Distributors. IDAHO CODE ANN. § 23-1328A(1)(f)</td>
<td>1. “It shall be a violation . . . for a supplier to . . . substantially change the competitive circumstances of the dealer agreement . . . or threaten to substantially change the competitive circumstances of the dealer agreement without good cause.” 2. “It shall be unlawful . . . to cause a . . . substantial change in competitive circumstances in the relationship with the distributor.”</td>
<td>1. 90 days. § 28-24-104 2. 90 days. § 23-1328A</td>
</tr>
<tr>
<td>Iowa</td>
<td>Equipment Dealership Agreements. IOWA CODE § 322F.2(1)</td>
<td>“A supplier shall terminate . . . by . . . a substantial change in competitive circumstances only upon good cause and [notice]. . .”</td>
<td>90 days. § 322F.2 1a</td>
</tr>
<tr>
<td>State</td>
<td>Section</td>
<td>Text</td>
<td>Penalty</td>
</tr>
<tr>
<td>----------</td>
<td>-------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td>Kansas</td>
<td>KAN. STAT. ANN. § 16-1203</td>
<td>“No farm equipment manufacturer . . . may . . . substantially change the competitive circumstances of a dealership agreement without good cause.”</td>
<td>NONE</td>
</tr>
<tr>
<td>Kentucky</td>
<td>Ky Rev. Stat. Ann. § 365.831(1)</td>
<td>“No supplier . . . shall terminate or substantially change the competitive circumstances of a retail agreement contract without good cause.”</td>
<td>NONE</td>
</tr>
<tr>
<td>Louisiana</td>
<td>1. LA. REV. STAT. ANN. § 51:482(A)(1)</td>
<td>“No agent . . . may . . . substantially change the competitive circumstances of a dealership agreement or contract without good cause.”</td>
<td>1. NONE</td>
</tr>
<tr>
<td></td>
<td>2. LA. REV. STAT. ANN. § 51:483(A)(4)</td>
<td>“It shall be a violation . . . for an agent to attempt or threaten to . . . substantially change the competitive circumstances of the dealership agreement based on . . . circumstances beyond the dealer's control.”</td>
<td>2. NONE</td>
</tr>
<tr>
<td>Maryland</td>
<td>1. Md. Code Ann., Com. Law § 19-103(a) [NOTE: § 19-103(a), (b)(1), (b)(2) all have “substantially change”]</td>
<td>“A supplier may not . . . substantially change the competitive circumstances of a contract without good cause.”</td>
<td>1. 90 days. § 19-103(b)(2) [only if substantially changed based on dealer’s failure to capture the required market share]</td>
</tr>
<tr>
<td></td>
<td>2. Md. Code Ann., Com. Law § 19-301(4)</td>
<td>“A supplier may not . . . substantially change the competitive circumstances of the retail agreement based on the results of any circumstance beyond the dealer’s control. . . .”</td>
<td>2. NONE</td>
</tr>
<tr>
<td>STATE</td>
<td>ACT</td>
<td>LANGUAGE</td>
<td>NOTICE</td>
</tr>
<tr>
<td>------------</td>
<td>----------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------</td>
<td>-------------------------------</td>
</tr>
<tr>
<td>Minnesota</td>
<td>1. Heavy and Utility Equipment Manufacturers and Dealers Act (HUEMDA). Minn. Stat. § 325E.0681 subd. 1</td>
<td>1. “No equipment manufacturer . . . may . . . substantially change the competitive circumstances of a dealership agreement without good cause.”</td>
<td>1. NONE</td>
</tr>
<tr>
<td></td>
<td>2. Farm Equipment Dealerships. Minn. Stat. § 325E.062 subd. 1</td>
<td>2. “No farm equipment manufacturer . . . may . . . substantially change the competitive circumstances of a dealership agreement without good cause.”</td>
<td>2. NONE</td>
</tr>
<tr>
<td>Mississippi</td>
<td>Repurchase of Inventories from Retailers Upon Termination of Contract. Miss. Code Ann. § 75-77-2(1)</td>
<td>“No supplier . . . may . . . substantially change the competitive circumstances of a retail agreement without good cause.”</td>
<td>NONE</td>
</tr>
<tr>
<td>Missouri</td>
<td>Farm Implement Dealership Agreements. Mo. Rev. Stat. § 407.840</td>
<td>“No farm equipment manufacturer . . . may . . . substantially change the competitive circumstances of a farm equipment dealership without good cause.”</td>
<td>NONE</td>
</tr>
<tr>
<td>Montana</td>
<td>1. Farm Implement Dealership Agreement. Mont. Code Ann. §§ 30-11-802, 803</td>
<td>1. “No grantor may . . . substantially change the competitive circumstances of a dealership agreement without good cause.”</td>
<td>1. 90 days (if nonpayment of sums due, then 10 days’ notice). § 30-11-803</td>
</tr>
<tr>
<td>State</td>
<td>Legislation</td>
<td>Relevant Text</td>
<td>Notice Period</td>
</tr>
<tr>
<td>-------------</td>
<td>------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------</td>
<td>---------------</td>
</tr>
<tr>
<td>Nebraska</td>
<td>Equipment Business Regulations. Neb. Rev. Stat. § 87-704(4)</td>
<td>“It shall be a violation . . . for a supplier to take action . . . substantially changing the competitive circumstances intended by the dealer agreement due to the results of conditions beyond the dealer’s control. . . .”</td>
<td>NONE</td>
</tr>
<tr>
<td></td>
<td>2. Nev. Rev. Stat. § 597.115(4)</td>
<td>“A supplier shall not . . . substantially change the terms of a dealer agreement because of . . . circumstances which are beyond the control of the dealer.”</td>
<td>NONE</td>
</tr>
<tr>
<td>North Carolina</td>
<td>1. Farm Machinery Agreements. N.C. Gen. Stat. § 66-182(a)</td>
<td>“A supplier who . . . substantially changes the competitive circumstances of an agreement with a dealer without good cause shall notify the dealer of the termination. . . .”</td>
<td>90 days' notice, 60 days to cure. § 66-182</td>
</tr>
<tr>
<td></td>
<td>2. N.C. Gen. Stat. § 66-187.1(4)</td>
<td>“No supplier shall . . . substantially change the competitive circumstances of the retail agreement based on the results of any circumstance beyond the dealer’s control. . . .”</td>
<td>NONE</td>
</tr>
<tr>
<td>STATE</td>
<td>ACT</td>
<td>LANGUAGE</td>
<td>NOTICE</td>
</tr>
<tr>
<td>-------------</td>
<td>----------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------</td>
<td>--------</td>
</tr>
<tr>
<td>North Dakota</td>
<td>1. Prohibited Practices Under Farm Equipment Dealership Contracts. N.D. CENT. CODE § 51-07-01.2(5)</td>
<td>1. “A manufacturer . . . may not . . . attempt or threaten to . . . substantially change the competitive circumstances of the dealership contract for any reason other than failure of the farm equipment dealer to comply with the terms of the written contract. . . .” 2. “A manufacturer . . . of automobiles or trucks . . . may not . . . attempt or threaten to . . . substantially change the competitive circumstances of the dealership contracts . . . if the attempt or threat is based on the results of a circumstance beyond the retailer's control. . . .”</td>
<td>1. NONE 2. NONE</td>
</tr>
<tr>
<td>Ohio</td>
<td>Equipment Dealer Agreements. OHIO REV. CODE ANN. § 1353.06(A)(1)</td>
<td>“No supplier, without good cause, shall . . . substantially alter the competitive circumstances of a dealer agreement. . . .”</td>
<td>NONE</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>Fair Practices of Equipment Manufacturers, Distributors, Wholesalers and Dealers. OKLA. STAT. 15, §§ 245A.3(B), 245(22)</td>
<td>“No supplier may terminate a dealer agreement without good cause.” “Terminate” means “to “substantially change the competitive circumstances of a dealer agreement.”</td>
<td>NONE</td>
</tr>
<tr>
<td>State</td>
<td>Section 1</td>
<td>Section 2</td>
<td>Section 3</td>
</tr>
<tr>
<td>---------------</td>
<td>---------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Oregon</td>
<td>Trade Regulation (Repurchase of Farm Implements). <em>Or. Rev. Stat.</em> § 646A.312 (2)</td>
<td>“With good cause, a supplier . . . may . . . substantially change the competitive circumstances of a retailer agreement.” NOTE: “Change in competitive circumstances means a material detrimental effect on a retailer’s ability to compete with another retailer who sells the same brand of farm implements.” [defined by § 646A.300 (2)]</td>
<td>90 days. § 646A.312(3)(a)</td>
</tr>
<tr>
<td>South Dakota</td>
<td>Regulation of Vehicle Dealers. <em>S.D. Codified Laws</em> § 32-6B-45</td>
<td>“No franchisor may . . . substantially change the competitive circumstances of a vehicle dealership agreement without good cause.”</td>
<td>NONE</td>
</tr>
<tr>
<td>Tennessee</td>
<td>1. Repurchase of Terminated Franchise Inventory. <em>Tenn. Code Ann.</em> § 47-25-1302(a)</td>
<td>1. “No supplier . . . may . . . substantially change the competitive circumstances of a retail agreement without good cause.”</td>
<td>1. NONE</td>
</tr>
<tr>
<td>STATE</td>
<td>ACT</td>
<td>LANGUAGE</td>
<td>NOTICE</td>
</tr>
<tr>
<td>---------------</td>
<td>----------------------------------------------------------</td>
<td>--------------------------------------------------------------------------</td>
<td>-------------------</td>
</tr>
<tr>
<td>Virginia</td>
<td>Equipment Dealers Protection Act. Va. CODE ANN. § 59.1-352.3(A)</td>
<td>“No supplier . . . may . . . substantially change the competitive circumstances of an agreement without good cause.”</td>
<td>NONE</td>
</tr>
<tr>
<td>Washington</td>
<td>Farm Implements, Machinery, Parts. WASH. REV. CODE § 19.98.120(4)</td>
<td>“It shall be a violation . . . for a supplier to . . . substantially change the dealer’s competitive circumstances . . . or threaten . . . to substantially change the competitive circumstances without good cause.”</td>
<td>90 days unless exempted. § 19.98.130(1)</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>Fair Dealership Law. Wis. STAT. § 135.03</td>
<td>“No grantor . . . may . . . substantially change the competitive circumstances of a dealership agreement without good cause.”</td>
<td>90 days. § 135.04</td>
</tr>
</tbody>
</table>

NOTE: “‘Terminate’ . . . means to terminate, cancel, fail to renew, or substantially change the competitive circumstances of a dealer agreement.” § 57.002(21)
Enforcing Arbitration Awards in International Franchising

Ronald A. Giller, Sarah L. Wieselgren, and Lynette Gladdis

In an increasingly global franchising market, it is imperative for franchisors to be able to enforce their agreements and protect their intellectual property in every market they enter. Regardless of how franchisors structure their international partnerships, whether through master franchising or otherwise, many franchise systems use arbitration to resolve international disputes.¹ This article takes a closer look at enforceability through the arbitration process, including challenges relating to the extraterritorial application of the Lanham Act, and focuses on how courts in certain emerging markets have dealt with U.S. awards and what obstacles franchisors may face. Because the law is not well-settled in this area in many countries, the authors also consulted with legal experts from the emerging markets discussed in this article—Russia, China, India, South Africa, and Brazil.

With the expanding franchise market comes an increasing number of international disputes among franchisors, master franchisees, and franchisees. “Among franchisors, there is a strong trend toward contractual arbitration of

all disputes arising from the franchise agreement or the relationship,” and arbitration is a viable and, at times, cost-effective alternative to litigation. Because there is no inherent right to arbitrate, if a franchisor wishes to resolve disputes through arbitration, it must include an arbitration clause in the franchise agreement.

The arbitration clause should be carefully crafted and include specific provisions as to both procedural and substantive matters. It should be broad enough to encompass all issues that may need enforcement on foreign soil. Beyond the typical provisions, the franchisor may want to include language that addresses arbitration issues specific to the foreign jurisdiction. To do that, it is important that franchisors (or their counsel) become knowledgeable about foreign laws or rules that may cause the arbitration clause to be unenforceable or prevent the parties from arbitrating certain issues. Franchisors should also determine the foreign court system’s requirements for the recognition and enforcement of foreign arbitral awards and incorporate those provisions into the arbitration clause.

Extraterritorial Application of the Lanham Act

One issue that can arise in the domestic arbitration of an international agreement providing for the application of U.S. law is whether the franchisor can rely on the Lanham Act to obtain damages resulting from a former franchisee’s continued use of the franchisor’s trademarks outside of the United States after termination of the franchise agreement. Although such relief is routinely granted against U.S. citizens, jurisdictional issues may arise when attempting to obtain Lanham Act relief as a result of wrongful conduct outside of the United States or against a non-U.S. citizen or foreign entity.

The Supreme Court considered the Lanham Act’s extraterritorial application in Steele v. Bulova Watch Co. In that seminal case, the defendant, an American citizen, sold watches with the “Bulova” mark in Mexico. The parts for the watches were manufactured in the United States and Switzerland, but the watches themselves were assembled and sold only in Mexico. The products did, however, ultimately end up in the United States via American tourists who purchased the watches while in Mexico. The Court construed the Lanham Act broadly and rejected the defendant’s argument that his activities did not fall within the jurisdictional scope of the Act, finding

3. The following issues should be spelled out: (1) the location where the arbitration will take place, (2) the applicable laws, (3) time limits for each step of the process, (4) how many arbitrators and the selection process, (5) the arbiters’ powers, and (6) the court or courts in which the final determination will be entered for confirmation. Additionally, a confidentiality clause should also be included if the parties wish to avoid disclosure of the arbitration; however, it should be noted that it is not certain that such clauses would be enforceable. See id. §§ 5.03A[10], 5-138.
5. Id. at 285.
6. Id. at 286.
that the defendant’s purchase of parts in the United States was an “essential step” in the course of his business and that the infiltration of counterfeit watches into the United States could have an adverse effect on the plaintiff’s reputation both domestically and abroad.7

Following the Supreme Court’s decision in Bulova, the Second Circuit in Vanity Fair Mills, Inc. v. T. Eaton Co.8 established a three-factor test to determine whether the Lanham Act should apply extraterritorially against a foreign entity. In Vanity Fair, the defendant, a Canadian corporation, successfully registered the plaintiff’s trademark in Canada after the plaintiff, a Pennsylvania corporation, registered the trademark in the United States.9 The defendant then ceased using its trademark and instead purchased and sold the plaintiff’s products in Canada for approximately nine years.10 Thereafter, the defendant resumed use of its trademark and sold products of inferior quality, while at the same time continuing to sell plaintiff’s products in Canada.11 The plaintiff sued seeking declaratory and injunctive relief.12 Relying on Bulova, the court enumerated three factors to be considered: (1) whether the defendant’s conduct had a substantial effect on U.S. commerce; (2) whether the defendant was a U.S. citizen; and (3) whether a conflict existed as to trademark rights established under the foreign law.13 The court found that while the defendant’s conduct had a substantial effect on U.S. commerce, the second two factors were not present. Noting that “the absence of one of the above factors might well be determinative and that the absence of both is certainly fatal,” the court further concluded that the remedies available under the Lanham Act, with the exception of those provided for in § 44,14 “should not be given extraterritorial application against foreign citizens acting under presumably valid trade-marks in a foreign country.”15

After Vanity Fair, a number of circuits adopted the Second Circuit’s three-factor test or a variation.16 For example, the Fourth Circuit requires a balancing of the three factors, with no one factor being dispositive, but modified the first factor to require a “significant” effect as opposed to a “substantial effect on U.S. commerce.”17 The First Circuit likewise uses the

7. Id. at 286–87.
8. 234 F.2d 633 (2d Cir. 1956).
9. Id. at 637.
10. Id.
11. Id.
12. Id.
13. Id. at 642.
14. Section 44 affords U.S. citizens protection against unfair competition by foreigners who are nationals of international convention countries.
15. Id. at 642–43.
three-factor *Vanity Fair* test, but has disaggregated the factors and first determines whether the defendant is an American citizen.\(^{18}\) If the defendant is not an American citizen, the court will then use the substantial effects test as the “sole touchstone to determine jurisdiction,” and only thereafter will consider comity.\(^{19}\) On the other hand, the Fifth Circuit has incorporated both the *Vanity Fair* three-factor analysis and part of the analysis used in *Bulova*.\(^{20}\) In *American Rice, Inc. v. Arkansas Rice Growers Cooperative Association*,\(^{21}\) the court determined that the Lanham Act could be applied to prevent conduct of the defendant U.S. corporation, even though the sale of the products bearing the allegedly infringing marks occurred in a foreign country.\(^{22}\) This decision was based on the court’s findings that the defendant’s activities, i.e., the processing and packaging, transportation, and distribution of products, had “more than an insignificant effect on United States Commerce” and that while these activities, in isolation, were not unlawful, they were “essential steps in the course of business consummated abroad.”\(^ {23}\)

Unlike the aforementioned circuit courts, the Ninth Circuit has adopted a much more involved, but less restrictive, analysis to determine whether the extraterritorial application of the Lanham Act is appropriate.\(^ {24}\)

For the Lanham Act to apply extraterritorially: (1) the alleged violations must create some effect on American foreign commerce; (2) the effect must be sufficiently great to present a cognizable injury to the plaintiffs under the Lanham Act; and (3) the interests of and links to American foreign commerce must be sufficiently strong in relation to those of other nations to justify an assertion of extraterritorial authority.\(^ {25}\)

The third element, however, requires a balancing of seven factors:

the degree of conflict with foreign law or policy, the nationality or allegiance of the parties and the locations or principal places of business of corporations, the extent to which enforcement by either state can be expected to achieve compliance, the relative significance of effects on the United States as compared with those elsewhere, the extent to which there is explicit purpose to harm or affect American commerce, the foreseeability of such effect, and the relative importance to the violations charged of conduct within the United States as compared with conduct abroad.\(^ {26}\)

---

19. *Id.* at 121; see also Robins & Donahue, *supra* note 16, at 107.
21. *See id.*
22. *See id.*
23. *Id.* at 414.
26. *Id.* at 1394 (9th Cir. 1985), quoting Timberlane Lumber Co. v. Bank of Am., N.T. & S.A., 549 F.2d 597, 614 (9th Cir. 1976).
This broader test, which requires only “some” effect on U.S. foreign commerce and weighs citizenship and conflicts of law issues against five other factors, enables the court to apply the Lanham Act extraterritorially where such application would not otherwise be permissible under the *Vanity Fair* test.27

Overall, whether the Lanham Act will be applied extraterritorially to provide relief for infringing conduct is a fact-sensitive inquiry. It should be noted, however, that the majority of cases cited above involved disputes concerning goods bearing registered trademarks as opposed to suits related to the franchise or service industries. Thus, it is also questionable to what extent the Lanham Act would be applied extraterritorially to provide relief for a former franchisee’s violations outside of the United States.

**Enforcing Arbitration Awards under the New York Convention**

As any franchisor that has litigated against a foreign franchisee is aware, obtaining an award is only half the battle. The award must also be enforced in the country in which the franchisee resides or has assets that can be garnished or attached. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, known as the New York Convention, was implemented in 1959, during a United Nations conference, to promote the use of arbitration on an international scale. The New York Convention provides that signatories, or Contracting States, will “recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon.”28 A Contracting State, when signing the Convention, may indicate that it will recognize and enforce awards made only within other Contracting States.29 As of 2013, the number of Contracting States has grown to 149, which includes the United States.30

The New York Convention further provides for the referral of a dispute to arbitration by a court in a Contracting State. Article II of the Convention states that Contracting States must recognize agreements between the parties to resolve legal disputes through arbitration whether such agreement is in the form of an arbitration agreement or an arbitral clause in a contract.31 Unless a court of a Contracting State finds an agreement is “null and void, inoperative, or incapable of being performed,” at the request of one of the parties, such court must refer the parties to arbitration.32

---

27. See Robins & Donahue, supra note 16, at 107.
29. Id. at art. I.
31. New York Convention, supra note 28, at art. II(1), (2).
32. Id. at art. II(3). There is little guidance in the legislative history for the meaning of “null and void” and when it should be applied. Several courts, especially in the United States, have
Article IV of the Convention sets forth the procedure to obtain the recognition and enforcement of an arbitral award in a Contracting State. The party making the application must submit, to the appropriate court in the Contracting State in which it seeks to enforce the award, the authenticated original award or a certified copy and the original agreement to arbitrate or a certified copy. Furthermore, if either of these documents is not in the official language of the county in which enforcement is sought, the application must include a translation, which must be “certified by an official or sworn translator or by a diplomatic or consular agent.”

Obstacles to the Enforcement of Foreign Arbitral Awards

While the purpose of the New York Convention is to promote arbitration as an effective international dispute resolution mechanism, there are a number of exceptions upon which a party seeking to avoid enforcement of an award may rely. The exceptions enumerated under Subsection 1 of Article V include circumstances where:

1. the agreement is not valid under the governing law or under the law of the country where the award was made;
2. insufficient notice of the proceedings is provided to the party against whom the award is invoked;
3. the arbitration resolves disputes not covered by the agreement’s arbitration provision, the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration;
4. the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the laws of the country where the arbitration took place;
5. the award has not yet become binding on the parties, or has been set aside by a competent authority of the country in which, or under the law of which, that award was made;
6. the subject matter of the dispute is not capable of settlement by arbitration under the laws of that country; and
7. the recognition of enforcement of the award would be contrary to the public policy of that country.

held that, having regard to the ‘pro-enforcement-bias’ of the Convention, the words should be construed narrowly and the invalidity of the arbitration agreement should be accepted in manifest cases only.” See Albert Jan van den Berg, NEW YORK CONVENTION OF 1958: TOWARDS A UNIFORM JUDICIAL INTERPRETATION 24 (Klewer 1981).

33. New York Convention, supra note 28, at art. IV(1).
34. Id. at art. IV(2).
35. Id. at art. V.
Although the exceptions enumerated in 1 through 5 are capable of being applied more uniformly by Contracting States, whether an exception provided for in 6 or 7 will enable a party to avoid enforcement of an arbitral award is a fact-sensitive inquiry. Depending on the country in which enforcement is sought, this inquiry may require a review of an arbitrator’s decision on liability as well as consideration of the relief sought in light of the Contracting State’s public policy.

To best illustrate the enforceability of such awards, we have focused on their enforcement in some of the world’s emerging franchise markets, notably Russia, China, India, South Africa, and Brazil. Specifically, we have surveyed the procedural aspects of enforcing awards in these countries and have examined the issues that may arise as related to the enforcement of awards providing for relief typically sought by franchisors, as a result of a former franchisee’s breach of the franchise agreement, i.e., damages that are provided for under the Lanham Act, including liquidated damages, treble damages, injunctive relief, and attorney fees. Because of the lack of relevant published case law in these countries, we also consulted with local experts in arbitration and/or franchising and reported their conclusions.

Russia

In 2013, the Russian Federation had a GDP of $2.55 trillion and had received $502.5 billion in foreign investments. The USSR acceded to the New York Convention in 1960 through the Decree of the Presidium of the Supreme Soviet dated August 10, 1960. Following the collapse of the Soviet Union, the Russian Federation declared itself a successor to the USSR, meaning that Russia would be bound by all international treaties to which the USSR was a party, including the New York Convention.

To enforce an arbitral award in Russia the party seeking enforcement (we will presume here the franchisor) must initiate enforcement proceedings within three years of the date of the award. The franchisor has to file an application with a state commercial court (arbitrazh court) in the franchisee’s domicile or where its assets are located. An original or certified copy of the arbitral award and the arbitration agreement must be included with the application, and all documents are required to be translated into Russian and notarized. Enforcement proceedings generally take between six to twenty

36. The authors consulted with attorneys Alexey Barnashov and Konstantin Ryabinin, counsel and associate, respectively, in the Moscow office of Mannheimer Swartling.
39. See id.
40. See id.
months; if the arbitrazh court denies the application, the decision may be appealed to the court of cassation.41

Because Russia is a signatory to the New York Convention, in theory, arbitral awards should be enforceable once they are recognized by the arbitrazh court, provided they do not include relief, such as trademark ownership, that is subject to the exclusive jurisdiction of the Russian court system. Within the franchising context, awards that include a monetary component or injunctive relief for infringement of a recognized trademark generally are enforceable, provided none of the exceptions to the New York Convention are applicable and there is no dispute over the rights to a trademark. It should be noted, however, that as part of ongoing judicial reform, in August 2014, the Supreme Court, which previously was the highest court only for the courts of general jurisdiction, in a sense “acquired” the Supreme Arbitrazh Court and assumed the additional function of reviewing decisions rendered by the lower arbitrazh courts. As such, it is uncertain whether the previous case law set by the Supreme Arbitrazh Court will be followed by the court going forward.

While arbitral awards are enforceable in Russia, notwithstanding the exceptions of Article V, the abuse of the public policy exception to enforcement is commonly used as the basis for Russian courts to deny enforcement of an award. While the determination as to whether an award will be enforced is a fact-specific inquiry, there are certain categories of relief (described below) that may not be enforced in a Russian court.

Like the Lanham Act, Russian law provides for damages where a party’s rights have been violated. Russian courts will enforce awards for actual damages. However, if an arbitral award exceeds the damages actually suffered by the franchisor, the Russian court may decline to enforce the award as contrary to public policy. Thus, while liquidated damages are achievable, liquidated damages must be calculated in a manner that compensates the franchisor for its loss, as opposed to punishing the franchisee. For example, in a recent case, the Supreme Arbitrazh Court, reversing all the lower court judgments denying enforcement, enforced a Swedish arbitral award for recovery of liquidated damages under contracts governed by Swedish law. In doing so, the court was effectively saying that although, strictly speaking, the concept of liquidated damages does not exist in Russian law, it bears similarity with certain Russian regulation.42 This arbitral award ended up in Russian bankruptcy proceedings where the Russian higher courts considered the legal nature of the liquidated damages, finding them to be compensatory (rather than punitive) and thus gave them certain priority in the bankruptcy proceedings.43

By contrast, a Russian court will likely not enforce an award of treble damages, due to public policy concerns, since such damages are seen as an

41. See id.
42. Resolution of the Presidium of the RF Supreme Arbitrazh Court, 2011, No. 9899/09.
extreme penalty against the wrongdoer. Under Russian law, while a claimant can obtain compensation for wrongful use of a trademark, the court will, in its discretion, award only a marginal amount, typically amounting to only a few thousand dollars, as compared to an award of treble damages under the Lanham Act. Additionally, it is unlikely that a Russian court would enforce an award that includes the profit that the former franchisee made as a result of its continued wrongful use of the franchisor’s trademark following the termination of the franchise agreement. Moreover, interest may be viewed by Russian courts as a penalty. Thus, if an arbitral award includes an interest component based upon what is deemed to be an excessive interest rate amounting to a penalty, the court may decrease the allowable interest in accordance with Article 333 of the Civil Code of the Russian Federation. 44

While the Russian legislature has implemented no specific rule or statute dealing with attorney fees, they are likely recoverable. Thus, if an arbitral award includes an award of fees in addition to monetary relief for damages suffered, the award will likely be enforced, unless the court makes a determination that one of the exceptions of Article V of the New York Convention applies and provides a reason to deny enforcement. It should be noted that it is not necessarily a requirement that an individual or entity be a prevailing party to obtain an award of attorney fees. In a recent case, the Supreme Arbitrazh Court confirmed the lower courts’ enforcement of a Swiss arbitral award that dealt exclusively with arbitration costs and attorney fees without resolving the dispute on the merits and terminating the arbitration proceedings on jurisdictional grounds. 45

China 46

The People’s Republic of China, with a population of 1.34 billion, is the world’s most populated country. 47 It has received $1.344 trillion in foreign investments. 48 China also has a GDP of $12.61 trillion. As of 2010, franchises accounted for 3 percent of China’s total retail sales; approximately fifty U.S. based franchisors are doing business in China. 49 In 2012, the number of franchises exceeded 180,000 units. 50 The New York Convention was adopted by China in 1987 pursuant to the Decision of the Standing
Committee of the National People’s Congress on China Joining the Convention on the Recognition and Enforcement of Foreign Awards.

To enforce an arbitration award in China, a foreign company must retain a Chinese attorney to file in a court in the jurisdiction in which the Chinese defendant is located. The court will then conduct a hearing to determine if the foreign arbitration award is enforceable. If the award does not violate the New York Convention, the local court will likely issue a decision to enforce the award. It typically takes six months to get an award enforced in China. The Chinese defendant may, however, attempt to block the enforcement of the award. Although it is unlikely that there would be any legal issues that would block enforcement, local protectionism could be a problem, and political connections to the judge or bribery could impact the decision. If that were to happen, however, and the foreign award was not enforced, the local court’s decision could be set aside by the Supreme People’s Court of China (SPC), which is likely to uphold such awards absent a violation of the New York Convention.

If an arbitral award was rendered outside of mainland China, it can only be set aside on the limited grounds set forth in the Convention. When an award has been rendered in mainland China, however, the award can be reversed by the Chinese courts, which can review the arbitrator’s finding of facts and application of the law. As such, it is important that a non-Chinese franchisor doing business in China include an arbitration clause that provides for arbitration to be conducted outside of mainland China. As to the type of relief that is enforceable in China, the perception that the Chinese courts tend to interpret the “public policy” exception loosely to avoid the enforcement of foreign awards appears to be changing. On April 17, 2000, the SPC implemented a process under which it automatically reviews any lower Chinese court’s refusal to enforce a foreign arbitral award. This, at least in theory, adds a layer of protection for non-Chinese businesses seeking to enforce awards against Chinese individuals and entities.

In the franchise context, enforcement of relief that is typically sought and obtained by franchisors generally should not be a problem. As a result, a franchisor can enforce an award that includes liquidated damages, injunctive relief, trademark damages, and attorney fees.

India

The Republic of India, with 1.22 billion people, is the second most populated country. India’s GDP is $4.761 trillion and it received $229.2 billion

---

52. See id. at 2.
53. See id.
54. The authors consulted with attorney Shwetasree Majumder of Fidus Law Chambers in Noida, India.
in foreign investments. Its franchising sector is growing approximately 30 percent per year. India became a signatory to the New York Convention in 1958 and ratified the Convention through the Foreign Awards (Recognition and Enforcement) Act of 1961.

To enforce a foreign arbitral award in India, the party seeking enforcement must file an application to the court of competent jurisdiction. India’s Arbitration & Conciliation Act of 1996 (Conciliation Act) provides as follows:

(1) The party applying for the enforcement of a foreign award shall, at the time of the application, produce before the court—
(a) The original award or a copy thereof, duly authenticated in the manner required by the law of the country in which it was made;
(b) The original agreement for arbitration or a duly certified copy thereof, and
(c) Such evidence as may be necessary to prove that the award is a foreign award.

Additionally, this law further requires that if the award or agreement is in a foreign language, the party seeking enforcement must also submit a translation into English which has been “certified as correct by a diplomatic or consular agent of the country to which that party belongs or certified as correct in such other manner as may be sufficient according to the law in force in India.” If the court determines that the arbitral award is enforceable under Chapter I of the Conciliation Act, the award will be deemed to be a decree of that court.

Arbitration awards are enforceable in India in accordance with the Act, which is the governing arbitration statute in India. The circumstances under which a court may refuse to enforce an award are almost a mirror image of those set forth in the New York Convention and are also set forth in Section 48 of the Conciliation Act. As to the exception providing that enforcement will not be required in the event it is contrary to the public policy of India, the Act specifically states that “[w]ithout prejudice to the generality of clause 48(2)(b), it is hereby declared, for the avoidance of any doubt, that an award is in conflict with the public policy of India if the making of the award was induced or affected by fraud or corruption.” In Renusagar Power Co. Ltd vs General Electric Co., the Indian Supreme Court held that the enforcement of foreign awards in India would be refused only if enforcement is contrary to public policy, further defined as

56. See id.
59. See id. § 47(2).
60. See id. § 49.
61. See id. § 48.
62. See id.
(1) fundamental policy of Indian law, or (2) the interests of India, or (3) justice or morality.63

However, like in Russia, typically only monetary awards are enforceable, and an arbitral award that has an effect of superseding the jurisdiction vested in an Indian court would be considered contrary to public policy. For example, a foreign arbitral award that decides the validity of a trademark in India would not be enforceable because such determinations must be made based upon Indian laws by an Indian civil court.

Courts in India generally allow liquidated damages and the inclusion of this type of damages in an arbitral award will not prevent enforcement. Treble damages will not be barred as contrary to public policy. While there are no reported instances of treble damages being awarded in India, a court enforcing the monetary component of an arbitral award will enforce it in its entirety. A court will not review or modify the amount of a monetary award.

Notably, a foreign arbitral award that includes preliminary or permanent injunctive relief would not be enforceable because the power to grant injunctive relief is a power vested solely in Indian courts. An arbitral tribunal is not considered a competent authority to enter an injunction under Indian civil laws. However, if an arbitral award contains factual findings necessitating an injunction, the party seeking such relief in India would be able to make a separate application in a civil court based upon those findings. A civil court would consider an arbitral tribunal’s findings to be persuasive and would give such findings weight in rendering its decision as to whether injunctive relief is warranted.

Lastly, attorney fees are considered “costs” in Indian jurisprudence and are general paid by the losing party. Regardless, the award of fees is not contrary to the public policy of India and will be enforced if included in an arbitral award.

South Africa64

Africa is another attractive development area for franchisors because of the growing consumer purchasing power. “It is estimated that African consumers will spend $2.2 trillion on goods and services by 2030.”65 The Republic of South Africa has a GDP of $592 billion and has received $139.7 billion in foreign investments.66 South Africa adopted the New York Convention through the promulgation of the Recognition and Enforcement of Foreign Arbitral Awards Act of 1977 (Recognition Act).


64. The authors consulted with Darryl Bernstein, a partner in the Johannesburg office of Baker & McKenzie, and Darren Band, a director with the law firm EN Safrica, also in Johannesburg.


The Recognition Act provides that parties seeking to enforce an arbitral award may file an application with the appropriate South African High Court. If the application is granted, the arbitral award will be made an order of that court and can be enforced as such. An application for an order of the court must include either the original foreign arbitral award and arbitration agreement, “authenticated in the manner in which foreign documents may be authenticated to enable them to be produced in any court,” or a certified copy of the award and the agreement. Additionally, if the award or the agreement is in any language other than one of the official languages of the Republic (of which English is one), the party seeking enforcement must submit a sworn translation into one of the official languages that has been properly authenticated. The process to enforce an award generally takes between one and six months, depending on whether the award is opposed. If unopposed, the process to enforce the award will likely cost approximately ZAE 50000, or roughly $5,000.

South African courts recognize a number of defenses to the enforcement of a foreign arbitral award. These exceptions are provided for in Section 4 of the Recognition Act and are essentially identical to the exceptions set forth in the New York Convention noted earlier in this article. In addition to these exceptions, it should further be noted that a defendant attempting to avoid enforcement of an arbitral award may argue that the absence of the consent of the minister of trade and industry precludes enforcement if the underlying transaction between the parties falls within the scope of Section 1(3) of the Protection of Businesses Act 99 of 1978. The Protection of Businesses Act, however, has been interpreted narrowly by the courts, and the requirement of obtaining ministerial consent is limited to acts or transactions involving raw materials or substances used to manufacture goods and excludes the manufactured goods themselves; thus, it is unlikely that the Act would impact the enforcement of an arbitral award obtained in the franchising context. Furthermore, the counsel we consulted was not aware of any recorded instance in South African case law in which a defendant successfully avoided the enforcement of an arbitral award based upon the Protection of Businesses Act.

With regard to franchisees attempting to avoid the enforcement of foreign arbitral awards, there are no specific exceptions to the New York Convention upon which they may rely. There is, however, consumer protection legislation that applies to franchise agreements, which arguably include distribution, licensing, and agency agreements in this context. The Consumer Protection Act of 1998 applies to every transaction occurring in South Africa, unless exempted by the minister, and provides comprehensive requirements to which franchise agreements must conform. Accordingly, where an award does not meet or negates these requirements, there may be grounds to raise opposition to enforcement on the basis of public policy. The success of

---

67. Recognition and Enforcement of Foreign Arbitral Awards Act 40 of 1977 s. 3(a)(i).
such an argument would depend on the facts and the extent of deviation from South Africa’s public policy.

Public policy in South Africa does not prevent a party from enforcing a foreign arbitral award of liquidated damages. Any foreign award for liquidated damages enforced by a South African court will be converted into local currency (South African Rand) at the prevailing exchange rate as of the date of the award. Treble and punitive damages, however, are generally not recognized under South African law, and an injured party is entitled to no more than compensation for actual damages. The quantum of damages awarded is in no way dependent upon the reprehensible behavior of the defendant. Thus, punitive or multiplied damages have, for the most part, been regarded as contrary to South African public policy.

The courts have made allowances for the enforcement of foreign judgments which include punitive damages, but only on a case-by-case basis. As an example, in the case of Jones v Krok 1996(1) SA 504 (T), an American plaintiff sought to enforce a judgment from the Superior Court of the State of California in a South African court against a South African defendant. The foreign judgment was for $13 million in compensatory damages and $12 million in punitive or exemplary damages. The defendant argued that recognizing and enforcing an award of punitive damages, being alien to South African law, would be contrary to South African public policy. The court held that the mere fact that foreign awards are made on a basis not recognized in South Africa does not necessarily mean they are contrary to public policy. Whether a foreign judgment is contrary to South African policy depends on the facts in each case. Ultimately, the award for punitive damages was so exorbitant that the court held that to enforce it would be contrary to South African public policy. However, this holding suggests that the South African courts have not foreclosed upon the possibility of enforcing an award which provides for treble or punitive damages. Generally speaking, however, it is unlikely that an arbitration award providing for treble damages pursuant to the Lanham Act would be recognized by a High Court of South Africa without a comprehensive justification.

Public policy in South Africa would not prevent the enforcement of an arbitral award that included preliminary injunctive relief, permanent injunctive relief, or a determination as to the validity of a trademark. While the determination as to whether to enforce is proper would need to be made on a case-by-case basis, such relief would appear to be compatible with national legislation, including the Trade Marks Act of 1993, which recognizes and protects well-known international trademarks under the Paris Convention. To the extent that an arbitral award falls out of line with the Paris Convention, the issue would be determined in accordance with public policy.

Finally, attorney fees and the cost of proceedings generally “follow the cause” and are awarded to a successful litigant. As such, it is unlikely that a reasonable award of fees would offend public policy in South Africa. Excessive fees, however, might be subject to a challenge.
Brazil

The Federative Republic of Brazil has a population of approximately 201 million and has received $595.7 billion in foreign investments. Franchises in Brazil generated $44 billion in profits in 2011. Brazil acceded to the Convention in 2002 through the passage of Legislative Decree No. 4.311/2002. However, prior to Brazil’s adoption of the Convention, arbitration had already been increasingly utilized as an alternative to litigation largely as a result of the passing of Brazil’s arbitration law, Law No. 9.307/1996 (Arbitration Act). Subsequent to the passage of the Convention, the legislature amended the Arbitration Act to include Articles 37 through 39, which essentially replicate Articles IV and V of the New York Convention.

For an arbitral award to be enforceable in Brazil, it must be approved by the Superior Court of Justice, the highest court in Brazil for non-constitutional questions of law. When examining a party’s application for the ratification of a foreign arbitral award, the court will not review the merits of the award, but rather will only conduct an analysis to determine whether the formal requirements of the Convention and the analogous provisions of the Arbitration Act have been satisfied. Once ratified, an arbitral award is fully enforceable in any court in Brazil. As a general rule, the Brazilian courts during both the ratification of an award and its execution respect and embrace the decisions rendered by arbitrators in foreign arbitration proceedings.

The Superior Court of Justice will ratify an award which contains relief in the form of liquidated damages. Article 210 of Brazilian Law No. 9.279 (Industrial Property Law) provides for a similar form of relief. Specifically, it provides as follows:

Loss of profits shall be determined using the most favorable criterion to the aggrieved party, which include:

I. the benefits that the aggrieved party would have made if the violation had not occurred;
II. the benefits made by the perpetrator of the violation of the right; or
III. the remuneration that the perpetrator of the violation would have paid to the titleholder of the violated right through the granting of a license that would have allowed him to lawfully exploit the property.

68. The authors consulted with attorneys Luiz Henrique Oliveira do Amaral and Rodrigo Torres, members of Dannemann Siemsen in Rio de Janeiro.
72. Id.
As such, Brazil seemingly has implemented a legislative scheme providing for relief similar to liquidated damages permitted under the Lanham Act.

Arbitral awards which provide for treble damages are likewise enforceable in Brazil. However, the award should note that the treble damages amount to a penalty so that the Brazilian Court understands why such damages are higher than the actual damages suffered by the party seeking ratification and enforcement. Provided that it does not fall within one of the exceptions set forth under Article V of the Convention, the Superior Court of Justice will ratify a foreign arbitral award which includes preliminary or permanent injunctive relief, thereby rendering it enforceable. Finally, attorney fees are recoverable in Brazil, and thus, an arbitral award providing for the imposition of fees would be enforceable. Like awards for treble damages, the arbitral award should specify the portion of the amount attributable to attorney fees.

Moving Forward

Franchisors seeking to expand into an international market should be aware of issues that may arise in connection with the enforcement of an arbitral award obtained in the United States. While these issues cannot be avoided, franchisors should take certain steps to better safeguard themselves, even before the franchise relationship begins and during the drafting and negotiation process. Here are some practical considerations and recommendation when preparing an agreement:

- Most importantly, there must be an express arbitration clause in the franchise agreement because certain arbitration organizations like the AAA and JAMS require a provision allowing them to arbitrate the matter.
- State the venue of the arbitration.
- Specify the choice of law that will govern the franchise agreement. AAA and other organizations also have their own set of rules. In addition, keep in mind that if the franchisee is a foreign citizen or company, the Ninth Circuit looks at the exterritorial application of the Lanham Act more favorably than other jurisdictions.
- Because the exterritorial application of the Lanham Act may be an issue, the franchise agreement should not only provide that U.S. law (including the Lanham Act) applies, it should spell out compensatory and liquidated damages as well as injunctive relief. If Lanham Act damages are not awarded, the franchisor may still be able to receive other forms of recovery.
- The parties should provide for a formula for calculating any liquidated damages and should state that it would be difficult to otherwise predict and calculate liquidated damages. In addition, the parties should agree that liquidated damages are not a penalty, but merely a reasonable calculation of what the franchisor would have received in royalties had the franchise agreement not been terminated prematurely.
• Provide a provision for the award of attorney fees and costs to the franchisor should it be forced to bring an arbitration proceeding against the franchisee.

• Because it may take some time to arbitrate and enforce an award, the franchisor may wish to provide for the calculation of interest from the time a royalty payment is overdue.

• Even if a country is a member to the New York Convention, it may have its own particular rules for domesticating and enforcing the arbitral award. Public policy issues unique to each country also could potentially present problems. Thus, if possible, franchisors should consult local counsel even before considering expansion to that market. Certainly, franchisors should consult such counsel prior to concluding an arbitration to make sure the actual award is written and positioned for optimal enforcement.
ALTERNATIVES TO FRANCHISING

*Bennett v. Itochu Int’l, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,313, 572 F. App’x 80 (3d Cir. 2014)

In 2007, appellants and respondents started negotiations for two cooperative business ventures: one involved an investment by respondents in appellants’ firm; the second involved a joint venture to sell medication-mixing robots. For various reasons, neither of the projects materialized. On appeal, two substantive issues were raised: (1) whether respondents breached their duty to negotiate in good faith; and (2) whether appellants were entitled to rely on promissory estoppel.

With respect to the duty of good faith argument, the Third Circuit affirmed the decision of the district court for two reasons: (1) appellants failed to identify a specific promise to negotiate in good faith; and (2) the term sheet relied upon by appellants used “unambiguous language to disclaim any intent by the parties to bind each other.”

The court noted that a duty to negotiate in good faith requires a binding agreement between the parties expressing their commitment to negotiate in good faith and reach an agreement. Therefore, the language in the term sheet was fatal to appellants’ claim. The court also upheld the district court’s
decision with respect to the promissory estoppel argument, holding that appellants’ reliance on oral promises was contradicted by the parties’ signed writings, which clearly state that any binding agreement results only from a formal, written contract.

Appellants also sought to rely on an oral promise that respondents would be an equal partner in the joint venture. Appellants admitted that they knew the equal partnership was contingent on approval from respondents’ investment committee. The court held that reliance on a contingent promise is unreasonable as a matter of law.

AMERICANS WITH DISABILITIES ACT


Portia Lemmons brought an action against her local hardware store (the franchisee) and its franchisor, Ace Hardware Corporation, for discrimination under the Unruh Act and the California Disabled Persons Act (CDPA). The claims were both predicated on violations of Title III of the Americans with Disabilities Act (ADA). Lemmons moved for summary judgment of her claims under the Unruh Act and the CDPA. Both Ace and the franchisee opposed the motion and moved for summary judgment as to Lemmons’ claims against Ace on the ground that Ace was not an owner, lessee, or operator for the purposes of the ADA.

The U.S. District Court for the Northern District of California granted summary judgment to Lemmons on her claim under the Unruh Act with respect to the franchisee. The court also granted summary judgment to Ace with respect to claims brought against it. The court held that, in the absence of evidence showing Ace could dictate the physical layout of the store or that its conduct was otherwise discriminatory against Lemmons, Ace was not an operator for the purposes of the ADA.

Although Lemmons’ evidence showed that, under the franchise agreement, Ace required the franchisee to abide by all federal and state laws, including those pertaining to disability access, the court held this evidence was insufficient because the contractual terms alone did not grant Ace control of the physical layout of the store. It held a franchisor will be seen as the operator only where there is evidence that the franchisor has control over a store such that it can ensure nondiscrimination against the disabled.

ANTITRUST

*Dunlap v. Cottman Transmissions Sys., LLC*, Bus. Franchise Guide (CCH) ¶ 15,325, 539 F. App’x 69 (4th Cir. 2013)

This case is discussed under the topic heading “Tortious Interference.”
ARBITRATION

*Druco Rest., Inc.* v. *Steak n Shake Enter., Inc.*, Bus. Franchise Guide (CCH) ¶ 15,354, 765 F.3d 776 (7th Cir. 2014)

The Seventh Circuit affirmed a federal district court’s refusal to stay litigation and compel nonbinding arbitration of claims brought by Steak n Shake franchisees in three separate actions, finding the parties’ agreements to arbitrate illusory under Indiana law.

Plaintiffs Druco Restaurants, Inc., Scott’s S&S, Inc., and People Sales & Profit Co. (PSPC) are all current Steak n Shake franchisees with several restaurants in Missouri, Pennsylvania, and Georgia. All of the franchise agreements they signed contain a venue and dispute resolution provision, and all but one of those provisions (known as the Brunswick Agreement) states that: Steak n Shake “reserves the right to institute at any time a system of non-binding arbitration or mediation[;]” the franchisee “will be obligated to participate in such system, at [Steak n Shake’s] request, in the event of a dispute[;]” and the Federal Arbitration Act (FAA) applies to the arbitration clauses.

Steak n Shake adopted its arbitration policy about one month after plaintiffs filed suit in Indiana federal court, seeking declaratory judgment and other relief from Steak n Shake’s pricing and promotion policy, which requires system wide adherence to corporate menu pricing and promotions. According to plaintiffs, under the terms of their franchise agreements, they, not Steak n Shake, may set their own menu prices and decide whether to participate in corporate promotions. The arbitration policy Steak n Shake adopted provides, in relevant part:

> If a lawsuit is filed in which claims are based on or arise out of a franchise agreement between the Company and a franchisee, and the franchise agreement at issue permits the Company to require the franchisee to participate in nonbinding arbitration or mediation, the parties shall, at the request of the Company, submit to nonbinding arbitration or mediation as described in the applicable franchise agreement. . . . If the underlying franchise agreement permits the Company to require participation in arbitration, the proceedings will be conducted . . . according to the then-current Commercial Arbitration Rules of the American Arbitration Association. . . . All matters relating to an arbitration will be governed by the [FAA] except that the decision of the arbitrator will be nonbinding.

Pursuant to the arbitration clauses and arbitration policy, Steak n Shake initiated arbitration proceedings with the American Arbitration Association (AAA) and moved the district court to compel nonbinding arbitration of all of the plaintiffs’ claims, except for those relating to the Brunswick Agreement, which were not subject to arbitration, and to stay the lawsuits pending the outcome of arbitration. The district court denied the motions in all three cases, finding that the agreements to arbitrate were illusory because there was no limit on Steak n Shake’s ability to arbitrate (or to avoid arbitration) on a whim. According to the district court, performance of the arbitration clause was entirely optional for Steak n Shake, and Steak n Shake retained the ability to terminate its system of arbitration at any time.

Plaintiff (Moody) purchased a metal supply franchise from defendant (MSFA). In connection with the sale, Moody entered into a franchise agreement with MSFA that contained an arbitration provision requiring both sides to submit disputes to arbitration, but permitted only MSFA to turn to courts for injunctive relief. After a dispute arose, MSFA sought to compel arbitration, and Moody sought to invalidate the arbitration provision on the grounds that its lack of mutuality made it unconscionable.

In arguing his position, Moody relied primarily on precedent established in an employment law case, in which a one-sided arbitration provision was found unconscionable even though the plaintiff was represented by an attorney and negotiated other provisions of the agreement. However, the district court pointed out that in reaching that decision the court deciding the employment law case applied a sliding scale test, holding the higher the substantive unconscionability, the lower the requirement for procedural unconscionability. In that case, the dispute resolution provision contained not just a one-sided arbitration provision, but also required the plaintiff to engage in discussions with his supervisors before submitting the dispute to arbitration, thereby giving the defendant a peek at the plaintiff’s case. The fact that the employee was represented by counsel was therefore outweighed by the high degree of substantive unconscionability of the provision. With respect to the present case, the court held that Moody’s arbitration provision was less substantively unconscionable, so the precedent of the employment case did not apply. The court granted MSFA’s motion to compel arbitration.

MFSA also sought reimbursement of attorney fees from Moody. The court held that MFSA was not entitled to such fees because the attorney fee provision in the franchise agreement granted the prevailing party fees and costs only for claims for money owed by the franchisee or for breach of the franchise agreement by the franchisee. In the present case, Moody’s cause of action was for clarification of the parties’ rights and obligations related to certain contractual provisions, not for money owed or breach of the agreement; therefore, the attorney fees provision did not apply.


This case reinforces the principle that a party may seek preliminary injunctive relief in an otherwise arbitrable dispute without forfeiting its right to arbitration. Defendants, former Pla-Fit franchisees, entered into franchise agreements for two gyms in Massachusetts. Within months of entering into the agreements, the franchisees disputed with the franchisor on a variety of financial and operational issues that ultimately resulted in the franchisees filing a lawsuit in the U.S. District Court for the District of Massachusetts
for breach of contract, conversion, and violation of the Massachusetts Consumer Protection Statute.

The franchise agreements at issue both contained mandatory arbitration provisions, and Pla-Fit successfully moved the Massachusetts court to compel arbitration on that basis. Before the matters were compelled to arbitration, Pla-Fit sent the franchisees default notices for certain chronic violations of the franchise agreements and demanded that the franchisees cure such defaults within thirty days. The parties negotiated several extensions, but were ultimately unable to resolve these issues. On November 11, 2013—about four months after the motion to compel arbitration was granted but before either party commenced any arbitration proceeding—Pla-Fit sent the franchisees termination notices. On November 14, 2013, Pla-Fit commenced this action in the District of New Hampshire, filing a complaint seeking preliminary and permanent injunctive relief for trademark infringement, a declaratory judgment that the franchisees continued to operate a competitive businesses in violation of their franchise agreements, and damages for breach of contract. The next day, Pla-Fit filed a motion for preliminary injunction. Notably, in the complaint, Pla-Fit did not expressly reserve its right, or otherwise disclose its intention, to arbitrate those claims ancillary to its claims for injunctive relief.

A few weeks later, the franchisees agreed to de-brand their stores, mooting the motion for preliminary injunction. On December 13, 2013, Pla-Fit sent the franchisees a proposed order dismissing the New Hampshire action and submitting all disputes to arbitration. The franchisees did not agree and shortly thereafter filed an answer and counterclaims, which were substantially similar to the claims the franchisees brought in the Massachusetts action. On January 6, 2014, Pla-Fit filed a motion to compel arbitration in the New Hampshire action.

The franchisees argued that Pla-Fit waived its right to arbitration by invoking the court’s jurisdiction without expressly reserving its right to arbitrate. At the outset, the court discussed the proper standard of review for a motion to compel arbitration and noted a divide in authority between the Federal Rule of Civil Procedure 12(b)(6) standard and the summary judgment standard. The court reasoned that the standard applied depends on the materials submitted in support of the motion. Because the parties submitted documents that generally cannot be considered under the Rule 12(b)(6) standard, including affidavits and other exhibits, the court held that it would resolve the motion to compel under the summary judgment standard.

Next, the court acknowledged that a party can waive its right to arbitrate by implication, but refused to apply a blanket rule that a party automatically waives its right to arbitrate by initiating a lawsuit. “Instead, any arbitration waiver claim must be judged on its own facts and all relevant circumstances.” Here, the court noted that Pla-Fit filed its lawsuit in part to protect itself from the franchisees’ alleged trademark infringement. Under Teradyne, Inc.
v. Mostek Corp., 797 F.2d 43, 51 (1st Cir. 1986), a party may seek preliminary injunctive relief in an otherwise arbitrable dispute without forfeiting its right to arbitration. Although noting that the best practice is to expressly reserve the right to arbitrate in the complaint, the court observed that Pla-Fit revealed its proposal to arbitrate to the franchisees within days after its request for injunctive relief was mooted.

The franchisees argued they were nevertheless prejudiced by Pla-Fit’s actions in commencing the New Hampshire lawsuit. The First Circuit emphasized prejudice as a key factor in any waiver analysis, and stated the elements to a prejudice inquiry include: (1) the length of the delay, (2) the litigation activities engaged in, and (3) whether a party has been unfairly misled in the process. See Restoration Pres. Masonary, Inc. v. Grove Eur., Ltd., 325 F.3d 54, 61 (1st Cir. 2003). The court held that Pla-Fit failed to establish prejudice under any of these prongs.

First, as to the length of the delay, the court noted that Pla-Fit informed the franchisees of its intention to arbitrate less than three weeks after the franchisees agreed to de-brand, and Pla-Fit moved to compel arbitration within two months after the parties were unable to reach a mutual agreement to arbitrate. Also important to the court’s delay analysis was the fact that neither party had engaged in any discovery other than the submission of a joint discovery plan.

Second, the franchisees argued that because of Pla-Fit’s actions they were forced to (1) retain local counsel, (2) answer the complaint, (3) de-brand more quickly than they would have otherwise, (4) file pro hac vice motions for their counsel, and (5) file the discovery plan mentioned earlier. The court observed that the franchisees would have had to do the first three tasks in order to respond to the motion for preliminary injunction even if Pla-Fit had immediately invoked its right to arbitrate all other matters in the complaint. The last two tasks were given little weight because the franchisees voluntarily undertook them after Pla-Fit filed its motion to compel arbitration.

Third, the court held that the primary reason Pla-Fit filed the complaint was to protect its trademark rights. Because the franchisees knew or should have known that Pla-Fit wished to arbitrate any remaining claims, they were not unfairly misled.

Finally, the court rejected the franchisees’ argument that Pla-Fit acted in bad faith. The court disregarded their argument that they were entitled to joint arbitrations because the arbitration provision did not provide for such relief. Accordingly, the court granted the motion to compel arbitration and stayed the lawsuit until such arbitration occurred.


Plaintiffs entered into a franchise agreement with defendant franchisor and incurred significant debt in opening and operating the franchised restaurant
instead of realizing profits that they had expected. Plaintiffs’ attorney contacted defendant, claiming the defendant and some of its principals violated the Maryland Franchise Registration and Disclosure Law. The attorney asked defendant to discuss mediation. The franchisor, however, then filed a demand for arbitration and plaintiffs argued the arbitration clause in the franchise agreement was unenforceable under the Maryland Franchise Law.

Plaintiffs then filed suit against defendants, alleging fraud and violations of the Maryland Franchise Law and seeking declaratory judgments and injunctive relief from the pending arbitration. Thus, the U.S. District Court for the District of Maryland had to determine whether the arbitration clause was valid and enforceable. Plaintiffs filed a motion for preliminary injunction seeking relief from the pending arbitration and defendants filed a cross-motion to compel arbitration and to stay the action in court.

The court held that Congress enacted the Federal Arbitration Act to promote the enforceability of arbitration agreements, and the question was whether the franchise agreements included a valid arbitration provision pertaining to this dispute. Because arbitration is a matter of contract, the court applied contract law to determine whether the arbitration clause was valid and enforceable. In particular, the court looked to whether or not the arbitration clause at issue was ambiguous when read in conjunction with the “Maryland Clause” in the agreement, which provided for modification of contract provisions inconsistent with state law and stated that the provisions of the franchise agreement do not require the franchisee to waive its right to file a lawsuit alleging a cause of action under the Maryland Franchise Law.

The franchisor argued that the arbitration clause could function in harmony with the “Maryland Clause” to mean that a franchisee generally has the right to filed suit in Maryland but that the franchisees here voluntarily waived that right in the franchise agreement and were therefore bound to the arbitration clause. Under this reading, the arbitration clause would be valid and enforceable. On the other hand, the franchisees argued that the “Maryland Clause” controlled and operated to free them from the arbitration clause.

The court held that the contract language was ambiguous. Because the franchise agreement was ambiguous as to whether the parties intended to arbitrate as opposed to litigate franchise claims arising under the Maryland Franchise Law and whether the franchise agreement required such claims to be brought in Texas or Maryland, the court held that these issues must be resolved through a jury trial.


This case is discussed under the topic heading “Fraud.”
ATTORNEY FEES


Plaintiff, a franchisee auto dealer (Autofair), appealed an order granting summary judgment to defendant franchisor (American Honda) on Autofair’s petition for attorney fees. Autofair successfully petitioned the New Hampshire Motor Vehicle Industry Board to reduce “chargebacks” imposed by American Honda following an audit into warranty repair work on motor vehicles.

Autofair filed a petition for attorney fees and costs pursuant to the New Hampshire Dealership Act, which provided in part that a prevailing party is entitled to reasonable attorney fees when the Board finds the other party has violated the Act. While the appeal was pending, the legislature amended the Act to add a definition of “chargeback.” At dispute was whether this section could be applied retrospectively.

The Supreme Court of New Hampshire held that if American Honda could propose chargebacks without violating the Act prior to the amendment, even though the amended Act prohibited those same proposed chargebacks, then the amendment placed a new disability on American Honda and could not be applied retrospectively. The court found that prior to the amendment, the Act prohibited American Honda from making certain chargebacks. In contrast, following the amendment, the Act prohibited even announcing an intention to impose chargebacks.

Because the proposed chargebacks would not violate the Act prior to the enactment of the amendment, but would violate it under the amended scheme, the court found the Act could not be applied retrospectively. On this basis, the court affirmed the trial court’s order granting summary judgment.

Laguna v. Coverall N. Am., Inc., Bus. Franchise Guide (CCH) ¶ 15,299, 753 F.3d 918 (9th Cir. 2014)

The United States Court of Appeals for the Ninth Circuit upheld a district court’s approval of a settlement that included an attorneys fee award of $994,800 to plaintiffs’ counsel. After two years of litigation, Coverall North America, Inc. (Coverall) and a group of its franchisees reached a settlement in a class action filed by the franchisees, alleging Coverall misclassified its California franchisees as independent contractors, breached its franchise agreements, and committed fraudulent and unfair practices by removing customer accounts from franchisees without cause in order to resell them. Amit Singh, a class member, was the sole objector to the proposed settlement, and in particular, to the proposed award of $994,800 in attorney fees. The district court approved the settlement and Singh appealed.
At the outset, the Ninth Circuit noted that when a class action settlement is submitted for approval, the initial decision to approve or reject is committed to the sound discretion of the district court. Here, the district court determined that the settlement was fundamentally fair, adequate, and reasonable over Singh’s objections to: (1) the conditional assignment of customer accounts to the franchisees until the franchisees paid the franchise fees in full, (2) former franchisees each receiving $475 and a $750 credit toward a new franchise, (3) new franchises having a 30-day rescission right to receive all money they paid, except for the $75 investigation fee, and (4) attorney fees of $994,800.

Taking the fee award first, the Ninth Circuit determined that the district court had an independent obligation to ensure the award itself was reasonable even though the parties agreed to it. But, the court continued that in the context of a settlement where fees are the subject of compromise, the district court need not inquire into the reasonableness of the fees with the same level of scrutiny as when the fee amount is litigated.

Depending on the circumstances, there are two methods that may be used to calculate a reasonable attorneys’ fee award. The lodestar method is appropriate when the relief sought is primarily injunctive in nature, so the Ninth Circuit concluded that the district court correctly used the lodestar method in gauging the fairness of the attorneys’ fee award in this case because the settlement provisions were mostly injunctive in nature.

The Ninth Circuit found that the district court had correctly calculated the lodestar amount and had reasonably concluded that the agreed upon award was appropriate. In its analysis, the district court noted that the case was contentiously litigated for over two years and in that time plaintiffs’ counsel had collectively billed over 4,500 hours. Based on that number, the district court calculated the lodestar amount to be almost $3 million. Thus, the attorney fees award of $994,800—not even one-third of the lodestar—was reasonable. The district court then cross-checked the reasonableness of the award by applying the percentage-of-recovery method using a benchmark figure of 25%, which is an appropriate gauge in common fund settlement cases. Here, Singh valued the settlement at $56,525 while the plaintiffs ascribed a $20 million valuation. The district court found that Singh’s figure did not give any value to the injunctive relief, and it correctly surmised that even if the plaintiffs’ value was high, the value of the settlement only needed to be $4 million for the fees awarded to plaintiffs’ class counsel to be within the normal bounds of reasonableness under the percentage-of-recovery method.

Singh’s principal argument against the reasonableness of the fee award was that the actual value of the settlement, which he characterized as primarily the amount of cash payments, was so low (i.e., $475 per plaintiff in the class). Although the Ninth Circuit observed that Singh had correctly noted the benefit obtained for the class was important in determining
whether to adjust the lodestar amount, any such adjustment was equitable and squarely within the discretion of the district court. The Ninth Circuit added that Singh presented no evidence that the district court abused its discretion in declining further adjustment from the lodestar and that the district court acted within its proper discretion when it concluded the settlement contained significant benefits for the class plaintiffs beyond the cash recovery. For all of these reasons, the Ninth Circuit affirmed the district court’s award of $994,800 to the class action plaintiffs’ counsel.

Next, turning to the settlement as a whole, the Ninth Circuit determined that the district court did not abuse its discretion in finding the settlement to be fundamentally fair under the Churchill factors. These include the strength of the plaintiffs’ case; the risk, expense, complexity and likely duration of further litigation; the risk of maintaining class action status throughout the trial; the amount offered in settlement; the extent of discovery completed and the stage of the proceedings; the experience and views of counsel; the presence of a governmental participant; and the reaction of class members to the proposed settlement. In particular, the Ninth Circuit restated with approval the district court’s evaluation of the various risks of continuing in litigation: California employment law and other Supreme Court decisions would make obtaining class certification difficult or might prove fatal to class certification; Coverall was in a difficult financial position which increased risks to the plaintiffs; and there was no governmental entity involved. And, it noted that the settlement contained significant benefits to the plaintiffs, especially in the assignment of accounts.

Singh argued that the district court was under a special obligation to make clear fact-based findings on the value of the nonmonetary terms. The Ninth Circuit disagreed, stating that district courts have no obligation to make explicit monetary valuations of an injunction term and that such valuations would be difficult and imprecise.

Singh also argued that there were “warning signs” of collusion that should have made the district court exercise a heightened review. The Ninth Circuit found that the first warning sign of disproportionate distribution to counsel was not present because the district court found the fee award to be reasonable. The Ninth Circuit agreed. The next warning sign—presence of a reversion clause—was present because the payment to the former franchisees would revert to the franchisor if the franchisees did not file. However, the Ninth Circuit found that the district court balanced this factor with the overall settlement benefits.

In addition, Singh claimed a violation of the Class Action Fairness Act and requested rejection of the settlement. The Ninth Circuit found that Singh did not have standing because the remedy for a violation of that Act was to be exempt from the settlement—not rejection, and Coverall had properly notified the California Attorney General. Finally, the Ninth Circuit found there was no abuse of discretion in requiring objectors be available for depositions as it is a common requirement.

Jack in the Box, Inc. (JIB) sued two former franchisees in Northern California, alleging various claims relating to the franchisees’ failure to make timely payments under the franchise agreement and lease. Before the court was a motion by JIB to amend the court’s prior orders and approve a private foreclosure sale between JIB and a bank that lent money to the franchisees and therefore had a security interest in collateral in the franchisees’ restaurants. The franchisees objected to the foreclosure sale.

In 2012, the franchisees executed a promissory note and security agreement with the bank that granted the bank a security interest in the interior fixtures and furnishings used to operate the franchised restaurants. JIB consented to the bank obtaining a security interest in the collateral and agreed that its own security interest would be subordinate to that of the bank. After JIB initiated the lawsuit against the franchisees, the bank moved the court to intervene. While the intervention motion was pending, the court granted an order, which permitted JIB to take over operations of the franchisees’ restaurants (Turnover Order). The Turnover Order enjoined creditors from taking any actions that would in any way interfere with JIB’s control of the restaurants. JIB and the bank jointly sought a modification of the Turnover Order to allow for the foreclosure sale of certain assets of the restaurants from the bank to JIB.

The court examined the California Commercial Code sections which apply to remedies available to secured parties and noted that all disposition of assets in any way must be “commercially reasonable.” Although the code expressly identifies three conditions of a commercially reasonable sale, those conditions are not exclusive and the issue is “generally a question of fact and depends on all of the circumstances existing at the time of the sale.”

The specific terms of the asset purchase agreement between JIB and the bank were filed under seal, and the court only noted that JIB agreed to purchase from the bank all of the bank’s collateral. JIB argued that the foreclosure sale was “commercially reasonable” for three reasons. First, the
asset purchase agreement was negotiated at arm’s length and between sophisticated business entities that were interested in selling at the highest price and buying at the lowest price. Second, the nature of the collateral is more valuable if purchased “in place” as opposed to being sold off in pieces at a private sale. Third, the sale includes terms consistent with the code’s requirements regarding notice and the transfer of ownership rights.

The franchisees argued that JIB had no standing to negotiate such a sale and the approval of the sale would violate the franchisees’ due process rights. The court rejected that argument because it ignores that the franchisees’ defaulted on their financing agreement with the bank. Any argument that JIB had no standing was irrelevant because the bank was entitled to “sell, lease, license, or otherwise dispose of any or all of the collateral” under California Commercial Code § 9610.

The franchisees also argued that the foreclosure sale was premature before trial. The court disagreed and noted that the trial related to issues between JIB and the franchisees and had no bearing on the financing arrangement between the franchisees and the bank. Lastly, the court rejected the franchisees’ argument that the franchisees could have negotiated a higher price for the sale of the collateral, reasoning it was mere “speculation.”

Because the terms of the sale were commercially reasonable, the court granted the motion to amend the Turnover Order and approved the foreclosure sale.


Following Chapter 11 Bankruptcy filing by four franchisees owned by defendant (Kazi) operating 142 KFC restaurants, plaintiff KFC Corporation (KFC) sought to collect various debts covered by guarantees signed by Kazi for each restaurant. Kazi moved for summary judgment dismissing KFC’s claim on the basis that the guarantees were not enforceable.

In dismissing the motion, the district court for the Western District of Kentucky found that the guarantees were enforceable under the second prong of Kentucky’s guarantee statute since they expressly referred to the instruments being guaranteed. The court found each guarantee expressly referred to the franchise agreement and specifically identified each restaurant by its geographic street and address. As a result, the court held KFC could enforce the guarantees to collect royalty payments, advertising payments, de-imaging costs and equipment lease payments. Each of these obligations was specifically contemplated in each restaurant’s franchise agreement, and the subject of each guarantee expressly referred to the corresponding restaurant’s franchise agreement. However, the court found that a $250,000 liability cap in each guarantee applied for each restaurant.
BREAKAWAY FRANCHISEES


This case is discussed under the topic heading “Non-Compete Agreements.”


A breakaway franchisee moved to dismiss the franchisor’s counterclaims for breach of contract and misappropriation of trade secrets, but the court ruled that the franchisor stated plausible breach of contract claims and denied the motion. In this case, a Roanoke franchisee claimed that the franchisor of Mirko’s Pasta restaurants fraudulently induced it into entering the franchise agreement by making claims concerning the financial viability of a Mirko’s Pasta franchise. The franchisee (Bans) filed a lawsuit seeking rescission and re-opened its location as a different Italian restaurant. The franchisor (Mirko) counterclaimed for breach of contract, breach of personal guaranty, and misappropriation of trade secrets. Mirko alleged that the franchisee wrote a letter, which constructively terminated the franchise agreement, but continued to operate an Italian restaurant at the location while using Mirko’s proprietary signage, recipes and specifications for roughly five months prior to de-identifying and re-opening.

The franchisee argued that Mirko failed to state any claim upon which relief could be granted. The U.S. District Court for the Western District of Virginia disagreed, holding that the franchisor properly pleaded its claims for breach of contract because it alleged that Bans breached its obligations by, among other things, failing to continuously operate the restaurant, operating another business at the location, using Mirko’s proprietary marks without authorization, disclosing Mirko’s confidential information, not returning the confidential operations manual, and failing to pay royalties owed. The court rejected the franchisee’s argument that Mirko’s counterclaims failed to make adequate factual allegations to support its breach of contract and guaranty claims.

The franchisee also argued that Mirko could not assert its breach of contract claims seeking injunctive relief. It could not establish any threat of irreparable injury because the competing restaurant at the location had already been shut down. The court disagreed, holding instead that Mirko could seek injunctive relief enjoining disclosure of confidential information and the return of the operations manuals, at a minimum.

Finally, the franchisee challenged Mirko’s misappropriation of trade secrets claim because it could not plead a plausible claim on the statutory element that it acquired the knowledge of the trade secret by “improper means.” The court found Mirko’s allegations legally sufficient—that it divulged confidential information to the franchisee, that the franchisee
agreed to keep that information confidential, but used that information in a competing restaurant. The motion to dismiss the franchisor's counterclaims was therefore dismissed.


Plaintiff franchisor moved for a default judgment against a franchisee for claims of breach of contract, unfair competition in violation of the Lanham Act, trademark dilution under the Lanham Act, unfair competition and trade name infringement under Maryland common law, and tortious interference with contract. The franchisee failed to pay fees when due and after termination, failed to stop identifying the business as a Ledo Pizza store, and continued to sell food at the business following termination despite the covenant not to compete in the franchise agreement.

The U.S. District Court for the District of Maryland awarded the franchisor a default judgment for its claim of unfair competition under the Lanham Act because it owned a valid trademark, defendant used the mark in commerce without authorization, defendant used the mark in the sale of goods, and the defendant’s use of the mark was likely to cause confusion among consumers. The franchisor was also awarded a default judgment for its claim of trademark dilution under the Lanham Act because it was able to show that the trademark was famous, defendant was making commercial use of the mark in commerce, defendant’s use began after the mark became famous, and the defendant’s use of the mark diluted the quality of the mark by diminishing the capacity of the mark to identify and distinguish goods and services.

The franchisor was also awarded a default judgment for its claim for unfair competition and trade name infringement under Maryland common law because it showed that the defendant was using its mark without the right to do so. Plaintiff was awarded damages, attorney fees and costs, and a permanent injunction. The court awarded a permanent injunction because it held that the franchisor would suffer irreparable harm due to a loss of reputation and harm to goodwill. The equities also tipped in the franchisor’s favor because the franchisor worked with the franchisee to provide an opportunity to avoid termination prior to actual termination.


This case is discussed under the topic heading “Injunctive Relief.”


This case is discussed under the topic heading “Jurisdiction.”
CHOICE OF FORUM


The U.S. District Court for the District of Puerto Rico approved a transfer of venue to Florida despite Puerto Rico’s law stating that any stipulation to litigate outside of Puerto Rico is null and void. Burger King Corporation (BKC), a Florida corporation with its principal place of business in Florida, entered into 182 franchise agreements with Caribbean Restaurants, LLC (Caribbean), a Delaware company with its principal place of business in Puerto Rico, for locations to be operated in Puerto Rico. A dispute arose over BKC’s alleged attempt to take control over Caribbean’s expenditure of advertising, promotion, and public relation funds. Caribbean filed suit in the district court, alleging BKC breached its contracts and requesting damages, injunctive relief, and declaratory relief. BKC moved to dismiss under Federal Rule of Civil Procedure 12(b)(6) or, alternatively, sought to transfer venue to the Southern District of Florida.

The district court decided to treat BKC’s motion to dismiss solely as a motion to transfer under 28 U.S.C. § 1404(a) and analyzed the request under the Supreme Court’s decision in Atlantic Marine Construction Co., Inc. v. U.S. District Court, 134 S. Ct. 568 (2013). Under Atlantic Marine, the party acting in violation of a forum-selection clause bears the burden of showing that public interest factors overwhelmingly disfavor a transfer “insofar as all private interests” weigh in favor of a transfer.

Here, the court first evaluated whether the clause in the agreements stating that Florida was “the exclusive venue and proper forum” was valid. Caribbean argued that the venue clause was not valid under Puerto Rico Law 75 (Dealer’s Contracts Act Law) which provides that

[a]ny stipulation that obligates a dealer to . . . litigate any controversy that comes up regarding his dealer’s contract outside of Puerto Rico, or under foreign law or rule of law, shall be likewise considered as violating the public policy set forth by this chapter and is therefore null and void.

Despite such strong statutory language, the court followed a prior Puerto Rico decision, holding that the legislature of Puerto Rico did not intend for Law 75 to allow dealers to skirt the express terms of contracts into which they willingly entered. The court found the forum selection clause here to be valid because Caribbean did not allege fraud or overreaching on the part of BKC with respect to the inclusion of the forum selection clause in the franchise agreements, Caribbean was represented by legal counsel in its contract negotiations, and it elected to enter the agreements despite seeing the provision.

Having found the forum selection clause valid, the court turned to an analysis of whether public interest overwhelmingly disfavors transfer. Relevant public interest factors include: administrative difficulties, the value in
having local controversies decided at home, and the benefit of a forum familiar with the law governing a dispute. Caribbean did not meet its burden to show that any of these public interest factors favored litigation in Puerto Rico. Rather, the court stated that the Puerto Rico court had one of the most congested criminal and civil dockets, so this factor weighed heavily in favor of transfer. The court also disagreed with Caribbean’s argument that the issue concerned economic interests in Puerto Rico, holding instead that it was a contract dispute regarding a contract explicitly executed and accepted in Florida and governed by Florida law. The court also disagreed with Caribbean’s argument that Puerto Rico’s familiarity with Law 75 was a strong factor against transfer as all other issues involved Florida law, a federal judge in Florida would be more familiar with Florida law, and in any event, a court outside of Puerto Rico had previously heard a Law 75 claim. The court held that all public interest factors weighed in favor of transfer and, therefore, granted BKC’s motion to transfer to the Southern District of Florida, the forum selected by the parties in their agreements.


Delta Alcohol Distributors commenced an action against Anheuser-Busch International, Inc. for misrepresentation, defamation, and fraud after Anheuser-Busch terminated its relationship with Delta based on alleged breaches by Delta of the Foreign Corrupt Practices Act. In response, Anheuser-Busch brought a motion to dismiss the action on the basis of a forum selection clause in the distribution agreement.

In granting the motion, the Eastern District of Michigan relied on a letter agreement between the parties stating “all disputes shall be submitted to the exclusive jurisdiction of the courts of Geneva.” The court rejected Delta’s submission that the forum selection clause should not apply where the claim was based on actions Anheuser-Busch took after the relationship had been terminated because the clause did not contain any limiting language.

The court held that where a forum selection clause is applicable, the court must determine whether dismissal on forum non conveniens grounds is appropriate. Following the Supreme Court in *Atlantic Marine Construction Co., Inc. v. U.S. District Court*, 134 S. Ct. 568, 582 (2013), the court found that where there is an applicable forum selection clause only public-interest factors may be considered under the forum non conveniens analysis. In the case at bar, it found the courts of Geneva, Switzerland, to be an available and adequate alternative forum. Moreover, the letter agreement being governed by Swiss law weighed in favor of adjudication in the Geneva courts. Finally, the majority of the alleged conduct occurred
in Iraq and not Michigan. For these reasons, the court granted Anheuser-Busch’s motion to dismiss.


The U.S. District Court for the Eastern District of Pennsylvania held that franchisor Saladworks, LLC was permitted to bring its complaint in the State of Pennsylvania against a California-based franchisee and its owner. The court found that the franchise agreement contained a valid forum selection clause that selected Pennsylvania and dismissed the franchisee’s California public policy concerns.

Saladworks sought to amend its complaint to plead the existence of a forum selection clause and defendants sought to dismiss the complaint for lack of jurisdiction or to transfer venue to California. In finding that the forum selection clause was valid, the court granted Saladworks’ motion and dismissed defendants’ motions.

Defendants argued there was strong California public policy restricting California-based franchise actions to be heard in California. The court considered and disregarded the California Business & Professions Code, which states that a “provision in a franchise agreement restricting venue to a forum outside this state is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state.” The court held that only the public policy of the jurisdiction in which the action is brought should be considered. It also held that it should not deprive Saladworks of the benefit of its bargain to have the action heard in Pennsylvania.

**CLASS ACTIONS**

**Laguna v. Coverall N. Am., Inc., Bus. Franchise Guide (CCH) ¶ 15,299, 753 F.3d 918 (9th Cir. 2014)**

This case is discussed under the topic heading “Attorney Fees.”


The U.S. District Court for the District of New Jersey held that it was premature to dismiss class action allegations claiming violations of the New Jersey Franchise Practices Act (NJFPA) at the complaint stage due to alleged deficiencies in predominance, ascertainability, and Article III standing.

In 2006, Joseph McPeak entered into an agreement with S-L Distribution Company, Inc., granting him an exclusive right to sell and distribute certain products in a specified geographic region in southern New Jersey. The distributor agreement classified McPeak as an independent contractor, explicitly stating that he was not considered a franchisee, partner, agent, or
employee of S-L and that he was not to conduct his business under S-L’s name or use its marks without prior written consent.

In November 2011, S-L gave notice to McPeak that it was terminating the distributor agreement. He filed suit alleging that S-L improperly terminated his franchise in violation of the NJFPA. S-L moved to dismiss the action, claiming that McPeak was not a franchisee entitled to protection under the NJFPA. The court granted the motion to dismiss but allowed McPeak to file an amended complaint. McPeak did so, and S-L moved to strike the class action allegations, the requests for injunctive and declaratory relief, the demand for certain damages, the jury demand, and several factual allegations from the amended complaint. The court granted in part and denied in part S-L’s request.

First, S-L argued that certification of McPeak’s NJFPA claim as a class action was improper on its face because it lacked commonality and thus failed the predominance requirement set forth in Federal Rule of Civil Procedure 23(b)(3). S-L asserted that since a claim under the NJFPA requires proof that each plaintiff is a franchisee and such status was expressly disclaimed in the contracts between S-L and each potential class member, there could be no common proof. While the court acknowledged that some of McPeak’s allegations were individual to him, it concluded that it did not automatically follow that no common facts could be developed through the course of discovery. Following the Third Circuit’s caution against striking class allegations prior to discovery based on lack of predominance, the court held that although it may be difficult for McPeak to produce evidence of a franchise under the NJFPA through evidence common to the class, the complaint itself did not lead to the conclusion that no such evidence could ever be produced.

S-L also argued that the class was not ascertainable through objective criteria—that is, class members would be impossible to identify without extensive and individualized fact-finding. McPeak identified the class as all individuals or entities that operated out of a warehouse in New Jersey that were parties to a distributor agreement with Snyder’s-Lance Distribution, Inc. on November 1, 2011. The court found that all persons meeting this definition could be ascertained through objective methods, such as through S-L’s records of its distributor agreements. S-L’s objections would be properly addressed through a summary judgment motion or at the class certification stage.

Finally, S-L argued that McPeak’s proposed class included persons without Article III standing, arguing that the proposed class definition lacked facts sufficient to establish the existence of a franchise for all purported class members. But, the court found that if all persons with a distributor agreement with S-L and warehouse space in New Jersey were franchisees under the NJFPA, they would each appear to have standing. McPeak was entitled to develop such evidence through discovery.

As to the collateral issues, the court dismissed McPeak’s request for injunctive and declaratory relief as he was not entitled to this relief (because
he sold his distributor route and no longer had any interest in the distributor agreement), and the named plaintiff in a putative class action must have standing himself to pursue injunctive relief on behalf of a class. The court also dismissed his demand for consequential, incidental, special, and punitive damages as those categories of damages were waived by the distributor agreement, and McPeak did not object to their dismissal. The court declined to strike McPeak’s jury demand on the basis of a jury waiver clause in the distributor agreement, holding this issue was premature. The parties were entitled to develop whether the waiver was made knowingly and voluntarily throughout discovery. The court held that this was particularly true as the law in the Third Circuit was unsettled as to which party bears the burden of proof. And, finally, the court denied S-L’s motion to strike McPeak’s factual allegations referring to rent, which S-L argued were contradicted by exhibits attached to the complaint. The court held that disputed issues of fact were not properly addressed through motions to strike as Rule 12(f) only allows a court to strike a “redundant, immaterial, impertinent, or scandalous matter,” none of which was present here.


Plaintiffs are former clients and certain franchisees of It’s Just Lunch, Int’l (IJL). Plaintiffs brought claims alleging fraud and unjust enrichment by IJL and its franchisees and proposed certification of both a national class of plaintiffs and a New York class of plaintiffs. The Southern District of New York granted the plaintiffs’ motion in part and denied it in part. The court certified the national class to pursue fraud claims after determining that the class met the standards established in Federal Rule of Civil Procedure 23. In reaching its decision, the court particularly focused on the fact that IJL trained its sales staff to use a specific sales script that included a number of potentially fraudulent statements that were to be made verbatim. For example, the script included a statement that the sales person already had multiple matches in mind for that prospective client. IJL also provided copies of this script to its franchisees for use by their sales teams. The court relied on evidence related to this script to satisfy a number of prongs of the test for class certification, such as the claims raised common questions of law and fact and the named plaintiffs’ claims are typical of the national class’s claims. In reaching its decision to certify a national class for the fraud claims, the court also found the number of plaintiffs to be sufficiently numerous (10,000 individuals), the class to be easily ascertainable (because of the records of services kept by IJL), and all other prongs of Rule 23 to be satisfied. Further, the court held that variances in state fraud statutes were not material enough to preclude a finding that common issues predominated over individual issues.

With respect to the unjust enrichment claims, the court also certified a class of plaintiffs in New York on the grounds that IJL and its franchisees
routinely charged more than $1,000 for one year of service in violation of the New York General Business Law. However, the court denied class certification for a national class pursuing unjust enrichment claim on the grounds that variations in state unjust enrichment laws were significant, and plaintiffs did not sufficiently address how these various elements could be established through class-wide proof.

**CONTRACT ISSUES**


Plaintiff was the exclusive distributor in the United States of a European company’s “soft-feeling” paint. Plaintiff entered into a contract with defendant in which plaintiff and defendant agreed to work together to develop markets for the soft-feeling paint. The parties’ dispute arose from defendant’s termination of the parties’ contract, which plaintiff alleged was pretextual so that defendant could avoid its obligations to plaintiff, such as the obligation to pay royalties on the sale of the paint.

The court granted defendant’s motion to dismiss plaintiff’s claims of fraudulent inducement, fraud, and breach of fiduciary duties under Pennsylvania’s common law “gist of the action” doctrine. This doctrine precludes plaintiffs from “recasting ordinary breach of contract claims into tort actions.” However, this doctrine does not preclude tort claims when the parties have a contractual relationship, unless the plaintiff can point to separate or independent events giving rise to the tort, the tort claims are improper. The court also dismissed plaintiff’s claim for breach of contract because plaintiff failed to allege any specific term of the parties’ contract that defendant breached.

*Bennett v. Itochu Int’l, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,313, 572 F. App’x 80 (3d Cir. 2014)

This case is discussed under the topic heading “Alternatives to Franchising.”


Plaintiff Century 21 Real Estate LLC brought an unopposed motion for summary judgment against defendant franchisees. After signing a franchise agreement, defendants failed to pay royalty and advertising fees and failed to report the royalty-bearing transaction. After three notices of default that the defendants did not cure, Century 21 terminated the franchise agreement. Defendants paid none of the fees owed and continued using Century 21’s marks.

As an initial matter, the U.S. District Court for the Northern District of California decided that New Jersey state law applied since, although
defendants were California-based, the franchise agreement stipulated that New Jersey state law applied. In addition, New Jersey had a substantial relationship to at least one party, Century 21, because its principal place of business was in the state.

The court granted summary judgment on all of Century 21’s claims and accepted all of its evidence. Century 21 was awarded nearly $200,000 for its breach of contract claim and another $2,367 for the infringement of its trademarks. The court also awarded a permanent injunction enjoining the defendants from using the Century 21 marks or holding themselves out as Century 21 franchisees.

This case is discussed under the topic heading “Unfair Competition/Unfair and Deceptive Practices.”

Two brothers formed a company (Degla) to enter into a franchise agreement with a Danish furniture franchisor (BoConcept). The brothers did not want to sign a personal guaranty for the franchise, so instead they printed their names in the acknowledgment section of the franchise agreement that stated:

The following persons (the “Principals”) represent all individuals that hold an interest in Franchisee, directly or indirectly. By signing this acknowledgment, the Principals consent to the execution of this Agreement by Franchisee, and agree to be bound by those terms of the Agreement that relate to their duties and obligations as Principals.

The brothers printed their names as an attempt to identify themselves as principals of the franchisee without agreeing to be bound by the personal guaranty.

Degla became delinquent on payments owed to BoConcept and BoConcept terminated the franchise agreement. Degla sued BoConcept alleging breach of contract and unlawful termination and BoConcept filed counterclaims alleging breach of the franchise agreement. BoConcept alleged that the brothers breached the contract and that they were personally obligated under the terms of the franchise agreement because of the personal guaranty. The brothers argued that because they only printed their names in the acknowledgment section of the franchise agreement, they were not bound personally.

Following trial, the U.S. District Court for the Central District of California held that by printing their names in the acknowledgment section, they signed that section in their individual capacities. The court held further that the brothers intended their printed names to be signatures because the
acknowledgment specifically called for a signature, and it was reasonable to infer that a person who writes his name underneath a statement calling for a signature, even if printed, intends to sign the contract. Because the acknowledgment stated that by signing it, “the Principals consent to the execution of this Agreement by Franchisee, and agree to be bound by those terms of the Agreement that relate to their duties and obligations as Principals,” the brothers had consented to the personal guaranty provision contained in the franchise agreement.


This case is discussed under the topic heading “Damages.”


Plaintiffs Derrick Johnson, his entity F&J Holdings, Inc. and Charles Thomson, as well as Intervenor Pittsburgh Baker’s Dozen (PBD), brought promissory estoppel claims against Dunkin’ Donuts Franchising L.L.C. (Dunkin’) arising from failed investments in renovating two buildings for the purpose of starting a donut commissary. Dunkin’ brought a motion for summary judgment, which the Western District of Pennsylvania granted.

The court found that a claim for promissory estoppel must arise in a promisee/promisor relationship. However, in the case at bar, Dunkin’ had agreed to do business via an agent. The court found the evidence overwhelmingly pointed to a relationship as between PBD and Dunkin’ whereby PBD would build a commissary from which Dunkin’ would direct its franchisees to purchase fresh donuts and other baked items once completed. The arrangement was communicated to PBD via its agents, who were plaintiffs in the action.

The evidence contained neither a direct relationship nor any direct promises between Dunkin’ and plaintiffs. The court accordingly found that any purported promise plaintiffs assumed would constitute, at most, implied promises based on their own judgments, which was insufficient to ground a claim for promissory estoppel.


Plaintiff Kumon North America, Inc. (Kumon) moved to dismiss franchisee Demetrio Timban’s (Timban) counterclaims in a matter regarding Timban’s alleged continued operation of the franchise after termination of the franchise agreement. The U.S. District Court for the District of New Jersey granted Kumon’s motion and dismissed Timban’s counterclaims.

Timban entered into a franchise agreement with Kumon to operate a Kumon Math and Reading Centre in Medford, New Jersey. Kumon issued
a notice of default for Timban’s failure to pay royalties. Timban was afforded an opportunity to cure, but was not able to do so. Kumon advised Timban that his franchise agreement would be terminated, but termination would be delayed to allow Timban the opportunity to transfer the franchise, subject to Kumon’s approval. Timban was not able to find purchasers satisfactory to Kumon. As a result, Kumon terminated the franchise agreement. Kumon commenced an action against Timban for continuing to operate the franchise post-termination. Timban counterclaimed against Kumon for: (1) violation of the New Jersey Franchise Practices Act (NJFPA); (2) breach of contract; (3) breach of the implied duty of good faith and fair dealing; (4) tortious interference; (5) unjust enrichment; and (6) violation of the New Jersey Consumer Fraud Act (NJCFA).

The court dismissed Timban’s claims for violation of the NJFPA, breach of contract, breach of the implied duty of good faith and fair dealing, tortious interference and unjust enrichment because the franchise agreement specifically afforded Kumon the right to have final approval of prospective transferees. Once Timban failed to pay royalties to Kumon, he lost any right to continued operation or transfer for value. Regarding Timban’s claim for unjust enrichment, the court found that unjust enrichment is an equitable remedy resorted to only when there is no express contract providing for remuneration. Since the contract expressly afforded Kumon the right to reject prospective transferees, unjust enrichment could not apply. Regarding the claim that Kumon violated the NJCFA, the court followed the Third Circuit decision in J&R Ice Cream Corp. v. California Smoothie Licensing Corp., 31 F.3d 1259, 1273 (3d Cir. 1994), which held that the NJCFA does not apply to franchises.


In a dispute between Chrysler Group LLC (Chrysler) and its dealer LaFontaine, the Supreme Court of Michigan ruled that a 2010 amendment of the Motor Vehicle Dealer Act (MVDA), which expanded the relevant market area from a six-mile radius to a nine-mile radius, did not apply retroactively. The six-mile radius in effect under the Act’s market area provisions when Chrysler and IHS Automotive Group, LLC (IHS), another Dodge automobile dealer, entered into a “Letter of Intent to Add Vehicle Line” was expanded to nine miles in 2010. LaFontaine then filed a complaint for declaratory relief, challenging the proposed dealership under the MVDA.

The court held that the relevant market area was the area where automobile manufacturers were obligated to notify an existing dealership of the manufacturer’s intent to set up a dealership selling the same line of automobiles as the existing dealer. The 2010 amendment of the MVDA did not contain language suggesting retroactivity, so the parties’ existing contract rights would be altered if the amendment were applied as such. Since there was no
contrary language and since the 2010 amendment did not apply retroactively, the court vacated the appellate court’s judgment.


This case is discussed under the topic heading “Fraud.”


Plaintiff Newspaper LLC (Newspaper) alleged thirty-one theories of liability, including breach of contract, good faith and fair dealing claims, various Minnesota Franchise Act (MFA) claims and promissory estoppel claims against its franchisor Party City Corporation (PCC) and the franchisor’s suppliers Amscan Holdings, Inc. Newspaper and its affiliates owned and operated twenty-six Party City franchise stores primarily in the Midwest. PCC owned or franchised more than 800 party supply stores nationwide. The franchise agreement granted Newspaper the exclusive right to operate Party City stores within a number of states primarily in the Midwest. PCC stores already in operation were excluded (the Excluded Stores).

The U.S. District Court for the District of Minnesota dismissed all of Newspaper’s allegations, which were made in express contradiction to the clear wording of the franchise agreement and its addendum. The court found that all but one of Newspaper’s claims failed to state a claim upon which relief can be granted.

The court found it was premature to dismiss Newspaper’s claim relating to discrimination under the MFA. Newspaper alleged that PCC’s preferential treatment of the Excluded Stores violated the MFA. PCC argued that since it terminated the Excluded Stores’ franchise agreements and replaced them with supply agreements, they were not subject to the MFA. The court held that regardless of what an agreement is called, it may establish a franchise relationship provided that it meets the statutory requirements. The court found Newspaper plausibly alleged the supply agreement had allowed the Excluded Stores to continue a franchise relationship with defendants by another name and that the Excluded Stores received more favorable treatment.


Ramsey, a terminated distributor of Bimbo Foods Bakeries Distribution, Inc. (Bimbo), filed a complaint asserting claims for breach of contract, violation of North Carolina’s Unfair and Deceptive Trade Practices Act (UDTPA), and fraud. Ramsey also moved for preliminary injunction. Bimbo filed a motion to dismiss all claims pursuant to Federal Rule of
Civil Procedure 12(b)(6). In this opinion, the court held that Ramsey adequately alleged claims for breach of contract and violation of UDTPA sufficient to survive Bimbo’s motion to dismiss, but not for fraud. In addition, the court denied Ramsey’s motion for preliminary injunction.

Ramsey entered into a distribution agreement with Bimbo and purchased a distribution route which granted the exclusive right to purchase bakery products and sell those products at grocery store chains and independent grocers in a designated area. In June 2013, Bimbo informed Ramsey and other local independent operators that it was reducing the margins they would be paid. Ramsey and the other operators resisted and formed a committee of which Ramsey was one of the more outspoken members. According to Ramsey, Bimbo refused to negotiate.

Meanwhile, a significant conflict arose between Ramsey and Harris Teeter, one of the stores he serviced on his route. Harris Teeter reported to Bimbo that Ramsey was no longer permitted to service its store with Bimbo products due to Ramsey’s continuous failure to provide proper and satisfactory service. As a result, Bimbo issued Ramsey a notice of termination and eventually terminated the distribution agreement. This suit followed.

In its motion to dismiss, Bimbo argued that Ramsey did not allege improper termination sufficient to support a breach of contract claim. The court noted that according to the relevant terms of the distribution agreement Bimbo was allowed to terminate if Ramsey did not cure a breach. Bimbo argued that because Ramsey was banned from entering the Harris Teeter store, he was unable to service all of the stores on his distribution route and thus was in breach of the agreement, making termination proper. Ramsey countered that any breach was not material. The court could not decide on a motion to dismiss whether the inability to service one retail store on the distributor’s route constituted a material breach of the distribution agreement justifying termination. However, Ramsey did adequately allege that Bimbo unjustifiably terminated the agreement as a pretext to punish Ramsey’s efforts to overturn the reduced margins and to profit financially from the resale of his distribution route. For these reasons, the court refused to dismiss Ramsey’s breach of contract claim.

Likewise, the court denied Bimbo’s motion to dismiss the UDTPA claim because of Ramsey’s allegations that Bimbo acted unfairly and deceptively by pretextually terminating the distribution agreement. The court held that pretextual termination may constitute a substantial “aggravating circumstance” attendant to the breach of contract claim sufficient to establish a violation of UDTPA.

However, the court dismissed Ramsey’s fraud claim. Ramsey contended that Bimbo committed fraud by intentionally and fraudulently making false and untrue allegations in the notice of termination for the purpose of attempting to create a claim that would justify termination of Ramsey’s agreement. The court found that there was no merit to Ramsey’s fraud claim for two reasons. First, the court found that Ramsey was seeking to
transform a separate breach of contract claim into a fraud claim based on a failure to perform in accordance with the contract’s terms and that this theory of liability was not viable as a matter of law. Second, the court noted that there was no evidence Ramsey was deceived by Bimbo’s purportedly false statements in the notice of termination and, therefore, Ramsey failed to state a claim for fraud. For these reasons, Bimbo’s motion to dismiss Ramsey’s fraud claim was granted.

Finally, the court denied Ramsey’s motion for preliminary injunction regarding the breach of contract claim. Ramsey’s motion asked the court to enjoin Bimbo from interfering with the operation of his bakery products distribution route and from forcing the sale of the route. Ramsey did not show either likelihood of success on the merits or irreparable harm. Specifically, the court held that because Ramsey was operating the distribution route for five years prior to the termination, there was sufficient historical data to calculate monetary damages. In addition, the court found that a monetary value could be placed on any loss of goodwill as there was an active market for the sale of rights to distribute Bimbo products in North Carolina and fair market value of the distributorship was based on a formula using weekly average of net product sales revenue.

This case is discussed under the topic heading “Arbitration.”

Plaintiff franchisor Valvoline Instant Oil Change Franchising, Inc. (VIOCF) entered into forty-four renewal license agreements with RFG Oil, Inc. (RFG), as franchisee, under which RFG operated forty-four oil change facilities using Valvoline trademarks. In December 2010, RFG fell behind in payments owed to VIOCF for products purchased from VIOCF. In January 2011, VIOCF issued a notice of default, which provided RFG an opportunity to cure. VIOCF issued a notice of termination in November 2011 based on RFG’s failure to cure the default, which terminated each of the forty-four renewal license agreements and sought damages under the contract totaling over $14,610,680.10.

VIOCF was willing to settle its claims if RFG would enter into “We Feature” agreements for each of the oil change facilities. Under the agreements, RFG would no longer operate under the Valvoline trademarks or be required to pay royalties, but would sell Valvoline branded products under the terms and conditions of the We Feature agreements.

During this same time period, VIOCF was also in talks with a third party that intended to purchase seventy-two oil change facilities which it would
convert into Valvoline branded oil change facilities. Some of those seventy-twenty-two facilities were located within RFG’s protected territory under the renewal license agreements. Once RFG discovered that VIOCF intended to allow a third party to operate oil change facilities within its protected territory, it disputed the termination of the renewal license agreements and the validity of the “We Feature agreements.” This lawsuit followed and at issue was whether VIOCF is entitled to declaratory judgment that the renewal license agreements and the We Feature agreements were all terminated.

As to the declaratory judgment that the renewal license agreements were terminated, the court found that a genuine issue of material fact existed and could not grant declaratory judgment. Although RFG made weekly payments to VIOCF following the notice of default, the sum of which would amount to payment in full of the amounts owed to VIOCF, at issue was whether the amounts RFG paid to VIOCF were toward the amounts owed on credit or for the purchase of future products. The renewal license agreements included a provision stating that if VIOCF extended credit to RFG, payments made would be applied to the oldest portion of the account first. However, around the time of the default, the arrangement between the parties changed such that products would no longer be purchased on credit and instead paid for in advance of delivery. Neither the renewal license agreements, nor any other agreement between the parties, provided for how to handle application of payments from RFG to VIOCF in a situation such as this where RFG went from having a credit account to paying before delivery. VIOCF applied the payments received from RFG to the purchase of products to be delivered. RFG contends that the payments should have been applied to the credit account first. Had the amounts paid been applied to the oldest portion of the credit account first, RFG would have cured the default and VIOCF could not have terminated the renewal license agreements for non-payment. Therefore, the court could not find the absence of a genuine issue of material fact.

The court also denied the plaintiff’s motion for summary judgment on whether the We Feature agreements were properly terminated because there was a genuine issue of material fact as to whether the agreements were ever validly executed. Although both parties signed the agreement, there was no meeting of the minds as to a material term of the agreements because the parties continued to negotiate the term of the agreements as they exchanged signature pages. Therefore, the court found it was improper to grant a motion for summary judgment declaring the We Feature agreements terminated.


The Northern District of Texas struck in part pleadings for alleged breaches of two franchise agreements on the basis that the counterclaiming
franchisees had not adequately pled how breaches of the franchise agreement caused them harm.

The franchisor Yumilicious Franchise, L.L.C. (Yumilicious) brought an action against franchisee defendants for alleged breaches of two franchise agreements for yogurt shops, alleging the franchisees breached the agreements by closing the stores without prior authorization and failing to pay for ordered products and royalties. The franchisees maintained that the shops were doomed because they were unable to obtain proprietary and contractually mandated yogurt products at a reasonable price in the state where the franchises were located. The franchisees asserted counterclaims for breach of contract, fraud, negligent misrepresentation and violations of the Texas Deceptive Trade Practices Act. Yumilicious moved to strike and dismiss the counterclaim.

The court concluded the franchisees adequately pled that Yumilicious made false statements regarding franchise costs and products supplied to induce the franchisees into entering into the franchise agreements, and the franchisees relied on those statements in entering into the agreements.

However, the court rejected the franchisees’ pleadings for breach of the franchise agreement for failure to conduct on-site evaluations and inspections because it was unclear from the pleadings, described as “sparse,” why the franchisees believed they suffered damages as a result of those breaches.

**DAMAGES**


Derma Pen, LLC, which owns the micro needling product known as Derma Pen, sought rescission of its distribution agreement with distributor 4EverYoung Limited. 4EverYoung moved for summary judgment, which the District of Utah granted in part.

Derma Pen sought rescission after discovering misrepresentations allegedly made by the distributor. However, the distribution agreement was a two-year agreement and had already expired. Therefore, the court held that Derma Pen failed to timely assert or pursue rescission. There was no purpose in rescinding a contract that was already ended by termination and no ground for rescission if the contract was already completely performed. Moreover, Derma Pen’s continued performance under the contract for its term was inconsistent with the remedy of rescission. Therefore, the court granted 4EverYoung’s partial motion for summary judgment on Derma Pen’s claim for rescission. Derma Pen became aware of misrepresentations prior to the expiration of its agreement, but stayed in the contractual relationship up through early termination that it initiated and at no time prior to the notice of termination did it say anything about rescission. Allowing Derma Pen to rescind after the agreement terminated would lead to an
inequitable result which could permit it to avoid post-termination provisions even though it obtained the benefits of full performance.

**DISCRIMINATION**


Dealer plaintiffs Hudson Valley Volkswagen, LLC (Hudson Valley) and CMS Volkswagen Holdings LLC (CMS) sued franchisor Volkswagen Group of America (Volkswagen) for violations of the New York Franchised Motor Vehicle Dealer Act (Dealer Act). Plaintiffs, both Volkswagen dealerships in New York, asserted causes of action seeking injunctive relief, declaratory relief, and damages on the basis that the Dealer Sales Index (DSI) and Variable Bonus Program (VBP) included in their dealer agreements violated the Dealer Act for pricing and bonus discrimination. In addition, plaintiffs sought declarative and permanent injunctive relief on the basis that Volkswagen unreasonably withheld its consent to the transfer of ownership interests and made unreasonable modifications to the dealer agreements in violation of the Act.

Volkswagen moved to dismiss each of the claims and plaintiffs sought a motion to amend their complaints. The court granted the motion to dismiss and denied the motion to amend claims, alleging it was impossible for plaintiffs to meet the standards for the VBP due to consumer preferences because the VBP was not applied disproportionately. The court refused to dismiss the claim that the DSI violated the Act by using an unreasonable, arbitrary, or unfair sales or performance standard. The court allowed plaintiffs to amend a claim that Volkswagen unreasonably withheld consent to transfer an ownership interest on the basis that they had adequately alleged a violation of the Act and dismissed the claim that Volkswagen had illegally modified the dealership agreement since the language of the Act only prohibited unilateral amendment without notice.


This case is discussed under the topic heading “Good Faith and Fair Dealing.”

**ENCROACHMENT**


This case is discussed under the topic heading “Good Faith and Fair Dealing.”

YSA Motorsports, LLC (YSA) objected to Yamaha Corporation, U.S.A.’s (Yamaha) proposal to open a new dealership in North Scottsdale. Under Arizona Revised Statutes § 28-4452(B), Yamaha was prohibited from establishing a dealership in a community if an existing franchise with standing objected, unless Yamaha established that “there is good cause . . . and unless it is in the public interest.” In the case of a dispute, an Administrative Law Judge (ALJ) was to determine whether the franchisor had established good cause by considering the “existing circumstances” and five factors outlined in the applicable statute (Ariz. Rev. Stat. § 28-4457(E)).

A hearing was held before an ALJ, who decided in favor of YSA. The superior court upheld that decision on review. Yamaha sought to overturn that decision on appeal to the Arizona Court of Appeals, which affirmed the ALJ’s conclusion that the appellant franchisor had not established “good cause” necessary to permit it to open a new franchise.

Yamaha’s arguments on appeal were focused on the ALJ’s consideration of the economic impact on existing franchisees, one of the five factors outlined in the applicable statute. First, Yamaha argued that since the ALJ stated neither side had conclusively proved its case regarding the economic impact of the proposed dealership, she should have ruled in favor of Yamaha. The court rejected this argument because, based on the evidence before her, the ALJ concluded that an added competitor would be “more likely” to have a negative rather than a positive impact on the existing franchisees. Second, Yamaha argued the ALJ should have rejected YSA’s evidence as speculative and unreliable as it came from individuals who had a stake in the existing franchises. However, the court concluded that the witnesses were qualified to testify before the ALJ because of their experience in the business. Also, Yamaha had the opportunity to raise any issues with the witnesses on cross-examination. Thirdly, Yamaha argued the ALJ should have ruled against YSA because of its failure to quantify the alleged economic harm the existing dealers would suffer if the proposed new dealership was allowed. The court stated that YSA was not required to quantify the alleged harm under the applicable statute and, at most, the lack of quantification would impact the weight given to YSA’s evidence. On this issue, the court also rejected Yamaha’s claim that expert evidence should always be preferred to lay evidence, and YSA’s failure to present any expert evidence should have resulted in a ruling in favor of Yamaha. Finally, Yamaha also argued the ALJ had placed an undue amount of emphasis on the factor of the economic impact of the proposed dealership. The court rejected this argument as well both because the ALJ was not required to give equal weight to every factor and because it had given roughly equal consideration to the five factors outlined in its decision.
FINANCIAL PERFORMANCE REPRESENTATION


A convenience store franchisor attempted to dismiss a franchisee’s claim under the New York Franchise Act (NYFA) for damages and rescission arising from the failure to make required disclosures. The franchisee alleged that 7-Eleven provided financial performance representations outside of the franchise disclosure document (FDD). 7-Eleven argued that the NYFA claim should be dismissed because the information contained in the alleged earnings claims was included in the FDD. The franchisee, however, argued that the FDD contained no reference to the New York market where the purchased franchise was located. The alleged representations related to statements that stores in Manhattan and Long Island were more expensive due to higher sales volumes and because they were more profitable, but it was not clear as to which locations the representative was comparing the Manhattan and Long Island stores. Moreover, 7-Eleven’s representative purportedly stated that the franchisee’s location should do between $2 million and $3 million, but that $1.7 million to $1.8 million was consistent with 7-Eleven’s estimates and should be used for preparing a business plan. Nothing in the FDD, however, indicated where the franchisee’s particular store could be expected to fall and or described the methods and computations used in arriving at those estimates as required by § 683 of the NYFA. 7-Eleven also argued that the franchisee could not show reliance on the representative’s statements, but the Southern District of New York held that reliance was not a required element under § 683 because it only enumerates information required to be disclosed when selling franchises.

The franchisee also asserted a claim for damages and rescission under § 687, which prohibits franchisors from employing any device, scheme, or artifice to defraud. However, the court dismissed this claim because the contractual disclaimer of reliance in the FDD was given effect. The franchisee argued that the representative’s oral statements were fraudulent misrepresentations, but the franchisee disclaimed reliance upon any representations outside of the agreement or FDD when it signed the agreement. The court did hold that projections of financial performance could serve as the basis for actionable fraud claims because even though statements of prediction are generally not actionable as fraud, 7-Eleven had superior knowledge of performance and the projections could have been construed as representations of existing fact. Under New York law, however, a party cannot disclaim reliance and then claim fraud. While the NYFA’s anti-waiver provision has been interpreted to provide an exception to this common law rule for claims, the court chose to diverge from a New York Appellate Division decision (Emfore Corp. v. Blimpie Associates, Ltd., Bus. Franchise Guide (CCH) ¶ 13,889 (N.Y. App. Div. May 6, 2008)) that held disclaimers did not
preclude fraud claims under the NYFA on the grounds that the decision was not binding on the federal district court, the NYFA does not give a franchisee the right to purchase a franchise while relying on oral representations outside of the written agreement, and refusing to enforce the non-reliance disclaimer would violate the “sanctity of contracts.”

The franchisee’s claims for breach of the covenant of good faith and fair dealing regarding the franchisor’s obligation to provide merchandising advice and operational systems designed to meet customers’ needs, survived a motion to dismiss because the complaint alleged that the franchisor canceled more than twenty meetings during a one-year period concerning the franchisee’s store’s performance, operations, and merchandising. The court held that this was enough to state a claim for relief because persistent cancellations could constitute the withholding of the benefits of the contract. Claims for violation of the covenant of good faith and fair dealing related to a lack of ongoing training were dismissed because the agreement provided that 7-Eleven may offer additional training, but was not obligated to do so.


A former franchisee of a day care franchise and its owners (Mamilove) recovered a $1.1 million judgment against the franchisor Legacy Academy, Inc. and its officers for violations of the Georgia Racketeer Influenced and Corrupt Organizations Act based on Legacy Academy’s alleged violations of the FTC Franchise Rule, fraud, and rescission. The trial court ruled in favor of the franchisee, and the franchisor appealed.

Legacy Academy argued that Mamilove: (1) did not seek rescission of the franchise agreement in a timely manner; (2) affirmed the agreement by pleading a contract-based defense; and (3) knowingly agreed to the provisions of the franchise agreement which disclaimed the making of any financial performance representation, the subject of Mamilove’s claim for fraud. The Georgia Court of Appeals disagreed. Legacy Academy provided Mamilove with earnings projections stating that it would earn approximately $260,000 in net income after the first year and $440,000 in net income for the second and third years. These projections failed to come to fruition and Mamilove sued for rescission. The court held that sufficient evidence was presented at trial to support the jury’s finding that Mamilove timely asserted its rescission claim. Legacy Academy also argued that Mamilove affirmed the franchise agreement when it asserted a contract-based defense to Legacy Academy’s breach of contract counterclaim, thereby, waiving its right to rescission. The court disagreed and held that Mamilove could pursue its tort claim for rescission while asserting a contract-based defense to the counterclaim because a defense is fundamentally distinct from a claim. Legacy Academy also argued that Mamilove could not prove that it entered into the agreement based on fraudulent representations because the agreement expressly stated that Mamilove did not receive any representations of potential income or earnings capabilities prior
to signing. The court, however, held that sufficient evidence showed that Legacy Academy had intentionally prevented Mamilove from reading the franchise disclosure document or franchise agreement prior to signing by pressuring Mamilove to sign as soon as possible in order to avoid losing territory and so Legacy Academy could conceal the false financial performance representation contained in the agreement.

Mamilove also argued that its claim under the Georgia statute based on the franchisor’s violations of the FTC Rule failed because the Georgia statute provided for a private right of action only where no other cause of action was available and the FTC Franchise Rule permitted Mamilove to complain to the FTC to file a cause of action on its behalf. The court disagreed, holding that the FTC’s ability to pursue an action against the franchisor was not a cause of action for purposes of the Georgia statute, which provides that

when the law requires a person to perform an act for the benefit of another or to refrain from doing an act which may injure another, although no cause of action is given in express terms, the injured party may recover for the breach of such legal duty if he suffers damage thereby.


A three-arbitrator panel found a franchisor liable for making oral financial performance representations to a then-prospective franchisee in violation of “applicable Franchise Disclosure laws.” The franchisee brought claims against the franchisor before the American Arbitration Association, asserting that the franchisor made financial performance representations in violation of the disclosure provisions of both the Minnesota Franchise Act and the North Dakota Franchise Act. Although the panel did not specify which act applied, it held that the franchisee established that, at a 2008 investor conference, the franchisor’s director endorsed the financial projections for a potential hotel in Rogers, Minnesota. The projections had been adopted into a pro-forma for the hotel and included the hotel’s average daily rates. At the conference, the director endorsed the numbers in the pro forma as being “attainable,” “conservative,” and/or “spot-on.” The panel held that such statements were unlawful financial performance representations made outside of Item 19 of the Franchise Disclosure Document provided to the franchisee.

The panel also found that the director’s statements were false. In the franchisor’s last full year of operation before the conference, only 2.3 percent of all hotels had ever achieved such performance. The director failed to disclose that figure, which the panel held was material as a historical achievement number and should have been disclosed.

Because the franchisee established that it had reasonably relied on the director’s statements, the panel did not address whether reasonable reliance was a required element for a claim under either act. The franchisee also asserted claims of common law fraud, negligent misrepresentation, breach of
contract, and other violations of franchise disclosure laws, all of which were rejected by the panel.

FRAUD


This case is discussed under the topic heading “Contract Issues.”


Plaintiff was an independent distributor that had exclusive rights to purchase bakery products from defendant manufacturer and sell those products to grocery store chains and independent grocers in a designated area. The manufacturer sent the distributor a notice of termination, stating it recently discovered that the distributor had engaged in the practice of “flushing” product by creating false sales and buy-back invoices for which plaintiff received approximately $2,500 to which he was not entitled.

Plaintiff distributor filed a lawsuit asserting claims for breach of contract, fraud, and unfair and deceptive trade practices. Defendant manufacturer moved to dismiss the distributor’s fraud and unfair and deceptive trade practices claims related to the termination. Plaintiff’s fraud claim was based on the manufacturer’s purported fraud by intentionally and fraudulently making false and untrue allegations in the notice of termination for the purpose of attempting to create a claim that would justify termination.

According to plaintiff, he did not engage in “flushing” as set forth in the notice of termination and the statements in the notice of termination were false pretext for terminating him. Plaintiff argued that the manufacturer’s real reason for terminating the distribution agreement was to punish him for taking an active role in attempting to negotiate higher margins and to profit from the resale of the distribution business. Under North Carolina law, the elements of fraud are: (1) a false representation or concealment of a material fact; (2) reasonably calculated to deceive; (3) made with the intent to deceive; (4) which does in fact deceive; and (5) resulting in damage to the injured party. Here, because plaintiff was not in fact deceived by the purportedly false statements in the notice of termination, he failed to state a claim for fraud.

In order to state a claim under North Carolina’s Unfair and Deceptive Trade Practices Act, a plaintiff must show: “(1) defendant committed an unfair deceptive act or practice; (2) the action in question was in or effecting commerce; and (3) the act proximately caused injury to the plaintiff.” Because plaintiff claimed defendant terminated the agreement not only contrary to its terms but also that defendant acted unfairly and deceptively by pretextually terminating the agreement, this pretextual termination could
constitute a substantial aggravating circumstance attendant to the breach of contract and could support a claim for violation of the Act. Therefore, there may be a violation of the Act where a breach of contract is accompanied by aggravating factors. Thus, the Eastern District of North Carolina denied defendant's motion to dismiss this claim.


This case is discussed under the topic heading “Contract Issues.”


Yogo Factory Franchising, Inc. (YFF) is the franchisor of the Yogo Factory franchise system. Between August 2011 and June 2012, YFF sold two new franchises and one company-owned store to a third-party franchisee (Ying). Ying struggled to make the franchised units profitable. YFF brought suit in the federal court of the District of New Jersey against Ying on multiple grounds. Ying counterclaimed that YFF fraudulently induced him to purchase the franchises and brought claims of fraud, negligent misrepresentations, and violations of the New Jersey Consumer Fraud Act.

With respect to one franchise agreement, the court dismissed all claims and ordered the parties to submit those claims to arbitration in accordance with the arbitration provision in the franchise agreement. The arbitration provision stated it would apply to any disputes “arising from” the franchise agreement. Ying argued that his tort and statutory claims fell outside the scope of the arbitration clause because they were not contract claims. However, the court disagreed, electing to interpret the language of the arbitration provision broadly.

With respect to the two other franchise agreements, the court dismissed Ying’s fraud claims on two grounds. First, the court held that Ying failed to plead the claim with sufficient particularity. Ying alleged one broad claim of fraud as to all YFF parties and did not specify which representatives of YFF made what alleged representation and when. Second, the court stated that even if the claim was pled with particularity, it would still fail because Ying was not able to show that he reasonably relied on any alleged misrepresentations made by YFF. In reaching this conclusion, the court pointed out that the franchise agreements contained integration clauses that specifically excluded all outside agreements and outside representations made by either party. Ying also signed a representations statement under which he specifically represented that he did not rely on any representations made by any YFF parties and that no YFF parties made any promises concerning profitability of the franchises. Lastly, the FDDs provided to Ying indicated that Item 7 numbers were “estimates” and contained disclaimers in Item 19.
stating that individual results may vary and that YFF provided no assurances or representations that any franchisee would earn the disclosed amounts. Based on these documents, the court found that any reliance on other representations made by any YFF parties was unreasonable.

The court also rejected Ying’s claim under the New Jersey Consumer Fraud Act (NJCA), citing existing precedent that the NJCA did not apply to franchise sales because franchises were not commercial “goods or services.”

**FTC FRANCHISING RULE**


This case is discussed under the topic heading “Financial Performance Representation.”

**GOOD FAITH AND FAIR DEALING**


This case is discussed under the topic heading “Alternatives to Franchising.”


This case is discussed under the topic heading “Unfair Competition/Unfair and Deceptive Practices.”


This case is discussed under the topic heading “Financial Performance Representation.”


This case is discussed under the topic heading “Contract Issues.”


Chrysler Group LLC moved to dismiss a claim by dealer Mathew Enterprise, Inc. after Chrysler established two additional dealers in Mathew’s geographic area. Due to the increased competition, Mathew’s sales declined and it failed to qualify for payments under Chrysler’s “volume growth” sales incentive program. Mathew also complained about rent subsidies that
Chrysler provided to its competitors and the mix of vehicles that Chrysler supplied.

The U.S. District Court for the Northern District of California denied Chrysler’s motion with regard to the allegation that its “volume growth” program amounted to prohibited price discrimination. Section 2(a) of the Robinson-Patman Act prohibits a seller from discriminating in price between two customers if there is a reasonable possibility that doing so will adversely affect competition. Mathew pleaded sufficient facts to show that payments under the volume growth program were “functionally unavailable” to it and that the impact was significant enough to affect competition.

The court allowed the motion and dismissed, with leave to amend, Mathew’s claim that rent subsidies provided to its competitors amounted to prohibited price discrimination on the basis that a rental agreement could not be considered a commodity subject to the Robinson-Patman Act. Further, although Mathew argued that the rental subsidies amounted to a “disguised price discount,” it did not plead any facts showing a connection between the rental subsidies and the volume of cars sold by its competitors.

The court also dismissed, with leave to amend, Mathew’s claim based on California Vehicle Code § 11713.3(a). That section makes it unlawful for a dealer to fail to deliver, “in reasonable quantities and within a reasonable time after receipt of an order,” vehicles that are covered under the franchise agreement and which have been “publicly advertised as being available for delivery or [were] actually being delivered.” The court noted that Mathew’s allegations only suggested dissatisfaction with the vehicle mix offered by Chrysler. Mathew did not plead any facts that established any of the elements necessary for the claim, namely that Mathew placed an order, the order was for a reasonable quantity, or that Chrysler failed to deliver a placed order.

Finally, the court dismissed with prejudice Mathew’s claim alleging a violation of the implied covenant of good faith and fair dealing. Under the Michigan law governing the contract, there could not be any implied duty of good faith and fair dealing with regards to a particular matter where a contract granted a party absolute and unfettered authority with respect to that matter. Since the parties’ contract granted Chrysler expressed authority to set sales targets as it saw fit, there was no implied duty.


This case is discussed under the topic heading “Labor and Employment.”

**INJUNCTIVE RELIEF**


This case is discussed under the topic heading “Non-Compete Agreements.”
In this case, a Georgia federal district court found that the franchisor of Stevi B’s all-you-can-eat pizza restaurants properly terminated its franchisee and granted a preliminary injunction enjoining the defendant from using the franchisor’s trademarks. The franchisor, ACG Pizza Partners, terminated the franchise agreement for several reasons. First, ACG Pizza Partners demonstrated that defendant defaulted multiple times during the past year by not adhering to the trade dress standards (non-conforming chairs) and three months later for serving unauthorized menu items like soup and submarine sandwiches. Second, ACG Pizza Partners discovered that defendant was using an offline point-of-sale system to underreport net sales and avoid royalties. Third, ACG Pizza Partners proved that defendant was insolvent after it stopped making payments for its leased soft-serve ice cream machine and defaulted on its small business loan. Both the lessor and the bank secured consent judgments against the defendant totaling more than $700,000.

After the termination, defendant continued to operate a restaurant at the formerly franchised location using the Stevi B’s Pizza trademarks. The evidence established that defendant fell behind in its payments to its dough and sauce supplier, which stopped deliveries as a result, causing the franchisee to sell a different and inferior product after the termination. Defendant admitted that it had non-conforming chairs and food. Defendant contended that the additional cash register was a “back up,” but the court found that testimony not credible. Defendant raised an “unrelated issue” in its defense: another Stevi B’s Pizza had opened a few miles away. The court found that the franchise agreement granted no territorial protection and dismissed the argument.

The court found ACG Pizza Partners met its burden of showing that it would suffer irreparable harm to its reputation and loss of customers due to the trademark infringement. The court acknowledged that defendant serving different food threatened the brand’s consistency and also noted that the defendant’s inability to pay for pest control created a potential health hazard that could be attributed to the brand. The court further found that the balance of harms favored an injunction because the harm to defendant—although “unfortunate”—was self-inflicted and outweighed by the harm to ACG Pizza Partners for continuing infringement of its trademarks. The injunction served the public interest because it prevented customer confusion. The court therefore enjoined the franchisee from (1) using the Stevi B’s Pizza trademarks and (2) causing any likelihood of confusion as to the source or sponsor of the business or as to defendant’s affiliation with the franchisor. The court set the bond amount at $100,000.
The U.S. District Court for the Eastern District of North Carolina held that franchisor Dairy Queen was entitled to treble damages, attorney fees, and an injunction based on its former franchisee’s trademark infringement. Dairy Queen initially sought a preliminary injunction, which the court granted when defendants did not oppose the motion.

Dairy Queen then sought a default judgment because defendants did not respond to plaintiff’s complaint. The court granted the motion, awarding treble damages pursuant to 16 U.S.C. § 1117(a) and attorney fees, and converted the preliminary injunction to a permanent injunction.

Plaintiffs, Dunkin’ Donuts and Baskin Robbins, moved for a preliminary injunction to enjoin a former franchisee’s continued operation under their trademarks. Defendant, the franchisee, was required to remodel its store but several unforeseen obstacles caused delays in 2013, including the lack of necessary approvals from the health department and an issue with the drinking water well that was still not resolved by August 2014. As a result of the delayed renovations, plaintiffs issued a notice of termination. Defendant argued that plaintiffs continued to accept fees after the purported termination and that defendant continued to operate as a franchisee. Nonetheless, plaintiffs sought a preliminary injunction against the continued use of their intellectual property.

In analyzing whether to issue a preliminary injunction, a court must consider the likelihood that the moving party would succeed on the merits of its claim, the extent to which the moving party would be irreparably harmed without an injunction, the extent to which the non-moving party would suffer irreparable harm if the injunction was issued, and the public interest. The U.S. District Court for the Eastern District of Pennsylvania held that it was reasonably likely that plaintiffs would succeed on the merits because the renovations were not finished and plaintiffs provided multiple notices of default with an opportunity to cure. Thus, even though the remodel defaults were not necessarily in defendant’s control, the fact that the remodel was incomplete was not in question.

Nonetheless, the court refused to grant an injunction because it was not persuaded that plaintiffs would suffer irreparable harm. While the Third Circuit applied a presumption of irreparable harm from the trademark infringement, the court noted that a growing number of courts recognized that eBay, Inc. v. MercExchange, L.L.C., 547 U.S. 388 (2006), appeared to prohibit courts from applying an automatic presumption of irreparable harm in
cases of intellectual property infringement. Taking a cue from eBay, the court held that it could not presume irreparable harm and instead independently evaluated whether plaintiffs established they would suffer irreparable harm absent a preliminary injunction.

Here, because defendants continued to operate their stores according to Dunkin’ Donuts rules and procedures, there was no indication that sales suffered in any way or that goodwill was harmed. The only deviation by defendant was the failure to remodel, but the premises were clean and not in disrepair. The most that could be said is that the franchisors’ customers were “not experiencing the next generation of Dunkin’ Donuts décor.” Thus, because defendant was operating in conformity with the rules other than the delayed remodel, the court found that any damages plaintiffs may be suffering were compensable with monetary damages and plaintiffs failed to show irreparable harm.

Moreover, the court held that defendant would suffer substantial harm if enjoined from operating because an injunction would be the death of defendant’s business, deprive it of any income, and leave it with the costs of maintaining the store. The court also held that the reason for termination was not necessarily defendant’s wrongful conduct but due to delays outside of its control. Therefore, the court held that defendant’s harm if an injunction was issued far outweighed any harm to plaintiffs stemming from defendant’s continued operation of the existing store.


In this case, the court granted a preliminary injunction against the former franchisee of a grout-cleaning and repair franchise from continuing to use the franchisor’s trademarks and holding itself out as a franchisee. The former franchisee operated a business offering grout cleaning and repair under a renewal franchise agreement with plaintiff. Shortly after the franchise agreement was renewed, the franchisor terminated it after receiving complaints that the franchisee performed faulty work and “engaged in conduct which caused customers . . . to fear for their safety.” In addition, the former franchisee failed to pay a renewal fee and to submit gross sales reports.

After termination, the former franchisee started a so-called vendetta campaign against plaintiff by leaving threatening voicemails for plaintiff’s executives and the web developer responsible for plaintiff’s website. The former franchisee also attempted to register plaintiff’s trademarks for itself with the U.S. Patent and Trademark Office and published e-books for sale on Amazon.com using plaintiff’s marks and logos.

Applying these facts, the court found that plaintiff met each of the four elements for granting a preliminary injunction: (1) it was likely to succeed on the merits; (2) it was likely to suffer irreparable harm in the absence of preliminary injunctive relief; (3) the balance of equities tipped in its favor; and
an injunction was in the public interest. The court determined that plain-
tiff had at least showed that it would prevail on its trademark infringement
claims and that the former franchisee’s continued use of the trademarks
would cause irreparable harm. Particularly concerning to the court were
the threatening voicemails left by the former franchisee, which called into
question his mental and emotional stability. Thus, the court preliminarily en-
joined the former franchisee from continuing to infringe on plaintiff’s trade-
marks, holding itself out as plaintiff’s franchisee, breaching post-termination
covenants in the franchise agreement, harassing and threatening plaintiff and
its employees, and making false claims to federal and state agencies.

**Ledo Pizza Sys., Inc. v. Singh, Bus. Franchise Guide (CCH) ¶ 15,335,**
This case is discussed under the topic heading “Breakaway Franchisees.”

(CCH) ¶ 15,301, No. 5:14-CV-17-BR, 2014 WL 2439954 (E.D.N.C. May 30, 2014)
Plaintiff, a baked goods distributor of Bimbo Foods Bakeries Distribution,
Inc., was not entitled to a preliminary injunction enjoining termination of
its distribution agreement for allegedly flushing product within its territory
because it failed to clearly demonstrate both the likelihood of success on the
merits of its breach of contract claim and the likelihood of suffering irrepa-
ribly harm without an injunction. Plaintiff and Bimbo had entered into a dis-
tribution agreement in 2006, under which plaintiff purchased exclusive rights
to sell and distribute Bimbo bakery goods to grocery stores in specified ter-
ritorial areas; it was to be paid a percentage of sales or a margin on the sale of
product. In June 2013, after Bimbo informed plaintiff and other distributors
that it was reducing the margins, they formed a six-member committee to
negotiate the reduced margins with the company. According to plaintiff,
who was an active member of the committee, Bimbo refused to negotiate
with the committee. On December 21, 2013, Bimbo delivered a notice ter-
minating his distribution agreement effective immediately for a non-curable
breach of the distribution agreement. The notice stated as grounds for the
termination that Bimbo recently discovered plaintiff’s practice of flushing
product by creating false sales and buyback invoices, for which plaintiff re-
ceived approximately $2,500 to which it was not entitled.

According to the parties’ distribution agreement, a non-curable breach
that entitled Bimbo to terminate immediately, upon written notice and
with no opportunity to cure, included where the distributor’s breach in-
volved criminal activity or fraud, threatened public health or safety, or
threatened significant harm to the company. Plaintiff claimed that Bimbo’s
stated reasons for termination were pretext for retaliating against him for
his role in opposing the reduced margins paid to distributors and requested
a hearing with Bimbo to produce evidence regarding the termination. When
Bimbo refused the request, plaintiff filed suit in state court, bringing claims of unfair and deceptive trade practices under North Carolina law, breach of contract, and fraud, and moved for a temporary restraining order. When Bimbo removed the action to the Eastern District of North Carolina, plaintiff filed this motion to preliminarily enjoin Bimbo from in any way interfering with its operation of its bakery products distribution route and from taking any action or invoking any timeline to force the sale of their distribution agreement.

In denying plaintiff’s motion for preliminary injunction, the court held that because there were factual disputes regarding whether Bimbo properly terminated the distribution agreement, plaintiff failed to clearly show it would likely succeed on the merits of its breach of contract claim. Although Bimbo argued it instituted and distributed a specific written policy against flushing of product in 2009, plaintiff argued (with supporting affidavits from other distributors) that it never received any training or notice of the anti-flushing policy.

Moreover, even if plaintiff could make such a showing, the court held that it did not clearly show that it would likely be irreparably harmed unless a preliminary injunction was issued. Although plaintiff argued that its damages were incalculable based on the harm to its reputation and goodwill, the court found that goodwill could be valued in monetary terms and damages calculated because plaintiff operated its route for more than seven years when Bimbo terminated it. Because plaintiff’s distribution route was well established at the time of termination, there was more than sufficient historical data from which to calculate monetary damages. Additionally, any goodwill plaintiff built in the distribution route was included in the valuation of the route, as evidenced by plaintiff’s own testimony that it created equity in the route and its value increased from $108,000 to $140,000. Because plaintiff’s breach of contract damages was calculable, it was therefore unable to clearly show it was likely to be irreparably harmed absent injunctive relief. Without that showing, the court found the balance of the equities did not tip in favor of plaintiff. Because the propriety of the termination of the distribution agreement was factually disputed, the court found that the public interest in enforcement of contractual obligations was served no matter whether the court granted or denied preliminary injunctive relief. Plaintiff was unable to make the requisite showing to justify a preliminary injunction; thus, the court denied its motion.


Meineke, a muffler shop franchisor, was entitled to a permanent injunction, enjoining its former franchisee from post-termination use of the franchisor’s marks and the operation of a competing car care center in the same location. Upon termination of the franchise, defendant continued to operate under
Meineke’s marks. Meineke filed a complaint against defendant and then moved for a default judgment when defendant failed to answer.

The U.S. District Court for the Western District of North Carolina held that Meineke showed it owned the trademark and defendant was infringing on its trademark rights. Thus, it showed a likelihood of success on the merits. The court held Meineke also showed irreparable harm because Meineke suffered damage to goodwill and reputation, as well as lost sales. Moreover, monetary damages were inadequate because the denial of an injunction would force the plaintiff to suffer continued infringement and bring successive suits for monetary damages indefinitely. Finally, granting the injunction would serve the public interest to avoid consumer confusion that would otherwise result from defendants’ unauthorized use of the trademark.

The court also agreed to enjoin defendants from competing in violation of the franchise agreement’s non-compete. It held that the non-compete, prohibiting competition for one year within a six-mile radius of the franchised location and any other Meineke Center in operation, was reasonable in duration and geographic scope. The court, however, denied Meineke’s request for attorney fees, even though the agreement provided for an award of attorney fees to the prevailing party. The provision of attorney fees in North Carolina is at the court’s discretion; considering all relevant facts and circumstances, the court denied Meineke’s request for attorney fees.


The court partially granted plaintiffs’ motion for a preliminary injunction preventing a former franchisee from using the franchisor’s registered trademarks and from competing against the franchisor’s other franchisees by operating an ice cream truck franchise.

Defendant was a former franchisee who operated Mister Softee franchised ice cream trucks for nearly thirty years. The franchise agreements were terminated after defendant ceased making royalty payments and parking his trucks at the required depot (necessary to clean and store the trucks). However, defendant continued operating the ice cream trucks in his former franchise territories using names such as “Master Softee” and “Soft King.” Defendant’s renamed trucks also contained similar lettering and paint schemes as the franchisor’s trucks; truck design was a federal registered trademark. Finally, defendant’s trucks featured an “anthropomorphized waffle cone character,” wearing a blue jacket and red bow tie, which was also a federally trademarked feature of Mister Softee trucks. However, defendant did not use Mister Softee’s trademarked jingle.

Because of these similarities, the court granted plaintiffs’ motion for preliminary injunction with respect to defendant’s use of the registered trademarks because of the likelihood of confusion with the Mister Softee brand.

Plaintiffs also sought to enforce a non-compete agreement that prohibited defendant from competing in the ice cream business—both retail and
wholesale and mobile and fixed—for two years anywhere in defendant’s for-
mer franchise territory as well as any territory of any other Mister Softee
franchisee. The court took judicial notice that the protection being sought
by plaintiffs would be well over 100 miles in length and included four bor-
oughs of New York City (excluding Staten Island) and all of Long Island.
The court agreed to enforce the non-compete within defendant’s former ter-
ritories and within the territories of other franchisees that are within a five-

term of defendant’s former territory, for both retail and wholesale op-
erations. In rejecting the non-compete for other areas, the court held that the
plaintiffs failed to make a clear showing why their legitimate business inter-
ests required restraint in those areas. The court deemed the two-year
restriction reasonable.

Defendant argued he was entitled to rescission because the plaintiffs
failed to comply with the prospectus delivery requirements of the New
York General Business Law. The New York statute provides that a fran-
chise may not be sold without first “providing” a prospectus to the franchi-
see. A person who sells a franchise without compliance is liable for rescis-
sion if the violation was “willful and material.” Plaintiffs filed an affidavit in
which they declared that an officer offered defendant a prospectus, but he
refused to review it because he told the officer he had been a franchisee for
nearly thirty years and already knew everything about the system. The
court declared that the common English usage of “provide” means to “sup-
ply or make available.” Because defendant did not rebut plaintiffs’ affidavit
that they offered the prospectus, this was enough in the court’s opinion to
satisfy the requirement that the franchisor “made available” the prospectus.
Moreover, even if the failure to follow through and physically deliver the
prospectus was a violation of the New York statute, nothing in the evidence
suggested the failure was “willful,” so rescission would not be an appro-
perate remedy.

This case is discussed under the topic heading “Arbitration.”

RE/MAX of New England, Inc. v. Prestige Real Estate, Inc., Bus. Fran-
chise Guide (CCH) ¶ 15,314, No. 14-12121-GAO, 2014 WL 3058295
Plaintiff RE/MAX of New England sought a preliminary injunction to re-
strain its former franchisees from competing with its real estate brand.
RE/MAX sought to restrain the former franchisees from continuing to use
its trademarks, competing with it, and continuing to use certain phone num-
bers and domain names post-termination.

Defendants Prestige Real Estate, Inc., Stacey Alcorn, and Andrew Armata
(collectively Prestige) operated real estate offices under a franchise agree-
ment with RE/MAX. In April 2014, Prestige sent RE/MAX a letter
terminating the relationship and alleging unfair business practices. Defendants began operating their real estate offices as LAER Realty Partners.

The U.S. District Court for the District of Massachusetts denied RE/MAX’s requested injunction in full. The court found Prestige did not wish to continue using RE/MAX’s trademarks and held that undated photographs submitted by RE/MAX were unreliable evidence that Prestige continued to use the RE/MAX name and marks. The court further found RE/MAX did not establish Prestige violated any of its in-term and post-termination non-compete obligations. Regarding the in-term non-competes RE/MAX argued applied to ten franchises with unexpired agreements, the court found they limited ordering competition. The court held there were no trade secrets and there was reason to wonder whether any goodwill generated by Prestige office was due to RE/MAX branding and method or the work and personal relationships of agents. The court held the record did not convincingly support the former possibility. As for the post-termination non-competes, the court held the clause was meant to prevent a former franchisee from joining another real estate franchise, organization or network, not to prevent it from conducting its own real estate business. As for the phone numbers, the court held that an injunction was not warranted in light of its findings regarding the alleged trademark infringement.


This case is discussed under the topic heading “Statutory Claims.”


This case is discussed under the topic heading “Non-Compete Agreements.”

**JURISDICTION**


This case is discussed under the topic heading “Contract Issue.”


A franchisor sued a terminated franchisee that allegedly continued to operate its restaurant under a different name. The franchisee moved to dismiss on the grounds that the U.S. District Court for the Eastern District of Louisiana lacked subject matter jurisdiction because the amount in controversy requirement of $75,000 was not met. The franchisee argued it stopped
operating any restaurant at all seven months after termination because it was not profitable, and while the franchisor showed lost fees and royalties for that period to be roughly $17,000, this was well below the jurisdictional threshold.

The franchisor also argued that because the franchise agreement was for twenty years, the amount in controversy should reflect monthly fees for those twenty years. The court declined to indulge the franchisor’s conclusions, holding that royalties are calculated as a percentage of gross sales, and here, the franchisee ceased operating not long after termination. Moreover, while the franchisor argued the franchisee stole proprietary information, there was no reasonable basis to believe that any damages arising from this would raise the amount in controversy to over $75,000. Thus, the court granted the franchisee’s motion to dismiss because it lacked subject matter jurisdiction.

LABOR AND EMPLOYMENT


7-Eleven franchisees filed a claim against the franchisor alleging it violated the Federal Fair Labor Standards Act (FLSA) and the New Jersey Wage and Hour Law (NJWHL). Plaintiffs alleged a variety of factors that entitled them to protections under the FLSA and NJWHL, including: (1) the franchisor’s tight level of control over the regulation of vendors and supply, pricing, advertising, and promotional items; (2) the franchisor processed payroll through its internal payroll system; (3) plaintiffs were required to wear the franchisor’s uniforms in the store and at off-site events and were subject to “intense daily oversight” by the franchisor’s managers; (4) plaintiffs could not control the volume of their televisions or the air conditioning and heat in their stores and that the franchisor controlled these from its corporate headquarters; (5) plaintiffs were restricted from having interests in other business entities; (6) bookkeeping and accounting were all done by the franchisor, and plaintiffs could not withdraw money without the franchisor’s approval; and (7) the franchisor would be unable to operate in the manner it does without the plaintiffs.

Claims under the NJWHL were for unpaid wages and unpaid overtime. The U.S. District Court for the District of New Jersey held the New Jersey Supreme Court recently accepted certification of a case that would address the appropriate test for whether an individual is deemed to be an independent contractor or an employee. Claims under the NJWHL are only available to employees. Therefore, the court refused to dismiss plaintiffs’ claims under the NJWHL on the franchisor’s motion to dismiss because it was an unsettled issue as to how courts determine whether a party is an independent contractor or an employee and would remain so until the New Jersey Supreme Court resolved the issue.
The court then turned to the FLSA claims and held that the Third Circuit set forth a six factor test in determining whether an individual is an employee under the FLSA: (1) the degree of the alleged employer’s right to control the manner in which the work is to be performed; (2) the alleged employee’s opportunity for profit or loss depending upon his managerial skill; (3) the alleged employee’s investment in equipment or materials required for his task or his employment of helpers; (4) whether the service rendered requires a special skill; (5) the degree of permanence of the working relationship; and (6) whether the service rendered is an integral part of the alleged employer’s business. Moreover, the court held that it must consider whether as a matter of economic reality the individuals were dependent upon the business to which they render service. The court held that plaintiffs pled a claim for relief sufficient to withstand the franchisor’s motion to dismiss because they asserted sufficient facts to allege employee status under the FLSA. For example, plaintiffs alleged that the franchisor regulated vendors and supply, product pricing, advertising, and promotional items; controlled all bookkeeping and accounting; and required plaintiffs to obtain approval before withdrawing money. The court also held that plaintiffs’ opportunity for profit or loss was partially dependent upon their ability to manage the store and hire employees, but the franchisor’s conduct undercut those opportunities through pervasive control. The court also held that plaintiffs were integral to the franchisor’s business, which weighed in favor of classifying plaintiffs as employees. The court noted that it was unclear how the franchisor could run its business at all without its franchisees. Moreover, because the franchisor’s control significantly limited the franchisees’ discretion to run their franchises, the franchisees alleged an economic reality of dependence on the franchisor.

Plaintiffs asserted claims for violation of the covenant of good faith and fair dealing due to the franchisor’s purported failure to properly maintain the franchised stores and respond to plaintiffs’ request for service, unfairly burdening plaintiffs through their actions in negotiating vendor contracts, refusing to properly train plaintiffs on equipment, demanding maintenance of minimum credit balances despite audit irregularities perpetuated by defendants, and refusing to pay plaintiffs’ promotional incentives and earn “bill backs.” The franchisor argued that plaintiffs failed to support this claim because they did not identify the terms of the contract out of which the implied covenant arose. The court, however, found that plaintiffs adequately set forth allegations of a violation of the covenant of good faith and fair dealing by alleging that the franchisor’s actions have the effect of destroying or injuring the rights of the franchisees to receive the fruits of the contract. See Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 587 (N.J. 1997). Plaintiffs also asserted the requisite bad motive by contending that the franchisor’s alleged breach of the duty of good faith and fair dealing was an attempt to create a hostile environment for plaintiffs and intimidate them into surrendering their franchises.
Plaintiffs asserted claims under the New Jersey Franchise Practices Act (NJFPA) for constructive termination, but the court dismissed plaintiff’s NJFPA claim, holding that there could be no NJFPA claim for constructive termination where the franchise is still in operation. Plaintiffs also alleged claims under the NJFPA for imposing unreasonable standards of performance. Plaintiffs contended that their maintenance contracts with the franchisor constituted unreasonable standards because they required that franchisees assume all responsibility for maintenance of their franchises; the plaintiffs were required to purchase maintenance contracts from the franchisor, leaving them at the mercy of the franchisor when repairs are needed as the maintenance calls go unanswered. As a result, plaintiffs alleged they lost profits due to spoiled product. Plaintiffs also alleged that the franchisor had an unreasonable policy against replacing equipment in stores that grossed below a certain amount annually. Thus, the court held that the NJFPA claim based on the imposition of unreasonable standards of performance survived the franchisor’s motion to dismiss.


A class of employees, who worked as porters, dish washers, food preparers, and cooks, brought an action against franchisees operating under the name Bare Burger. Franchisee defendants operated the restaurants pursuant to contracts with Bare Burger Group LLC and Bare Burger Inc. Plaintiffs also sued the franchisor and individual defendants who served as executives of the franchisor, alleging that defendants failed to “pay minimum wage, overtime, and spread-of-hours compensation” and maintain accurate records of hours worked. Thus, plaintiffs brought actions under the Fair Labor Standards Act (FLSA) and New York Labor Law (NYLL).

The franchisor and the individual defendants filed a motion to dismiss. The relevant sections of the FLSA and NYLL apply only to employers; thus, the motion to dismiss turned on the single question of whether plaintiffs pled facts sufficient to allege a plausible claim that defendants were their employers.

The FLSA defines employer as “any person acting directly or indirectly in the interest of an employer in relation to an employee.” 29 U.S.C. § 203(d). Moreover, an individual may simultaneously have multiple employers for purposes of the FLSA in which case all joint employers are responsible both individually and jointly for compliance with the applicable provisions of the FLSA. Whether an employer-employee relationship exists for purposes of the FLSA is grounded in an economic reality test. The Second Circuit articulated two tests for determining whether an employment relationship exists for purposes of the FLSA, one relating to formal control and the other to functional control. The formal control test asks whether the alleged employer: (1) had the power to hire and fire the employees; (2) supervised and controlled the employee work schedules or conditions of employment;
(3) determined the rate and method of payment; and (4) maintained employment records. Formal control may not be exercised continuously and may be exercised only occasionally. The functional control test looks at a variety of factors, including but not limited to: (1) whether the alleged employers’ premises and equipment were used for plaintiffs’ works; (2) whether the alleged employee had a business that could or did shift as a unit from one putative joint employer to another; (3) the extent to which the alleged employee performed a discrete line-job that was integral to the alleged employers’ process of production; (4) whether responsibility under the contracts can pass from one employee to another without material changes; (5) the degree to which the alleged employers or their agents supervised the alleged employee’s work; and (6) whether the alleged employee worked exclusively or predominately for the alleged employers. The statutory standard for employer status under the NYLL is nearly identical to that of the FLSA.

Plaintiffs alleged that franchisor defendants were employers of plaintiffs because they (1) guided franchisees on how to hire and train employees; (2) set and enforced requirements for the operation of their franchises; (3) monitored employee performance; (4) specified the methods and procedures used by those employees to prepare customer orders; (5) exercised control over the work of employees; (6) required franchises to employ record keeping for their operations, including systems for tracking hours and wages and for retaining payroll records; and (7) exercised control over their franchisees’ time keeping and payroll practices. Moreover, plaintiffs alleged that defendants had the right to inspect the facilities and operations of the franchisees, audit any franchisees’ financial records, and terminate the franchise agreement and the operations of any restaurant that violated the FLSA or NYLL. As to individual defendants, plaintiffs alleged that they determined the wages and compensation of plaintiffs, established the schedules of employees, maintained employee records, and had the authority to hire and fire employees. The U.S. District Court for the Southern District of New York held that these allegations were sufficient at the motion to dismiss stage to state a claim for relief under the FLSA and NYLL.


Benjamin Orozco, a former employee of a Craig O’s Pizza and Pasteria franchise, alleged multiple violations of the Fair Labor Standards Act (FLSA) against his employers, alleging he was not paid overtime or minimum wage as entitled under the Act. After settling with the franchisee owners, Orozco added Craig Plackis, the founder of the franchisor Craig O’s Pizza and Pasteria, as a defendant. At the district court, a jury found Plackis was an “employer” for the purposes of the FLSA.

On appeal, the Fifth Circuit reversed the district court’s finding. The court relied on the economic reality test, whereby a party’s status as an employer is evaluated with reference to whether the alleged employer: (1) possessed the
power to hire and fire employees; (2) supervised and controlled employee work schedules or conditions of employment; (3) determined the rate and method of payment; and (4) maintained employment records.

With respect to Orozco’s argument that Plackis was responsible for hiring and firing, the court held there was no evidence Plackis directed the franchisee to hire or fire employees. Any input from Plackis was characterized as advice “on improving profitability” in order to assist a struggling franchisee. The ultimate authority to hire and fire rested with the franchisee. With respect to Orozco’s argument that Plackis supervised and controlled employee work schedules or conditions of employment, the court held that it was insufficient to infer control from the effect that a franchisor’s advice might have on the actions of a franchisee. Plackis merely provided advice to the franchisee and could not be said to “control” any aspect of work schedules or conditions of employment. The evidence that Plackis reviewed schedules and trained employees was insufficient to establish control.

The court left open the possibility that, in certain circumstances, a franchisor may qualify as the FLSA employer of the franchisee’s employees, where sufficient evidence is produced to satisfy the economic reality test.


This case is discussed under the topic heading “Vicarious Liability.”

**NONCOMPETE AGREEMENTS**


A franchisor of sports training gyms moved for a preliminary injunction, requesting that the court enjoin defendant from operating sports training gyms allegedly in violation of post-termination covenants not to compete. The U.S. District Court for the District of Utah granted the franchisor’s motion with respect to one location in Scottsdale, Arizona, because the former franchisee’s current location was within the territory set forth in the post-termination noncompete agreement. The court held that allowing defendants to ignore the noncompete would result in irreparable harm by harming the franchisor’s goodwill, customer relationships, and relationships with other franchisees. The court, however, refused to grant plaintiff’s requested injunction for the franchisee’s location in Tempe, Arizona, because that location was outside the boundaries of the protected territory in the noncompete.


This case is discussed under the topic heading “Injunctive Relief.”
This case is discussed under the topic heading “Injunctive Relief.”

This case is discussed under the topic heading “Injunctive Relief.”

The court granted SmallBizPros, Inc. d/b/a Padgett Business Services’ motion for preliminary injunction against a former franchisee who failed to comply with the post-termination noncompetition obligations of his franchise agreement.

Padgett is the franchisor of bookkeeping, tax preparation, and business services companies. John A. Terris, Sr. was a franchisee of Padgett for twenty years. His franchise agreement expired when he chose not to renew, allegedly because he planned to retire. The agreement’s post-termination obligations included: (1) a duty not to compete in the same county for a one-year period; (2) a duty not to divert clients to a competing business; and (3) an obligation to cooperate in the transition of clients to Padgett or its designee. Padgett sued and moved for a preliminary injunction after learning that Terris allegedly violated all three post-termination obligations.

At the evidentiary hearing, Terris testified that he had completely retired and that he had no involvement in any bookkeeping, tax preparation, or business services company. Terris further testified that after his franchise agreement expired, his wife established a new limited liability company doing business as Premiere Business Services, which provided the same services as Padgett. Terris contended that he had no present involvement in Premiere’s operations, Premiere was wholly owned by his wife, and he had nothing to do with it other than occasionally visiting the office for lunch.

However, Padgett submitted evidence that directly contradicted Terris’s testimony and led to the inescapable conclusion that he violated his post-termination obligations. In particular, Padgett presented a photocopy of Premiere’s website, which included a photograph of Terris with his professional biography describing him as a valued member of the Premiere team, thereby giving the impression that he was actively involved in the operation. More troubling, as of the date of the hearing, the website listed Terris as “John Alvin” as opposed to his full name (the court surmised that “Alvin” was Terris’s middle name), but continued to state his same biography. The court found this to be an egregiously deceptive and dishonest attempt to avoid his contractual obligations. Moreover,
lying to the court about his involvement at the evidentiary hearing was sanctionable. Padgett also submitted a video and audio recording of a private investigator who posed as a potential client of Premiere. The evidence depicted Terris as working for Premiere in a managerial role and inducing a prospective client to bring his accounting and tax business to Premiere. Consequently, there was a substantial likelihood that Padgett would prevail on its claim that Terris breached the post-termination obligations of his franchise agreement.

The court granted Padgett’s motion for preliminary injunction and enjoined Terris from: (1) working at a competing business as a manager or owner for one year; (2) working at Premiere or otherwise being associated with that business for one year; (3) diverting or attempting to divert any customers to Premiere; (4) employing or attempting to employ any former employee of his franchise; and (5) disclosing any information or knowledge regarding Padgett customers, methods, promotion, advertising, or other methods of operation. The court also ordered Terris to cooperate in the transfer of clients that were served by his Padgett franchise; work with Padgett in transferring any telephone numbers that were used by the franchise; and return all files, signs, and materials to Padgett.

ORAL AGREEMENTS

*Bennett v. Itochu Int’l, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,313, 572 F. App’x 80 (3d Cir. 2014)

This case is discussed under the topic heading “Alternatives to Franchising.”

STATE DISCLOSURE/REGISTRATION LAWS


This case is discussed under the topic heading “Financial Performance Representation.”


This case is discussed under the topic heading “Encroachment.”

STATUTE OF LIMITATIONS

*Dunlap v. Cottman Transmissions Sys., LLC*, Bus. Franchise Guide (CCH) ¶ 15,325, 539 F. App’x 69 (4th Cir. 2013)

This case is discussed under the topic heading “Tortious Interference.”
STATUTORY CLAIMS


Plaintiff tire dealer filed a motion to amend a complaint, asserting claims that the manufacturer terminated the dealer in violation of the Ohio Farm Machinery Dealer Law (the Act) and engaged in unlawful restraint of trade. The U.S. District Court for the Northern District of Ohio held that the dealer could not set forth a claim under the Act because it made no allegation that it was a farm machinery or construction equipment dealer. Plaintiff failed to allege that it was engaged in the retail sale of farm machinery or construction equipment, which is necessary to state a claim under the Act. Moreover, even if it had successfully alleged that this law did apply, it sought a remedy not provided for in the statute—the only remedy provided for in that statute is the repurchase of inventory, and plaintiff made no request that the manufacturer repurchase its inventory. Moreover, the dealer failed to state a cause of action for restraint of trade and could not do so because it provided little detail and failed to allege an agreement in restraint of trade, allege the restraint of trade was unreasonable, and demonstrate or allege any anti-competitive effects within a relevant market.

The dealer also moved to amend the complaint to reflect additional facts adduced in discovery, and the defendants did not oppose this portion of the motion. Therefore, the court granted plaintiff’s motion to amend the complaint to add facts adduced in discovery, but denied the motion to amend the complaint to add a claim under the Ohio Farm Machinery Dealer Law and to add a claim for violation of the Ohio Antitrust Law.


This case is discussed under the topic heading “Unfair Competition/Unfair and Deceptive Practices.”


The Supreme Judicial Court of Massachusetts affirmed that a manufacturer is not obligated under Massachusetts General Laws ch. 93B § 8(a) to defend a negligence claim on behalf of a motor vehicle franchisee where plaintiff’s allegations are against both the manufacturer and the dealer.

Matthew Ferreira purchased from Somerset Auto Group, a Jeep Wrangler manufactured by a predecessor Chrysler Group LLC. Ferreira filed a claim against both defendants. The claim against Chrysler alleged breach of warranty and unfair and deceptive trade practices. The claim against Somerset
alleged misrepresentations regarding the warranty and unfair and deceptive trade practices. The trial judge dismissed the claim against Chrysler.

Somerset filed a cross-claim alleging Chrysler was obligated to defend the action against Somerset under § 8(a). Both the Superior Court and the Massachusetts Appeals Court dismissed the cross-claim. Somerset further appealed that decision.

Chrysler argued it was not obligated to defend the claim against Somerset until Somerset was found liable. The court rejected this argument and stated that the duty will be triggered by a claim before any determination of liability. The court also rejected the trial judge’s conclusion that there was no duty to defend unless the claim specifically alleged negligent design or manufacture. It held that the duty would be triggered so long as the claim was predicated upon negligent design or manufacture of a motor vehicle.

The court held that the duty to defend under § 8(a) is triggered in cases where a complainant makes allegations solely against the manufacturer and where the claim does not allege any fault or neglect on the part of the dealer. Specifically, the court held that the purpose of this provision is to protect an essentially innocent dealer which would be found liable or would have to bear the expense of mounting a defense without any fault alleged against it. In this case, Ferreira alleged fault on the part of both the manufacturer and dealer. Therefore, Chrysler was not obligated to take on the defense of the claim against Somerset.

This case is discussed under the topic heading “Financial Performance Representation.”

Plaintiff dealer sued the supplier under the North Carolina Farm Machinery Franchise Act as a result of a dispute following termination and the supplier’s obligations to repurchase inventory. Following a bench trial, the U.S. District Court for the Western District of North Carolina held that the encumbrance on the inventory at the time of termination did not excuse the supplier’s repurchase obligation. Upon termination of the agreement, a dispute arose as to the extent to which the supplier was obligated to repurchase inventory from the dealer given that the inventory was encumbered by a lien. In this case, the lien was held by the dealer’s president and sole shareholder, whose representative told the court that the encumbrance would be cancelled and extinguished at the close of the repurchased transaction. Therefore, while the property to be repurchased was encumbered, which would excuse the supplier from having to meet its statutory repurchase obligations under the Farm
Machinery Franchise Act, the court held that the proper focus should be that the inventory is free of liens at the time of closing of the repurchase transaction, not at the time of termination. Therefore, the supplier’s statutory obligation to repurchase inventory remained but was conditioned on proof of the extinguishment of the president’s lien at the closing of the repurchased transaction.

This case is discussed under the topic heading “Breakaway Franchisees.”

This case is discussed under the topic heading “Financial Performance Representation.”

This case is discussed under the topic heading “Good Faith and Fair Dealing.”

A beer importer and beer distributor were engaged in a lawsuit concerning the importer’s termination of the distributor’s franchise to distribute the importer’s beer in Florida. The distributor initiated litigation concerning the termination and the importer asserted counterclaims. Both sides moved for summary judgment.

The distributor alleged that the importer did not have good cause for termination because the deficiencies cited as the reasons for termination were not provisions of the franchise agreement because there was no written agreement. The importer argued that even in the absence of a written distributor agreement, the distributor was required under Florida beer distribution law to use due diligence and reasonable efforts and resources to promote the product and expand the market within its exclusive territory. The distributor purportedly failed to fulfill that obligation and the importer argued that this constituted good cause for termination. Specifically, the importer argued that the distributor lacked an adequate sales presence in the Florida panhandle region and the Florida Keys, and it refused to sell through the Publix supermarket chain. The distributor argued that these were not provisions of an agreement and therefore could not be used as good cause for termination.

The U.S. District Court for the Middle District of Florida held that the issue was how to read the good cause provision of § 563.022(7)(a) of the
Florida Beer Distribution Law in harmony with the reasonable efforts and resources provision of § 563.022(12) when there is no written agreement. The court held that where there is no written agreement, the reasonable efforts and resources provision of § 563.022(12) must be read as a provision of the agreement under the good cause provision of § 563.022(7)(a). Section 563.022(7)(a) defines “good cause” as a failure by a distributor to comply with a provision of the agreement that is both reasonable and of material significance to the business relationship between the distributor and the manufacturer. Section 563.022(12), however, requires a distributor to devote such efforts and resources as required in the agreement as long as the requirements are reasonable and in the absence of a written agreement, the distributor should devote reasonable efforts and resources to distribution and sales. The reasonableness of the distributor’s distribution and sales efforts was an issue of material fact and therefore, whether the importer had good cause to terminate the distribution agreement was also an issue of fact, so the court refused to grant summary judgment for either party.


This case is discussed under the topic heading “Labor and Employment.”


This case is discussed under the topic heading “Contract Issues.”


This case is discussed under the topic heading “Labor and Employment.”


Plaintiffs, owners of a 7-Eleven franchise, alleging constructive termination following their failure of an unannounced audit by 7-Eleven, were not entitled to a preliminary injunction enjoining termination of their franchise under the Delaware Franchise Security Law (DFSFL).

Pursuant to the parties’ June 3, 2013, franchise agreement, 7-Eleven agreed to establish and maintain financing for plaintiffs, provided that 7-Eleven would conduct quarterly audits of the store. 7-Eleven expressly preserved in the franchise agreement the right to enter the store and conduct an audit at any time and without notice and to discontinue financing if plaintiffs materially breached the franchise agreement.
Plaintiffs commenced operations in August 2013. On March 31, 2014, 7-Eleven conducted an unannounced audit at plaintiffs’ store and found an inventory shortage exceeding $30,000. According to 7-Eleven, with this shortage plaintiffs’ equity investment in the store fell significantly below the minimum required under the franchise agreement. Plaintiffs disputed the propriety of the audit, claiming the auditor failed to include large sections of merchandise and that the audit was done to constructively terminate the franchise agreement; they requested a second audit. 7-Eleven served two notices of material breach (which were subsequently withdrawn), removed the store’s money order equipment, and discontinued financing. Plaintiffs instituted this action and filed their motion for injunctive relief on May 7, 2014, claiming that 7-Eleven constructively terminated the franchise agreement by removing the equipment and discontinuing financing. On May 12, 2014, 7-Eleven served a curable notice of material breach to plaintiffs for their store’s failure to maintain the required minimum net worth as of April 30, 2014, with a termination date ninety days from receipt of the notice. 7-Eleven also attempted to conduct a regularly scheduled audit of the store on May 19, 2014, but plaintiffs refused access.

In their motion for injunctive relief, plaintiffs argued that the DFSL, instead of the usual standard for injunctive relief, applied. The court agreed that the DFSL permits a cause of action for constructive termination and requires that, in order to maintain the status quo pending a full hearing, a franchisee must show “some probability” that the franchisor was attempting to terminate the relationship in bad faith or without just cause. Plaintiffs were therefore not required to show for the first prong of the injunctive relief standard a likelihood of eventual success on the merits, but rather they needed only demonstrate by a preponderance of the evidence that it was “more likely than not” that 7-Eleven was constructively terminating the franchise in bad faith.

The court concluded that plaintiffs failed to carry their burden of proof and declined to issue injunctive relief. It found plaintiffs’ supporting declarations merely repeated and provided no additional evidentiary support for their claims. Based on this record, the court also could not conclude that 7-Eleven’s unannounced audit was either inaccurate or conducted outside the scope of the franchise agreement. If anything, the court noted the fact that plaintiffs refused to permit 7-Eleven to conduct a scheduled audit or failed to arrange their own independent audit counterbalanced the alleged impropriety of the unannounced audit. As to the remaining prongs of the preliminary injunction standard, the court found that discontinuation of financing by 7-Eleven was a substantial hardship to plaintiffs, but as a secured creditor, 7-Eleven had contractual rights under the franchise agreement that would be harmed if forced to resume financing; and the public interest lied somewhere in between these two positions. Because none of the prongs weighed “so heavily” in favor of plaintiffs, the court denied their motion for injunctive relief.
Beer distributors won an injunction challenging their supplier’s termination of their franchises. The supplier, however, moved to vacate the preliminary injunction. The U.S. District Court for the Southern District of Ohio granted the motion due to the franchisees’ reduced likelihood of success on the merits, based on an intervening ruling by the Ohio Supreme Court that permitted terminations by a successor manufacturer without cause upon due notice under the Ohio Alcoholic Beverage Franchise Act.

The distributors had franchise relationships with Labatt USA Operating Co., LLC, which was indirectly owned by North American Breweries Holdings and underwent a change of ownership. After the change in ownership, Labatt USA notified the distributors that their distribution agreements were being terminated under the successor manufacturer provision of the Ohio Alcoholic Beverage Franchise Act. The provision permits a successor manufacturer to terminate a distribution relationship without cause. The distributors obtained a preliminary injunction barring termination, which was granted, but there was an open question as to whether that provision applied to distribution relationships governed by written agreements.

The Ohio Supreme Court then issued a decision holding the relevant statute applied to written franchise agreements. Esber Beverages Co. v. Labatt United States Operating Co., L.L.C., 3 N.E.3d 1173 (Ohio 2013). Therefore, the distributors no longer had a likelihood of success on the merits because the relevant provision of the Ohio Alcoholic Beverage Franchise Act was now held to apply to written franchise agreements.

This case is discussed under the topic heading “Arbitration.”

**TERMINATION AND NONRENEWAL**

A former John Deere dealer brought claims against John Deere in the U.S. District Court for the District of Puerto Rico under the Puerto Rico Dealers Act, P.R. LAWS ANN. tit. 10 §§ 278 et seq., which is commonly referred to as Law 75. Both the dealer and John Deere moved for summary judgment, and the court denied both motions.

The court began by explaining the history of and purpose behind Law 75. Although the Act initially regulated only the termination of suppliers’
relationships with dealers, its protections were eventually extended to include conduct that is sufficiently "detrimental to the established relationship, even where the contract was not terminated." See Caribe Industrial System, Inc. v. National Starch & Chemical Co., 212 F.3d 26, 29 (1st Cir. 2000). Certain actions by suppliers—including failing to adequately fill orders—create a rebuttable "presumption of impairment" to the established relationship. If the dealer demonstrates that any of these actions occurred, the burden shifts to the supplier to show just cause existed for such actions.

Just cause is defined as the: nonperformance of any of the essential obligations of the dealer’s contract, on the part of the dealer, or any action or omission on [the dealer’s] part that adversely and substantially affects the interests of the [supplier] in promoting the marketing or distribution of the merchandise or service.

The court emphasized that determining whether just cause exists is typically a question of fact. It also noted that the “established relationship between dealer and [supplier] is bounded by the distribution agreement and therefore the act only protects against detriments to contractually acquired rights.”

The dealer alleged that John Deere violated Law 75 as follows: (1) in December 2012, John Deere unilaterally canceled a purchase order for an excavator that the dealer would have sold for a substantial price; and (2) in March 2013, John Deere terminated the distribution agreement because of the dealer’s alleged indebtedness. The dealer argued that John Deere’s failure to provide the excavator impaired the dealer’s cash flow such that it constituted a constructive termination of the agreement and that consequently the dealer was unable to pay John Deere on its debt, which ultimately resulted in John Deere formally terminating the agreement. John Deere countered that it was justified in canceling the excavator order because the dealer had not completed new model qualification (NMQ) training, which according to John Deere was an “essential obligation” under the agreement. John Deere also argued that in addition to failure to maintain NMQ compliance, the dealer violated a host of other essential obligations under the agreement, which independently warranted termination.

First, the court noted that it was unclear whether the Puerto Rico legislature and courts allowed for a constructive termination claim as a separate cause of action under Law 75, and it chose instead to read the dealer’s constructive termination claim as “an effort to emphasize the impairment endured” by the dealer. Second, the court rejected John Deere’s argument that the presumption of impairment applies only when there are multiple cancellations of orders, as opposed to the single cancellation at issue here. Third, the court was unpersuaded that John Deere was entitled to summary judgment as to whether just cause existed for termination simply because it presented evidence that the dealer violated nearly all of the obligations set forth in the “Essential Obligations” section of the agreement. The court identified a common theme in all of the ostensible reasons for termination
given by John Deere: “resolving whether a breach occurred requires assessing the adequacy or reasonableness of [the dealer’s] performances and course of conduct, an investigation which turns entirely on fact.” Consequently, summary judgment was improper.

For example, although the dealer admitted that its employees were not yet fully trained in NMQ compliance at the time of the order, the dealer argued that they were in the process of training and John Deere’s policy had always been to allow dealers a ninety-day grace period after the sale to complete such training. The court held that given the competing evidence in the record on this key issue—whether NMQ compliance was an essential obligation and prerequisite for filling any purchase orders—it could not resolve the matter at the summary judgment stage.

The court similarly held that the issue of whether John Deere was liable for breach of good faith and fair dealing was “attached” to the Law 75 claim and required resolution of the factual issues surrounding the Law 75 claim first. Lastly, the court rejected John Deere’s argument that the dealer could not prove damages even if it was ultimately determined that NMQ compliance was not an essential obligation. The court noted that clearly the dealer might be able to show damages if John Deere withheld products without just cause the dealer wished to sell. Such a refusal also could have prevented the dealer from timely paying its debts. Ultimately, the damages issue was for the factfinder.

This case is discussed under the topic heading “Unfair Competition/Unfair and Deceptive Practices.”

This case is discussed under the topic heading “Injunctive Relief.”

Giuffre Hyundai, Ltd. v. Hyundai Motor Am., Bus. Franchise Guide (CCH) ¶ 15,326, 756 F.3d 204 (2d Cir. 2014)
The Second Circuit ruled that § 463 of the New York Vehicle and Traffic Law, which provides protections to motor vehicle franchisees in their dealings with automobile manufacturers, did not abrogate the common law right to immediately terminate the contract for incurable breaches.

Plaintiff Giuffre Hyundai was a Hyundai dealer pursuant to a contract with defendant, Hyundai’s domestic affiliate. A state court concluded Giuffre engaged in fraudulent, illegal, and deceptive business practices in clear violation of the contract terms. Giuffre sought to prevent termination of the
contract on the grounds that it was entitled to cure the breach and alleged § 463 required Hyundai to provide an opportunity to cure the breach occasioned by the state court's ruling. The court affirmed the district court’s finding that the breach was incurable and that Hyundai was entitled to terminate the contract immediately.


This case is discussed under the topic heading “Injunctive Relief.”


This case is discussed under the topic heading “Statutory Claims.”

**TORTIOUS INTERFERENCE**


This case is discussed under the topic heading “Unfair Competition/Unfair and Deceptive Practices.”

**Dunlap v. Cottman Transmissions Sys., LLC, Bus. Franchise Guide (CCH) ¶ 15,325, 539 F. App’x 69 (4th Cir. 2013)**

Plaintiff James M. Dunlap operated two AAMCO franchises and alleged that defendants Cottman Transmissions Systems and Todd Leff, the president of AAMCO, conspired to force him out of business with local competitors. Dunlap named Cottman and Leff in an action claiming violation of Virginia’s business conspiracy statute (Va. Code §§ 18.2-499, 18.2-500), tortious interference with a contract, and tortious interference with business expediency. At issue were three questions: (1) whether defendants’ actions could form the required acts to proceed on a business conspiracy claim; (2) what limitation period applied; and (3) whether the intracorporate immunity doctrine shielded defendants in this case.

While the U.S. District Court for the Eastern District of Virginia dismissed Dunlap’s suit, the Supreme Court of Virginia answered those questions otherwise on a certification request. The Fourth Circuit accordingly vacated the district court’s judgment.

On the first question, the court, overruling the district court’s judgment, ruled that tortious interference with a contract and tortious interference with business expediency could form the required acts to proceed on a business conspiracy claim under the Virginia statute. On the second question, the
court ruled that this sort of action was not personal injury and thus was not subject to a two-year limitation period. Since the action was directed at the contract it was therefore subject to the five-year limitation period for personal property. On the final question, the court rejected defendant’s invocation of the intracorporate immunity doctrine, which provides related parties with immunity from conspiracy allegations. However, while some of the named parties did have the necessary relationship, other parties did not; thus, the doctrine did not apply here.


This case is discussed under the topic heading “Contract Issues.”

*Priority Auto Grp., Inc. v. Ford Motor Co., Bus. Franchise Guide (CCH) ¶ 15,324, 757 F.3d 137 (4th Cir. 2014)*

Priority Auto Group, Inc. failed to show that Ford Motor Company improperly exercised a right of first refusal when preventing Priority from purchasing one of its franchises. Priority entered into an agreement with the owners of Kimnach Ford, Inc. to purchase the Kimnach dealership. The franchise agreement between Kimnach and Ford gave Ford a right of first refusal, and the agreement between Kimnach and Priority was conditional upon receiving Ford’s approval for the sale. Ford declined to approve the sale and assigned its right of first refusal to a third party. That third party purchased Kimnach, dispersed its assets, and closed the dealership. Priority filed suit against Ford.

The District Court for the Eastern District of Virginia dismissed the claim pursuant to a motion by Ford under Federal Rule of Civil Procedure 12(c). Priority appealed that decision to the Fourth Circuit.

Priority advanced two alternate claims. Its first claim was that Ford violated Virginia Code § 46.2-1569(3a), which governs the imposition of conditions on the transfer or sale of motor vehicle franchises. Although § 46.2-1569(3a) stated that the exercise of a right of first refusal could not be considered a condition prohibited by that section, Priority argued Ford could not rely on this clause because it failed to fulfill the requirement under § 46.2-1569.1—that its exercise of the right of first refusal resulted in the dealership receiving the same or greater consideration than what it would have received under a proposed sales agreement. The court rejected this argument because the requirement was enacted to protect the interests of dealers, and therefore, Priority, as a prospective purchaser, could not rely on it.

Priority also argued Ford’s actions constituted tortious interference with Priority’s contract and business expectancy. Under Virginia common law, a claimant alleging tortious interference must show that defendant employed improper means. The court held that since Ford was authorized to exercise a right of first refusal by both contract and statute, its actions preventing Priority from purchasing the Kimnach dealership could not constitute improper means.
TRADENAME MARK INFRINGEMENT

This case is discussed under the topic heading “Contract Issues.”

This case is discussed under the topic heading “Injunctive Relief.”

This case is discussed under the topic heading “Injunctive Relief.”

This case is discussed under the topic heading “Breakaway Franchisees.”

This case is discussed under the topic heading “Injunctive Relief.”

This case is discussed under the topic heading “Arbitration.”

TRANSFERS

This case is discussed under the topic heading “Tortious Interference.”

UNFAIR COMPETITION/UNFAIR AND DECEPTIVE PRACTICES

A terminated Porsche dealer in Broward County, Florida, which sold more Porsches than any other dealer in the United States since 1998, filed a lawsuit against the Porsche distributor in Florida state court, asserting claims, among others, for (1) violation of § 320.64(18) of the Florida Automobile Dealers Act (FADA), (2) tortious interference with business relationship,
(3) violation of the Florida Deceptive Unfair Trade Practices Act (FDUTA), (4) breach of contract, and (5) breach of the implied covenant of good faith and fair dealing. Porsche removed the lawsuit to the U.S. District Court for the Southern District of Florida and moved to dismiss the previously mentioned claims. The court granted the motion in part, but allowed certain alleged violations of the FDUTA to proceed.

The parties’ dispute stems from the following facts. The dealer wanted to sell even more cars, but Porsche repeatedly denied the dealer’s requests for more inventory. Then, during a regional dealer’s meeting, one of the dealer’s employees took photos of a presentation with confidential pictures of new Porsche models, and those photos were subsequently leaked to a third-party website. In response, Porsche filed a lawsuit for misappropriation against the dealer in Georgia state court and one day later notified the dealer that it would terminate the dealer’s franchise. A month later, Porsche filed administrative notice with the Florida Department of Highway Safety and Motor Vehicles, as required under the FADA, to add a new dealership to Broward County. The dealer did not object during the administrative process, and the department approved the new dealership. A day later, the dealer filed the lawsuit at issue.

The dealer claimed that by modifying its system of distribution to add an additional Porsche dealer in Broward County, Porsche violated FADA § 320.64(18), which prohibits distributors from “establish[ing]” or “imple-ment[ing]” a “system of motor vehicle allocation or distribution” that is “un-fair” or “inequitable.”

At the outset, Porsche argued that the dealer’s exclusive remedy under the FADA was to object to the department, and by not doing so, the dealer waived any remedy it may have for a potential violation of § 3230.64(18). In rejecting this argument, the court relied heavily on Barry Cook Ford, Inc. v. Ford Motor Co., 616 So. 2d 512 (Fla. Dist. Ct. App. 1993), in which a Florida state court denied the same exclusivity argument for a parallel provision of the FADA. Applying the same analysis of the statutory scheme as the Barry Cook court, the court agreed that the legislature did not intend for department procedure to be exclusive. The court reasoned that the FADA provides alternative remedies for the same harm, provides for damages or injunctive relief “notwithstanding the existence of any other” remedies, fails to confer exclusive jurisdiction on the department, and allows the dealer to seek damages, which the department’s procedure cannot provide. For those reasons, the dealer did not waive its right to assert claims under the FADA by failing to protest at the administrative level.

Nonetheless, the court held that the dealer failed to state a claim that Porsche violated FADA § 320.64(18). The dealer claimed that by Porsche rejecting the dealer’s requests for increased inventory and establishing a new dealership—which would take vehicles or customers from the dealer—Porsche established or implemented a system of distribution in violation of § 320.64(18). The court noted that even if establishing the new dealership
constituted establishing a distribution system, which it declined to address, the
dealer failed to plead that the system was unfair and distributed a benefit to the
new dealership that was not distributed to the dealer. In the absence of any
alleged unfairness, the establishment of a new dealership, by itself, was insuf-
ficient to support a claim under § 320.64(18).

The court briefly addressed the dealer’s claim for tortious interference
with a business relationship. Under Florida law, it is well settled that “a plain-
tiff cannot claim tortious interference with a business relationship when the
defendant is a party to the relationship.” See Genet Co. v. Annheuser-Busch,
Inc., 498 So. 2d 683, 684 (Fla. Dist. Ct. App. 1986). Accordingly, the dealer
could not assert a claim for tortious interference against Porsche.

The dealer alleged that Porsche violated FDUTPA § 501.204(1), which
prohibits unfair or deceptive acts or practices in the conduct of any trade
or commerce, in four ways. Its first argument—that Porsche violated the
FDUTPA by adding a competitive new dealership—ignored that the
FDUTPA exempts any act or practice “specifically permitted by federal
and state law.” Fla. Stat. § 501.212(1). Because adding a new dealership
was permitted by state law, the court dismissed this claim. Second, the dealer
claimed that Porsche violated the FDUTPA by filing the Georgia lawsuit as
an ulterior motive to terminate the dealer. The court explained that a claim
under § 501.204(1) requires that the act or practice itself be in the conduct
of trade or commerce. “In Florida, a lawsuit is not an act or practice in the con-
duct of trade or commerce, regardless if the business that files the lawsuit is
in the conduct of trade or commerce.” Because Porsche is not in the business
of filing lawsuits, the dealer could not claim that Porsche violated the
FDUTPA by filing the Georgia lawsuit.

As to its third and fourth claimed violations of FDUTPA, the dealer al-
leged that Porsche caused it to spend money improving its dealership and
denied its requests for additional inventory, all the while intending to add
the new dealership. The court reasoned that whether this conduct was “un-
fair or deceptive,” a necessary element for any claim under the FDUTPA—
was a question of fact. See Witt v. LaGorce Country Club, Inc., 35 So. 3d 1033,
1040 (Fla. Dist. Ct. App. 2010). Accordingly, the court allowed these claims
to proceed.

Lastly, as to the dealer’s claims for breach of contract and the implied cov-
enant of good faith and fair dealing, the court noted that the franchise agree-
ment granted the dealer no exclusivity rights and expressly allowed for
Porsche to “add, relocate, or replace dealers” in the dealer’s primary area
of responsibility. The dealer pointed to a provision in the franchise agree-
ment which read: “Porsche and [the dealer] shall refrain from conduct
which may be detrimental to or adversely reflect upon the reputation of
PORSCHE AG, Porsche, [the dealer] or PORSCHE PRODUCTS in gen-
eral.” The dealer argued that this provision precluded Porsche from engag-
ing in conduct which may be detrimental to the dealer. Porsche argued that
the provision only prohibited Porsche from engaging in conduct detrimental
to the dealer’s reputation. The court conceded that the sentence standing alone was open to two reasonable interpretations and was therefore ambiguous. “However, while this isolated sentence may be ambiguous, the contract is not.” Under Florida law, specific provisions in a contract govern its construction over general provisions if the provisions relate to the same subject matter. See Ibis Lakes Homeowners Ass’n, Inc. v. Ibis Isle Homeowners Ass’n, Inc., 102 So. 3d 722, 728 (Fla. Dist. Ct. App. 2012). The court held that even if the general prohibition against detrimental conduct was ambiguous, it was “superseded by the special provision permitting Porsche to add dealerships.” The dealer’s breach of contract claim was accordingly dismissed.

In the absence of a breach of contract claim, the court dismissed the dealer’s claim for breach of the implied covenant of good faith and fair dealing. It is well settled that such a claim requires allegations that the defendant breached an express term of the contract. Because the dealer’s breach of contract claims were dismissed, it could not allege that Porsche breached an express provision of the franchise agreement.

This case is discussed under the topic heading “Breakaway Franchisees.”

This case is discussed under the topic heading “Fraud.”

This case is discussed under the topic heading “Contract Issues.”

VICARIOUS LIABILITY

Plaintiff was a customer of a franchisee that helped run estate sales as part of the franchised business. Plaintiff sued the franchisee for breach of contract and fraudulent misrepresentations in connection with the sale of antiques and other personal belongings. Plaintiff also sued the franchisor CT Franchising Systems, Inc. (CTFSI) under theories of agency and vicarious liability, arguing that although the franchisor was not the party it contracted with, the franchisor held national meetings with franchisees, provided franchisees with initial training and preapproved advertising and public relations materials, and that the franchisee was the agent of the franchisor.
The franchisor moved for judgment on the pleadings pursuant to Federal Rule of Civil Procedure 12(c). Plaintiff argued that the provision of training and marketing materials showed an agency relationship because the franchisor had a right to control the franchisee. While the U.S. District Court for the Southern District of Ohio held the existence and extent of an agency relationship is a question of fact, plaintiff failed to allege facts sufficient to show an agency relationship and merely alleged legal conclusions. Specifically, the court held that holding meetings and providing marketing materials and training did not suggest that CTFSI had the right to control the means and methods by which the franchisee conducted its business. Under Ohio law, the determinant factor in deciding whether an agency relationship exists between a franchisor and a franchisee is the degree of control a franchisor has over the operations of a franchisee’s business and here, there was no allegation of high levels of control.

Plaintiff also argued that she pled the existence of an agency relationship by alleging that CTFSI was aware or should have been aware of the franchisee’s misconduct. The court held, however, that mere knowledge of another’s actions does not give rise to any agency relationship and therefore, the court granted the franchisor’s motion for judgment on the pleadings, holding that it was neither a principal of the franchisee nor vicariously liable for the franchisee’s conduct.


The District Court of Massachusetts allowed summary judgment on a number of counts against defendant master franchisor (Jan-Pro) due to the lack of control exercised over its franchisee and sub-franchisee in a two-tiered system.

Seven franchisee plaintiffs alleged unfair and deceptive business practices, misclassification as independent contractors, related wage-law violations, misrepresentation, quantum meruit and unjust enrichment against Jan-Pro. Jan-Pro sold the right to use its name to regional master franchisees such as plaintiffs, which acquired exclusive rights to sell unit franchises in their respective territories. Jan-Pro exercised a high degree of control over the business.

Regarding the franchisees’ classification as a contractor or employee, the court found it was obligated to adopt a previous order in the Georgia Court of Appeal finding that the franchisees were contractors rather than employees. In addition, the court found that the Georgia order was in accordance with Massachusetts law on the basis that the franchisees were free from Jan-Pro’s control and discretion, owing both to the master franchisee structure and the low degree of control Jan-Pro exercised over the business.

Regarding the claim for misrepresentation, the court found that Jan-Pro was not vicariously liable for the alleged wrongdoing of the regional master
franchisee because no reasonable trier of fact could find Jan-Pro controlled, or had the right to control, the relevant instrumentality of the regional master franchisee’s business. However, the court found the record contained sufficient evidence to permit a reasonable trier of fact to conclude Jan-Pro controlled the policies and procedures relevant to allegations of unfair business practices.

The court granted Jan-Pro’s motion to dismiss the franchisees’ quantum meruit claim on the basis that the franchisees were compensated by the master franchisee rather than by Jan-Pro and therefore did not have any reasonable expectation to be compensated by Jan-Pro for their services. The court left determination of unjust enrichment for a later date.

This case is discussed under the topic heading “Americans With Disabilities Act.”

_Orozco v. Plackis, Bus. Franchise Guide (CCH) ¶ 15,316, 757 F.3d 445 (5th Cir. 2014)_
This case is discussed under the topic heading “Labor and Employment.”

_Patterson v. Domino’s Pizza, LLC, Bus. Franchise Guide (CCH) ¶ 15,357, 333 P.3d 723 (Cal. 2014)_
The Supreme Court of California rejected a claim for vicarious liability by Domino’s Pizza, LLC following harassment in the workplace at one of its franchises on the basis that Domino’s did not exercise the requisite control over the franchisee with regard to employment and disciplinary matters.

Plaintiff Patterson, an employee of the franchisee, sued both the franchisee and Domino’s following sexual harassment committed by another employee. Patterson claimed that because Domino’s was the “employer” of persons working for the franchisee, and because the franchisee was the “agent” of Domino’s, as franchisor Domino’s could be held vicariously liable.

The court rejected Patterson’s submission that the degree of control exercised by franchisors like Domino’s made each franchisee the agent of the franchisor for all business purposes and rendered each employee of the franchisee an employee of the franchisor. It stated that the “means and manner” test generally used could not stand for the proposition that an operating system alone constituted the necessary control.

The court noted that Domino’s prescribed standards involving pizza making, delivery, general store operations and brand image, but that the franchisee made day-to-day decisions involving the hiring, supervising, and disciplining of employees. The franchisee suspended the harassing employee, and all relevant training on sexual harassment was by the franchisee.
The court accordingly held that training employees on workplace conduct, monitoring and reporting of sexual harassment and disciplinary measures in the case at hand were undertaken by the franchisee, and Domino’s lacked the general control of an employer or principal over the relevant day-to-day aspects of the business.