Franchise Law Journal

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FRANCHISE LAW JOURNAL

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Deadline for 2017 Edward Wood Dunham Rising Scholar Award Announced

The deadline for the 2017 Rising Scholar Award will be Monday, July 17, 2017. 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 Gary R. Batenhorst, the editor-in-chief of the *Franchise Law Journal*, no later than Monday, July 17, 2017, to be considered in this year's competition. All inquiries should be directed to: gbatenhorst@clinewilliams.com.

We look forward to receiving the submissions!

From the Editor-In-Chief

Gary R. Batenhorst

Mr. Batenhorst

As I write this column for the Winter 2017 issue, we are now over halfway through winter—a big deal for those of us who live in cold climates. Starting off this issue are two other big deals. First, a Save –the-Date notice for the 40th Annual Forum on Franchising from October 18 to October 20 at the JW Marriott Desert Springs in Palm Desert, California. As always, there will be great programs, great networking, and a great venue—and we look forward to seeing you there.

The other big deal is the Forum's Edward Wood Dunham Rising Scholar Award. More information can be found on the award in this issue. It is a writing competition for franchise lawyers from zero to four years out of law school, and it's a wonderful way to start your Forum writing career. The deadline for entries for this year's competition is July 17, 2017.

We have some great articles in this issue. Our first article is the winning entry in the 2016 Rising Scholar competition. Emily Bridges won the award for her insightful article entitled *Keep Off My (Virtual) Lawn: Encroachment in the Age of the Internet*.

Emily is a hard act to follow, so we assigned that task to the immediate past editor-in-chief of the *Franchise Law Journal*, Bethany Appleby, and her colleagues Robert Burstein and John Doroghazi. They responded to the challenge with an excellent article on Little FTC act claims entitled *Cause of Action Alchemy: Little FTC Act Claims Based on Alleged Disclosure Violations*.

A hot topic in recent years is the applicability of the Americans with Disabilities Act to franchise websites. Minh Vu and Julia Sarnoff provide us with a timely and well-written survey of the issues and the law in this area in *Websites, Kiosks, and Other Self-Service Equipment in Franchising: Legal Pitfalls Posed by Title III of the Americans with Disabilities Act*.

In our Spring 2016 issue, incoming Forum chair Eric Karp and his colleague, Ari Stern, presented a thought-provoking proposal for the use of a

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mandatory summary franchise disclosure document. Now comes Forum veteran Carl Zwisler and his colleagues John McNutt and Frank Sciremammano with a response entitled *A Proposed Mandatory Summary Franchise Disclosure Document: A Solution in Search of a Problem*. The *Journal* editors are big fans of this type of point-counterpoint discussion, and we are pleased to air both sides of this issue.

The role of area representatives in franchising has always been somewhat of a mystery to me. Here to provide clues to solving that mystery are Cheryl Mullin and Todd Fisher in *Franchisee v. Agent: The Relationship Between Franchisors and Area Representatives*. You will have a much better understanding of the role of area representatives after reading this very interesting article.

Finally we wrap up the articles in the winter issue with something a little different. If you've ever thought about teaching franchise law at your local law school, you are in luck. Another Forum veteran, David Gurnick, and Alexander Meiklejohn from Quinnipiac Law School have served up a timely and helpful look at what you need to know about teaching franchise law in *Teaching Franchise Law in Law Schools: A Role for Experienced Franchise Lawyers*. I taught franchise law at Creighton University School of Law in Omaha for fourteen years and now teach business planning there. If you haven't tried teaching you are in for a great experience. I learn a lot in preparing for classes and interacting with a new group of neophyte lawyers each year is always fun.

Added to this very nice variety of articles is a great set of Currents from experienced editors, Dan Oates and Jan Gilbert, and one of our promising rookies, Bill Bryner.

So there you have it, an issue is missing only one thing—your name in the table of contents. We are always looking for authors. Whether you are an experienced *Journal* contributor or a potential rising scholar, we welcome your contributions. Send me an email if you are interested, and I will send you our open topics list and author guidelines. In winter or any season you will find it to be a good experience to write for the *Franchise Law Journal*. Our readers look forward to your contributions.


SAVE THE DATE
40th Annual Forum on Franchising
October 18 – 20, 2017
JW Marriott Desert Springs
Palm Desert, CA

Keep Off My (Virtual) Lawn: Encroachment in the Age of the Internet

Emily I. Bridges

Ms. Bridges

The Internet has made reaching customers across the country and around the world much more possible and feasible for businesses. Franchisors should take advantage of the power of the Internet to reach new customers; maintaining the online presence of the franchise system is one way to do accomplish this goal. Franchises now offer sales over the Internet to allow customers additional convenience and flexibility when ordering products or services from the franchise. Although setting up a website can be a simple process, the Internet presence of franchise systems Internet may be complicated by concerns over encroachment issues as well as promises of territory exclusivity. Although encroachment, exclusivity, and the size of a territory have often been areas of contention between franchisors and their franchisees, Internet and online sales have further complicated this relationship.

Prior to the explosion of Internet commerce, many franchise agreements did not address the issue of electronic encroachment. Franchisors did not anticipate the need to address electronic encroachment and instead focused their efforts on brick-and-mortar, physical encroachment concerns. Because of this, franchisors have faced problems arising out of existing franchise agreements, which contained exclusive territory provisions but did not address Internet commerce. Many franchisors wished to capitalize on the Internet market as it was developing, but had difficulty when faced with sales to consumers in areas where an exclusive franchisee was operating. It is critical franchisors ensure they have addressed this issue or risk an unhappy franchisee suing under a theory of electronic encroachment.

This article will examine the current state of the law regarding electronic encroachment claims by franchisees. The first part of this article will discuss the history of encroachment claims, both traditional encroachment claims involving physical territory disputes as well as claims involving electronic encroachment. The second section will discuss the current status of the law regarding electronic encroachment through a summary and examination of

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several arbitration panel decisions and court decisions. Third, it will describe the parallels and differences in approaches taken by courts if the issue involves a claim for traditional encroachment or instead involves alleged electronic encroachment. Finally, it will offer recommendations to franchisors on how they can best avoid electronic encroachment claims by franchisees. Franchisors can increase their revenues by offering sales through the Internet and other electronic means; however, they must ensure they have properly reserved this right to themselves and have not opened the door to a franchisee's successful claim for electronic encroachment.

I. Traditional Encroachment: A History

An encroachment claim by a franchisee typically arises out of the franchisee's belief that the franchisor has improperly violated the terms of the territory it granted to the franchisee.[1] Although some franchisors continue to offer exclusive territories, this practice has been in gradual decline.[2] Physical, or traditional, encroachment typically occurs when a franchisor grants a license to a competing franchise within territory already given or very close to an existing franchise. Another type of traditional encroachment arises when the franchisor opens a company-owned store within the territory of the franchisee, which is then in direct competition with the franchisee for customers and sales.

An expansive definition of traditional encroachment was supported and articulated in *Scheck v. Burger King*[3] and *Vylene Enterprises, Inc. v. Naugles, Inc.*[4] Scheck owned a Burger King franchise in Lee, Massachusetts, and filed suit against the franchisor when the franchisor permitted the Marriott Corporation to convert a Howard Johnson restaurant located only two miles away from his location into a Burger King franchise.[5] One of Scheck's claims was that the franchisor had violated the implied covenant of good faith and fair dealing by permitting this new restaurant to open within two miles of his existing franchise.[6] The franchise agreement at issue did not grant Scheck the right to an exclusive territory, but the U.S. District Court for the Southern District of Florida held this fact did not necessarily mean Burger King had the right to place other stores in the nearby area unless the right to do so had been expressly retained, which it had not.[7] The court found that the franchisor's "alleged failure to exercise [its] discretion with good faith and fair dealing" was sufficient to state a claim such that summary judgment was inappropriate.[8]

1. Robert W. Emerson, *Franchise Encroachment*, 47 Am. Bus. L.J. 191, 193 (2010).
2. *Id.* at 206.
3. 756 F. Supp. 543 (S.D. Fla. 1991).
4. 90 F.3d 1472 (9th Cir. 1996).
5. *Scheck*, 756 F. Supp. at 545.
6. *Id.* at 549.
7. *Id.*
8. *Id.*

The reasoning of this decision was cited with approval by the Ninth Circuit in *Vylene*. In the *Vylene* case, the franchisor opened a company-owned restaurant approximately one-and-a half miles from a franchisee's existing location.[9] The franchisee alleged the franchisor had breached the covenant of good faith and fair dealing by opening a restaurant that directly competed with the franchisee.[10] Citing to *Scheck*, the court stated that "the franchisee, although not entitled to an exclusive territory, was still entitled to expect that the franchisor would 'not act to destroy the right of the franchisee to enjoy the fruits of the contract.'"[11] The court's reasoning in *Scheck* was heavily criticized and somewhat discredited.[12] Much of the criticism focuses on how, in practical effect, the reasoning of both *Scheck* and *Vylene* give the franchisee the right to an exclusive territory, something the franchise agreement did not specifically grant.[13]

The reasoning of *Scheck*, however, has been narrowed.[14] In *Burger King Corp. v. Weaver*, the Eleventh Circuit held that "[t]he rights and duties of the parties to a franchise agreement are created by the agreement. In the absence of an agreement, neither party has a duty to perform and neither has a right against the other."[15] Furthermore, "if one party to a contract has no *right* to exclusive territory, the other party has no *duty* to limit licensing of new restaurants."[16] Although the reasoning of *Scheck* has been restricted by courts,[17] franchisees often continue to cite to this case when bringing a claim under a theory of traditional encroachment.

Electronic encroachment is different than traditional encroachment. Generally, electronic encroachment refers to sales on any type of platform other than a traditional, in-person purchase at a franchise location. This could include catalog sales, telephone sales, and Internet sales.[18] Often, when a franchise first begins, the franchisor may not have considered offering sales through the Internet or over the phone; thus the franchise agreements will not address this area. As an additional complication, franchisees are often skeptical of a franchisor's online sales system in that they may "believe[] that any franchisor with an e-commerce presence [has] become a competitor

9. *Vylene*, 90 F.3d at 1474.
10. *Id.* at 1477.
11. *Id.* (citing *Scheck*, 756 F. Supp. at 549).
12. *See, e.g.*, Payne v. McDonald's Corp., 957 F. Supp. 749, 760 (D. Md. 1997); Barnes v. Burger King Corp., 932 F. Supp. 1420, 1437 (S.D. Fla. 1996); Burger King Corp. v. Holder, 844 F. Supp. 1528, 1530 (S.D. Fla. 1993).
13. *See* Kathryn Lea Harman, *The Good Faith Gamble in Franchise Agreements: Does Your Implied Covenant Trump My Express Term?* 28 CUMBERLAND L. REV. 473, 505 (1997–98).
14. 169 F.3d 1310 (11th Cir. 1999).
15. *Id.* at 1317.
16. *Id.*
17. *See, e.g.*, Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp., 139 F.3d 1396 (11th Cir. 1998); Clark v. America's Favorite Chicken Co., 916 F. Supp. 586 (E.D. La. 1996); Barnes v. Burger King Corp., 932 F. Supp. 1420 (S.D. Fla. 1996); Cook v. Little Caesar Enters., Inc., 972 F. Supp. 400 (E.D. Mich. 1997).
18. *See* Emerson, *supra* note 1, at 223.

and that every Internet sale represent[s] a franchisee's lost sale."[19] Although this attitude may have changed as Internet commerce has become more common, accepted, and anticipated, franchisees are likely still wary of the franchisor's ability to control Internet commerce and may attempt to bring claims against a franchisor under a theory of electronic encroachment.

II. Development of Electronic Encroachment

Initially, franchise territory provisions focused on physical, brick-and-mortar encroachment, and agreements defined territories by various methods, including by mileage radius, population density, or county boundaries. Today, especially with the large increase in consumer Internet usage, electronic encroachment claims will continue to be an issue franchisors face. Many franchise agreements contain arbitration provisions; therefore, several electronic encroachment cases have been resolved through arbitration rather than through the courts. These decisions may be instructive as to how a franchisor may limit its exposure to claims of electronic encroachment. There have been some court cases, however, which have addressed franchisee claims of electronic encroachment.

A. *Arbitration Decisions*

One of the earliest arbitration decisions regarding electronic encroachment arose in *Emporium Drug Mart, Inc. v. Drug Emporium, Inc. of Denton*.[20] Drug Emporium, Inc. (DEI) was the franchisor of Drug Emporium drugstores; in 1997, it began experimenting with offering an online drugstore. Initially, DEI did not serve customers through this website if the customers were in a franchisee's protected territory, but later modified its website to permit such direct sales. It proposed a plan to share with franchisees 1.25% of Internet gross sales from customers within a franchisee's protected territory.[21] In August 1999, the franchisor launched a new website that made no reference to the physical franchise locations. As part of the new website, DEI proposed to pay franchises a 2.5% commission on any online sales generated from customers within a franchisee's protected territory.[22] Several franchisees objected to this proposal and, following DEI's refusal to modify it, began an arbitration action against DEI, alleging breach of contract and breach of the implied covenant of good faith and fair dealing due to the alleged electronic encroachment by the franchisor.[23] While these claims were pending, DEI announced a proposed sale of its website to an online drug re-

19. Gaylen L. Knack & Ann K. Bloodhart, *Do Franchisors Need to Rechart the Course to Internet Success?*, 20 Franchise L.J. 101, 134 (2001).
20. *Id.* Because this was an arbitration, the decision and accompanying records are not publicly available.
21. *Id.* at 135.
22. *Id.*
23. *Id.*

tailer, and the franchisees immediately filed a motion for a preliminary injunction, claiming the franchisor's electronic encroachment into their territories was causing them irreparable harm.[24] A divided arbitration panel granted the franchisees' motion for preliminary injunction, finding that the virtual store was a store under the franchise agreement based in part on the franchisor's advertising of the website as a full service online drugstore.[25] The arbitration panel agreed with the franchisees that there was a reasonable expectation in the agreement that the franchisees would not be competing against the franchisor in direct drugstore sales, and the franchisor's website was a type of direct competition.[26] This decision appears to give franchisees wide latitude in asserting claims for electronic encroachment, similar to the arguments franchisees were asserting under the reasoning of *Scheck*. However, following the arbitration panel's decision in the *Drug Emporium* case, other arbitration panels and courts began limiting electronic encroachment causes of action.

A different arbitration panel rejected a franchisee's electronic encroachment claim a year later in *Hale v. Conroy's, Inc.*[27] In this case, the franchise agreement granted Hale an exclusive territory of two miles from his flower shop. Following the signing of this agreement, the franchisor launched a telephone-ordering network, to which Hale consented.[28] However, when the franchisor began offering online ordering, the franchisee sued for electronic encroachment. The arbitration panel rejected the franchisee's claim, finding the franchisor's actions were not the same as if the franchisor had operated a physical store.[29] The agreement to which the franchisee voluntarily agreed regarding telephone sales also reserved the right of the franchisor to develop new technologies for ordering. Finally, the franchisee was aware of the Internet at the time of signing this agreement, further supporting the franchisor's argument that it had the right to conduct these sales.[30]

In *Franklin 1989 Revocable Family Trust v. H & R Block, Inc.*, an arbitration panel rejected another franchisee's electronic encroachment claim. The franchisee was granted a particular territory and promised that the franchisor would not operate a tax preparation service within its territory; however, the franchisor then began selling tax preparation software throughout the United States directly to consumers.[31] The exact phrasing in the franchise agreement was that the franchisor would not operate a tax preparation service "from a location within the franchise territory;" the panel found this to be ambiguous as to Internet sales, looking then to the implied covenant

24. *Id.*
25. *Id.*
26. *Id.*
27. Gary R. Duvall, *Using the Web More Effectively*, FRANCHISE L.J. 173, 175 (2005).
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.*

of good faith and fair dealing.[32] The panel determined, however, that there was no violation of good faith or fair dealing because the franchisee had not suffered an unreasonable impact on its business due to the electronic sales.[33]

B. *Court Decisions*

Several courts have also been asked to address electronic encroachment claims.

In *Armstrong Business Services, Inc. v. H & R Block*,[34] the franchisees made a similar argument as the franchisees in the *Franklin 1989* case. They argued that, by selling tax preparation software online, the franchisor committed breach of contract, breach of good faith and fair dealing, and unfair business practices.[35] The franchise agreements in this case were somewhat different than those in the *Franklin 1989* case in that they did not contain any express references to the Internet, but they did include a "broad grant of an exclusive territory for tax preparation and for related services."[36] H & R Block argued Internet customers could not be considered a "related service," but a jury disagreed, finding for the plaintiff.[37] Although this case could be read as a step back toward the reasoning of *Drug Emporium*, this is not necessarily true. The court focused on the exact language of the contract at issue rather than implying a further duty of good faith and fair dealing on the franchisor. This case demonstrates the court's emphasis on the specific language regarding Internet sales contained in the franchise agreement.

A more recent court decision in the area of electronic encroachment arose in Michigan in *Pro Golf of Florida, Inc. v. Pro Golf of America, Inc.*[38] This case involved a dispute between Pro Golf of America (PGA), a golf store franchisor, and one of its franchisees. In 1999, PGA announced to its franchisees its intent to sell golf products over the Internet and formed a new corporation to manage these Internet sales.[39] The franchisor would allow franchisees to invest in the Internet sales corporation, but after receiving objections from several franchisees and difficulty obtaining financing, abandoned the idea for several years.[40] Two years later, PGA once again attempted to begin an Internet business and asked franchisees to sign a "ProGolf.com Internet Participation Agreement."[41] This agreement proposed a commission system by which franchisees would receive a percentage of sales from customers within their territories in exchange for other obligations.[42] The Internet participation agree-

32. *Id.*
33. *Id.*
34. 96 S.W.3d 867 (Miss. Ct. App. 2002).
35. *Id.* at 870.
36. Duvall, *supra* note 27, at 175 (internal quotations omitted).
37. *Id.*
38. No. 05-71380, 2006 WL 508631 (E.D. Mich. Mar. 1, 2006).
39. *Id.* at *1.
40. *Id.*
41. *Id.*
42. *Id.*

ment also required franchisees "to waive any territorial rights that the franchise agreements may have afforded them in the area of Internet sales."[43] The plaintiff franchisee did not sign the Internet participation agreement, and the franchisor initially agreed to block Internet sales to customers located in the plaintiff's franchise territory; however, in 2004, PGA decided that Internet sales of the golf merchandise did not violate the franchise agreement with plaintiff and expanded Internet sales into all territories.[44] After learning of this plan for expanded Internet sales, the franchisee sent a notice of default to the franchisor, stating its belief that PGA had breached the franchise agreement by offering Internet sales to customers in the franchisee's territory.[45] During the mandatory cure period, the franchisor attempted to address the franchisee's concerns, but in February 2005 the franchisor received a letter from the franchisee seeking termination of the franchise agreement due to the Internet sales dispute.[46] The parties were unable to resolve their conflict regarding Internet sales, and PGA filed a demand for arbitration in 2005.[47] The franchisees initiated a lawsuit and sought a stay of the arbitration proceedings, which was granted by the court.[48]

The franchisees argued PGA breached the franchise agreements through the Internet sales of golf merchandise, seeking partial summary judgment on the issues of whether the franchisor breached the franchise agreement and whether the franchisee was therefore entitled to terminate the franchise agreement.[49] The franchisee operated three stores—one in Tennessee and two in Florida. The Tennessee territory restriction specified mileage radii within which the franchisor agreed it would not place a new franchise location.[50] The restriction in the Florida franchise agreement was based on particular counties, and it stated the franchisor would not permit additional stores in two specified counties.[51] Neither franchise agreement nor either territory restriction section addressed the issue of Internet sales; however, the court found the language of the franchise agreements to be unambiguous.[52] The court stated that to determine whether the franchisor breached the territory provisions of the franchise agreements, it must determine where the Internet sales occurred. Since neither party had submitted copies of sales invoices or shipping documents to identify the contractual terms that would disclose when title passed from the seller to the buyer, there was a question of fact as to whether the sales were made within the franchisee's defined territories.[53]

43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.* at *2
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.* at *4.
51. *Id.*
52. *Id.* at *5.
53. *Id.* at *6.

The court found it was possible, if not likely, that the Internet sales did not occur within the plaintiff's defined territories.[54] Additionally, the franchisees did not have an exclusive right to sell PGA's merchandise to customers residing within its territory, regardless of how or where the merchandise was purchased.[55] Because there was a question of fact regarding whether the Internet sales were made in the franchisee's defined territories, summary judgment for the franchisee could not be granted.[56]

The court's reasoning in this case supports the idea that, even in the absence of an express provision in the franchise agreement regarding Internet commerce, a franchisor's Internet sales to customers located in a franchisee's exclusive territory may not be a violation of the franchise agreement. *Pro Golf of America* arose prior to the explosion of electronic commerce and expansion of Internet sales, but the reasoning of this court appears to support the idea that a franchisor is able to operate a website offering sales through the Internet to customers located in a franchisee's exclusive territory.

More recently, the U.S. District Court for the Southern District of California examined a franchise agreement under Texas law in *Stillwell v. RadioShack Corp.*[57] In this case, each plaintiff-franchisee operated a RadioShack franchise, and they sued the franchisor for violations of several provisions of the franchise agreement, including the territory restriction, under a theory of electronic encroachment.[58] The territory provision of the agreements referred to an "area of primary responsibility," which guaranteed to the franchisee that the franchisor would not open a company store or authorize another franchise within the area without first giving the existing franchisee the option to open such a store and that the franchisor would not authorize the establishment of an "authorized sales center" within the territory.[59] The plaintiffs argued RadioShack violated this provision by operating RadioShack.com as an Internet store and directing customers to make their purchases from the Internet store.[60] The district court examined the plain language of the territory provision, finding that it only prohibited RadioShack from doing the actions specifically mentioned within this section. The provision was not ambiguous and, on its face, did not prohibit Internet sales by the franchisor. Therefore, the district court granted RadioShack's motion for summary judgment.[61]

The franchisee also sued for violation of the covenant of good faith and fair dealing, which was a stated provision in the franchise agreement.[62] Inter-

54. *Id.* at *7.
55. *Id.*
56. *Id.*
57. 676 F. Supp. 2d 962 (S.D. Cal. 2009).
58. *Id.* at 969.
59. *Id.*
60. *Id.* at 970.
61. *Id.* at 971.
62. *Id.* at 968. The agreement stated that neither the franchisor nor the franchisee "shall do or fail to do anything which would deprive the other party of the benefits of [the Franchise

preting this agreement under Texas law, the court stated that there generally is not an implied covenant of good faith and fair dealing unless there is a "special relationship" between the parties.[63] Under Texas law, a franchisor-franchisee relationship is not considered a "special relationship," so the plaintiffs' claim for breach of the covenant of good faith and fair dealing could only be based on the terms of the franchise agreement.[64] Because a provision in the franchise agreement stated that both parties would be governed by the standards of good faith and fair dealing, the court examined whether any of the franchisor's actions may have violated this duty. The district court found that the franchisor's Internet sales may have violated the express duty of good faith and fair dealing when Radioshack.com offered merchandise directly to consumer at prices lower than the wholesale prices offered to franchisees and required the franchisee accept returns of merchandise ordered from Radioshack.com.[65] Because there were issues of material fact regarding this provision, the district court denied the motion for summary judgment on this claim.[66]

Stillwell v. RadioShack demonstrates how this court examined the pure language of the franchise agreement when it came to territory restrictions and electronic encroachment rather than implying a covenant of good faith and fair dealing. If the agreement itself contains explicit language imposing a duty of good faith and fair dealing, however, a court may enforce it.

Finally, *Newspaper, LLC v. Party City Corp.*[67] recently addressed the issue of electronic encroachment and the scope of a territory restriction. The plaintiff and its affiliates owned numerous franchises across Minnesota, Wisconsin, Iowa, North Dakota, and Texas.[68] The franchisor was involved in a series of mergers, resulting in the signing of a new general agreement with Newspaper.[69] In this agreement, Newspaper was given the exclusive right to operate franchise stores in its region, but the franchisor reserved the right to sell products through other channels of distribution, including the Internet.[70] At the time of signing, the website was used primarily for marketing and communication purposes and did not offer products for direct sale to customers.[71] Approximately two years after this agreement was signed, the franchisor launched an expansive Internet store offering the same products sold at retail locations, angering many franchisees, including Newspaper.[72]

Agreement], meaning that both [franchisor and franchisee] shall be governed by the standards of good faith and fair dealing." *Id.* at 975.

63. *Id.* at 974.
64. *Id.* at 975.
65. *Id.* at 976.
66. *Id.*
67. No. 13-1735 ADM/LIB, 2013 WL 5406722 (D. Minn. Sept. 25, 2013).
68. *Id.* at *1.
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.*

In 2010, in an effort to resolve the conflict, Newspaper and other franchisees executed an addendum that focused on Internet sales. This addendum affirmed the franchisor's rights to sell products online, and in exchange, Newspaper would receive a share of revenue from Internet sales based on the customer's location. Newspaper further agreed to accept returns for online sales.[73] In 2013, Newspaper filed suit against the franchisor alleging the franchisor had breached the exclusivity agreement by conducting Internet sales.[74] The franchisor filed a motion to dismiss this breach of contract claim, which the court granted. The court stated that although the franchisor granted Newspaper exclusive rights in establishing Party City stores in a specific territory, it explicitly reserved the right to conduct sales through alternate channels.[75] These alternate channels specifically included wholesale sales and sales by or through the Internet.[76] Moreover, the franchisees entered into an addendum regarding the Internet, which permitted the franchisor to conduct Internet sales while obligating the franchisor to share a portion of the revenue with a franchisee if the sold products were delivered to an address within the area as defined by the franchise agreement.[77] The court found that Newspaper failed to establish a breach of contract claim regarding the online sales. The agreement stated, in part, that: "Party City shall have the right to sell its goods 'by or through the Internet.'"[78] More importantly, Newspaper expressly agreed in the addendum that the franchisor could sell the products online to any customer and through any method.[79] Therefore, the court granted the franchisor's motion to dismiss on this claim.[80]

III. Courts' Approaches to Traditional versus Electronic Encroachment Claims

As the use of the Internet has expanded, courts have been forced to interpret and examine franchise agreements that both do and do not specifically address Internet commerce. When looking at a traditional encroachment case, courts have focused on the specific language of the franchise agreement as to the distance and the type of location that will not be included in the agreement.[81] Although the reasoning of *Scheck* has been narrowed in recent cases, its reasoning continues to confuse the issues surrounding traditional encroachment. If a territory restriction is drafted clearly in a franchise agreement, courts will often interpret the language as written; however, there con-

73. *Id.* at *2.
74. *Id.*
75. *Id.* at *4.
76. *Id.*
77. *Id.*
78. *Id.* at *5.
79. *Id.*
80. *Id.*
81. *See, e.g.*, Burger King v. Weaver, 169 F.3d 1310 (11th Cir. 1999).

tinues to be recognition by courts that a franchisor cannot act in bad faith.[82] In several states, courts have continued to focus on the implied covenant of good faith and fair dealing when examining claims under traditional encroachment.[83]

Prior to the widespread acceptance and use of Internet commerce, courts attempted to incorporate the principles of traditional encroachment claims when faced with franchisee complaints based on electronic encroachment. In early arbitration decisions, arbitrators looked more to the expectations of the parties, applying similar reasoning as under the theory of the implied covenant of good faith and fair dealing.[84] As the Internet became more accepted as a stream of commerce, however, courts focused much more on the specific language of the contract and territory terms at issue. Additionally, courts shifted their focus more quickly to the specific language of the agreement when examining an issue of electronic encroachment than when presented with a claim under traditional encroachment. In examining the territory provisions in respect to electronic encroachment, courts today may use black-letter contract and commercial law analysis rather than attempt to rewrite the agreement due to an unforeseen development or event, such as new technology.[85] Courts generally seem to approach these agreements by being bound by the writing, which often restricts the ability of a franchisee to achieve a more favorable interpretation and allows a franchisor greater latitude in constructing territory restrictions.

IV. Recommendations for Franchisors

As Internet commerce continues to grow and franchises focus on reaching the public not only where there are franchise locations but also through the Internet, properly formulated territory provisions have become even more critical. Many franchisors will want to control all Internet commerce rather than allow individual franchisees to be responsible for these sales. This allows the franchisor to maintain control of the products and its marks while also increasing its own revenue. In order to address concerns over electronic encroachment, franchisors have taken a variety of approaches. These may include no territorial exclusivity, a type of revenue sharing model, a form of an advertising co-op, or other methods.

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82. *See, e.g.*, Servpro Indus., Inc. v. Pizzillo, No. M2000-00832-COA-R3-CV, 2001 WL 120731 (Tenn. Ct. App. Feb. 14, 2001) (including discussion that franchisor cannot act in bad faith).

83. *See* Thomas A. Diamond, *Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery*, 47 Hastings L.J. 585 (1996).

84. *See* Knack and Bloodhart, *supra* note 19, at 134 n.3 (discussion of Emporium Drug Mart, Inc. v. Drug Emporium, Inc., No. 71 114 0126 00 (Am. Arbitration Ass'n 2000).

85. *See* Emerson, *supra* note 1, at 228 (discussing *Pro Golf of Fla., Inc. v. Pro Golf of Am., Inc.*, No. 05-71380, 2006 WL 508631 (E.D. Mich. Mar. 1, 2006)).

Although a franchisee may be seeking to receive an exclusive territory, granting a franchisee an exclusive territory may not be the best practice for a franchisor. Should a franchisor grant a franchisee an exclusive territory in the franchise agreement, a court may find this would require the franchisor to permit the franchisee to either manage, or at least receive a percentage of, any sales through the Internet or over the telephone, especially if the franchise agreement does not address such electronic sales. A franchisor would be wise to examine all of its agreements to determine whether Internet commerce is specifically addressed.

Additionally, a franchisor may be better served by not granting the franchisee an exclusive territory. This would allow a franchisor to ensure it is not subject to a claim for electronic encroachment if no territory restrictions have been violated. However, prospective franchisees may be wary of entering into a franchise agreement without any type of assurance that the franchisor will not place another franchisee or company store within close proximity.

There can be, however, language in the franchise agreement that balances the concerns of a franchisor regarding potential electronic encroachment claims with a franchisee's fears of competition directly from the franchisor or another franchisee. For example, a franchisor could not grant an "exclusive" territory, but, instead, include assurances that it will not grant a second franchisee a physical, brick-and-mortar location within a certain radius of the initial franchisee. Moreover, it is recommended that a franchisor include specific language in the franchise agreement that reserves its ability to exclusively conduct Internet and other types of electronic sales. If the franchisor includes such specific language in its franchise agreement, a court will most likely interpret the language as written in the contract. For example, the franchise agreement could reserve to the franchisor the right to provide services or products also offered to the franchisee through "alternate channels of distribution." These alternate channels of distribution could then be defined as including, but not limited, to the Internet, World Wide Web, catalog sales, telemarketing, telephone sales, or other similar methods. By keeping the language broad, the franchisor gives space for the development of new technology or sales methods. The agreement should clarify that a franchisee will not and has no right to receive revenues or other compensation from sales made through such alternate channels of distribution. The franchise agreement may also then state that the franchisee cannot use the alternate channels of distribution to make sales within its territory or outside of this territory. This type of specific and definitional language should make it clear to the franchisee, and a court or arbitration panel should a franchisor be subject to suit, that the franchisor has given the franchisee no rights relating to electronic sales. Specifically addressing Internet, telephone, and catalog sales diminishes the likelihood that a franchisee could successfully assert a claim for electronic encroachment.

Finally, it would be best for a franchisor to refrain from including a specific provision stating that the actions of both the franchisor and franchisee will be governed under standards of good faith and fair dealing, as was the case in *Stillwell v. RadioShack*.[86] Although the provisions of the agreement may still be subject to this standard in some jurisdictions, a court is more likely to interpret the territory provision of the agreement under the black letter language rather than implying such a duty into the agreement.

V. Conclusion

Franchisors have faced encroachment claims from franchisees for many years, but the rise of the Internet and sales through other channels of commerce has brought forth electronic encroachment claims. Initially, courts were uncertain how to address these claims, especially when franchise agreements did not anticipate the prevalence of the Internet, and struggled with examining such claims under a theory of good faith and fair dealing. However, many courts began examining electronic encroachment claims using contract analysis reasoning, focusing on the exact language of the franchise agreement and the territory restrictions rather than implying any type of additional duties on the franchisor or franchisee. As Internet commerce has become more prevalent and anticipated, franchisors are advised to update their franchise agreements to more specifically address Internet commerce and other alternate channels of distribution. Franchisors should ensure they expressly reserve such methods of sales for themselves rather than subjecting themselves to a court's interpretation of the territory provisions of the agreement. As Internet usage continues to expand and other technologies become available, franchisors can protect themselves from electronic encroachment claims by ensuring they address such issues from the outset in the territory provisions of the franchise agreements.

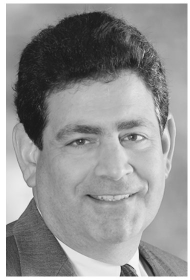
86. *See*, *e.g.*, Stillwell v. RadioShack Corp., 676 F. Supp. 2d 962, 975 (S.D. Calif. 2009).

Cause of Action Alchemy: Little FTC Act Claims Based on Alleged Disclosure Violations

Bethany L. Appleby, Robert S. Burstein, and John M. Doroghazi

The Federal Trade Commission Franchise Rule (FTC Rule)[1] does not provide a private right of action,[2] but its detailed disclosure standards are a siren call for franchisees looking for a good cause of action. In the fifteen states with state franchise disclosure laws providing a private right of action, franchisees generally assert claims under

Ms. Appleby



Mr. Burstein

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1. Federal Trade Commission, Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. § 436.
2. *See*, *e.g.*, Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities; Final Rule, 72 Fed. Reg. 15444, 15478, n.350 (Mar. 30, 2007) (providing FTC Statement of Basis and Purpose) ("We note that there is no private right of action to enforce the Franchise Rule."); Yumilicious Franchise, LLC v. Barrie, No. 3:13-CV-4841-L, 2015 WL 2359504 (N.D. Tex. May 18, 2015) (no private right of action is available to franchisee for franchisor's failure to furnish required information under FTC Rule), *aff'd*, 819 F.3d 170 (5th Cir. 2016); A Love of Food I, LLC v. Maoz Vegetarian USA, Inc., 70 F. Supp. 3d 376, 382 (D.D.C. 2014) (same); Robinson v. Wingate Inns Int'l, Inc., Civil Action No. 13–cv–2468, 2013 WL 6860723, at *2 (D.N.J. Dec. 20, 2013) ("It is well-settled that there is no private cause of action for violation of the FTC franchise disclosure rules."); Hidden Values, Inc. v. Wade, No. 3:11-cv-1917-C, 2012 WL 1836087, at *7 (N.D. Tex. May 18, 2012) (collecting cases); Vino 100, LLC v. Smoke on the Water, LLC, 864 F. Supp. 2d 269, 281 (E.D. Pa. 2012) (same).

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those statutes.[3] In states without their own disclosure laws, however, franchisors and other businesses have seen a recent proliferation of lawsuits alleging FTC Rule violations as the basis of a state law unfair trade practice claim, or "Little FTC Act" claim. Many of these claims assert that the failure to provide a compliant Franchise Disclosure Document (FDD) before entering into a franchise business relationship violated the FTC Rule, which in turn violated the state's Little FTC Act. This article addresses state statutory claims, other than state disclosure law claims, predicated on a violation of the FTC Rule and some potentially powerful defenses to those claims. Part I briefly discusses the basics of the FTC Rule's FDD requirement. Part II discusses the types of parties that commonly claim a violation. Part III discusses claims made under state Little FTC Acts for FTC Rule violations. It also addresses potential defenses and provides other practice tips for franchisors that find themselves the target of such claims. Part IV discusses whether a contract is "illegal," and therefore void or voidable, when the franchisor fails to comply with the FTC Rule's disclosure requirements.

I. The FTC Rule'S FDD Requirement

The FTC Rule requires that franchisors, among other things, provide an FDD to "prospective franchisees"[4] at least fourteen days before the prospective franchisee signs a binding agreement or pays money to the franchisor or its affiliate.[5] Under the FTC Rule, a "franchise" is defined as follows:

> *Franchise* means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:
>
> (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;
>
> (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and

3. The fifteen states are California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. 1 Franchise and Distribution Law and Practice § 5A:45. The private right of action may apply only to certain claims under the disclosure law and not others, for example, claims based on fraud or misrepresentation but not a failure to disclose. *See, e.g.*, *Maoz*, 70 F. Supp. 3d at 395 (New York provides a private cause of action for the selling of a franchise without timely disclosure of the offering prospectus where Maryland does not); Cont'l Basketball Ass'n, Inc. v. Ellenstein Enters., Inc., 669 N.E.2d 134, 137 (Ind. 1996) (private right of action under the Indiana Franchise Disclosure Act arises only upon allegations of facts supporting an inference of fraud, deceit, or misrepresentation and not violations of disclosure provisions).

4. The FTC Rule defines "prospective franchisee" as "any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship." 16 C.F.R. § 436.1(r).

5. 16 C.F.R. § 436.2(a).

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.[6]

Whether a particular business arrangement meets this franchise definition is not always clear because each element is subject to interpretation. The FTC Rule also has a number of exceptions to the FDD requirement, including where "required payments" are less than $570,[7] for fractional franchises,[8] "leased departments,"[9] relationships covered by the Petroleum Marketing Practices Act,[10] franchises with initial investments of at least $1,143,100 with a contemporaneous exemption acknowledgment,[11] sales to franchisees that have been in business for at least five years and have a net worth of at least $5,715,500,[12] sales to certain categories of insiders,[13] and oral franchise agreements.[14]

Analyzing the definition of "franchise" under the FTC Rule and state franchise registration and disclosure laws is beyond this article's scope, but there are multiple sources that franchise litigators should review when one of their clients is sued or wants to sue. In addition to the FTC Rule itself, essential reference materials include the FTC 2007 Statement of Basis and Purpose;[15] the FTC 2008 Compliance Guide;[16] the FTC's Amended Franchise Rule FAQs;[17] the North American Securities Administrators Association, Inc. (NASAA) 2008 Franchise Registration and Disclosure Guidelines;[18] the NASAA Commentary on the 2008 Franchise Registration and Disclosure Guidelines;[19] and the NASAA's Multi-Unit Commentary (adopted September 16, 2014).[20] Moreover, on October 1, 2015, NASAA requested comments

6. 16 C.F.R. § 436.1(h).

7. 16 C.F.R. § 436.8(a)(1) (indexed for inflation as of July 1, 2016); 16 C.F.R. § 436.8(b); the inflation adjustment for this exemption and two additional exemptions cited below is at 81 Fed. Reg. 31500 (May 19, 2016), https://www.ftc.gov/system/files/documents/federal_register_notices/2016/05/160519franchiserulefrn.pdf

8. 16 C.F.R. § 436.8(a)(2) (indexed for inflation as of July 1, 2016).

9. 16 C.F.R. § 436.8(a)(3).

10. 16 C.F.R. § 436.8(a)(4).

11. 16 C.F.R. § 436.8(a)(5)(i) (indexed for inflation as of July 1, 2016); 16. C.F.R. § 436.8(b).

12. 16 C.F.R. § 436.8(a)(5)(ii) (indexed for inflation as of July 1, 2016); 16. C.F.R. § 436.8(b).

13. 16 C.F.R. § 436.8(a)(6).

14. 16 C.F.R. § 436.8(a)(7).

15. 2007 Statement of Basis and Purpose, 72 Fed. Reg. 15444 (Mar. 30, 2007), https://www.ftc.gov/sites/default/files/070330franchiserulefrnotice.pdf; *see also* 1978 Original Statement of Basis and Purpose, 43 Fed Reg. 59674 (Dec. 21, 1978).

16. Franchise Rule Compliance Guide, *available at* https://www.ftc.gov/tips-advice/business-center/guidance/franchise-rule-compliance-guide.

17. FTC Amended Franchise Rule FAQs, *available at* https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs.

18. NASAA 2008 Franchise Registration and Disclosure Guidelines (Amended and Restated UFOC Guidelines), *available at* http://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf.

19. NASAA Commentary on the 2008 Franchise Registration and Disclosure Guidelines, *available at* http://www.nasaa.org/wp-content/uploads/2011/08/FranchiseCommentary_final.pdf.

20. NASAA Multi-Unit Commentary, *available at* http://www.nasaa.org/wp-content/uploads/2011/08/Franchise-Multi-Unit-Commentary-effective-Adopted-Sept.-16-2014.pdf.

on a document titled "Proposed Franchise Commentary on Financial Performance Representations."[21] After reviewing the comments it receives, NASAA is expected to revise the document and call for another round of comments on the revised version. When approved, the final commentary should contain important rules for the preparation and use of financial performance representations, formerly called "earnings claims," in FDDs and in advertisements. Finally, cases decided under state law may be referenced when the state provision in question is similar to its FTC Rule counterpart.[22]

II. Parties Claiming FTC Rule Violations

Different types of plaintiffs have asserted claims based on disclosure violations, and each has its own challenges and opportunities.

A. *Acknowledged Franchisees*

The first category of plaintiff is the undisputed franchisee —that is, everyone agrees that a franchise relationship existed. These plaintiffs generally focus their claims on whether the franchisor provided proper disclosure under the FTC Rule. A compliant FDD must follow a very specific format and adhere to many detailed requirements.[23] There are many traps for the unwary. A franchisee may not have received an FDD at all or may have received a deficient, inaccurate, or untimely FDD. That franchisee may decide to sue the franchisor if the business has failed or the relationship has soured, whether or not these problems were related in any way to the alleged FTC Rule violations.

B. *Unacknowledged, "Accidental," or "De Facto" Franchisees*

The next type of plaintiff is one where there is disagreement about the plaintiff's franchise status. This often occurs when distributors or licensees claim, after the fact, that their business relationships fell within the FTC Rule's definition of "franchise" and that they were therefore entitled to an FDD.[24] Parties that never actually entered into an agreement may also attempt to claim that they were offered a franchise and that disclosure was therefore required.

21. Notice of Request for Comments Regarding a Proposed Franchise Commentary on Financial Performance Representations, *available at* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2015/10/FPR-Commentary-Request-For-Comments.pdf.

22. 2007 Statement of Basis and Purpose, *supra* note 15 (recognizing that it may be appropriate to look to state law when interpreting the FTC Rule).

23. *See* 16 C.F.R. § 436.5 and NASAA 2008 Franchise Registration and Disclosure Guidelines, Part III.

24. Dale E. Cantone, Kim A. Lambert & Karen C. Marchiano, *So It Really Is a Franchise: Bringing Non-Compliant Franchisors into Compliance*, ABA 37th Annual Forum on Franchising, W-1 (2014); Dean Fournaris & Robert Burstein, *Licensing Against the Wave of Franchising—Avoiding the Hidden or Inadvertent Franchise*, 29:5 LICENSING J. 1 (May 2009). Mr. Burstein is one of this article's authors, and Mr. Fournaris is a partner at the authors' firm.

C. *Spouses, Creditors, Investors, and Other Related Parties*

Sometimes spouses, creditors, investors, and other indirectly related parties come out of the woodwork and assert claims based on alleged FTC Rule violations. In many cases, the franchisor, or putative franchisor, did not even know that these individuals or entities existed.[25] These plaintiffs operate from flawed assumptions and ignore that the fact that simply because a party benefitted from or claims an interest in a franchise does not mean that they should have received an FDD. As the FTC's 2007 Statement of Basis and Purpose explains:

> **Section 436.1(i): Franchisee**
>
> The original Rule defined "franchisee as: "any person (1) who participates in a franchise relationship as a franchisee . . . or (2) to whom an interest in a franchise is sold." The definition proposed in the Franchise [Notice of Proposed Rulemaking] was "any person who is granted an interest in a franchise." Section 436.1(i) of the final amended Rule adopts an even more precise version: "Franchisee means any person who is granted a franchise." This narrowing of the definition is in response to commenters who voiced concern that the phrase "an interest in a franchise" is too broad, arguably sweeping in shareholders of publicly traded companies and other investors. The amended definition's focus on the granting of a franchise (as opposed to an interest in a franchise) is also consistent with the states' approach, thereby reducing unnecessary inconsistencies.[26]

This conclusion makes sense because for FDD disclosure purposes, "prospective franchisee" includes "any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss *the possible establishment of a franchise relationship*."[27] The FTC originally created the FTC Rule in 1978 (effective in 1979, the FTC Rule was amended in 2007) to stop deceptive and unfair practices that occur when a *prospective franchisee* enters into a *franchise relationship* with a franchisor, not when a prospective franchisee declines to purchase a franchise.[28] This concept should apply with equal force where the party is an investor or creditor

25. Claims brought by franchise agreement non-signatories are discussed in Christine Jean-Louis, *Wait! You, Too? Litigation Brought by Nonsignatories to Franchise Agreements*, 34 Franchise L.J. 17 (2014). Ms. Jean-Louis was an associate in the authors' law firm when she wrote this article.

26. 2007 Statement of Basis and Purpose, *supra* note 15, at 15460. Similarly, at least one court has held that a guarantor is not entitled to the protections of a state registration and disclosure law. G&R Moojestic Treats Inc. v. Maggiemoo's Int'l, LLC, No. 03 Civ. 10027 (RWS), 2004 WL 1110423, at *8 (S.D.N.Y. May 19, 2004) (guarantor of an ice cream shop franchise agreement lacked standing to bring a claim as a "franchisee" against a franchisor under the Maryland Franchise Registration and Disclosure Law).

27. 16 C.F.R. § 436.1(r) (emphasis added).

28. *See, e.g.*, FTC Statement on Franchise Rule, 43 Fed. Reg. 59614, 59627–39 (proposed Dec. 21, 1978) (discussing in detail four circumstances, each of which involves purchase by prospective franchisee of a franchise, for why rule is necessary); *see also* Final FTC Statement on FTC Rule, 44 Fed. Reg. 49966, 49966 (Aug. 24, 1979) ("In general, the rule addresses the problem of nondisclosure and misrepresentation which arise when prospective franchisees purchase franchises without essential and reliable information about them."); Colo. Coffee Bean, LLC v. Peaberry Coffee Inc., 251 P.3d 9, 23 (Colo. Ct. App. 2010) (quoting FTC Statement on Amendments to Franchise Rule, 72 Fed. Reg. 15444, 15536 (Mar. 30, 2007) ("the [FTC Rule] seeks to

that never intended to become a franchisee or sign any franchise agreement because the franchisor would not have had to provide an FDD to that party.

These plaintiffs also forget that in order to comply with the requirement to provide an FDD to a "prospective franchisee," it is sufficient to simply provide disclosure to an agent or representative of that prospective franchisee.[29] Indeed, the FTC Compliance Guide explicitly states that "[i]n the case of a corporate prospect, disclosures can be furnished to a company officer."[30] Accordingly, giving an appropriate representative (such as the actual franchisee) an FDD should satisfy the franchisor's FTC Rule obligations.

III. Little FTC Act Claims Based on Alleged FTC Rule Violation

As noted above, it is well established that there is no private right of action for FTC Rule violations. Accordingly, parties must shoehorn an FTC violation into another law. If the franchisor provides false disclosures, the plaintiff may assert a claim for fraud in the inducement or other related common law claims, irrespective of the FTC Rule.[31] However, common law fraud claims often have high standards of proof and do not always come with the panoply of relief that statutory causes of action do. Thus, a plaintiff may prefer to assert an FTC Rule violation through an applicable state "Little FTC Act" by claiming that the FTC Rule violation is the "predicate" for a Little FTC Act violation. "Little FTC Act" is a commonly used name for state consumer protection statutes that are analogous to the FTC Act. Little FTC Act violations can be based on—or predicated on—violations of other statutes or regulations.[32]

To succeed, a party alleging that an FTC Rule violation was the predicate for a state Little FTC Act violation must establish (1) an FTC Rule violation; (2) that a particular state's Little FTC Act applies; (3) that an FTC Rule violation can serve as a predicate for a violation of the applicable Little FTC Act; (4) that the claim is timely; and (5) that each of the applicable Little FTC Act's elements is met.[33] Franchisors defending against a claim should also investigate whether a disclaimer or release provides a defense in a par-

protect franchisees from unfair or deceptive practices.")). The authors are not aware of any precedent where a court has held that a non-franchisee can base a claim on an FTC Rule violation.

29. *See* FTC Compliance Guide, *supra* note 16, at 18.

30. *Id.; see also* Jean-Louis, *supra* note 25, at 27–28.

31. *See, e.g.*, Cantone, *supra* note 24; Altresha Q. Burchett-Williams, Robert M. Einhorn & Paula J. Morency, *Claims Under the "Little FTC Acts" The High Stakes of Risk and Reward*, ABA 33rd Annual Forum on Franchising, W-6 (2010); John G. Parker & Angela M. Fifelski, *Claims Under Little FTC Acts*, ABA 28th Annual Forum on Franchising, W-4 (2005); Arthur L. Pressman, Ellen R. Lokker & Eric H. Karp, *The Use of State Little FTC Acts in Franchise Relationship Litigation*, 31st Annual Int'l Franchise Ass'n Legal Symposium (1998).

32. Robert Langer & Matthew W. Sawchak, *Business Torts as Little FTC Act Claims: Does the Difference Really Make a Difference?* ABA Section of Antitrust Law Business Torts & RICO News (2013), *available at* http://www.wiggin.com/14583. Mr. Langer is a partner at the authors' law firm.

33. Although beyond the scope of this article, parties may similarly attempt to claim violation of the federal Business Opportunity Rule, 16 C.F.R. Part 37, as a Little FTC Act predicate.

ticular case. In addition, Little FTC Act remedies vary widely by state, and franchisors may be successful in limiting recovery even if the plaintiff ultimately proves a violation.

A. *Establishing an FTC Rule Violation*

The threshold issue, of course, is determining if an FTC Rule violation even occurred. For claims brought by acknowledged franchisees, the franchisor must "simply" review the FDD it provided and whether the FDD complied with the FTC Rule by being properly prepared; accurate; currently effective; registered with the appropriate state(s), if applicable; and timely given. Occasionally, one of the exceptions to the FTC Rule disclosure requirement may apply, and a common law fraud claim may then be the only potential action available. For a "de facto" or "accidental" franchisee, the defendant will have to analyze the facts carefully and determine whether the relationship was, in fact, a franchise under the FTC Rule and then consider whether an exemption could apply.

For spouses, creditors, investors, or other related entities or individuals, the franchisor must consider why they claim they should have received an FDD. What was their alleged relationship to the franchisee, and what were their interactions with the franchisor? If there was no obligation to provide an FDD to a particular individual or entity, no violation occurred, and there should be no viable cause of action based on FTC Rule violation.

B. *Which Little FTC Act Applies?*

If there is a plausible FTC Rule violation, a franchisor must determine which state's Little FTC Act applies. This is an important determination because the acts vary significantly.[34] Although a plaintiff may plead in the alternative, eventually the plaintiff must choose, or the court or arbitrator will have to make that determination based on a choice of law analysis, which may also involve an analysis of the enforceability and effect of any contractual choice of law provision. The answer to the choice of law question, as explained below, could be dispositive. It is also important to keep in mind that some states do not apply their Little FTC Acts extraterritorially.[35]

C. *Does the Applicable Little FTC Act Even Apply to Commercial Relationships or Otherwise Recognize an FTC Rule Violation as a Predicate Act?*

After the choice of law analysis, a franchisor's next step is to determine whether the applicable state Little FTC Act would apply to the franchise relationship and whether a plaintiff could use an FTC Rule violation a requi-

34. Burchett-Williams et al., *supra* note 31, at 5–11.

35. Dennis R. LaFiura, Peter Lagarias & Victor Vital, *Comparison of the Trilogy: Common Law Fraud, Franchise Investment Laws, and Little FTC Laws Remedies for Misrepresentations and Omissions in the Offer and Sale of Franchises*, at 9, 34th ABA Forum on Franchising, W-9 (2011).

site predicate act. Some states' Little FTC Acts apply only to consumer or similar relationships and not to commercial relationships (like the franchise relationship). For example, Pennsylvania's Unfair Trade Practices and Consumer Protection Law (PUTPCPL) provides a private right of action to "[a]ny person who purchases or leases goods or services *primarily for personal, family or household purposes.*"[36] PUTPCPL applies only when the purchase at issue was made for a primarily personal reason, not a commercial one. Therefore, a franchisee has no cause of action for an FTC Rule violation under PUTPCPL.[37] The Michigan Consumer Protection Act (MCPA) also does not provide a private right of action in commercial relationships, and therefore, a Little FTC Act claim based on a franchise agreement or franchise sale will fail.[38] Missouri's Merchandising Practice Act similarly limits private rights of action to disputes relating to items for household use.[39] Likewise, a court dismissed a franchisee's claim that the franchisor's alleged FTC Rule violation violated the Kentucky Consumer Protection Act (KCPA) because that act provides relief only for claims relating to goods and services purchased for household use, and a franchise is not a good or service.[40] Other states limiting Little FTC Act application to transactions involving goods or services for personal use include California,[41] Georgia,[42] Hawaii,[43] Mississippi,[44] Rhode Island,[45] and Virginia.[46]

Some jurisdictions' Little FTC Acts apply only to the sale of goods or services generally, which has led some courts to hold that this limitation precludes claims relating to franchise sales because, in those courts' view, a franchise is not a good or service.[47] For example, in deciding this question, New Jersey determines whether its Little FTC Act applies to franchises on a case-by-case basis, and its case law strongly suggests that its Little FTC Act does not apply to most complex franchise transactions.[48]

36. 73 PA. STAT. § 201-9.2(a) (emphasis added).

37. *See, e.g.*, Family Wireless #1, LLC v. Auto. Techs., Inc., No. 15-CV-1310 (JCH), 2016 WL 183475, at *5 n.17 (D. Conn. Jan. 14, 2016) ("[T]he Pennsylvania Unfair Trade Practices and Consumer Protection Law . . . do[es] not apply to the sale of franchises."). The authors' law firm represented the defendant in this case.

38. MICH. COMP. LAWS ANN. § 445.902.

39. MO. ANN. STAT. § 407.025.

40. 859 Boutique Fitness LLC v. Cyclebar Franchising, LLC, No. 5:16-CV-018-KKC, 2016 WL 2599112, at *1 (E.D. Ky. May 5, 2016).

41. CAL. CIV. CODE § 1761.

42. GA. CODE ANN. § 10-1-392.

43. HAW. REV. STAT. ANN. § 480-1.

44. MISS. CODE. ANN. § 75-24-15.

45. 6 R.I. GEN. LAWS ANN. § 6-13.1-5.2.

46. VA. CODE ANN. § 59.1-198.

47. Pressman et al., *supra* note 31, at 5–6.

48. *See* J & R Ice Cream Corp. v. Calif. Smoothie Licensing Corp., 31 F.3d 1259, 1273 (3d Cir.1994); Kavky v. Herbalife Int'l of Am., 820 A.2d 677, 685 (N.J. App. Div. 2003); Morgan v. Air Brook Limousine, Inc., 510 A.2d 1197, 1198 (N.J. App. Law. Div. 1986). Similarly, West Virginia's case law suggests that franchises would not be considered "goods" or "services" because of the complex nature of the franchise transaction and the presence of significant regulation of the industry. State *ex rel.* McGraw v. Bear, Stearns & Co., 618 S.E.2d 582, 587 (W. Va.

A plaintiff asserting a Little FTC Act claim must also have sufficient standing to bring the claim.[49] Some states require the plaintiff to be a "consumer,"[50] and twenty-one jurisdictions allow recovery only in consumer transactions.[51] This raises the question of whether franchisees are "consumers," which different jurisdictions determine differently.[52]

Some states also require a showing that the alleged conduct injures the public as a whole. The Colorado Consumer Protection Act (CCPA) applies only to deceptive business practices that "may prove injurious, offensive, or dangerous to the public."[53] Similarly, corporate entities can sue under New York's deceptive trade practices statute as long as the general public is affected.[54] Depending on the situation, the franchisor may be able to argue that the franchise sale was a commercial transaction between two business parties and therefore unrelated to the general public's interest. A Louisiana court has also held that in the absence of "fraud, misrepresentation, deception, or unethical conduct," there is no unfair trade practice, and therefore "failure to comply with FTC disclosure regulations d[oes] not constitute an unfair trade practice."[55]

Finally, courts in other jurisdictions have simply concluded that, because there is no private cause action under the FTC Rule, parties should not be able to plead one under the state's Little FTC Act.[56] As is evident from the discussion above, this view is not universally shared, and some courts

2005) (concluding that the West Virginia Consumer Credit Protection Act did not apply to "highly specialized and complex conduct involved in providing securities research and analysis as a component of investment banking"); Wamsley v. LifeNet Transplant Servs. Inc., No. 2:10-CV-00990, 2011 WL 5520245, at *11 (S.D. W.Va. Nov. 10, 2011) (relying on presence of significant federal regulation to determine that WVCCPA did not apply to industry at issue).

49. Burchett-Williams et al., *supra* note 31, at 11–16.

50. *Id.* at 11.

51. David L. Belt, Robert M. Langer & John T. Morgan, Connecticut Unfair Trade Practices, Business Torts and Antitrust, App. K (2015–2016 ed). The following jurisdictions require a "consumer transaction": Alabama, Arkansas, California, District of Columbia, Georgia, Indiana, Kentucky, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Ohio, Pennsylvania, Rhode Island, Texas, Utah, Vermont, Virginia, and the U.S. Virgin Islands; *see id.*, n. 38–48.

52. *See* Burchett-Williams et al., *supra* note 31, at 12; Bixby's Food Sys., Inc. v. McKay, 985 F. Supp. 802, 807 (N.D. Ill. 1997).

53. Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc., 62 P.3d 142, 146 (Colo. 2003); *see also* LaFiura et al., *supra* note 35.

54. Securitron Magnalock Corp. v. Schnabolk, 65 F.3d 256, 264 (2d Cir. 1995).

55. LeBlanc v. Belt Ctr. Inc., 509 So. 2d 134, 137 (La. Ct. App. 1987).

56. LaFiura et al., *supra* note 35 (citing St. Martin v. KFC Corp., 935 F. Supp. 898, 907 (W.D. Ky. 1996) ("Because Congress did not intend to permit a private cause of action under the FTC Act and regulations, plaintiffs cannot invoke KRS 446.070 to create this type of private right.")); *cf.* Morrison v. Back Yard Burgers, Inc., 91 F.3d 1184, 1187 (8th Cir. 1996) ("A plaintiff should not be permitted to plead violation of FTC regulations as part of a state common law fraud case. A decision to the contrary could be interpreted as substituting violation of FTC regulations for state law requirements, thereby effectively extending a private cause of action under the Federal Trade Commission Act.").

have gone so far as to hold that an FTC Rule violation is a *per se* Little FTC Act violation.[57]

D. *Is the Alleged FTC Rule Violation Beyond the Applicable Statute of Limitation?*

Little FTC Act statutes of limitation vary widely from one year[58] to six years.[59] States also vary in the method of calculating the commencement of the limitations period. For example, it may commence when the violation occurred[60] or not until discovery of the violation.[61] At least for "non-discovery" states, the violation and injury generally would have occurred no later than the date of contract execution.[62] In addition, many contracts contain limitations periods or notice requirements. Failure to comply with these requirements can result in the waiver of claims.[63] Contractual limitations period can be an extremely powerful defense because, unlike statutes of limitation, they may not be subject to equitable tolling doctrines.[64]

E. *Can the Plaintiff Establish All of the Applicable Little FTC Act Elements?*

As discussed above, the relevant jurisdiction's Little FTC Act may not even apply to franchise relationships, making further analysis unnecessary, while other states have gone so far as to determine that an FTC Rule violation is a *per se* Little FTC Act violation.

Even if the franchisor finds itself in a *per se* violation state, all may not be lost. A technical FTC Rule violation may be sufficient for an FTC enforcement action, but often not for a Little FTC Act claim with an FTC Rule violation as its predicate. That is because the plaintiff may not be able to establish the other requisite statutory elements, which may include ascertainable or actual damages flowing directly from the alleged violation (which is a common Little FTC Act requirement).

57. *See* LaFiura et al., *supra* note 35 (citing Nieman v. Dryclean USA Franchise Co., 178 F.3d 1126, 1128–29 (11th Cir. 1999); Morgan v. Air Brook Limousine, Inc., 510 A.2d 1197 (N.J. Super Ct. 1986); Rodopoulos v. Sam Piki Enters., Inc., 570 So. 2d 661 (Ala. 1990); Atl. Sport Boat Sales, Inc. v. Cigarette Racing Team, Inc., 695 F. Supp. 58 (D. Mass. 1988); Bailey Emp't Sys., Inc. v. Hahn, 545 F. Supp. 62 (D. Conn. 1982), *aff'd*, 723 F.2d 895 (2d Cir. 1983); Aurigemma v. Arco Petroleum Prods. Co., 734 F. Supp. 1025, 1027 (D. Conn. 1990).

58. *See e.g.*, ALA. CODE § 8-19-14 (one year statute of limitation).

59. *See e.g.*, Gabriel v. O'Hara, 534 A.2d 488 (Pa. Super. Ct. 1987) (Pennsylvania Little FTC Act has six-year statute of limitation).

60. *See, e.g.*, CONN. GEN. STAT. § 42-110g(f).

61. Burchett-Williams et al., *supra* note 31, at 17.

62. In states that begin the limitations period upon violation alone, the franchisor may be able to argue successfully that the limitations period began on the date that the franchisor was allegedly obligated to provide the FDD, which would have been earlier than contract execution.

63. *See, e.g.*, Air Brake Sys., Inc. v. TUV Rheinland of N. Am., Inc., 699 F. Supp. 2d 462, 470 (D. Conn. 2010) (collecting cases for the proposition that Connecticut and federal "jurisprudence has recognized that parties to a contract may require a specific period of time within which to assert their respective claims, and that longer statutes of limitation do not prevent such agreements as a matter of principle").

64. *Id.*

Florida's Little FTC Act, the Florida Deceptive and Unfair Trade Practices Act (FDUTPA)[65] is an illustrative example. To establish a FDUTPA claim, a plaintiff must prove three elements: (1) a deceptive act or unfair practice, (2) causation, and (3) actual damages.[66] Florida federal courts have made it clear that each of these elements must be met,[67] even when claiming a *per se* FDUTPA violation based on FTC Rule violation. As the U.S. District Court for the Middle District of Florida recently explained:

> [A] plaintiff must show not only that the conduct complained of was unfair, unconscionable, or deceptive, but also that it has suffered actual damages proximately caused by the unlawful conduct." *Hanson Hams, Inc. v. HBH Franchise Co.*, LLC, No. 03–61198–CIV, 2004 WL 5470401, at *4 (S.D. Fla. Dec. 21, 2004). "Actual damages" under FDUTPA must directly flow from the alleged deceptive act or unfair practice. *Hennegan Co. v. Arriola*, 855 F. Supp. 2d 1354, 1361 (S.D. Fla. 2012). FDUTPA does not provide for the recovery of nominal damages, speculative losses, or compensation for subjective feelings of disappointment.[68]

Accordingly, "liability under the Franchise Rules, and thus the Florida Deceptive and Unfair Trade Practices Act, requires more than a mere technical violation. . . ."[69] This holding was based on the Eleventh Circuit's interpretation of FDUTPA, which requires, in addition to a technical FTC Rule violation, that "a party must also prove that the alleged deceptive or unfair practice was likely to deceive a consumer acting reasonably in the same circumstances."[70]

If the applicable little FTC Act requires the plaintiff to establish reliance, causation, or damages, it is important to establish what information the plaintiff claims was not properly disclosed or not disclosed at all and how that affected the plaintiff. Did the plaintiff know the correct or allegedly missing information anyway, either from prior experience or other sources? If so, then perhaps he or she cannot establish causation or reliance. If the plaintiff had known the correct or allegedly missing information, would he

65. FLA. STAT. ANN. § 501.203.

66. Bookworld Trade, Inc. v. Daughters of St. Paul, Inc., 532 F. Supp. 2d 1350, 1364 (M.D. Fla. 2007).

67. *Id.* (making clear that each Florida Deceptive and Unfair Trade Practices Act (FDUTPA) element must be met); *see also* Parr v. Maesbury Homes, Inc., No. 609CV-1268-ORL-19GJK, 2009 WL 5171770, at *8 (M.D. Fla. Dec. 22, 2009) ("However, regardless of whether a statute is a *per se* FDUTPA predicate or alleged to proscribe an unfair or deceptive practice and therefore serve as an implied FDUTPA predicate, a plaintiff is still required to plead the remaining two elements, causation and damages, in order to properly state a claim for a FDUTPA violation.").

68. Britt Green Trucking, Inc. v. FedEx Nat'l, LTL, Inc., Case No. 8:09-cv-445-T, 2014 WL 3417569, at *11–12 (M.D. Fla. July 14, 2014); *see also* FLA. STAT. ANN. § 501.211 ("In any action brought by a person who has *suffered a loss* as a result of a violation of this part, such person may recover actual damages, plus attorney's fees and court costs as provided in s. 501.2105.") (emphasis added).

69. Hetrick v. Ideal Image Dev. Corp., 758 F. Supp. 2d 1220, 1231 (M.D. Fla. 2010) (denying motion for summary judgment because an issue of fact remained about whether statements allegedly violating 16 C.F.R. § 436.9 were likely to deceive).

70. *Id.* (citing Cold Stone Creamery, Inc. v. Lenora Foods I, LLC, 332 F. App'x 565, 567 (11th Cir. 2009)).

or she have acted differently or been in a better position today? If not, then he or she may not be able to establish the requisite loss or damage. Finally, in the few states that require evidence of some form of "scienter" or knowledge of the wrongdoing to prove a Little FTC Act claim,[71] the lack of such knowledge or intent evidence could doom a franchisee's claim.

F. *Has the Claim Been Released?*

Franchisors often require franchisees to sign releases in connection with particular transactions, such as when the franchisor provides a royalty reduction, supplemental advertising or marketing funds or other benefits, on renewal of franchise rights, or when a multi-unit owner buys or sells a store. If the franchisee signs a release after entering into an agreement for which there was allegedly deficient disclosure, a release potentially could bar a Little FTC Act claim based on an FTC Rule violation.[72] The franchisor should always check all agreements with a franchisee, regardless of the subject matter, to determine whether there are any potentially applicable releases (or other helpful contractual terms).

G. *What Are the Possible Remedies?*

If the franchisor is unsuccessful in defending a Little FTC Act claim, the franchisee will be entitled to various remedies. Although these remedies vary by state, monetary damages are generally available, if proven. Some states do not allow recovery of certain kinds of economic damages.[73] Other jurisdictions provide for statutory damages.[74] Statutory provisions may include a guaranteed money recovery, treble damages, or the possibility of punitive damages.[75] Plaintiffs may also seek rescission of the franchise contract. Franchisors should also note that certain state Little FTC Acts may impose personal liability on owners, officers, and employees who participate in a violation.[76]

IV. Is the Contract "Illegal" if the FTC Rule was Violated?

Plaintiffs also occasionally seek to rescind or otherwise avoid their contractual obligations by arguing that their contracts were "illegal" and therefore void or otherwise unenforceable because of FTC Rule violations. Under

71. LaFiura, et al., *supra* note 35, at 15; *see also* KAN. STAT. ANN. § 50-626.

72. Franchisors have successfully used releases to defeat fraud claims in other contexts. *See, e.g.*, Coral Gables Imported Motorcars, Inc. v. Fiat Motors of N. Am., Inc., 673 F.2d 1234, 1238 (11th Cir.), *opinion modified on reh'g*, 680 F.2d 105 (11th Cir. 1982); LaFiura et al., *supra* note 35, at 30.

73. *See, e.g.*, Five for Entm't v. Rodriguez, 877 F. Supp. 2d 1321, 1331 (S.D. Fla. 2010) (stating that "it [also] remains well-settled in Florida that consequential damages in the form of lost profits are not recoverable under FDUTPA.").

74. LaFiura et al., *supra* note 35, at 21.

75. Carolyn L. Carter, *Consumer Protection in the United States* at 7 (2009), *available at* https://www.nclc.org/images/pdf/udap/report_50_states.pdf.

76. LaFiura et al., *supra* note 35, at 36.

common law, illegal contracts can be deemed unenforceable and rescinded.[77] In these instances, the court may award restitution[78] or reliance damages to put the injured party back in its original pre-contractual position.[79] Sometimes such remedies are limited. For example, under Connecticut law, the successful plaintiff can seek either rescission of a contract and restitution *or* can opt to enforce the contract and recover damages for breach.[80] The plaintiff cannot request both.[81]

However, rescission on the basis of "illegality" may not be available for FTC Rule violations. As the U.S District Court for the Western District of Pennsylvania explained in *Palermo Gelato, LLC v. Pino Gelato, Inc.*:

> It appears that every court that has confronted the issue has determined, with persuasive reasoning, that a violation of the disclosure requirements of the Franchise Rule does not provide the basis to render a subsequent agreement void as illegal or contrary to public policy. *See Vino 100, LLC v. Smoke on the Water, LLC*, 864 F. Supp. 2d 269, 281 (E.D. Pa. 2012); *Holiday Hospitality Franchising, Inc. v. 174 West St. Corp.*, No. 05-149, 2006 WL 2466819, at *13 (N.D. Ga. July 19, 2006); *Crawford*, 600 F. Supp. at 846. . . . Among the reasons enumerated in those opinions include the fact that the defendants' alleged failures to provide the Franchise Rule disclosures occurred outside of the formation of the contract and its terms, and thus any violation would not go to the validity of the contract; that because the Franchise Rule is a regulation and not a Congressional statute, violations of it do not provide as potent a force to unwind a contract; that there were no indications that their respective states had incorporated the FTC's regulations as so central to their own public policy as to render them void, and that the plaintiffs were essentially seeking to circumvent the bar on private actions to enforce the FTC Act. *See Vino 100*, 864 F. Supp. 2d at 280–81; *Holiday Hospitality*, 2006 WL 2466819, at *5–6; *Crawford*, 600 F. Supp. at 845–46.[82]

Accordingly, the plaintiff is unlikely to be able to undo or rescind a franchise agreement based on FTC Rule violation "illegality." The plaintiff may, however, be able to rescind if he or she can establish a violation of a Little FTC Act that permits rescission as a possible remedy.

V. Conclusion

Even though the FTC Rule does not provide a private right of action, state Little FTC Acts can sometimes do the trick. Prosecuting or defending against these claims must begin with a careful choice of law analysis and thoughtful consideration of the elements and other requirements of the applicable Little FTC Act. Due to the lack of uniform standards under Little FTC Acts for when disclosure violations may provide a cause of action, litigation in this area will continue to be hotly contested for the foreseeable future.

77. Restatement (Second) of Contracts § 8 (1981).
78. Restatement (Second) of Contracts § 345.
79. Restatement (Second) of Contracts § 8.
80. Little Mountains Enters., Inc. v. Groom, 64 A.3d 781, 786–87 (Conn. Ct. App. 2013).
81. *Id.*
82. No. 2:12-cv-00931, 2013 WL 285547, *7 (W.D. Pa. Jan. 24, 2013).

Websites, Kiosks, and Other Self-Service Equipment in Franchising: Legal Pitfalls Posed by Title III of the Americans with Disabilities Act

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Websites, mobile applications, and electronic self-service machines provide exciting and efficient ways for franchised businesses to deliver information, goods, and services to customers, but they also present thorny compliance issues under the Americans with Disabilities Act (ADA). The ADA prohibits discrimination against individuals with disabilities public accommodations (i.e., private entities that do business with the public)[1] and requires them to take affirmative steps to ensure that individuals with disabilities have equal access to their goods and services. This article reviews the most common types of customer-facing electronic information technology (EIT) that franchisors and franchisees are using, the murky and evolving legal requirements that apply to them, the legal controversies that have arisen in connection with their use, and what can be done to ensure legal compliance.

I. Customer-Facing EIT Used by Franchised Businesses and the Accessibility Challenges They Present for Individuals with Disabilities

Customer-facing EIT has become commonplace in many franchised businesses. The most common types of EIT are websites and mobile applications

1. The term "public accommodation" is a term of art defined in the ADA and the question of whether a private entity falls within the definition has been the subject of many lawsuits. The statute lists twelve categories of private entities that are covered, such as places of lodging, establishments serving food or drink, or sales or service establishments. 42 U.S.C. § 12181(7). Because most franchised businesses are likely to fall within the twelve categories, this article does not address the threshold question of coverage.

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(mobile apps). These websites and mobile apps allow customers to perform a variety of tasks, such as reserving hotel rooms, ordering food and beverages at quick service concepts, accessing loyalty accounts, paying for and researching goods and services, and finding store locations.

Once inside a place of business, customers are likely to encounter some type of electronic self-service machine, such as point of sale devices (POS), registration kiosks, ticket kiosks, self-checkout registers, iPads or tablet devices for placing orders, soda dispensers, vending/rental machines for various products, interactive facility directories, price scanning devices, coupon dispensers, water bottle return stations, and even key making machines. The possibilities are endless.

The use of electronic self-service machines can pose serious challenges for individuals with disabilities. People with certain types of disabilities find it difficult or even impossible to use websites or mobile apps that are not designed to be accessible to them. Blind individuals could access websites with screen reader software that translates on-screen text into audio that can be heard or Braille which appears on a refreshable Braille display. With audio or tactile cues, they could navigate the website using the tab key because they cannot simply point and click with the mouse. However, screen readers only work well (if at all) if the websites are designed to work with them, and most websites presently are not. As a result, blind users often have difficulty navigating sites, filling out forms, and identifying the function or significance of certain links or images. Individuals with low vision who do not use a screen reader may not be able to read text when there is insufficient contrast between the text and background. Color-blind individuals cannot see color cues often used by web designers to convey information (e.g., red for form fields with errors). Deaf individuals cannot perceive the audio content of videos without captioning. Individuals with limited manual dexterity may not be able to use a mouse and need to navigate websites using only a keyboard.

Like websites, mobile apps must also be designed with accessibility principles in mind to be usable by individuals with disabilities. All iOS and Android-based mobile devices have built-in screen reader capabilities that can be turned on by the user, but mobile apps will work only if they are designed to do so. Unfortunately, some, if not most, designers do not consider accessibility limitations when designing their mobile apps.

Like websites and mobile apps, most electronic self-service machines in the marketplace can be difficult or impossible to use by customers who are blind or have limited mobility. Smooth touch screens displaying virtual keys and information, which are commonly used as the customer interface for many types of electronic self-service machines without any tactile assistance, are barriers to blind people. Many self-service machines sell or rent products that can only be identified by sight, making them unusable by blind people. Self-service machines can also present accessibility barriers for individuals who use wheelchairs or scooters. Because they are seated in their mobility devices, these individuals typically cannot reach as high or as low as a person who is in a standing position. They also cannot see display screens that are placed higher than their line of sight and often angled upwards for a standing user.

II. Legal Requirements for Customer-Facing EIT

A. *Statute and Regulations Applicable to EIT*

Title III of the ADA states that no person "who owns, leases (or leases to), or operates a place of public accommodation" may discriminate on the basis of disability in the full and equal enjoyment of the goods, services, facilities, privileges, advantages, or accommodations of any place of public accommodation.[2] Although this non-discrimination mandate appears similar to those in other civil rights laws prohibiting discrimination based on other protected classes (i.e., race, gender, and national origin), it is actually much broader. The drafters of the ADA recognized that individuals with disabilities may need accommodations to have full and equal access to the goods and services offered by a public accommodation. Accordingly, the ADA requires public accommodations to provide at no additional cost "appropriate auxiliary aids and services where necessary to ensure effective communication with individuals with disabilities," unless the public accommodation "can demonstrate that taking those steps would fundamentally alter the nature of the goods, services, facilities, privileges, advantages, or accommodations being offered or would result in an undue burden, i.e., significant difficulty or expense."[3]

The principle underlying the "effective communication" requirement is that a person with a disability must be able to effectively communicate with a public accommodation in order to have equal access to all that a public accommodation offers to other members of the public. For example, a student who is deaf cannot understand what is being taught in class unless the aural information is translated into an accessible format such as sign language or text. Likewise, a blind customer who cannot read a menu will need to have the menu read aloud or translated into Braille.

In its first set of regulations issued in 1991 to implement Title III of the ADA, the U.S. Department of Justice (DOJ) provided a non-exclusive list of "auxiliary aids and services" that a public accommodation may need to provide to ensure effective communication with an individual with a disability.[4] At that time, the Web was in its infancy and few electronic self-service machines existed. Thus, the list of auxiliary aids and services did not reference websites or other EIT. However, when the DOJ revised its ADA Title III regulations in 2010, it expanded the definition of the term "auxiliary aids and services" to include "accessible electronic and information technology."[5]

2. 42 U.S.C. § 12182(a).
3. 42 U.S.C. § 12182(b)(2)(A)(iii); 28 C.F.R. § 36.303(a).
4. 28 C.F.R. § 36.303(b).
5. *Id.*

Websites, mobile apps, and other types of electronic self-service machines fall under this EIT umbrella.

Even with the 2010 revisions, the ADA Title III regulations still do not contain an explicit mandate that websites, mobile apps, or any other EIT machines must be accessible—other than automated teller machines (ATMs), fare vending machines (e.g., subway farecards), vending machines, and fuel dispensers for which there are technical legal standards. Moreover, the regulations do not provide any guidance on what accessibility features an accessible website, mobile app, or electronic self-service machine must have. Instead, the regulations simply require public accommodations to furnish "appropriate auxiliary aids and services" and provide a long menu of auxiliary aids and services that a public accommodation may provide after consulting with the individual with a disability about his or her preferred method of communication.[6] In fact, the regulations state that

> the ultimate decision as to what measures to take rests with the public accommodation, provided that the method chosen results in effective communication. In order to be effective, auxiliary aids and services must be provided in accessible formats, in a timely manner, and in such a way as to protect the privacy and independence of the individual with a disability.[7]

B. *Recent Regulatory Developments Relating to Websites and Mobile Apps*

When it issued revised Title III regulations in 2010 to include accessible EIT in the long list of auxiliary aids and services that a public accommodation may need to provide, the DOJ also announced that it would be issuing regulations addressing the websites of public accommodations under Title III of the ADA as well as the websites of state and local governments under Title II of the ADA. The DOJ's announcement came in the form of an Advanced Notice of Proposed Rulemaking (ANPRM).[8] In it, the DOJ explained that

> Although the Department has been clear that the ADA applies to websites of private entities that meet the definition of "public accommodations," inconsistent court decisions, differing standards for determining Web accessibility, and repeated calls for Department action indicate remaining uncertainty regarding the applicability of the ADA to websites of entities covered by Title III. For these reasons, the Department is exploring what regulatory guidance it can propose to make clear to entities covered by the ADA their obligations to make their websites accessible.[9]

The DOJ explicitly recognized in this ANPRM that a public accommodation need not always make its website accessible in order to comply with Title III of the ADA. It stated,

> The Department has taken the position that covered entities with inaccessible websites may comply with the ADA's requirement for access by providing an acces-

6. 28 C.F.R. § 36.303(c)(1)(ii).

7. *Id.*

8. Advance Notice of Proposed Rulemaking on Nondiscrimination on the Basis of Disability; Accessibility of Web Information and Services of State and Local Government Entities and Public Accommodations, 75 Fed. Reg. 43460 (July 26, 2010).

9. *Id.* at 43464.

> sible alternative, such as a staffed telephone line, for individuals to access the information, goods, and services of their website. *In order for an entity to meet its legal obligation under the ADA, an entity's alternative must provide an equal degree of access in terms of hours of operations and range of information, options, and services available.* For example, a department store that has an inaccessible website that allows customers to access their credit accounts 24 hours a day, 7 days a week in order to review their statements and make payments would need to provide access to the same information and provide the same payment options in its accessible alternative.[10]

The DOJ also clarified in the ANPRM that websites of businesses that have no brick-and-mortar locations but that provide the types of goods and services identified by Title III's definition of "place of public accommodation" are still covered under the ADA.[11] The DOJ went on to ask for public comment on key questions that the website regulation would have to address, such as how much time public accommodations should have to comply with any new website accessibility standard as well as what that accessibility standard should be.[12]

The DOJ's request for public comment on these questions naturally led most businesses to conclude that they would have time to make their websites conform to the accessibility standard that the DOJ ultimately adopts in a final rule. Most also decided that they should wait to see what that standard is before spending significant resources on redesigning their websites.

More than six years have now passed since the DOJ issued the ANPRM, and the DOJ has yet to issue even a proposed regulation, let alone a final rule on the websites of public accommodations or state and local governments. In its most recent regulatory agenda issued before the 2016 Presidential election, the DOJ announced that it would issue a proposed rule relating to accessible websites for public accommodations in 2018.[13] It is highly unlikely that the DOJ will issue any proposed regulations during the Trump administration in light of the President's Executive Order imposing drastic limitations on new regulations.[14]

Disability rights advocates have become increasingly frustrated by the lack of regulatory progress and have turned to the courts in recent years to forge a different path to website accessibility, as discussed in Part III below. Likewise, DOJ attorneys responsible for enforcing Title III of the ADA during the Obama administration also aggressively pushed the website accessibility agenda by opening investigations into the accessibility of various websites and demanding that their owners make their websites accessible now, even in the absence of any regulations.

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10. *Id.* at 43466 (emphasis added).
11. *Id.* at 43461–63.
12. *Id.* at 43464–67.
13. *See* Department of Justice, Fall 2015 Statement of Regulatory Priorities, *available at* http://www.reginfo.gov/public/jsp/eAgenda/StaticContent/201510/Statement_1100.html.
14. *See* Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs (Jan. 30, 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling.

The first significant action by the DOJ concerning websites and mobile apps since the ANPRM was its 2013 intervention as a plaintiff in a lawsuit against tax return preparation company H&R Block.[15] The National Association of the Blind of Massachusetts and several of its members had filed a federal lawsuit claiming that H&R Block's online tax preparation tool and website were not accessible to the blind and violated Title III of the ADA.[16] The DOJ intervened in the lawsuit as an additional plaintiff and expanded the matter to include H&R Block's mobile app.[17] In addition, the DOJ sought injunctive relief to make the website, mobile app, and online tax prep tool accessible to all persons with disabilities, not just those who are blind.[18] Not surprisingly, H&R Block settled the matter shortly after the DOJ's intervention with a very detailed consent decree in which it agreed to make its website, mobile app, and online tax preparation tool accessible to individuals with disabilities, using a privately developed set of accessibility guidelines called the Web Content Accessibility Guidelines (WCAG) version 2.0 Level AA.[19]

The DOJ's intervention in the H&R Block matter was the earliest sign to businesses that the DOJ was not going to wait for its website regulations to be issued before it would pursue an enforcement agenda against businesses with inaccessible websites. Indeed, the H&R Block consent decree was the first in a string of many settlements and consent decrees where the DOJ secured commitments from public accommodations or state and local governments to make their websites and/or mobile apps accessible with an actual or threatened enforcement lawsuit. Massive online open course provider edX,[20] online grocer Peapod,[21] Carnival Cruise Lines,[22] the Museum of Crime and Punishment,[23]

15. *See* United States of America Complaint in Intervention, Nat'l Fed'n of the Blind v. HRB Digital LLC, No. 1:13-cv-10799-GAO (D. Mass. Dec. 11, 2013), ECF No. 39.

16. *See* Class Action Complaint, Nat'l Fed'n of the Blind v. HRB Digital LLC, No. 1:13-cv-10799-GAO (D. Mass. Apr. 8, 2013), ECF No. 1.

17. *See* United States of America Complaint in Intervention, *supra* note 12, ¶¶ 15–36.

18. *Id.* ¶¶ 37–42.

19. Consent Decree, Nat'l Fed'n of the Blind v. HRB Digital LLC, No. 1:13-cv-10799-GAO (D. Mass. Mar. 25, 2014), ECF No. 60, *available at* https://www.ada.gov/hrb-cd.htm.

20. Settlement Agreement Between the United States of America and edX Inc., DJ No. 202-36-255 (Apr. 2, 2015), *available at* https://www.ada.gov/edx_sa.htm (edX commits to making website, mobile applications, and learning management system conform to WCAG 2.0 AA as a result of DOJ compliance review).

21. Settlement Agreement Between the United States of America and Ahold U.S.A., Inc. and Peapod, LLC, DJ No. 202-63-169 (Nov. 17, 2014), *available at* https://www.ada.gov/peapod_sa.htm (Peapod agrees to make website and mobile application conform to WCAG 2.0 AA to resolve DOJ investigation and compliance review).

22. Settlement Agreement Between the United States of America and Carnival Corp., DJ No. 202-17M-206 (July 23, 2015), *available at* https://www.ada.gov/carnival/carnival_sa.html (Carnival agrees to make websites and mobile applications for Carnival Cruise Lines, Holland America Line, and Princess Cruises conform to WCAG 2.0 in order to resolve DOJ investigation).

23. Settlement Agreement Between the United States of America and the National Museum of Crime and Punishment (Jan. 13, 2015), *available at* https://www.ada.gov/crime_punishment_museum/crime_punishment_sa.htm (agreement to make museum website conform to WCAG 2.0 following investigation and compliance review by DOJ).

Law School Admissions Council,[24] Florida State University,[25] and Miami University[26] are just some of the businesses that made commitments.

The DOJ's aggressive enforcement agenda signals its view—whether reasonable or not—that businesses need to make their websites accessible now, even before it issues a regulation containing technical standards defining an "accessible" website. The DOJ made this position clearer in June 2015 when it filed Statements of Interest in two lawsuits brought by the National Association of the Deaf (NAD) against Harvard University and the Massachusetts Institute of Technology (MIT).[27] The NAD brought suit under Title III of the ADA and Section 504 of the Rehabilitation Act, alleging that the schools had failed to caption thousands of videos that are posted to their various websites.[28] These are not videos that students enrolled in courses are required to view but free videos posted to university websites for the general interest and benefit of the public.[29]

Both schools asked the U.S. District Court for the District of Massachusetts to stay their respective cases until the DOJ issued final website regulations for public accommodations websites or to dismiss the cases in their entirety on other grounds.[30] Although not a party in either case, the DOJ filed

24. Settlement Agreement Between the National Federation of the Blind & Law School Admission Council, Inc. (Apr. 25, 2011), *available at* https://www.ada.gov/LSAC.htm (Law School Admission Council agrees to make lsac.org website and law school application service conform to WCAG 2.0 AA in order to resolve multiple complaints from National Federation of the Blind and related investigations by DOJ).

25. Settlement Agreement Between the United States of America and Florida State Univ., DJ No. 205-17-13 (May 29, 2014), *available at* https://www.ada.gov/floridastate-t1-sa.htm (university agrees to make campus law enforcement website, including its employment opportunities website and mobile applications, conform to WCAG 2.0 AA in order to resolve compliance review and investigation by DOJ).

26. *See* Joint Motion for Entry of Consent Decree by Intervenor Plaintiff United States of America, Dudley v. Miami Univ., No. 1:14-cv-00038-SJD (S.D. Ohio Oct. 17, 2016), ECF No. 63 (United States intervened in ADA Title II case brought by National Federation of the Blind regarding accessibility of university's web pages, web applications, and web content; university has tentatively agreed to make all web content and learning technology conform to WCAG 2.0 AA; hearing on Joint Motion for Entry of Consent Decree scheduled for Dec. 14, 2016 (ECF No. 64), proposed Consent Decree, *available at* https://www.ada.gov/miami_university_cd.html.

27. Statement of Interest of the United States of America, Nat'l Ass'n of the Deaf v. Harvard Univ., No. 3:15-CV-30023-MGM (D. Mass. June 25, 2015), *available at* https://www.ada.gov/briefs/harvard_soi.pdf; Statement of Interest of the United States of America, Nat'l Ass'n of the Deaf v. Mass. Inst. of Tech., No. 3:15-CV-30024-MGM (D. Mass. June 25, 2015), *available at* https://www.ada.gov/briefs/mit_soi.pdf.

28. *See* Complaint, Nat'l Ass'n of the Deaf v. Harvard Univ., No. 3:15-CV-30023-MGM (D. Mass. Feb. 12, 2015), ECF No. 1; Complaint, Nat'l Ass'n of the Deaf v. Mass. Inst. of Tech., No. 3:15-CV-30024-MGM (D. Mass. Feb. 12, 2015), ECF No. 1.

29. *See* Complaint, Nat'l Ass'n of the Deaf v. Harvard Univ., *supra* note 28; Complaint, Nat'l Ass'n of the Deaf v. Mass. Inst. of Tech., *supra* note 28.

30. *See* Nat'l Ass'n of the Deaf v. Harvard Univ., No. 3:15-CV-30023-MGM, 2016 WL 3561622 (D. Mass. Feb. 9, 2016) (denying Harvard's motion to dismiss and/or stay pending enactment of website regulations by DOJ), *report and recommendation adopted*, No. CV 15-30023-MGM, 2016 WL 6540446 (D. Mass. Nov. 3, 2016); Nat'l Ass'n of the Deaf v. Mass. Inst. of Tech., No. 3:15-CV-30024-MGM, 2016 WL 3561631 (D. Mass. Feb. 9, 2016) (same), *report and recommendation adopted*, No. CV 15-30024-MGM, 2016 WL 6652471 (D. Mass. Nov. 4, 2016).

a brief in both cases against the schools.[31] The most notable statement in these two Statements of Interest was the DOJ's assertion that the obligation to make websites accessible exists in the current law and regulations, even in the absence of any new regulations. The DOJ made this point indirectly by stating that when it issued the ANPRM in 2010, it was seeking "to explore whether rulemaking would be helpful in providing guidance as to how covered entities could meet *their pre-existing obligations* to make their websites accessible."[32] This position conflicted with the DOJ's statement in the 2010 ANPRM that public accommodations with inaccessible websites can still comply with the ADA by providing an equal degree of access through alternative means (e.g., the telephone).[33]

In May 2016, the DOJ made another surprise announcement in connection with its rulemaking for state and local government websites under Title II of the ADA. This rulemaking began as part of the 2010 ANPRM, but the DOJ later decided to place the state and local website rulemaking on a separate and faster track. In May 2016, the DOJ issued a Supplemental Advanced Notice of Proposed Rulemaking for the state and local government websites (SANPRM) where it previewed its position on numerous issues without actually providing a formal draft of a proposed rule for public comment.[34] The DOJ stated that, once issued, the regulations for state and local government websites would become a model for the public accommodations website regulation.[35]

The SANPRM is rich in content and questions, but among the more important statements made by the DOJ was its position that the privately developed WCAG 2.0 AA should be the accessibility standard for Web content.[36] Furthermore, the DOJ said it was considering giving public entities "two years after the publication of a final rule to make their Web sites and Web content accessible in conformance with WCAG 2.0 AA, unless compliance with the requirements would result in a fundamental alteration in the nature of a service, program, or activity or in undue financial and administrative burdens."[37] The SANPRM position about a possible two-year compliance period cannot be reconciled with the DOJ's more recent October

31. Statement of Interest of the United States of America, Nat'l Ass'n of the Deaf v. Harvard Univ., *supra* note 27; Statement of Interest of the United States of America, Nat'l Ass'n of the Deaf v. Mass. Inst. of Tech., *supra* note 27.

32. Statement of Interest of the United States of America, Nat'l Ass'n of the Deaf v. Harvard Univ., *supra* note 27, at 4–5 (emphasis added).

33. *See* Advance Notice of Proposed Rulemaking on Nondiscrimination on the Basis of Disability; Accessibility of Web Information and Services of State and Local Government Entities and Public Accommodations, 75 Fed. Reg. 43460 (July 26, 2010).

34. *See* Supplemental Advance Notice of Proposed Rulemaking on Nondiscrimination on the Basis of Disability; Accessibility of Web Information and Services of State and Local Government Entities and Public Accommodations, 81 Fed. Reg. 49908 (May 9, 2016), *available at* https://www.ada.gov/regs2016/sanprm.html.

35. *See id.* at 31.

36. *Id.* at 11–14.

37. *Id.* at 16.

2016 Letter of Findings to the University of California at Berkley in which the DOJ charged that the university had violated Title II of the ADA by failing to provide closed captioning for thousands of online videos of general interest and benefit to the public.[38]

C. *Recent Regulatory Developments Relating to Self-Service Machines*

Neither the law nor the regulations contain specific requirements for self-service EIT machines other than ATMs, fare vending machines, vending machines, and fuel dispensers.[39] ATMs and fare vending machines must meet specific requirements designed to ensure that they are accessible to the blind and to those with mobility disabilities.[40] For vending machines and fuel dispensers, the regulations specifically require only that they be accessible to individuals with mobility disabilities and contain no requirements for accessibility to the blind.[41] The DOJ has explained that it did not issue specific regulations about equipment in 1991 because "the requirements could be addressed under other sections of the regulation and because there were no appropriate accessibility standards applicable to many types of equipment at that time."[42] However, in 2010, the DOJ announced in an Advanced Notice of Proposed Rulemaking that it was starting the rulemaking process for equipment and furniture.[43] The DOJ has not issued a proposed rule or taken any other action on this rulemaking since that time.

In 2014, the DOJ announced in a Statement of Interest filed in *New v. Lucky Brand Dungarees Stores* that the absence of specific requirements for electronic self-service machines does not mean that the machines do not have to be accessible.[44] The blind plaintiff in that case sued a retailer that had POS devices that only had touchscreen interfaces. As a result, the plaintiff could not enter his PIN independently when paying with a debit card. The retailer argued that it was not required to have an accessible POS device

38. *See* Department of Justice, The United States' Findings and Conclusions Based on its Investigation Under Title II of the Americans with Disabilities Act of the University of California at Berkeley, DJ No. 204-11-309 (Aug. 30, 2016), *available at* https://www.ada.gov/briefs/uc_berkley_lof.pdf.

39. *See* sections 220 and 228 of the 2010 ADA Standards for Accessible Design set forth at 28 C.F.R. Part 36, Subpart D (2011) and 36 C.F.R. Part 1191, Appendices B and D (2009).

40. *See* sections 707 and 811 of the 2010 ADA Standards for Accessible Design set forth at 28 C.F.R. Part 36, Subpart D (2011) and 36 C.F.R. Part 1191, Appendices B and D (2009).

41. *See* section 309 of the 2010 ADA Standards for Accessible Design set forth at 28 C.F.R. Part 36, Subpart D (2011) and 36 C.F.R. Part 1191, Appendices B and D (2009).

42. *See* 28 C.F.R. Pt. 36, App. A, *available at* https://www.ada.gov/regs2010/titleIII_2010/titleIII_2010_regulations.htm#a2010guidance.

43. *See* Advance Notice of Proposed Rulemaking, Nondiscrimination on the Basis of Disability by State and Local Governments and Places of Public Accommodation; Equipment and Furniture, 75 Fed. Reg. 43452 (July 29, 2010), *available at* https://www.ada.gov/anprm2010/equipment_anprm_2010.htm.

44. Statement of Interest of the United States, New v. Lucky Brand Dungarees Stores, Inc., No. 1:14–cv–20574–UU (Apr. 10, 2014 S.D. Fla.), ECF No. 19, *available at* https://www.ada.gov/briefs/lucky_brand_soi.pdf.

because the regulations contained no standards for POS devices.[45] The DOJ intervened, arguing that

> Title III of the ADA requires that public accommodations provide appropriate auxiliary aids and services where necessary to ensure effective communication with individuals with disabilities (citations omitted). Mr. New's complaint alleges a valid claim of discrimination under Title III of the ADA—specifically, Lucky Brand discriminates on the basis of disability when it fails to afford individuals who are blind with the same ability to independently access the debit card payment option provided to others, thus failing to ensure effective communication with its blind customers during transactions for its goods and services. Contrary to Lucky Brand's assertions, neither the absence of specific technical requirements for POS devices nor the availability of other payment options defeats Mr. New's ADA claim. Mr. New's factual allegations—that he was unable to independently complete a debit card transaction because the POS device Lucky Brand provided was inaccessible and that Lucky Brand failed to provide an appropriate auxiliary aid or service to ensure effective communication during this transaction—fall squarely within Title III's statutory and regulatory protections.[46]

The DOJ did acknowledge that "[u]ntil the process of establishing specific technical requirements for POS devices is complete, public accommodations have a degree of flexibility in complying with Title III's more general requirements of nondiscrimination and effective communication—but they still must comply." As described below, those requirements include, absent a fundamental alteration or undue burden defense, providing auxiliary aids and services in accessible formats, in a timely manner, and in such a way as to protect the privacy and independence of the individual with a disability.[47] The DOJ went on to explain that providing assistance to a blind customer who needs help entering his or her PIN is not an appropriate auxiliary aid or service given the highly sensitive and confidential nature of the PIN and the fact that sighted customers are able to do so independently.[48] The DOJ's discussion suggests that providing assistance to a customer can be acceptable when the electronic self-service equipment is not accessible, but only when doing so does not compromise a person's confidential information. As discussed in Part III.B below, several courts have also taken this position.

III. Legal Controversies About the Use of EIT

A. *Website Lawsuits and Settlements*

The number of lawsuits concerning the accessibility of websites has increased dramatically in the past few years, driven in large part by a few plaintiffs' firms in Pennsylvania, New York, California, and Florida.[49] Although the

45. *Id.* at 2.
46. *Id.* at 5–6.
47. *Id.* at 8–9.
48. *Id.* at 2–3.
49. Minh Vu, *Federal Website Lawsuits Spike; Community Banks Get Demand Letters*, Seyfarth Shaw LLP (Oct. 31, 2016), *available at* http://www.adatitleiii.com/2016/10/federal-website-lawsuits-spike-community-banks-get-demand-letters/; Minh Vu, *ADA Title III Lawsuits Increase*

numbers are hard to track, Seyfarth Shaw's research team determined that plaintiffs have filed at least 300 such suits in federal court in 2015 and 2016.[50]

Despite the increase in lawsuits, there are still very few court decisions in cases alleging that an inaccessible website violates Title III of the ADA because the cases tend to settle early. There has only been one case where a court has held on the merits that a public accommodation engaged in disability discrimination by having an inaccessible website. In *Davis v. BMI/BNB Travelware Co.*, the blind plaintiff sued a retailer under the California Unruh Civil Rights Act for having an allegedly inaccessible website.[51] Ruling on summary judgment, a California state trial court found that the blind plaintiff had demonstrated that he sought goods and services from the retailer but could not use its website, www.ColoradoBaggage.com.[52] The very short decision contains very little insight or guidance and merely referenced the plaintiff's expert report for the actions that must be taken to make the website accessible.[53] It seems that the retailer did not offer any opposition to the plaintiff's report nor did it attempt to argue that the plaintiff could access the information in some equivalent manner, such as a staffed 24-hour toll free telephone line.[54] No court has considered the question of whether such a phone line would be a lawful alternative to having an accessible website.

The appropriate technical standard for determining whether a website is "accessible" also has not been decided by any court; until such a standard is adopted by the DOJ, courts may be inclined to take a more pragmatic approach and examine whether a plaintiff is able to use the website. The court took this approach in the *Davis* case where it concluded that "the undisputed evidence is that Plaintiff's access to the website was prevented by the Defendant at the time the website was designed."[55] Likewise, in the lawsuits brought against Harvard and MIT about the alleged lack of closed captioning for the tens of thousands of videos on their websites, the court stated that the plaintiffs had sufficiently stated a claim where they had "pleaded a lack of meaningful access and have identified captioning as the reasonable accommodation they require to gain that access."[56]

Another issue that the courts have yet to consider is a business' use of social media outlets to communicate with the public. Does a franchisee violate

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by 37 Percent in 2016, Seyfarth Shaw LLP (Jan. 23, 2017), *available at* http://www.adatitleiii.com/2017/01/ada-title-iii-lawsuits-increase-by-37-percent-in-2016/.

50. *Id.*

51. Davis v. BMI/BNB Travelware Co, 2016 WL 2935482, at *1–2 (Cal. Super. Ct. Mar. 21, 2016).

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. Nat'l Ass'n of the Deaf v. Harvard Univ., No. 3:15-CV-30023-MGM, 2016 WL 3561622, at *9 (D. Mass. Feb. 9, 2016), *report and recommendation adopted*, No. CV 15-30023-MGM, 2016 WL 6540446 (D. Mass. Nov. 3, 2016); Nat'l Ass'n of the Deaf v. Mass. Inst. of Tech., No. 3:15-CV-30024-MGM, 2016 WL 3561631, at *1 (D. Mass. Feb. 9, 2016), *report and recommendation adopted*, No. CV 15-30024-MGM, 2016 WL 6652471 (D. Mass. Nov. 4, 2016).

the ADA when it posts special offers, videos, or other information on a social medial website that is not accessible? The DOJ has yet to address this question for public accommodations covered by Title III of the ADA, but said that a state or local government entity that uses

> third-party social media Web site to implement its services, programs, or activities . . . is required to ensure access to that content for individuals with disabilities through other means. For example, if a public entity publishes information about an upcoming event on a third-party social media Web site, it must ensure that the same information about the event is also available to individuals with disabilities elsewhere, such as on the public entity's accessible Web site. Likewise, if a public entity solicits public feedback on an issue via a social media platform, the public entity must provide an alternative way to invite and receive feedback from person with disabilities on that topic.[57]

This statement suggests that the DOJ would expect public accommodations to ensure that any information conveyed to the public on an inaccessible social media website would also be available through some other accessible means.

Other issues pertaining to website accessibility are more settled. For example, all courts to have addressed the issue agree that if there is a nexus between a business's website and a physical location where customers are served, the website is covered under the law.[58] However, courts disagree over whether a website belonging to a business with no physical location is covered under Title III of the ADA. The Ninth Circuit is the only federal appellate court to have addressed this question *in cases involving websites*. In

57. *See* Supplemental Advance Notice of Proposed Rulemaking on Nondiscrimination on the Basis of Disability; Accessibility of Web Information and Services of State and Local Government Entities and Public Accommodations, 81 Fed. Reg. 49908 (May 9, 2016), *available at* https://www.ada.gov/regs2016/sanprm.html.

58. *See*, *e.g.* Nat'l Ass'n of the Deaf v. Mass. Inst. of Tech., No. 3:15-CV-30024-MGM, 2016 WL 3561631 (D. Mass. Feb. 9, 2016), *report and recommendation adopted*, No. CV 15-30024-MGM, 2016 WL 6652471 (D. Mass. Nov. 4, 2016) and Nat'l Ass'n of the Deaf v. Harvard Univ., No. 3:15-CV-30023-MGM, 2016 WL 3561622 (D. Mass. Feb. 9, 2016), *report and recommendation adopted*, No. CV 15-30023-MGM, 2016 WL 6540446 (D. Mass. Nov. 3, 2016) (motions by Harvard and MIT to dismiss or stay website accessibility class action lawsuits denied because existing law and regulations provide a basis for the deaf advocates' claim that the universities violated Title III of the ADA and Section 504 of the Rehabilitation Act by failing to provide closed captioning for thousands of videos on their websites); Shields v. Walt Disney Parks & Resorts US, Inc., 279 F.R.D. 529 (C.D. Cal. 2011) (certifying class of blind and partially sighted persons seeking declaratory and injunctive relief against resorts' owner-operator and purported owner-operator of websites associated with entertainment facilities); Nat'l Fed'n of the Blind v. Target Corp., 582 F. Supp. 2d 1185, 1191 (N.D. Cal. 2007) (holding that there was a sufficient nexus between Target's website and its stores to be covered under Title III of the ADA); Davis v. BMI/BNB Travelware Co., 2016 WL 2935482, at *1 (Cal. Super. Ct. Mar. 21, 2016) (plaintiff presented sufficient evidence and legal argument to conclude Title III of the ADA applied to the use of a website where plaintiff has demonstrated he sought goods and services from a place of public accommodation because he "demonstrated a sufficient nexus exists between defendant's retail store and its website that directly affects plaintiff's ability to access good and services.").

companion cases *Cullen v. Netflix*[59] and *Earl v. eBay*,[60] the Ninth Circuit held that Netflix's video streaming service, and eBay's web-based auction business, are not subject to the ADA's non-discrimination mandate because their services are not connected to any "actual, physical place."[61] The court held that the phrase "place of public accommodation" requires "some connection between the good or service complained of and an actual physical place," citing to its prior decision in *Weyer v. Twentieth Century Fox Film Corp.*[62] The district courts in the Ninth Circuit have consistently applied these precedents to dismiss lawsuits involving websites that have no nexus to a physical location where customers are served.[63] The Third and Sixth Circuits have also taken the position that only goods and services offered by a physical place of public accommodation are covered by Title III of the ADA, but have not considered cases involving websites.[64] District courts in Montana and Florida have held that websites are not places of public accommodation when they have no nexus to a physical place where customers are served.[65] The Second Circuit has yet to address the question, but has held that Title III of the ADA does

59. Cullen v. Netflix, Inc., Docket No. 13-15092 (9th Cir. Apr. 1, 2015), *available at* http://cdn.ca9.uscourts.gov/datastore/memoranda/2015/04/01/13-15092.pdf (affirming district court's decision to grant defendant's motion to dismiss plaintiff's disability discrimination claims under two California state laws predicated on the ADA).

60. Earll v. eBay Inc., 599 F. App'x 695, 696 (9th Cir. 2015) (affirming district court's decision to grant defendant's motion to dismiss with prejudice plaintiff's ADA and California Unruh Civil Rights Act claims).

61. *Cullen*, Docket No. 13-15092, at 2; *Earll*, 599 F. App'x, at 696.

62. *Cullen*, Docket No. 13-15092, at 2; *Earll*, 599 F. App'x, at 696 ("We have previously interpreted the term 'place of public accommodation' to require 'some connection between the good or service complained of and an actual physical place.'") (both quoting Weyer v. Twentieth Century Fox Film Corp., 198 F.3d 1104, 1114 (9th Cir. 2000)).

63. *See*, *e.g.* Young v. Facebook, Inc., 790 F. Supp. 2d 1110 (N.D. Cal. 2011) (social networking website not a place of public accommodation, even though defendant's headquarters were located in a physical space and defendant sold its gift cards in various brick-and-mortar retail stores across country); Jancik v. Redbox Automated Retail, LLC, No. SACV 13-1387-DOC, 2014 WL 1920751 (C.D. Cal. May 14, 2014) (website with videos not covered by Title III of the ADA because a website is not a place of public accommodation under Title III).

64. *See* Ford v. Schering-Plough Corp., 145 F.3d 601, 612-13 (3rd Cir. 1998) (disparity in employer's insurance benefits for employees' mental and physical disabilities did not violate ADA because disability benefits do not qualify as a public accommodation under Title III of the ADA ("The plain meaning of Title III is that a public accommodation is a place, leading to the conclusion that it is all of the services which the public accommodation offers, not all services which the lessor of the public accommodation offers, which fall within the scope of Title III.")). (internal citations and quotations omitted)*;* Parker v. Metro. Life Ins. Co., 121 F.3d 1006, 1010–14 (6th Cir. 1997) (employee benefit plan not a public accommodation under Title III of the ADA ("Title III regulates the availability of the goods and services the place of public accommodation offers as opposed to the contents of goods and services offered by the public accommodation.")).

65. *See* Access Now, Inc. v. Sw. Airlines, Co., 227 F. Supp. 2d 1312, 1317–21 (S.D. Fla. 2002) (district court holds that a web-only travel website is not a place of public accommodation); Kidwell v. Florida Comm'n on Human Relations, No. 2:16-CV-403-FTM-99CM, 2017 WL 176897, at *1 (M.D. Fla. Jan. 17, 2017) (federal magistrate judge holds that SeaWorld's website is not a place of public accommodation covered by Title III of the ADA because "[p]laintiff is unable to demonstrate that either Busch Gardens' or SeaWorld's online website prevents his access to a specific, physical, concrete space such as a particular airline ticket counter or travel agency"); Ouellette v. Viacom, No. CV 10-133-M-DWM-JCL, 2011 WL 1882780 (D. Mont.

cover products and services that are purchased in a physical place of public accommodation but used offsite (i.e., an insurance policy purchased from an insurance office).[66]

In contrast, the First and Seventh Circuits have held that Title III of the ADA applies to businesses with no physical locations.[67] None of these appellate decisions involved websites. District courts in the First and Seventh Circuits held that websites that have no nexus to a physical location are still covered by Title III of the ADA.[68]

Public accommodations defending website accessibility lawsuits do have some defenses available to them. The law does not require the provision of any auxiliary aids and services that would impose an undue burden or cause a fundamental alteration of the goods and services provided by the public accommodation.[69] No court has yet to consider the applications of these defenses in a website accessibility case, and they have been difficult to prove for entities with resources in other contexts. For example, in *Innes v. Board of Regents*, the University of Maryland argued that the purchase and installation of captioning boards for deaf spectators at athletic events would cost a total of $3.75 million and be an undue burden.[70] The U.S. District Court for the District of Maryland rejected this argument, holding that this amount did not establish undue burden as a matter of law. The court stated that other factors would have to be considered and refused to decide the issue on a motion to dismiss.[71] The undue burden and fundamental alteration defenses will feature prominently in the *Harvard* and *MIT* video captioning cases discussed earlier if these cases do not settle.

Some defendants in recent website accessibility lawsuits have argued that the court should stay the cases until the DOJ issues final rules for public accommodations websites. The courts have uniformly rejected this argument. In *Sipe v. Huntington National Bank*, the defendant moved to dismiss the lawsuit, arguing that the DOJ had not issued regulations.[72] The district court judge in the U.S. District Court for the Western District of Pennsylvania summarily denied the motion with no explanation.[73] The court in the *Harvard* and

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Mar. 31, 2011) (impeding access to an "online theater" is not an injury within the scope of the ADA).

66. *See* Pallozzi v. Allstate Life Ins. Co., 198 F.3d 28, 33 (2d Cir. 2000).

67. *See* Carparts Distrib. Ctr. v. Auto. Wholesalers' Ass'n of New England, 37 F.3d 12, 19–20 (1st Cir. 1994); Doe v. Mutual of Omaha Ins. Co., 179 F.3d 557, 559 (7th Cir. 1999).

68. *See* Nat'l Fed'n of the Blind v. Scribd Inc., 97 F. Supp. 3d 565 (D. Vt. 2015) (online-only website and mobile applications providing a reading subscription service covered by Title III of the ADA); Nat'l Ass'n of the Deaf v. Netflix, Inc., 869 F. Supp. 2d 196 (D. Mass. 2012) (online-only web-based subscription service for television and other programming covered by Title III of the ADA).

69. *See* 42 U.S.C. § 12182(b)(2)(A)(iii); 28 C.F.R. § 36.303(a).

70. Innes v. Bd of Regents, 121 F. Supp. 3d 504 (D. Md. 2015).

71. *Id.* at 513.

72. *See* Defendant's Brief in Support of Motion to Dismiss or, Alternatively, to Stay, Sipe v. Huntington Nat'l Bank, No. 2:15-cv-01083 (W.D. Penn. Oct. 26, 2015), ECF Nos. 14–15.

73. *See* Order Denying Motion to Dismiss or, Alternatively, to Stay, Sipe v. Huntington Nat'l Bank, No. 2:15-cv-01083 (W.D. Penn. Nov. 18, 2015), ECF No. 21.

MIT cases also rejected the argument, stating that the DOJ's pending development of website regulations did not impact the court's determination in those cases as to whether the two schools had discriminated against the deaf or hard of hearing by not providing closed captioning for its videos.[74]

ADA Title III plaintiffs' firms have seized upon the unfavorable litigation landscape to send out hundreds, possibly thousands, of demand letters about inaccessible websites in an effort to obtain settlements. Some have filed dozens of lawsuits. Most of the targeted businesses have chosen to settle these cases confidentially. Advocacy groups have also placed intense pressure on businesses to make their websites accessible. These efforts have resulted in dozens of public settlements over the past few years with businesses such as Netflix,[75] Scribd,[76] Charles Schwab,[77] Weight Watchers,[78] Major League Baseball,[79] CVS,[80] Wellpoint,[81] and Safeway.[82]

74. Nat'l Ass'n of the Deaf v. Harvard Univ., No. 3:15-CV-30023-MGM, 2016 WL 3561622, at *15 (D. Mass. Feb. 9, 2016), *report and recommendation adopted*, No. CV 15-30023-MGM, 2016 WL 6540446 (D. Mass. Nov. 3, 2016); Nat'l Ass'n of the Deaf v. Mass. Inst. of Tech., No. 3:15-CV-30024-MGM, 2016 WL 3561631, at *1–2 (D. Mass. Feb. 9, 2016), *report and recommendation adopted*, No. CV 15-30024-MGM, 2016 WL 6652471 (D. Mass. Nov. 4, 2016).

75. Netflix Website Accessibility Agreement (2016), *available at* http://www.adatitleiii.com/wp-content/uploads/sites/121/2016/04/Settlement_Agreement_FOR_WEBSITEv2.pdf (Netflix agrees to provide audio captioning for movies and videos offered through Netflix video streaming and DVD rental subscriptions).

76. Press Release, Nat'l Fed'n of the Blind, National Federation of the Blind and Scribd Agree to Collaborate to Make Reading Subscription Service Accessible to the Blind (Nov. 19, 2015), *available at* https://nfb.org/national-federation-blind-and-scribd-agree-collaborate-make-reading-subscription-service-accessible and https://nfb.org/images/photos/scribd%20settlement%20agreement%20and%20release.pdf (Scribd agrees to make ebooks, audiobooks and other published content accessible to blind users pursuant to WCAG 2.0 AA standards).

77. Charles Schwab Website Accessibility Settlement Agreement (Oct. 20, 2011), *available at* http://www.lflegal.com/2012/05/schwab-agreement/ (Charles Schwab agrees to enhance website accessibility using WCAG 2.0 Level AA).

78. Weight Watchers Print and Digital Accessibility Settlement Agreement (Apr. 15, 2013), *available at* http://www.lflegal.com/2013/06/weight-watchers-agreement/ (Weight Watchers agrees to use WCAG 2.0 Level AA as the standard for its online and mobile application content and to provide print material in accessible formats for persons with visual impairments who cannot read standard print).

79. Major League Baseball Accessible Website Agreement (Dec. 31, 2009), *available at* http://www.lflegal.com/2010/02/mlb-agreement/ (MLB agrees to make mlb.com and all Major League Baseball club websites accessible pursuant to WCAG 2.0 guidelines); First Addendum to MLB Settlement Agreement (Feb. 1, 2012), *available at* http://www.lflegal.com/2012/06/mlb-addendum/ (extending original agreement and expanding MLB's accessibility obligations regarding mobile applications).

80. CVS Accessible Website and Point of Sale Settlement Agreement (Apr. 15, 2009), *available at* http://www.lflegal.com/2009/07/cvs-agreement/ (CVS agrees to install accessible POS in every CVS store nationwide and to upgrade website to comply with WCAG).

81. WellPoint Accessible Information Agreement (Jan. 1, 2014), *available at* http://www.lflegal.com/2014/02/wellpoint-agreement/ (agreement to increase the accessibility of WellPoint websites, mobile applications and print materials for health plan members who are blind and visually impaired, applying WCAG 2.0).

82. Safeway Web Accessibility Agreement (Dec. 6, 2013), *available at* http://www.lflegal.com/2013/12/safeway-web/ (agreement to increase the accessibility of Safeway's online grocery delivery website using WCAG 2.0 AA as legal standard).

B. *Mobile Apps*

There have been far fewer controversies relating to the accessibility of mobile apps than websites, but they are likely to increase in number in the future. The legal theory for holding a business liable under Title III of the ADA for having a mobile app that is not accessible would be the same as for a website. The lack of lawsuits and judicial decisions addressing mobile apps does not mean that advocacy groups and the DOJ are not pushing businesses to make their mobile apps accessible. Over the past several years, businesses such as H&R Block,[83] edX,[84] Peapod,[85] Square,[86] Weight Watchers,[87] Carnival Cruise Lines,[88] Wellpoint,[89] Bank of America,[90] and Major League Baseball[91] have all agreed to make their mobile apps accessible by making coding and design changes.

C. *Point of Sale Devices/Self-Service Equipment*

Point of sale devices and other types of electronic self-service equipment have also been the subject of a number of lawsuits and controversies in recent years. In 2014, plaintiffs sued many retailers and even cab companies about touchscreen POS devices that did not have tactile keypads that would allow

83. Consent Decree, Nat'l Fed'n of the Blind v. HRB Digital LLC, No. 1:13-cv-10799-GAO (D. Mass. Mar. 24, 2014), ECF No. 60, *available at* https://www.ada.gov/hrb-cd.htm (agreement to make H&R Block's website and mobile applications conform to WCAG 2.0 AA).

84. Settlement Agreement Between the United States of America and edX Inc., DJ No. 202-36-255 (Apr. 2, 2015), *available at* https://www.ada.gov/edx_sa.htm (agreement to make edX website, mobile applications, and leaning management system conform to WCAG 2.0 AA).

85. Settlement Agreement Between the United States of America and Ahold U.S.A., Inc. and Peapod, LLC, DJ No. 202-63-169 (Nov. 17, 2014), *available at* https://www.ada.gov/peapod_sa.htm (agreement to make Peapod's website and mobile application accessible in conformance with WCAG 2.0 AA).

86. Square, Inc. Mobile Application Agreement (2013), *available at* http://www.trelegal.com/wp-content/uploads/2013/07/Final-Public-Accessibility-Agreement-Accessible.pdf (Square agrees to improve accessibility of Square Wallet and Square Register mobile applications in agreement with National Federation of the Blind of Massachusetts).

87. Weight Watchers Print and Digital Accessibility Settlement Agreement (Apr. 15, 2013), *available at* http://www.lflegal.com/2013/06/weight-watchers-agreement/ (Weight Watchers agrees to use WCAG 2.0 Level AA as the standard for its online and mobile application content).

88. Settlement Agreement Between the United States of America and Carnival Corp., DJ No. 202-17M-206 (July 23, 2015), *available at* https://www.ada.gov/carnival/carnival_sa.html (Carnival Cruise Lines commits to making its website and mobile applications conform to WCAG 2.0 after being investigated by DOJ).

89. WellPoint Accessible Information Agreement (Jan. 1, 2014), *available at* http://www.lflegal.com/2014/02/wellpoint-agreement/ (agreement to increase the accessibility of WellPoint websites, mobile applications and print materials for health plan members who are blind and visually impaired, applying WCAG 2.0).

90. Bank of America Accessible Information Agreement (Mar. 21, 2016), *available at* http://www.lflegal.com/2016/05/bankofamerica-mortgage-agreement/ (agreement to make online banking mobile application and website conform with WCAG 2.0 AA).

91. First Addendum to MLB Settlement Agreement (Feb. 1, 2012), *available at* http://www.lflegal.com/2012/06/mlb-addendum/ (extending original MLB website accessibility agreement and expanding MLB's obligations regarding its At Bat mobile application).

blind users to independently input their PINs,[92] including the suit that resulted in the filing of a Statement of Interest by the DOJ in the *Lucky Brands* case discussed earlier. Advocates have also approached businesses and proposed "structured negotiations" to ensure that they install accessible POS devices. Walmart,[93] Target,[94] Safeway,[95] Trader Joe's,[96] Rite Aid,[97] Raley's,[98] Radio Shack,[99] Dollar General,[100] CVS,[101] Best Buy,[102] and 7-Eleven[103] are some of the businesses that agreed to install accessible POS devices as a result

92. *See, e.g.*, Complaint, Jahoda v. Signet Jewelers Limited, d/b/a Kay Jewelers, No. 2:13-cv-01729-LPL (W.D. Penn. Dec. 4, 2013), ECF No. 1; First Amended Complaint, Nat'l Fed'n of the Blind v. RideCharge, Inc., No. 2:14-cv-2490 (C.D. Cal. Sept. 9, 2014), ECF No. 25; Complaint, New v. Lululemon USA, Inc., No. 1:14-cv-20589-DPG (S.D. Fla. Feb. 17, 2014), ECF No. 1; Complaint, New v. Apple, Inc., No. 1:14-cv-20767-MGC (S.D. Fla. Feb. 28, 2014), ECF No. 1; Complaint, Thurston v. J. Crew Group, Inc., No. 5:15-cv-01331-JAK-MRW (C.D. Cal. July 6, 2015), ECF No. 1-1; Complaint, Smith v. J. Crew Group, Inc., No. 2:15-cv-0375 (C.D. Cal. May 18, 2015), ECF No. 1; Complaint, Gomez v. J. Crew Group, Inc., No. 2:15-cv-03808 (C.D. Cal. May 20, 2015), ECF No. 1; Complaint, Gomez v. J. Crew Group, Inc. d/b/a Madewell, No. 2:15-cv-04161-JAK-MRW (C.D. Cal. June 3, 2016), ECF No. 1; Complaint, Nat'l Fed'n of the Blind v. Build-a-Bear Workshop, Inc., No. 1:15-cv-01724-KMT (D. Colo. Aug. 11, 2015), ECF No. 1; Complaint, Nat'l Fed'n of the Blind v. Container Store, Inc., No. 15-12984-NMG (D. Mass. July 20, 2015), ECF No. 1.

93. Wal-Mart Point of Sale Device Settlement Agreement (Oct. 15, 2005), *available at* http://www.lflegal.com/2005/10/walmart-pos-agreement/ (agreement to install tactile POS devices at Wal-Mart stores nationwide).

94. Target Point of Sale Device Settlement Agreement (Mar. 31, 2009), *available at* http://www.lflegal.com/2005/10/walmart-pos-agreement/ (agreement to install tactile POS devices at Target stores nationwide).

95. Safeway Point of Sale Device Settlement Agreement (Sept. 30, 2006), *available at* http://www.lflegal.com/2006/09/safeway-agreement/ (agreement to install tactile POS devices at all Safeway owned stores in the United States, including include Safeway, Vons, Randalls, Tom Thumb, Genuardi's, Pavilions, Dominick's, Pak'n Save Foods, and Carrs).

96. Trader Joe's Point of Sale Device Settlement Agreement (June 30, 2006), *available at* http://www.lflegal.com/2009/08/trader-joes-pos-agreement/ (agreement to install tactile POS devices at all Trader Joe's stores nationwide).

97. Rite Aid Point of Sale Device Agreement (Mar. 31, 2008), *available at* http://www.lflegal.com/2008/04/rite-aid-pos-agreement/ (agreement to install tactile POS devices at all Rite Aid stores nationwide).

98. Raley's Point of Sale Device Agreement (Jan. 15, 2015), *available at* http://www.lflegal.com/2015/04/raleys-agreement/ (agreement to install tactile POS devices at all California stores owned by Raley's, including Raley's, Aisle 1, Beverage Market, Food Source, Nob Hill, and Bel Air stores).

99. RadioShack Point of Sale Device Agreement (May 31, 2015), *available at* http://www.lflegal.com/2007/05/radio-shack-agreement/ (agreement to install tactile point of sale devices at every RadioShack store nationwide).

100. Dollar General Point of Sale Device Agreement (Oct. 15, 2008), *available at* http://www.lflegal.com/2008/12/dollar-general-settlement-agreement/ (agreement to install tactile point of sale devices at every Dollar General store nationwide).

101. CVS Point of Sale Device Agreement (Apr. 15, 2009), *available at* http://www.lflegal.com/2009/07/cvs-agreement/ (agreement to install tactile point of sale devices at every CVS store nationwide).

102. Best Buy Point of Sale Device Agreement (Jan. 15, 2010), *available at* http://www.lflegal.com/2010/03/best-buy-agreement/ (agreement to install tactile point of sale devices at every Best Buy store nationwide).

103. 7-Eleven Point of Sale Device Agreement (Oct. 31, 2007), *available at* http://www.lflegal.com/2007/10/7-eleven-pos-agreement/ (agreement to install tactile point of sale devices at every 7-Eleven store nationwide).

of structured negotiations. The wave of POS controversies has abated, however, because most businesses have replaced their POS devices in the past year to upgrade to new technology required by credit card companies. The new devices all have tactile keypads that can be used by the blind.

Other electronic self-service machines, however, continue to generate legal controversy. DVD rental kiosk company Redbox faced two class actions alleging that its DVD rental kiosks are not accessible to the blind. The first lawsuit was filed in 2012 in the U.S. District Court for the Northern District of California by several blind individuals and an advocacy group.[104] After two years of litigation and mediation, the parties entered into a California-wide class settlement under which Redbox agreed to incorporate audio guidance technology, a tactile keypad, and other accessibility features into its DVD rental kiosks in California; provide 24-hour telephone assistance at each kiosk; and pay $1.2 million in damages, $85,000 for kiosk testing, $10,000 to each named plaintiff in damages, and $800,000 for plaintiffs' attorney fees and costs.[105]

The second class action lawsuit was filed in 2014 in the U.S. District Court for the Western District of Pennsylvania[106] and resulted in a proposed nationwide class action settlement under which the company would agree to provide at least one kiosk per retail location that is accessible to the blind, pay damages, and pay $397,000 in attorney fees and costs to class counsel.[107] Although the proposed settlement was approved by the court,[108] the National Federation of the Blind, American Council of the Blind, and seven class members filed objections on the basis that the proposed relief was insufficient.[109] The parties are presently negotiating a revised settlement that has not yet been submitted to the court for preliminary approval.

104. Complaint, Lighthouse for the Blind and Visually Impaired v. Redbox Automated Retail, LLC, No. 4:12-cv-00195-PJH (N.D. Cal. Jan. 12, 2012), ECF No. 1.

105. Joint Motion for Preliminary Approval of Settlement and Order and Order Granting Final Approval of Class Settlement and Dismissing Claims, Lighthouse for the Blind and Visually Impaired v. Redbox Automated Retail, LLC, No. C12-00195 PJH (N.D. Cal. 2014), ECF Nos. 73 and 85.

106. Complaint, Jahoda v. Redbox Automated Retail, LLC, No. 2:14-cv-01278-LPL (W.D. Penn. Sept. 17, 2014), ECF No. 1.

107. Joint Motion for Preliminary Approval of Class Action Settlement, Jahoda v. Redbox Automated Retail, LLC, No. 2:14-cv-01278-LPL (W.D. Penn. Nov. 23, 2015), ECF Nos. 29 and 30.

108. Order Granting Motion for Preliminary Approval of Proposed Class Settlement, Jahoda v. Redbox Automated Retail, LLC, No. 2:14-cv-01278-LPL (W.D. Penn. Nov. 24, 2015), ECF No. 31.

109. Objections to Proposed Class Settlement by Kelly Josef Pierce, Jahoda v. Redbox Automated Retail, LLC, No. 2:14-cv-01278-LPL (W.D. Penn. Mar. 7, 2016), ECF No. 34; Objections to Proposed Class Settlement by Christian D. Hofstader, Jahoda v. Redbox Automated Retail, LLC, No. 2:14-cv-01278-LPL (W.D. Penn. Mar. 9, 2016), ECF No. 36; Objections to Proposed Class Settlement by Jason Meddaugh, Jahoda v. Redbox Automated Retail, LLC, No. 2:14-cv-01278-LPL (W.D. Penn. Mar. 15, 2016), ECF No. 37; Objections to Proposed Class Settlement by Am. Council of the Blind, Jahoda v. Redbox Automated Retail, LLC, No. 2:14-cv-01278-LPL (W.D. Penn. Mar. 15, 2016), ECF No. 38; Objections to Proposed Class Settlement by Nat'l Fed'n of the Blind, Jahoda v. Redbox Automated Retail, LLC, No. 2:14-cv-01278-LPL (W.D. Penn. Mar. 15, 2016), ECF No. 39.

In 2015, blind plaintiffs represented by the same firm brought three separate class actions in the U.S. District Court for the Southern District of New York against Moe's, Walgreens, and Five Guys for having inaccessible drink dispensers (the Freestyle machine) in their establishments.[110] Although the specific restaurant locations identified in the *Moe's* and the *Five Guys* complaints were franchises, the plaintiffs did not name the franchisees as defendants in the lawsuits. Instead, the plaintiffs based their claims on Moe's and Five Guys' alleged nationwide policies for installing Freestyle machines at all of their restaurant locations, whether franchised or not, and argued that these dispensers should have had technology to allow the plaintiffs to use the machines independently. In the first case to be decided, the district court held that "under the ADA, effective assistance from Moe's employees acting as 'qualified readers' is sufficient" and that the restaurant was not obligated to provide blind accessible drink dispensers.[111] The court also held that the restaurant's failure to provide assistance on one occasion was an isolated incident that could not be the basis for an ADA claim.[112] The court said that to state a claim that Moe's failed to adopt policies and procedures to provide assistance to blind customers, the plaintiff would have had to allege that he did not receive assistance on multiple occasions.[113]

Undeterred, the same plaintiffs in May 2016 filed a class action lawsuit against McDonald's Corporation and several franchisees alleging that the Freestyle machines are not accessible and that the restaurants failed to provide effective assistance to them *on many occasions*.[114] After McDonald's filed a motion for judgment on the pleadings in May 2016,[115] the plaintiffs voluntarily dismissed the lawsuit without prejudice even though no settlement was reached.[116]

The Freestyle machine cases illustrate that franchisors can face potential ADA Title III liability at franchisee locations when their brand standards re-

110. Complaint, West v. Moe's Franchisor, LLC, No. 15-CV-2846 (S.D.N.Y. Apr. 13, 2015), ECF No. 1; Complaint, Dicarlo v. Walgreens Boot Alliance, Inc., No. 15-CV-2919-JPO (S.D.N.Y. Apr. 15, 2015), ECF No. 1; Complaint, West v. Five Guys Enters., LLC, 1:15-CV-02845 (S.D.N.Y. Apr. 13, 2015), ECF No. 1.

111. West v. Moe's Franchisor, LLC, No. 15-CV-2846, 2015 WL 8484567, at *3 (S.D.N.Y. Dec. 9, 2015).

112. *Id.* at *4.

113. *Id.* The dismissal of plaintiffs' claims in West v. Moe's Franchisor, LLC quickly led to the dismissal of the two other Freestyle cases brought in the Southern District of New York. *See* Dicarlo v. Walgreens Boot Alliance, Inc., No. 15-CV-2919-JPO, 2016 WL 482982 (S.D.N.Y. Feb. 5, 2016) (granting defendant's motion to dismiss, relying on West v. Moe's Franchisor, LLC); West v. Five Guys Enters., LLC, No. 1:15-CV-02845, 2016 WL 482981 (S.D.N.Y. Feb. 5, 2016) (same).

114. Complaint, Dicarlo v. McDonald's Corp., No. 1:15-cv-02273-ALC-BCM (S.D.N.Y. Mar. 26, 2015), ECF No. 1.

115. Defendant's Notice of Motion and Memorandum of Law in Support of Judgment on the Pleadings, Dicarlo v. McDonald's Corp., No. 1:15-cv-02273-ALC-BCM (S.D.N.Y. May 24, 2016), ECF Nos. 57–58.

116. Stipulation of Voluntary Dismissal, Dicarlo v. McDonald's Corp., No. 1:15-cv-02273-ALC-BCM (S.D.N.Y. June 9, 2016), ECF No. 63.

quire franchisees to use of inaccessible customer-facing EIT. Depending on their franchise agreements, franchisees may look to franchisors for indemnification for such ADA liability. Consequently, franchisors should carefully consider accessibility when developing such EIT for use in their franchised systems. Manufacturers of customer-facing EIT cannot be expected to consider accessibility because they are not public accommodations and have no liability under Title III of the ADA. Case in point: vending-machine manufacturer Coca-Cola in 2016 defeated an ADA Title III class action lawsuit about its drink vending machine, which is not accessible to blind users. The Fifth Circuit upheld the district court's dismissal of the lawsuit, holding that the vending machine itself is not a "place of public accommodation."[117] The plaintiff had argued that the vending machine is a "sales establishment" that would place it within the statute's definition of a "place of public accommodation." The Fifth Circuit disagreed, finding that the term "establishment" includes "not only a business but also the physical space it occupies."[118] The court did note, however, that having an inaccessible vending machine could have legal implications for the owners and operators of the space in which the vending machine are located because that space could be a place of public accommodation.[119] The plaintiffs have petitioned the U.S. Supreme Court for review.[120]

Other types of self-service kiosks have been the subjects of lawsuits as well. In 2015, a blind plaintiff sued Sears for having price scanners in its stores that are not accessible to the blind.[121] That case resolved very quickly with no judicial determination or guidance because the parties agreed to settle the case without litigation.[122] In 2016, blind plaintiffs sued Panera for having iPad touchscreen kiosks for self-ordering in cafes that were allegedly not accessible to the blind.[123] That case also settled quickly, once again without providing us with more insight into the public accommodations requirements courts may seek to impose.[124] As a final example, in July 2016, the National Federation of the Blind and the Massachusetts attorney general announced that they had reached an agreement with Pursuant Health to en-

117. Magee v. Coca-Cola Refreshments USA, 833 F.3d 530 (5th Cir. 2016) *petition for cert. filed* (U.S. Nov. 11, 2016) (No. 16-668) (pending).

118. *Id.* at 534.

119. *Id.* at 536.

120. *Id.*

121. Complaint, Gomez v. Sears, Roebuck & Co., No. 1:15-cv-22749-KMW (S.D. Fla. July 23, 2015), ECF No. 1.

122. Notice of Settlement, Gomez v. Sears, Roebuck & Co., No. 1:15-cv-22749-KMW (S.D. Fla. Aug. 27, 2015), ECF No. 13; Order Dismissing Case, Gomez v. Sears, Roebuck & Co., No. 1:15-cv-22749-KMW (S.D. Fla. Oct. 5, 2015), ECF No. 18.

123. Complaint, Gomez v. Panera, LLC, No. 1:16-CV-21421-FAM (S.D. Fla. Apr. 21, 2016), ECF No. 1.

124. Notice of Settlement, Gomez v. Panera, LLC, No. 1:16-CV-21421-FAM (S.D. Fla. July 13, 2016), ECF No. 18.

sure that the company's self-service health care kiosk would be accessible to blind users.[125]

IV. Conclusion

The survey in this article of the legal landscape concerning customer-facing EIT shows that the use of technology to deliver goods and services to consumers can expose franchisors and franchisees to lawsuits and DOJ enforcement actions. To mitigate that exposure, businesses must ensure that accessibility is a factor in evaluating new customer-facing EIT in the procurement process. The question to ask is straightforward: will a person with a sight, hearing, speech, or mobility disability be able to use this new EIT? If the answer is no, then companies need to figure out how they are going to provide individuals with disabilities equal access to the goods, services, and information provided by the inaccessible EIT. Employee assistance with inaccessible EIT can be an option where a customer's privacy would not be implicated, but employees will need to be trained to provide assistance consistently and effectively. Procurement contracts for customer-facing EIT should contain specific provisions concerning accessibility and the standards to be met because general provisions requiring vendors to comply with applicable law will not ensure that the deliverable will be accessible. Franchisors and franchisees should seek to include indemnity provisions against vendors for ADA claims resulting from EIT that does not meet a contract's accessibility requirements.

These foregoing principles apply to all EIT, but websites and mobile apps require an even more robust process to ensure accessibility because making them accessible and keeping them that way can be very challenging due to a host of factors. The initial remediation/development work can be very time consuming and expensive. Changes made to websites and mobile apps take place daily and can impact accessibility. Many people and departments within an organization have the ability to change content on a website or mobile app, further increasing the risk that accessibility will be negatively affected. In short, developing and maintaining an accessible website or mobile app is a constant ongoing effort requiring the full commitment of the entire organization.

Franchisors should take special care to review any technological changes to their franchise system for accessibility issues. They may face liability claims for the use of a non-compliant website and/or mobile app as well as for non-compliant EIT imposed on their franchisees through a system requirement. Franchisees may be liable for claims by disabled customers as the

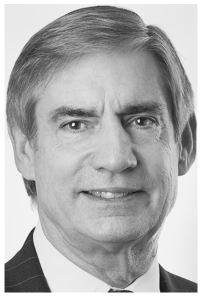
125. Press Release, Nat'l Fed'n of the Blind, AG Healey and National Federation of the Blind Announce Agreement to Make Health Care Kiosks Accessible to Blind Consumers (July 27, 2016), *available at* https://nfb.org/ag-healey-and-national-federation-blind-announce-agreement-make-health-care-kiosks-accessible-blind.

owner and operator of the business establishment, especially when the majority of franchise agreements shift the burden of ADA-compliance to the franchisee.

Ensuring that customer-facing EIT is accessible to individuals with disabilities requires commitment, awareness, and resources, but there are benefits, not the least of which are happier customers and fewer lawsuits.

A Proposed Mandatory Summary Franchise Disclosure Document: A Solution in Search of a Problem

Carl E. Zwisler, John J. McNutt, and Frank J. Sciremammano



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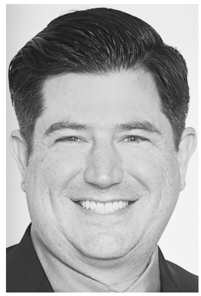

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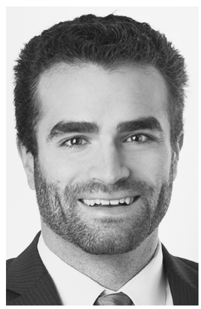

Mr. Sciremammano

In the Spring 2016 volume of the *Franchise Law Journal*, Eric Karp and Ari Stern published "A Proposal for a Mandatory Summary Franchise Disclosure Document."[1] Although the title would suggest it is a "modest proposal," it is anything but modest. Karp/Stern spend about one half of their article summarizing surveys, government reports, and articles that purport to identify problems in franchising that are not addressed in the current FTC disclosure requirements. They explain the rationale for the use of a Summary Disclosure approved for use in meeting Securities Exchange Commission (SEC) requirements for the offer of mutual funds. Then they leap to the conclusion that dramatic changes in Franchise Disclosure Document (FDD) disclosures must be made to correct the problems. They would do this by requiring franchisors to prepare a Summary FDD and by adding to the existing FDD. Both documents would be delivered to prospective franchisees. Although they claim that the current FDD format fails to achieve its objectives, neither their rationale nor the research they cite to support it can withstand scrutiny.[2]

In reality, the purported "Summary Franchise Disclosure Document," or SFDD, is not a summary of the FDD. Rather, Karp/Stern argue for five

1. Eric H. Karp & Ari N. Stern, *A Proposal for a Mandatory Summary Franchise Disclosure Document*, 35 Franchise L.J. 541 (2016).
2. *Id.* at 541–49.

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pages of tables[3] that are comprised of many entirely new disclosure requirements, and twelve entirely new disclosures that would be incorporated into the current FDD. They would prohibit footnotes or explanations in the Summary. They would require financial performance representations (FPRs) without providing any justification for changing the well-reasoned decision of the FTC in 2007 not to require this information.[4] They would require disclosures of FPRs about franchisees' first-year experiences. Because the Summary Tables they would require lack footnotes or explanations, the Summary Tables would not even satisfy the FTC's standards for online advertising.[5] Because most of the new disclosures would focus on franchisees' first-year of operation, new franchisors and many other franchisors that cannot collect the information would apparently not be able to offer franchises.

Karp/Stern explain that their proposal is designed to "spark a spirited debate and lead to the adoption of a Summary Disclosure Document as a part of the next generation of the FTC Franchise Rule."[6] Although their article may do the former, it neither establishes any plausible basis for developing a mandatory SFDD nor does it identify new information that is needed to fulfill the legitimate goals of franchise disclosure.

If adopted, the Karp/Stern proposal would require franchisors to expend thousands of additional dollars to try to collect and disseminate information that is likely to mislead prospective franchisees. Moreover, the Karp/Stern SFDD would not address the "problems" they have identified. Their proposal is a solution in search of a problem.

The following is a response to Karp/Stern's proposal. It is organized in three main sections. First, it examines the purported problems that allegedly require a change in the current disclosure standards. Second, it examines the merits of the proposal itself, and finally, it discusses the evolution of the franchise sales process over the decades, and why adding to the FDD makes little sense today.

3. Karp/Stern insist that all of the disclosures they require can and must be limited to five pages. By forcing disclosures into that format, they would eliminate footnotes, clarifications, and explanations of information that are necessary to assure that the disclosures are not misleading. Their focus on brevity also causes them to overlook the many variations in a franchise that may be offered in a single FDD. In an FDD that offers an area development franchise and a unit franchise, which permits conversions as well as start-up franchises, offers different fees for purchasers of multiple franchises, and shows different costs for different types of franchised locations, etc., it would be impossible to make the disclosures in five pages. If only the variations described in the preceding sentence were the subject of additional tables, the Summary would likely cover twenty or more pages.

4. *See* FTC Franchise Rule Statement of Basis and Purpose, 72 Fed. Reg. 15,497–98 (Mar. 30, 2007).

5. Federal Trade Commission, *.com Disclosures: How to Make Effective Disclosures in Digital Advertising*, at 10 (Mar. 2013), https://www.ftc.gov/tips-advice/business-center/guidance/com-disclosures-how-make-effective-disclosures-digital (last visited Dec. 16, 2016).

6. Karp & Stern, *supra* note 1, at 556.

I. A Change In Franchise Disclosure Is Not Necessary

Karp/Stern set forth several arguments for a change in existing franchise disclosure laws:

(1) The FDD has grown greatly in length and complexity.[7]

(2) There has been a "material and marked increase in the sheer amount of information contained in a typical FDD."[8]

(3) Franchising is a particularly risky venture.[9]

(4) Potential franchisees may not fully understand the contents of FDDs.[10]

(5) Potential franchisees have difficulty making well-informed decisions.[11]

(6) "Potential franchisees, by virtue of that lack of knowledge, experience, and business insight, tend to avoid the 'difficult work' of digesting an FDD and engaging in other investigative activities."[12]

(7) The Securities and Exchange Commission (SEC) developed a Summary Disclosure for use in the offer of mutual funds.

Essentially, the authors argue that because FDDs contain a lot of information, prospective franchisees either do not read all of the information they are given, do not use the disclosure tools they are given, or do not know how to use the information they obtain in making decisions about investing in a franchised business.

The authors present no cogent arguments for making wholesale changes to the current FDD. They fail to explain how any of the problems that they cite are not already addressed by current FDDs. Although they suggest,

7. Notably, Karp/Stern argue this is for the benefit of franchisors because additional disclosures protect franchisors from franchisees' claims. *Id.* at 543. Arguments for and against modifying and adding to disclosures and the rationales for adopting the current rules language are detailed in the Statement of Basis and Purpose. Statement of Basis and Purpose, 72 Fed. Reg. 15,444 (Mar. 30, 2007). The notion that FDDs have expanded and evolved to serve only the franchisor's interests is simply not true. Franchisee advocates and regulators, in addition to franchisors, have added disclosures to address perceived inadequacies in previous disclosures and to address concerns that have arisen through litigation and the regulatory process.

Although members of the franchisee bar argue that increasing detail in FDD requirements is designed to protect franchisors rather than to protect franchisees from fraud and misrepresentation, franchisors' counsel often see each additional requirement as an additional "gottcha" designed to give franchisees' counsel additional weapons to extricate franchisees from unsuccessful businesses that failed through no fault of their franchisors.

Well-intentioned disclosure advocates can frequently find something else to add to or clarify existing disclosures. Their assumption is that some prospective franchisees will not understand the current disclosures or would benefit from some elaboration on the current disclosure. *See* Statement of Basis and Purpose, 72 Fed. Reg. 15,444 (Mar. 30, 2007); NASAA, *Multi-Unit Commentary* (Sept. 16, 2014), http://www.nasaa.org/wp-content/uploads/2011/08/Franchise-Multi-Unit-Commentary-effective-Adopted-Sept.-16-2014.pdf (last visited Dec. 16, 2016).

8. Karp & Stern, *supra* note 1, at 543.

9. *Id.* at 547.

10. *Id.* at 548.

11. *Id.*

12. *Id.* at 549.

without expressly stating, that it would be nice if prospective franchisees had access to more information about the first-year performance of franchisees, and that FDD Item 20 disclosures should cover the previous five years, rather than for the previous three years that have been required since 1975, they do not explain how that prevents fraud. Nor do they make plausible arguments that franchisors are able to engage in fraud and deception under the current FDD requirements. Fraud and deception remain actionable without a rewrite of the FDD.

The FDD, as currently prescribed, is large, and costly to prepare. Reading it requires time and patience. Understanding parts of it often requires the help of an adviser. Not all prospective franchisees read or understand the entirety of the FDD, and not all prospective franchisees retain lawyers or consultants or follow their advice about a particular franchise investment.[13]

Most advocates of new regulations present evidence that certain problems cry out for a remedy, because the existing law does not provide an effective remedy. Karp/Stern argue that franchisees could not possibly understand what is in FDDs because many of them have invested in some franchise systems with high SBA loan default rates. They further argue that "turnover" rates in franchising are very high. How could franchisees really understand what they are getting into if they buy franchises in the face of these "facts"?[14]

If one assumes that high turnover and/or high SBA loan default rates are an issue, putting aside the complaints that would be evident on the Internet, a compliant FDD would provide ample evidence of the problems. FDDs are designed as a starting place for further investigation. High SBA loan default rates and franchisee turnover rates are addressed in the Tables of Item 20, and to a certain extent, in Item 3 of FDDs if the defaults have resulted in litigation. Item 20 also requires contact information for all franchisees that have ended their franchise relationship for any reason during the previous year to be disclosed. If a prospective franchisee is not concerned by a fully disclosed high turnover rate of franchisees, additional redundant disclosure will be of little value.

A curious prospective franchisee can find access to all kinds of information about franchises they are considering, how to evaluate a franchise and how to find lawyers and other advisers to help them to understand FDDs and franchise agreements and to help them to negotiate franchise agreements. If they are willing to take risk and invest in a franchise in spite of obvious high turnover, more disclosures are unlikely to change that.

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13. However, prospective franchisees have access to more information about the issues associated with getting into business than anyone who is considering starting a business on his/her own.

14. *See* Part IV (pages 470–71), in which the "facts" are analyzed.

Analysis of the Claims

II. The FDD Has Grown Greatly in Length and Complexity; There Has Been a Material and Marked Increase in the Sheer Amount of Information Contained in a Typical FDD

Notwithstanding the efforts of NASAA and the FTC to eliminate legalese and require many disclosures in tabular form, FDDs are long and require patience to read. However, they are not typically 500–1,000 pages, or more, as Karp/Stern suggest. The significance of some disclosures may be lost on lay readers—especially those who have not managed or owned a business or who have not been involved in franchising. But one does not correct the problem by substantially adding more information to FDDs.[15]

III. Franchising Is a Particularly Risky Venture

Karp/Stern cite the 2013 study of the U.S. Small Business Administration (SBA) franchise loan defaults conducted by the SBA's Office of Inspector General that concluded that three franchise systems had received a total of more than 1,000 franchise loans between 2002 and 2009 (the last two years of which were during the Great Recession) and that 501 of them defaulted.[16] The authors cite to no evidence of fraud or of disclosure law violations by the three franchisors. Presumably, each of the three franchisors made all of the requisite disclosures, but people continued to invest in the franchises in spite of the disclosures and what they otherwise learned through their due diligence. Presumably, all investors thought that their chances of success were better than 50-50. Karp/Stern do not explain why obvious problems in those three franchise organizations were not understood by most prospective franchisees who read FDDs and talked with existing and former franchisees. The role of a franchise disclosure regime is to provide disclosures; it is not to prohibit prospective franchisees from making an investment in a franchise after they become aware of its risks.

Karp/Stern also cite a 2013 GAO report dealing with SBA franchisee loan defaults.[17] It concluded that over eleven years (2000-2011), fifty-four lenders made 170 loans to franchisees, seventy-four of which resulted in defaults.[18] The investigators found that only four of the fifty-four lenders initiated 74 percent of the defaulting loans and that a single loan broker (who was sus-

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15. The answer to the problem is education and advice from experienced franchise lawyers about the contents of the FDD.

16. Small Business Administration, Audit Evaluation Report 13-17: The SBA's Portfolio Risk Management Program Can be Strengthened 3,7 (2013).

17. Karp/Stern, *supra* note 1, at 547.

18. U.S. Gov't Accountability Office, Small Bus. Admin., Review of 7(a) Guaranteed Loans to Select Franchisees 8 (Sept. 2013), http://www.gao.gov/assets/660/657723.pdf (last visited on Dec. 14, 2016).

pended from processing SBA loans) was involved in a majority of those defaults.[19] She allegedly falsified first-year performance figures that franchisees used in their loan applications.[20]

Karp/Stern would argue that if the franchisees had seen the information about first-year performance in their Summary FDDs, they would not have relied on information from the loan agent. However, had the franchisees talked with existing franchisees, they could have easily learned about the extensive problems the GAO study reports. But, without talking with franchisees, those prospective franchisees would have compared the inherently misleading[21] Summary Table numbers with what the loan agent purportedly said and, for reasons described below, would have had little idea about whether her numbers were accurate.

Karp/Stern's assertions regarding turnover statistics are misleading and unsupported by credible evidence.[22] They cite a study that purportedly demonstrates a very high failure rate for new franchisees that is no longer even available for review.[23] Highlights of the study were quoted in articles in Bloomberg[24] and Blue MauMau[25] as well as by Karp/Stern. However, the study is not available on-line, or by request from the company that conducted it.

IV. Potential Franchisees Fail to Read or Understand FDDs, Retain Advisers, or Have the Background to Make Well-Informed Decisions

One of Karp/Stern's principal justifications of the creation of a SFDD is that franchisees do not read and understand current FDDs.

Karp/Stern cite several studies to support their thesis, including a "2014 Franchise Grade Expert Survey" in which respondents, who were purportedly franchising experts, overwhelmingly reported believing that potential franchisees "sometimes, rarely, or never understood the FDD that they were given."[26]

19. *Id.* at 8, n.21.

20. *Id.* at 13–14.

21. *See* discussion of the Tables in Part VII (pages 474–84).

22. The study and its conclusions were published in 2014 and widely criticized for suggesting that franchise transfers, nonrenewals, and reacquisitions are generally symptomatic of franchise failures. John Reynolds, *From IFA FranBlog: A Closer Look into Bloomberg's: "Many Franchises Get Nothing for Their Investment*," Nov. 12, 2014, http://www.ifafranblog.com/a-closer-look-into-bloombergs-many-franchisees-get-nothing-for-their-investment-2/) (last visited Dec. 16, 2016)

23. The authors contacted FranchiseGrade.com requesting a copy of the research report but were told that the report is not available.

24. Patrick Clark, *Many Franchisees Get Nothing for Their Investment*, BLOOMBERG, Oct. 17, 2014, https://www.bloomberg.com/news/articles/2014-10-17/franchise-buyers-often-get-nothing-for-their-upfront-investment (last visited on Dec. 14, 2016).

25. Don Sniegowski, *U.S. Franchise Unit Turnover Rate is 122 Percent*, BLUE MAUMAU, Oct. 16, 2014, http://www.bluemaumau.org/14162/us_franchise_turnover_rate_122_percent) (last visited on Dec. 14, 2016).

26. Karp & Stern, *supra* note 1, at 548–49. This is actually a January 2015 survey. Karp/Stern have taken a "half-empty" approach to summarizing the respondents' opinions. They could have

The report is based upon "158 respondents representing the cross section of franchisees, franchisors, franchisor, and franchisee attorneys and franchise consultants."[27] Twenty-two percent of the respondents were actually franchisees.

Also in 2015, FranchiseGrade.com asked 1,122 franchisees the same question: whether they had read and understood the FDDs they had received. When speaking for themselves, seventy-two percent of respondents reported having a clear understanding of the obligations and commitments within the franchise agreements; eighty-two percent reported having read through the FDD and franchise agreement; and seventy-six percent reported that they had consulted with an attorney, accountant, or franchise consultant to help them to evaluate the franchise they were considering investing in.[28]

Even the twenty-year old study by Kimberly Morrison that Karp/Stern discuss at page 549 of the article, found that (1) most franchisees (58 percent) had business experience related to the franchise when they acquired it, (2) twenty percent had been business owners, and (3) thirty-five percent of them had "consulted" a UFOC before making an investment.[29] That same study reported that forty-nine percent had consulted a lawyer, forty-two percent had talked to an accountant, and seventy-five percent had spoken with current franchisees.[30]

No survey cited by the authors mentions how many prospective franchisees reviewed FDDs, franchise agreements, etc. and then decided not to invest in a franchise. It is possible that unfavorable information in FDDs has persuaded thousands of prospective franchisees not to pursue a franchise investment or has led some portion of them to shift their interest to a different franchise.[31] Until the data collected identifies the impact of FDD disclosure on the universe of prospective franchise purchasers, one should not extrapolate conclusions about the inadequacies of franchise disclosure laws from a few cases in which franchisees chose to invest and suffered losses in spite of presumably compliant disclosures. The limited data Karp/Stern rely upon cannot be a sound basis for radical changes in the existing disclosure regime.

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reported that 53 percent of respondents always, often, or sometimes understood the FDD they were given.

27. *2015 Franchise Grade Franchise Expert Survey*, FranchiseGrade.com 1 (Jan. 2015), http://www.franchisegrade.com/wp-content/uploads/2014/12/Franchise-Expert-Survey.pdf.

28. *National Survey of Franchisees 2015: An Analysis of National Survey Results*, FRANCHISEGRADE.COM, at 12 (2015).

29. Kimberly A. Morrison, *An Empirical Test of a Model of Franchisee Job Satisfaction*, 34 J. SMALL BUS. MGMT. 27, 31 (1996).

30. *Id.*

31. Franchise marketing professionals seem to agree that once a person has completed a form expressing an interest in acquiring a franchise, only one out of 100 to 150 will actually become a franchise of that brand. Although we have found no research to support this hypothesis, it is plausible to conclude that as many as 99 to 100 of prospective franchisees do not buy a franchise because of what they have learned in an FDD or from another source during their investigation of the franchise.

V. FDD Requirements of Additional Disclosures and More Comprehensive Explanations Have Been Added to Protect Franchisees from Misunderstandings

Karp/Stern grossly exaggerate the risk profile of a franchise investment. First and foremost, virtually all franchised businesses are financed through institutions that have developed expertise in evaluating the risks presented by lending to new businesses and many lenders specialize in lending to franchisees. Many lenders use the services of companies such as FRANdata or Boefly to obtain information that is not or cannot be included in FDDs to evaluate the soundness of a franchise brand and the creditworthiness of individual franchisees. As professional lenders who place their assets at risk when making a franchise loan, they are a good source of evaluating risk factors that may escape the attention of first time prospective franchisees.

In addition to the oversight provided by lenders that focus on franchising, the SBA is involved in assessing risk for potential franchisees because the SBA guarantees loans to thousands of franchisees each year. Following some well-publicized franchise lending losses[32] authored by the SBA inspector general and the GAO, the SBA has strengthened its risk management programs for franchise lending.

VI. The SEC Has Adopted a Summary Disclosure for Use and Offering of Mutual Funds

The fact that one of many disclosure regulations administered by the SEC now involves use of a Summary Disclosure document is not a reason to add a summary to FDDs.

32. *See* U.S. Small Bus. Admin., Office of Inspector Gen., The SBA's Portfolio Risk Management Program Can Be Strengthened (July 2, 2013); Review of 7(A) Guaranteed Loans to Select Franchisees, *supra* note 17. Karp/Stern rely heavily on the SBA data to infer that franchising is an overly risky venture. However, the SBA's default rate is not an accurate assessment of the typical franchisee risk profile. Not all franchisees receive loans guaranteed by the SBA, and the more sophisticated and well-established franchisees do not use SBA loans at all. So their financial results, which are likely better than the less sophisticated franchisees, are not captured by SBA default data. Additionally, to the extent Karp/Stern cite the general figures on page 1 of the GAO report, which purport to show generally applicable default rates on SBA guaranteed loans to franchised businesses, they fail to include important information regarding the accuracy of those figures in the GAO report. Specifically, the report states that the $1.5 billion figure, purportedly reflecting SBA payments made to honor SBA's guaranty on defaulted franchise loans, "does not include loan recoveries, and, therefore, losses may be less." Review of 7(A) Guaranteed Loans to Select Franchisees, *supra* note 18, at 1, n.1. Additionally, the GAO report states that the 32,323 figure, purportedly representing the total number of loans the SBA made to franchised businesses, only "reflected loans that lenders self-identified as SBA-guaranteed franchise loans"; thus, "the number may not reflect all franchise loans guaranteed by SBA." *Id.* Accordingly, the default rate and the losses resulting therefrom are likely less than the figures the Karp/Stern cite.

Karp/Stern cite a law review note, written by Sarah Zimmer, that explains the SEC's summary prospectus rule.[33] However, the note does not support the Karp/Stern thesis that their SFDD would be beneficial. Rather, Zimmer concludes that the SEC's summary prospectus rule "sends a mixed message to investors regarding whether or not they can rely solely on the summary prospectus when making an investment decision" and thus further complicates (rather than simplifies) the disclosure process.[34] Zimmer explains:

> In order for a disclosure system to be effective, not only must the information . . . be disclosed completely, clearly, and accurately, but it must also be read and comprehended by the consumer." The current disclosure regime is overly complex and ineffective, yet "[s]ecurities regulation is motivated by the assumption that more information is better than less." The philosophy behind the new rule—improving disclosure by providing investors with a streamlined disclosure piece—appears to take aim at this critique; *yet merely adding another layer of disclosure is not the proper solution. Investors should either be able to rely on the summary prospectus to make an investment decision or the length of the statutory prospectus should be significantly reduced so that it is the only disclosure document provided to investors. Parceling the disclosure process into a series of "layers" does not meaningfully streamline disclosure; in fact, it arguably generates confusion on the part of investors who do not know what information to rely on when making an investment decision.*[35] (emphasis added)

The same argument applies to the proposed SFDD. The SFDD would confuse the disclosure process and potentially induce a prospective franchise investor to rely on the Summary Tables rather than delve into the details and explanations of the FDD itself. This has the potential to lead to increased franchise litigation under the theory that the franchisor buried material information in the FDD rather than included it in the Summary.

Indeed, there are several distinguishing factors between an investment in a mutual fund and a franchise concept. For one, mutual fund investment opportunities are far more abundant than franchise investment opportunities. The Zimmer note states that "mutual funds represent the country's primary investment vehicle" with "over 8,000 funds to choose from" and "virtually every other household in the United States" having invested in them.[36] Accordingly, the summary prospectus rule was "tailored to the unique needs of mutual fund investors," namely, to assist the general public in screening more than 8,000 potential investment opportunities.[37] Unlike making *passive* investments in mutual funds (which tens of millions of Americans have done), investments in franchised businesses are orders of magnitude less common, both in the raw number of actual investors and the raw number

33. Karp & Stern, *supra* note 1, at 550 (citing Sarah B. Zimmer, *Note: Securities and Exchange Commission's Enhanced Disclosure and New Prospectus Delivery Option for Registered Mutual Funds*, 83 St. John's L. Rev. 1431 (2010).

34. Zimmer, *supra* note 33, at 1458.

35. *Id.* at 1459.

36. *Id.* at 1432.

37. *Id.* at 1441.

of potential investment opportunities. Mutual funds tend to be highly liquid; franchise investments are not. Franchise investments typically involve the commitment of a substantial portion of a franchisee's resources. Investors usually invest in several mutual funds. Accordingly, different policy considerations are at play. For instance, prospective franchisees are more likely to conduct much more substantial due diligence or franchise business than they would with a mutual fund. Indeed, the unique problems that the summary prospectus rule aimed to solve are not as prevalent in the franchise context.

To the extent that Karp/Stern suggest that the FTC could use the SEC's administrative record in promulgating the SFDD, they overlook a problem: the required disclosures in the SEC's Summary prospectus were implemented after the SEC studied what information is material to making an investment decision in a mutual fund.[38] Karp/Stern cite no similar study or compelling evidence that would warrant the time and expense of a study in the franchise context.

VII. The Proposed Summary Tables Are Misleading

Even if evidence existed that could support the mandatory use of SFDDs, the Karp/Stern proposal must be rejected because the proposed SFDD would be misleading to franchisees. Franchisors would be compelled to collect substantial new information to prepare the Summary and the expanded FDD. That new information would then need to be clarified and explained in the body of the FDD.

Karp/Stern propose many new disclosures, most of which would be made in Summary Disclosure Tables. Karp/Stern must believe that these new disclosures are "more material" than all other disclosures because these disclosures would consume the first five FDD pages. If we accept Karp/Stern's argument, that prospective franchisees already do not read a complete FDD because of its length, we must also assume that they will read even less of the full FDD if it is delivered with a Summary FDD. We will explore the problems with the Karp/Stern Summary Tables in more detail in the pages that follow.

Summaries of FDDs, like risk factor disclosures, focus the reader's attention on select information that someone thinks is more material or important than other FDD disclosures. Just as business executives often request an executive summary so they do not need to read an entire report, prospective franchisees who are given a Summary should be expected to only read "the important stuff" that is included in a Summary.

Is the information Karp/Stern include in their Summary Tables, most of which is not included in current FDDs, more important that other disclosures? We don't think so.

Section 12 of Karp/Stern's proposed instructions state, "No disclosure made in the Summary Disclosure Document shall contradict or vary from

38. *Id.* at 1442.

the same or similar disclosure in the disclosure document." As we demonstrate below, to avoid misleading prospects, the FDD disclosures *must* vary from the Summary Disclosures and will, in many ways, contradict many of the impressions that arise from use of the Karp/Stern's summary format.

A. *Proposed Disclosure No. 1*

Karp/Stern propose that franchisors disclose: "The identity of the principal owner of the franchisor."[39] They explain that this requirement is intended to require disclosure of "the ultimate principal owner or owners of the franchisor."[40] The disclosures would include addresses for all owners. But how would this information prevent fraud or aid in making a decision about whether to invest in a franchise? Information about parent companies, holding companies, predecessors, affiliates, officers, directors, and those with management responsibility for fulfilling the franchisor's duties to franchisees is already disclosed. Audited financial statements often provide additional information about the ownership structure of the franchise.

Who would be considered a "principal owner" of the franchise? Does that include a person or company with a ten percent equitable interest? A secured creditor or someone with the right to convert debt to equity under certain conditions? A person who may exercise "control" over the franchisor? Individual shareholders of a parent company of a franchisor? General partners of a private equity firm that hold a controlling interest in a franchisor? Partners in an entity that own more than fifty percent of a franchisor's parent?

What will a prospective franchisee do with this information? And how can franchisors keep this information current given the number of franchisors that have public ownership or are owned by funds with ownership structures that often change.

If the franchise agreement is between the franchisor and the franchisee, why is this information critical to a franchise investment decision? How many franchisees have ever successfully claimed that the absence of this information resulted in fraud, misrepresentation, or business failure?

B. *Proposed Disclosure No. 2*

Karp/Stern propose the following disclosure: "Identification of the principal competitors of the products and services offered by franchise system."[41] Although this added disclosure about competition may seem harmless, the subject is fraught with potential disputes about its scope. For example, would the franchisor be required to disclose information about global, national, regional, statewide, or only local competitors? And what is a competitor?

If it is a retail franchise, must the franchisor disclose the existence of Amazon and other online retailers? If the franchise is for a shoe store in a shop-

39. Karp & Stern, *supra* note 1, at 553.
40. *Id.* at 565.
41. *Id.*at 553.

ping mall, must the franchisor identify the five closest shoe stores in the mall or every business that sells shoes of any kind in the mall? If the franchise is for a pizza delivery business, must the franchisor disclose the five largest pizza delivery *franchises* in the area where the franchisee is considering establishing his business or the five largest pizza delivery *businesses* in the area? Must the franchisor disclose all pizza restaurants, even if they do not directly offer delivery, but merely provide in-house dining and pickup? Does the answer differ if an independent restaurant delivery service, e.g., Uber, makes deliveries to customers? Are take-and-bake pizza stores, such as Papa Murphy's, competitors? Are all other restaurants competitors if any of those restaurants serve pizza on the menu? How about grocery stores and convenience stores? Aren't all other purveyors of food "competitors"?

Is the purpose to disclose the identity of competing franchise systems or competition the franchisee will face? Disclosing competing franchise chains seems unnecessary. How many franchisees are ignorant of the competitors in a particular industry? Anyone can perform a basic Internet search for "pizza franchises" and find that information. If the purpose is to make the franchisor perform market research in each market to learn what a local prospective franchisee could learn on its own, that is nothing but a waste of time and resources. Franchisors would be expected to pass those costs on to franchisees.

Would a new disclosure be required for each locality or state? And how often must the franchisor investigate this information? Why should obtaining this disclosure be the franchisor's burden?

C. *Proposed Disclosure No. 3*

Karp/Stern propose the following disclosure: "Median initial investment over the first twelve months of operation."[42] This result would be a misleading metric. Before the 1993 revision to the UFOC Guidelines, NASAA developed the "additional funds-initial period" disclosure in the format that has been adopted by the FTC Rule.[43] The NASAA committee decided not to use the term "working capital" or to clearly define the disclosure that it wanted.[44] The committee was concerned that this information would become an "earnings claim." NASAA also recognized that those numbers could vary greatly from franchisee to franchisee.[45] NASAA's logic continues to make sense.

How would a "median initial investment" be calculated? For all franchisees that completed one year of operation during the previous fiscal year? For all franchisees in the system over a longer period? For all franchisees with a similar type of unit? Would this apply only to new start-up franchises? To transfers? Conversions? What if the investment varies widely among

42. *Id.*
43. Brett Lowell, Judith Bailey, Martin Cordell, Susan Grueneberg, Stephen W. Maxey & Dennis E. Wieczorek, *Catching the Next Wave: The New UFOC—Ready or Not, Here It Is*, 17th Annual ABA Forum on Franchising, at 33–35 (1994).
44. *Id.*
45. *Id.*

franchisees? For example, there could be a franchisee with a seventy-five-room hotel in a small town. The initial investment would be small compared to a franchisee with a 275-room hotel in the central business district of a major metropolis. Any averaging of the finances of those two franchisees would be misleading because they are operating in radically different markets. And how would this information help area representatives or master franchises that have acquired different size territories in different states?

This disclosure would require franchisees to report their investment information and subject their franchisees to termination for non-compliance if they did not deliver reliable information. Many franchisors have not required franchisees to report this and other information that Karp/Stern want to have included in an SFDD. To effectuate the requirement, a federal law requiring franchisees to make timely and accurate reports of this information would be required.

When franchisors modify the franchise offering and the initial investment changes, historical information can be inherently misleading. For example, if building and equipment expenses increase by twenty percent when the new model of a restaurant is used, the historical median initial investment is irrelevant to a franchisee investing in the franchise that is now being offered. However, Karp/Stern would not allow explanations in their Summary Tables.

If part of the purpose of the disclosures is to enable prospects to compare franchise offerings, standard definitions will be required to make that possible. For example, if Franchisee *A* leases its premises and equipment and Franchisee *B* purchases these items for cash, are their respective "initial" investments identical? *A* will likely be paying more over the term of the franchise than *B* because of the financing costs, but the initial "cash" investment for *A* is much lower than it is for *B*.

D. *Proposed Disclosure No. 4*

Karp/Stern propose the following disclosure: "The length of time that the typical franchised business takes to achieve breakeven status."[46] This would constitute another misleading metric. What is a "typical" franchised business? Over what period of time is the disclosure to be measured? All new franchisees during the last twelve months?

How can franchisors report this information unless they have a contractual right to collect it and actually do collect it from franchisees in usable form? How is this statement meaningful if one does not know the investment made, the amount financed, financing costs, rent and labor expenses, etc.?

Although franchisors would be required to collect information regarding the length of time that the typical franchised business takes to achieve breakeven status,[47] we are unaware of franchisors that collect or disclose such information. Moreover, even if this data is collected, if income equals or

46. Karp & Stern, *supra* note 1, at 553.
47. *Id.*

exceeds expenses in one month, but does not for the next two months, when has the franchisee achieved "breakeven status"? Is this requirement to apply to all new franchisees during the last twelve months? If a franchisee closes its business before breaking even, when finding a median date, what would a franchisor average with the other numbers?

Breakeven times vary presumably within a franchise system. For example, which standard is appropriate for this disclosure if Franchise *A* and Franchise *B* generate the same income, Franchisee *A* takes no money out of the business unless cash flow permits it, Franchisee *B* takes money out on a monthly basis, and Franchisee *C* accrues an imputed salary each month? Whatever number a franchisor would need to disclose would be inherently misleading without a significant explanation. And if prospective franchisees are supposed to be able to use the SFDDs to quickly compare competing franchise offerings, absent consistent disclosure standards, they would never be able to do that using the Karp/Stern formula.

E. *Proposed Disclosure No. 5*

Karp/Stern propose the following disclosure: "Median gross revenue of all franchised outlets during the first twelve months of operation."[48] This would constitute another misleading metric. Over what period of time is this measured? Would it include all franchisees that completed one year of operation during the previous fiscal year? Are gross revenues of all types of franchises offered by the franchisor in its FDD aggregated to compile the data? Are conversions and startup numbers averaged? If a car rental franchisee has one franchise with fifty cars and another franchisee has a 300-car fleet, how is the median number helpful?

F. *Proposed Disclosure No. 6*

Karp/Stern propose the following disclosure: "The percentage increase or decrease in same-store sales on a year-over-year basis."[49] This would constitute another misleading metric. How is this to be calculated? Using median store sales in operation for a full year at the end of each of the previous five fiscal years? May stores not open for a full year be eliminated from this calculation?

How would this work when franchisees do not operate "stores," but rather provide services in territories? If one franchisee operates from an office in a territory with a population of 100,000 people, and a second franchisee operates from an office in one territory with a population of 100,000 people, but sells services in another territory it has purchased from the same office and also serves some customers in vacant territory, are the two franchisees treated the same for purposes of this calculation? If some franchisees have invested in facilities personnel and equipment to add a business line, e.g., one restaurant now offers breakfast and others do not, the figures will be confusing and misleading.

48. *Id.*
49. *Id.*

G. *Proposed Disclosure No. 7*

Karp/Stern propose the following disclosure: "Working capital required over the first twelve months of operation."[50] This would constitute another misleading metric. Does this apply only to start-up franchises? Are different types of franchises combined, e.g., conversions, kiosks, storefronts, area development franchises? How is this helpful to a prospective franchisee if Franchisee *A* invests cash in the business, rents facilities and equipment, takes money out of the business only if a monthly cash surplus exists, and operates the smallest of three optional sizes of units in a small town, and Franchisee *B* borrows eighty percent of the investment at fourteen percent interest, payable over five years, purchases the building used for the business that is the largest of the three footprints allowed by the franchisor, operates in a major urban area, pays himself a salary, and leases a company car through the business? Or, one retail franchisee opens November 1 and has ramped up for the end of year holiday selling season, and a second retail franchisee opens in February? Is working capital defined as what franchisees conclude they spent to pay expenses of their business that exceeded revenue?

H. *Proposed Disclosure No. 8*

Karp/Stern propose the following new rule: "A prohibition on the use of the word 'renewal' unless the franchisee is permitted to continue the franchise relationship on the same terms and conditions." This rule is unnecessary and seems to be a way of creating a right to "extend" a franchise agreement when no such right is contained in the franchise agreement. The 2007 NASAA Guidelines already contain a risk factor disclosure addressing this issue.[51] Why is a restriction on use of the term "renewal" better than an explanation of what "renewal" means, a direction to the "renewal" language in a franchise agreement, or the presence of a risk factor on the FDD cover page? The concept of "renewal" is embedded in franchise relationship laws and in the FDD. Karp/Stern would require a significant change in the lexicon of franchising for no clear reason. FDD changes that would be required would include language of Items 6, 8, 11 and 17. Item 17 uses "renewal" in its title and for specific disclosures. Item 6 requires disclosure of renewal fees in other fees. Items 8 and 11 refer to "renewal." Many franchise agreements use the term "renewal" and require payment of a "renewal" fee as a condition of exercising a renewal right.

I. *Proposed Disclosure No. 9*

Karp/Stern propose the following new requirements: "Specific risk-based disclosures concerning the supply chain, territory, minimum royalties or

50. *Id.*

51. NASAA, Instructions for Filing a Uniform Franchise Registration Application Using the "New FTC Franchise Rule" After July 1, 2007, at 3, http://www.nasaa.org/wp-content/uploads/2011/08/Franchise_Interim_State_Guidelines.pdf (last visited on Dec. 14, 2016). It appears from the sample Summary Tables that Karp/Stern would discard the risk factors now commonly required by the NASAA Guidelines. *See* Karp & Stern, *supra* note 1, at 557–63.

minimum gross sales, pricing restrictions, the presence or absence of limits on additional investment required by franchisees, and any requirements for personal guarantees by spouses or other persons."

Karp/Stern seek to further highlight issues for franchisees by proposing that risk based disclosures be disclosed "to the extent contained in the applicable provisions of the franchise agreement." This is a further example of their conclusion that some disclosures are more important than others and deserve prominence. However, as noted in the Franchisegrade.com Experts Study, different categories of "experts," i.e., franchisors, franchisees, franchisor lawyers, franchisee lawyers, and consultants, have different opinions about which issues are or should be the most important to a franchisee's investment decision.[52] The Summary Tables and the addition of six risk factors presume that prospective franchisees are not smart enough to read, digest, and determine the importance of the FDD disclosures that have evolved over the last forty-six years. Identifying some issues as more important than others and focusing prospective franchisees' attention on them is a disservice to those who may assume that the "risks" associated with all of the FDD disclosures is less significant.

It would be more accurate to describe the so-called "risk-based disclosures" as "advice." Lawyers, consultants, books, and guides provide advice about how to read an FDD and a franchise agreement. Advice should depend upon the particular franchise and the needs of the particular franchisee prospect. Karp/Stern have not justified requiring "advice" about six aspects of a franchise investment to be included in an FDD, but not providing it about every other aspect of an FDD disclosure.[53] The original purpose of franchise disclosure laws is to prevent fraud and misrepresentation. That goal is not advanced by adding risk factors to the FDD. These requirements are unnecessary.

The instructions for the "risk-based disclosures" and our comments follow:

"Disclose the following risks to the extent contained in the applicable provision of the franchise agreement":

Supply Chain—"You must purchase all or nearly all of the inventory, equipment, or supplies that you need to operate your business from us, our affiliates, or suppliers designated by us and at prices we or the supplier set. These prices may be higher than prices you could obtain elsewhere for the same or similar goods or services."

Comment—A franchisee may be required to purchase all equipment, but no inventory from the franchisor and the impact of the purchases may be very different. In

52. *See 2015 Franchise Grade Franchise Expert Survey*, *supra* note 27.

53. Theresa Leets, Sawan Patel, Peggy Shanks & Phyllis Alden Truby, *Regulatory Update*, 39th Annual ABA Forum on Franchising, at 23 (2016). NASAA has convened a subcommittee of its Franchise Project Group "to identify issues that could be identified as common risk factors, and ultimately, create uniform language for those risk factors. . . . The Subcommittee believes that an issue warrants a risk factor when the FDD reveals a risk which might not be so obvious to a layperson evaluating the franchise opportunity. What is problematic is identifying which issues rise to that level, and when to require it."

some cases, the costs may be lower than the franchisee could obtain elsewhere for the same items, in which case the statement is inaccurate. Often supply agreements have been negotiated between the franchisor and a supplier and are not "set" by the franchisor or the supplier. Often franchisees purchase from cooperatives in which franchisees are driving forces in the purchase decisions. How would a franchisor respond if franchisees must purchase certain items from "approved" suppliers? How do they differ from "designated suppliers"? How is "all or nearly all" calculated? Is it based on the total number of items purchased? The relative cost of the items?

Territory—"You will not receive an exclusive territory. You will be subject to competition from us and our affiliates, possibly from other franchised or company owned outlets in close proximity to your franchised business."

Comment—FDD Item 12 disclosures and FTC FAQs 25 and 37 define "exclusive territory" in a way that is clear. Item 12 describes the type of competition a franchisee may face in considerable detail. It need not be repeated. The statement that "you will be subject to competition . . . from outlets . . . in close proximity to your franchised business" may be very misleading. Different distribution channels may not compete at all with a franchisee, and the absence of an exclusive territory does not mean that an outlet can be established in "close proximity" to a franchisee.

Minimums—"You must make minimum royalty or advertising payments regardless of your sales levels. You must maintain minimum sales performance levels. You must make inventory and supply purchases at specified minimums and/or maintain minimum inventory on hand, even if you do not need inventory at that level. Your inability to meet these minimums may result in termination of your franchise and loss of your investment."

Comment—We have not seen a franchise agreement that imposes each of the "minimums" disclosed in this risk factor, so we assume that Karp/Stern would want the appropriate "minimum" obligation disclosed in the risk factor. Regardless of how it is stated, this singles out one issue from a typical fifty-page franchise agreement as a potential cause of termination. Karp/Stern offer no evidence of franchisees not recognizing the importance of minimum requirements in franchise agreements or the need to add this risk factor to the other risk factors already required on the cover pages of the FDD. This issue is already addressed in FDD Items 12(5)(ii)(A) and 17.

Pricing—"You must comply with minimum and/or maximum prices set by us for the goods and services you sell. You must also participate in any promotional pricing established by us. These requirements may reduce your anticipated revenue and profit."

Comment—The statement that "These requirements may reduce your anticipated revenue and profit . . ." must be based on the assumption that they will.[54] *Although we are unaware of franchisors ever implementing pricing strategies that are designed to both reduce sales and profits of their franchisees, the statement suggests*

54. Any requirement of a franchise agreement "may" reduce revenues or profits.

sinister motives on the part of franchisors. Franchisors typically adopt pricing strategies to increase revenues and profits.

No Limit on Additional Investment—"There are no limits on our ability to require you to make additional capital investments in your franchise business."

Comment—The statement about "additional capital investment" would be appropriate only if there were no limits whatsoever. Presumably, Karp/Stern refer to contractual limitations, rather than to limitations that may be imposed by the covenant of good faith and fair dealing or franchise relationship laws.[55]

Financial Liability—"You and your spouse will be required to sign a document that makes both of you liable for your financial obligations under the franchise agreement, even if your spouse has no ownership interest in the business. This guarantee will place both your and your spouse's marital and personal assets, including your house, at risk if your franchise fails."

Comment—The guaranty statement may be inaccurate and inconsistent with the Equal Access to Credit Act.

J. *Proposed Disclosure No. 10*

The article proposes the following new requirements: "mandatory financial performance representations of franchised businesses in the system as to gross revenue and net profit for the immediately preceding five years, including definitions of 'gross revenue' and 'net profit.'"[56]

Mandatory FPR requirements would overturn sound decisions reached by NASAA and the FTC during the last twenty years. Many franchisors, including all franchisors with less than five years of franchising experience, would be unable to make the disclosures the authors would require and still comply with the reasonable basis requirements of Item 19 or with the proposed FPR Commentary.

K. *Proposed Disclosure No. 11*

Karp/Stern propose the following new requirements: "Disclosures concerning franchised and company-owned outlets over a five-year period, including a definition of 'company owned outlets.'"[57]

Comment—Karp/Stern provide no reason for adding two additional years of information to the FDD. It would not be helpful to prospective franchisees.

55. *See, e.g.*, Ark. Code § 4-72-206(6) (prohibiting franchisors from refusing to deal with a franchisee "in a commercially reasonable manner and in good faith"); Haw. Rev. Stat. § 482E-6(1) and (2)(G) (requiring franchisors deal with franchisees in good faith and prohibiting franchisors from imposing "any unreasonable and arbitrary standard of conduct"); Minn. Stat. § 2860.4400(G) (prohibiting franchisors from imposing on a franchisee "any standard of conduct that is unreasonable"); Neb. Rev. Stat. § 87-406(5) (prohibiting franchisors from imposing "unreasonable standards of performance upon a franchisee"); N.J. Stat. § 56:10-7(e) (prohibiting franchisors from imposing "unreasonable standards of performance upon a franchisee").

56. Karp & Stern, *supra* note 1, at 554.

57. *Id.*

L. *Proposed Disclosure No. 12*

The article proposes the following new requirements: "the turnover rate of both franchised and company-owned outlets over the preceding five years, including a definition of 'turnover rate.'"[58]

Comment—Curiously, after years of comment that led up to the development of the 2007 version of the FDD with its many Item 20 tables describing "Outlets and Franchisee Information," Karp/Stern want to shorten the tabular information and, in essence, require franchisors to calculate "rates" of "turnover" so that readers will have yet another table to review. The calculations required are reasonably easy for a franchisee to make from the current Item 20 tables, which clearly show increases or decreases from year to year in each category of information. Unlike Item 20, the Summary Tables would not include information about franchised outlets that have been "reacquired by the franchisor."

It is unclear how this table would reduce fraud or misrepresentation.

VIII. The Burdens of Additional Mandatory Disclosures Are Not Warranted Because Franchises Are No Longer Evaluated As They Were in the 1970s

The differences in the knowledge and resources available to franchisees in 2017, compared to those in 1970, are substantial. They warrant a reexamination of the way in which FDDs are used. Resources available to prospective franchisees are now so abundant that the emphasis that has been placed on making FDDs the source of virtually all material information about franchises is questionable. Adding to the FDD disclosure requirements is not warranted in the absence of evidence that the current FDD format enables fraud and misrepresentation.

To prevent fraud and abuse in the sale of franchises, state legislatures and the FTC have developed franchise disclosure regulations. FDDs provide a prospective franchisee with the material information needed to evaluate a franchise offering. They now provide information to bankers, franchise evaluation services, and franchise advisers. Franchise disclosure laws require franchisors to disclose facts in FDDs upon which prospective franchisees can rely when deciding whether to buy a franchise. FDDs provide information that can be a starting point for further investigation about a franchise when a prospective franchisee or his or her advisers conclude that more information is needed to make an investment decision.

FDDs are themselves summaries of facts that may prompt prospective franchisees to ask questions. FDDs also provide contact information for current and former franchisees so that prospective franchisees can learn about franchises from the perspective of current and former franchise owners.

58. *Id.*

FDDs are not designed to answer every question that might be important to any particular prospective franchisee; rather, they are tools designed to help prospective franchisees acquire additional information.

Although franchisors that do not properly prepare and deliver FDDs face significant sanctions, no law requires prospective franchisees to read FDDs, to try to understand them, or to retain lawyers or other advisers to alert them to risks that are disclosed in FDDs. Laws cannot compel prospective franchisees to make a franchise investment decision based upon what is in an FDD.

Franchise disclosure regulations were developed between the late 1960s, when the California Legislature enacted the California Franchise Investment Law (CFIL), and 1980, when the New York State Legislature adopted the New York Franchise Sales Law.[59] During the 1970s, the Federal Trade Commission's first Franchising Trade Regulation Rule (FTC Franchising Rule or FTC Rule) was developed.[60] These laws arose because of a general lack of understanding about franchising and stories of franchisors making claims or expressing opinions about the likely success of their franchisees or their potential for profits. During the 1970s, most Americans were generally unfamiliar with franchising as a concept; and had limited ways to learn about it, investigate franchisors and their offerings, and get access to potentially troublesome information about a franchise investment that a franchisor was not willing to reveal.[61]

IX. The Role of Franchise Disclosure Documents Has Diminished

Today, although FDDs can play an important role in a prospective franchisee's decision-making process, many factors make it less important. They include: (1) online access to all kinds of information, analysis, and comparisons of franchises; (2) online and in-person advice about how to evaluate franchise offerings; (3) the tendency of competing brands to explain relative deficiencies of competitors to franchise prospects; (4) the experience of multi-unit franchisees, which own most U.S. franchises; (5) the experience of franchise-focused lenders with franchising and individual franchise

59. Cal. Corp. Code § 31000 *et seq*. (effective Jan. 1, 1971); N.Y. Gen. Bus. Law §§ 680–695 (effective Jan. 1, 1981).

60. *See* FTC Franchising Rule, Statement of Basis and Purpose, 43 Fed. Reg. 59,621 (Dec. 21, 1978). In the mid-1970s, the Midwest Securities Commissioners Association and representatives of the franchisor community developed the Uniform Franchise Offering Circular (UFOC), which, as amended, became the U.S. standard for franchise disclosure until the amended FTC Franchise Rule became effective in 2007.

61. Author Carl Zwisler, a former general counsel to the International Franchise Association (IFA), was looking for a position in an association where he could use his legal and advocacy skills in 1975 when he answered an advertisement for a job at the IFA. Not really understanding what a "franchise" was, he turned to his dictionary, which defined a "franchise" as the right to vote. His first interview with the IFA chief of staff began with a question: "What is a franchise"? In 2016, no one who is interested in the answer would not have a general understanding of the concept as a result of fifteen minutes of Internet research.

brands; and (6) more rigorous underwriting standards promulgated by the SBA.

In the world before the widespread use of the Internet, franchise disclosure laws really helped to overcome the "informational imbalance" that the FTC referenced in its justification for the FTC Franchising Rule.[62] However, in the forty-six years since the CFIL became effective, the environment in which franchise investments are made has changed dramatically. The concept of franchising is better understood. The Internet provides prospective franchisees with virtually unlimited information that allows them to assess a potential franchise investment. Websites offer prospective franchisees many tools for use in evaluating and comparing franchise offerings. Franchise lawyers and consultants offer their advisory services. Numerous companies rate franchisors, rank franchises, and publish SBA loan default rates for franchise chains, and some websites feature gripes about various franchisors.[63] The franchise press regularly provide information about developments in franchising.

There is also an abundance of anecdotal information, reviews, and commentary from organizations that track the franchise industry. Companies such as FranchiseGrade.com, with which Eric Karp is affiliated,[64] evaluate franchise offerings and also post a checklist of questions to use in reviewing an FDD.[65] The International Franchise Association (IFA) provides a free online course titled "Franchise Basics" that reviews the content of an FDD and explains why each item in an FDD is included in the document.[66] Franchise Basics also provides guidance on how to evaluate disclosures that are made.[67]

According to recent surveys published by FRANdata, and quoted in several publications, between fifty-three percent and fifty-five percent of the franchised units in the United States are owned by multi-unit franchisees.[68]

62. FTC Franchising Rule, Statement of Basis and Purpose, 43 Fed. Reg. 59,621, at 59,625 (Dec. 21, 1978).

63. *See, e.g.*, http://www.unhappyfranchisee.com/; http://www.franchisecomplaints.org/; http://www.franchiserankings.com/; https://franchisebusinessreview.com/; *Best and Worst Franchises to Buy*, FORBES, http://www.forbes.com/best-worst-franchises-to-buy/#5c51ebcd1a03 (last visited Dec. 16, 2016).

64. Franchisegrades.com identifies Eric Karp as one of four individuals involved in the management of the company. *See* www.Franchisegrades.com/about (visited Dec. 14, 2016).

65. *See How to Analyze a Franchise System Before You Invest*, FranchiseGrade.com, https://www.franchisegrade.com/educational/article/analyze-franchise-system-invest (last visited Dec. 14, 2016).

66. www.FranchiseUniversity.org, Carl Zwisler is the author of the course.

67. *Id. See also* Dale Cantone, Eric Karp & Max Schott II, *Advanced Drafting of Financial Performance Representations: A Reasonable Basis*, 39th Annual ABA Forum on Franchising, at 36 (2016), which serves as an excellent example of advice offered to lawyers and others who advise prospective franchisees.

68. Jason Daley, *Why Multi-Unit Franchise Ownership Is Now the Norm*, ENTREPRENEUR (June 2015), https://www.entrepreneur.com/article/245881 (last visited Dec. 16, 2016); Emma Pearson, *Top Multi-Unit Franchises 2015*, FRANCHISEBUSINESSREVIEW.COM (Apr. 1, 2015), https://franchisebusinessreview.com/franchise-reports/top-multi-unit-franchises-2015/) (last visited Dec. 16, 2016). A survey of representatives of 167 franchise brands who attended the 2016 Franchise Update Franchise Leadership and Development Conference found that participants ex-

Presumably, their owners have a background with business, franchising in general, and the particular franchises in which they are investing.[69] They have much less use for FDDs when buying an additional franchise than a new franchisee.

The SBA and franchise lenders help prospective franchisors avoid problematic franchises. Besides having many resources that can be used to evaluate franchises themselves, many franchisees benefit from the due diligence performed by their lenders.[70]

If a prospective franchisee does not find an evaluation of a particular franchise on the Internet, competing franchise sales personnel will usually provide it. Franchisors regularly track what is published about them and their competitors and share comparisons with their prospective franchisees, especially when the comparisons are favorable to the franchise they are selling. In 2017, most prospective U.S. franchisees who are truly interested in a particular franchise have access to abundant information about the franchise before they see an FDD.[71]

X. Many Prospective Franchisees Make Investment Decisions Based Upon Factors Not Addressed in FDDs

According to two recent surveys, the most significant factor in a person's decision to buy a franchise is what existing franchisees say about a franchise. Many prospective franchisees will never make investment decisions based upon an FDD.

Even when prospective franchisees do report reading and understanding FDDs and franchise agreements, those documents are not the principal factor in the purchase decisions they make. For example, according to the Fran-

pected that 1,966 of the 6,536 franchised units they expected to add during 2017 would be added by their existing franchisees. Eddy Goldberg, *2017 AFDR: It's Benchmarking Time!*, Franchise Update, Issue IV, at 30 (2016) (2017 AFDR Survey).

69. Daley, *supra* note 68; Pearson, *supra* note 68.

70. Today franchisee financing remains dispersed among many banks and other organizations. FRANdata has emerged as a leading link among franchisors, the SBA, and lenders. It has been instrumental in the development of underwriting tools that are used by franchise lenders, whether they want to participate in SBA financing or just better understand the risks associated with lending to franchisees of a particular franchise brand. As a consequence of this development, the organizations that focus most on lending to franchisees have developed sophisticated systems for the evaluating franchise systems, and they make their lending decisions based upon their analysis of data that they demand from franchisors. Some of this information is not typically, or ever, included in FDDs, in part, because the franchisors could not deliver it to franchisees in a form that complies with FDD Item 19's requirements.

Ironically, financial institutions that often place more of their capital at risk in a franchised business than their franchisee-borrowers are able to receive and review financial performance information that franchise regulations will not allow franchisors to deliver to prospective franchisees.

71. Although the franchisor's advertising for franchisees is generally required to be submitted for review in a majority of states with franchise registration laws, information not released by the franchisor or its affiliates or agents is not subject to scrutiny for completeness or accuracy by state franchise examiners.

chiseGrade.com Franchise Expert Survey,[72] experts rank "independent franchisee satisfaction data" more important to prospective franchisees than whether an FDD has Item 19 disclosures, the number of SBA loan defaults in the franchise network, or the franchisor's financial statements. In fact, franchisee satisfaction (presumably existing franchisees' satisfaction with their franchise investments) was the most important factor in prospective franchisees' decision about whether to purchase a franchise. Of course, FDDs do not contain franchisee satisfaction surveys, although they provide prospects with contact information for current and former franchisees that they can use to gauge satisfaction and other issues that are important to the prospects.

According to the 2017 AFDR Survey, referrals from existing franchisees have been the second most important source of new franchisees for the surveyed franchisors.[73] Between 2011 and 2016, referrals have accounted for between twenty-seven percent and thirty-two percent.[74]

Banks that seek SBA guarantees and banks that specialize in franchise lending perform extensive due diligence on prospective franchisees and franchisors. They often collect and analyze more information on franchise systems than their franchisee clients.[75]

XI. Conclusion

The only evident beneficiaries of the Karp/Stern proposal are lawyers seeking additional grounds for suing franchisors when their clients lose money in a franchise, and lawyers for franchisors who would materially increase their billable hours in the preparation, registration, and defense of the SFDD. Compliance and defense costs would increase for franchisors without any real benefit provided to prospective franchisees. Although the authors assert that information in the additional disclosures is readily available to most franchisors, they fail to explain their basis for that conclusion, beyond stating that some of it is published regularly by publicly traded companies. Of course, the vast majority of franchisors are small and privately held.

Karp/Stern do not explain what happens to franchisors that do not have either access to that information or the right to acquire it? Are they to be precluded from franchising?

72. *2015 Franchise Grade Franchise Expert Survey*, *supra* note 27.

73. 2017 AFDR Survey, *supra* note 68.

74. *Id.*

75. According to FRANdata, 43 percent of first time franchisees obtained SBA financing in 2014, and 23 percent of franchisees acquiring an additional unit obtained SBA financing. *See* FRANdata, *Small Business Lending Matrix and Analysis: The Impact of the Credit Crisis on the Franchise Sector*, *Volume VI* (Mar. 2014), http://emarket.franchise.org/SBLM_Vol6.pdf) (last visited on Dec. 14, 2016).

What is the basis for extending the amount of information to be collected and disclosed to five years? What evidence exists that prospective franchisees base purchase decisions on information that is four and five years old when they are reviewing information from the previous three years?

Currently, Item 19 (which NASAA scrutinized in 2016) has no minimum time period required for disclosures. FDD Items 20 and 21 require disclosures going back three years.

If the proposal were to be adopted, franchisors would be required to collect extensive information that they do not already have. Assuming the other problems with the disclosures that are mentioned above could be resolved, a uniform system of accounting would be required for use by all franchisees, and franchisors may be forced to take harsh actions to remedy noncompliance by franchisees with these new reporting requirements.

In their conclusion the Karp/Stern write: "The time has come for franchise disclosure to restore its original mission by pursuing two distinct but related goals. First, to present user-friendly disclosure documents that focus on investor education and information, facilitating due diligence and marked by the use of technology of the kind that prospective investors expect in the twenty-first century. Second, to return to the roots of franchise disclosure so that the disclosure document serves the interests of the investor more than that of the issuer."[76]

The goals that Karp/Stern have identified are not the proper goals of franchise disclosure regulation, regardless how laudable they may be in the abstract. Moreover, in the context of public policy, their proposal would not effectuate those goals. A document is not "user-friendly" if it is inherently misleading, if its bulk leads fewer prospective franchisees to attempt to review it, or if it raises questions that require prospective franchisees to pay advisers to explain its apparent inconsistencies.

The proposed so-called "Summary Disclosure Document" does add information that is not provided in the current FDD. But it does not explain the significance of what is added or summarized. It does not educate the novice potential business owner. It adds value only if every prospective first-time franchisee has an adviser who can interpret both the current and new disclosures and how they could impact their success as a franchisee. If there is a problem with the length and scope of the current FDD, it is that the longer it is, the less significance can be attributed to any given disclosure. This is especially true when every disclosure item is claimed to be "material" or so important that if the information is omitted or misstated, a franchisor may face a claim for misrepresentation, violation of a franchise law, fraud, or worse.

The current FDD format may be delivered electronically with internal links. It must be written in "plain English," and it contains numerous tables

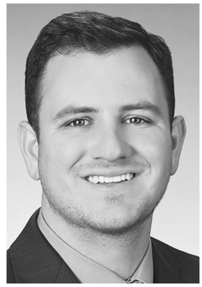
76. Karp & Stern, *supra* note 1, at 555–56.

that present information in a format that is supposed to be user-friendly. On the other hand, the proposed Summary Disclosure Document would present information to prospective franchisees in a way the FTC should never allow because it is inherently misleading. With explanations and admonitions (presumably) permitted only in the body of the complete FDD, the Summary Disclosures that appear twenty-to-fifty pages before the explanations will only cause confusion.

Franchisee v. Agent: The Relationship between Franchisors and Area Representatives

Cheryl L. Mullin and Todd A. Fisher

Ms. Mullin



Mr. Fisher

Outsourcing corporate functions is hardly a new business model, and Subway's application of the concept to franchising in the 1970s contributed to unprecedented growth for the restaurant chain. Not surprisingly for an industry founded on business model licensing, other franchisors began replicating Subway's "development agent" model, and by the turn of the century, the terms "area representative" and "development agent" had become permanently ingrained into the franchise vernacular.

Today, an "area representative" (sometimes called a "development agent" and, less frequently, a "master franchisee") is known to be a person or organization that (1) assists the franchisor in finding and qualifying franchise candidates and (2) provides operational support to franchisees in an area of responsibility. For employment law purposes, an area representative is considered an independent contractor and is typically paid on commission. In consideration for recruiting services, an area representative generally receives a percentage of the initial fee paid to the franchisor; in consideration for support services, an area representative usually receives a percentage of the royalty fees paid to the franchisor.

With respect to franchise laws, the area representative arrangement raises two questions: First, is the area representative a "subfranchisor," responsible for providing disclosures to prospective franchisees? Second, is the area representative arrangement itself a "franchise," meaning that the area representative offering must be registered as a franchise and that prospective area representatives are entitled to receive franchise disclosures?

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Much has been written concerning the first question, and the answer differs by jurisdiction. For federal law purposes, to be considered a franchisor, a person must be in privity of contract with a franchisee. Specifically, the person must have, "(1) the authority to enter into a franchise agreement (or another agreement relating to the franchise), and (2) as a result of entering into such an agreement, that party is obligated to perform after the purchase of the franchise is consummated."[1] In 2008, the California Department of Corporations followed the Federal Trade Commission's (FTC) position, ruling that "[t]o be a subfranchisor [under the California Franchise Investment Law], a [person] must have the authority to enter into a franchise agreement; i.e., be a party to the franchise agreement, and as a result of entering into the agreement, be obligated to perform franchise obligations."[2] Other states have taken the position that privity of contract is not required to be a "subfranchisor."[3]

The remainder of this article explores the second question: whether the area representative arrangement itself is a franchise, and whether prospective area representatives should be entitled to the protections afforded by federal and state franchise laws. Or whether, perhaps, the relationship between a franchisor and an area representative constitutes a pure agency relationship, in

1. The FTC explains in its Amended Franchise Rule FAQ's as follows:

> Even if a person performs post-sale on behalf of a franchisor, that person or entity is not a "subfranchisor" under the amended Rule unless that person is a party to the franchise agreement (or to another agreement involved in the franchise). This is true regardless of the name given to the person, be it "development agent," "area developer," or "regional developer."
>
> Staff's determination as to whether a "development agent" should be considered a "subfranchisor" begins with consideration of how the amended Rule treats the term "subfranchisor." The amended Rule delineates the term "subfranchisor" within the definition of the term "franchisor," as follows: Franchisor means any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes subfranchisors. For purposes of this definition, a "subfranchisor" means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.
>
> Thus, a "subfranchisor" is a person "who functions as a franchisor;" by use of the qualifying phrases "grants a franchise" and "participates in the franchise relationship," the amended Rule clarifies that in order to be considered a subfranchisor, a party must have—as a franchisor has—(1) the authority to enter into a franchise agreement (or another agreement relating to the franchise), and (2) as a result of entering into such an agreement, that party is obligated to perform after the purchase of the franchise is consummated.

Fed. Trade Comm'n, Amended Franchise Rule FAQs, https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs#9.

2. *See* Preston DuFauchard, Cal. Dep't of Corps., Franchisors, Subfranchisors, and Development Agents (Release No. 18-F) (Feb. 1, 2008), http://www.dbo.ca.gov/Commissioner/Releases/pdf/18F.pdf.

3. *See* Ill. Admin. Code tit. 14 § 200.702 (2016) (considering a subfranchise to exist as soon as a franchisor sells the third party a right to negotiate sales of unit franchises); Md. Code Ann., Bus. Reg. §§ 14-201(c),(i) (2016) (considering a subfranchisor to be any party to whom the right is granted "to sell or negotiate the sale of franchises in the name of or for the franchisor"); Pinchin v. Nick-N-Willy's Franchise Pizza Co., No. 63417-8-I, 2009 Wash. LEXIS 1069, at *8 (Wash. July 22, 2009) (holding that area representatives with the ability to negotiate the sale of a franchise may be considered subfranchisors even if they do not sign the franchise agreement); Op. Haw. Bus. Registration Div., 1989 Haw. Sec. LEXIS 46 (Aug. 11, 1989) (advising that a development agent was a subfranchisor when the development agent only identified qualified buyers and received an ongoing royalty from approved purchasers).

which case, the franchise sales laws do not benefit the area representative and applying the franchise relationship laws to an area representative arrangement could penalize franchisors for terminating a harmful agency relationship.

I. The Area Representative Arrangement Is not a "Franchise" under Franchise Law

The Amended FTC Rule defines a "franchise" as follows:

> Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:
>
> (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;
>
> (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and
>
> (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.[4]

At the state level, twelve of the states with franchise sales legislation define a "franchise" in a manner similar to federal law in that a "franchise" will be deemed to exist whenever there is a trademark license, control over a franchisee's method of operation (or franchisee's adherence to a "marketing plan prescribed in substantial part by the franchisor"), and payment of a fee.[5,6,7] Under the so-called "marketing plan" approach, the franchisor groups outlets together as a whole and presents them as having uniform stan-

4. 16 U.S.C. § 4361(h)(1–3).

5. California, Illinois, Indiana, Maryland, Michigan, New York, North Dakota, Oregon, Rhode Island, Virginia, Washington, and Wisconsin (under the Wisconsin Franchise Investment Law).

6. The Illinois Franchise Disclosure Act of 1987, which also contains relationship provisions, for example, defines a "franchise" as

> a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which: (a) a franchisee is granted the right to engage in the business of offering, selling or distributing goods or services, under a marketing plan or system prescribed or suggested in substantial part by a franchisor; and (b) the operation of the franchisee's business is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate; and (c) the person granted the right to engage in such business is required to pay to the franchisor or an affiliate of the franchisor, directly or indirectly, a franchise fee of $500 or more.

815 ILL. COMP. STAT. 705/3(1).

7. According to the Illinois Franchise Disclosure Act of 1987, a "marketing plan or system" as "a plan or system relating to some aspect of conduct of a party to a contract in conducting business, including but not limited to (a) specification of price, or special pricing systems or discount plans, (b) use of particular sales or display equipment or merchandising devices, (c) use of specific sales techniques, (d) use of advertising or promotional materials or cooperation in advertising efforts . . ." 815 ILL. COMP. STAT. 705/3(18).

dards relating to advertising, hours of operation, training, and site selection, to name a few.[8] Most states consider the marketing plan element present only when the franchisor mandates that its franchisees include its marketing plan in their business operations.[9]

A different kind of a "control," however, exists within an agency relationship. In an agency relationship, "the principal's right of control presuppose that the principal retains the capacity throughout the relationship to assess the agent's performance, provide instructions to the agent, and terminate the agency relationship by revoking the agent's authority."[10] If an area representative is serving as a franchisor's agent, the franchisor clearly has the right to control the area representative's conduct during the term of the agency. But a franchisor typically does not exert significant control over, or provide significant assistance in an area representative's entire method of operation, as contemplated by the Amended FTC Rule and the state franchise laws adopting the "control" or "marketing plan" approach. Specifically, a franchisor typically does not have the right to approve the location or impose site design or appearance requirements for an area representative's office and does not dictate an area representative's hours of operation, accounting practices, or personnel policies. An area representative has only one customer—the franchisor—so there is no need for a marketing plan, promotional campaigns, or sales programs to further the area representative's independent business.

Two states with registration and disclosure requirements, namely, Hawaii[11] and Minnesota,[12] replace the "control" or "marketing plan" element with a "community of interest" standard. The Hawaii Franchise Investment Law, for example, defines a "franchise" as an "oral or written contract or agreement, either expressed or implied, in which a person grants to another person, a license to use a trade name, service mark, trademark, logotype or related characteristic in which there is a community of interest in the business of offering, selling, or distributing goods or services at wholesale or retail, leasing, or otherwise, and in which the franchisee is required to pay, directly or indirectly, a franchise fee.[13]

The Minnesota franchise law defines a "franchise" to mean

> (1) a contract or agreement, either express or implied, whether oral or written, for a definite or indefinite period, between two or more persons: (i) by which a franchisee is granted the right to engage in the business of offering or distributing goods or services using the franchisor's trade name, trademark, service mark, logotype, advertising, or other commercial symbol or related characteristics; (ii) in which the franchisor and franchisee have a community of interest in the marketing

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8. *See, e.g.*, 815 Ill. Comp. Stat. 705/3(18); *see also* Petereit v. S.B. Thomas, Inc., 853 F. Supp. 55 (D. Conn. 1993).

9. *See, e.g.*, Charts v. Nationwide Mut. Ins. Co., 397 F. Supp. 2d 357 (D. Conn. 2005); Edmands v. CUNO, Inc., 892 A.2d 938 (Conn. 2006).

10. Restatement (Third) of Agency § 1.01 cmt. f (2006).

11. Haw. Rev. Stat. § 482E-2 (2016).

12. Minn. Stat. § 80C.01 (2016).

13. Haw. Rev. Stat. § 482E-2 (2016).

> of goods or services at wholesale, retail, by lease, agreement, or otherwise; and (iii) for which the franchisee pays, directly or indirectly, a franchise fee."[14]

The "community of interest" definition casts a wider net than the "control" or "marketing plan" element because no right of control is needed for a franchise to exist.

Even under these states' definitions, however, the area representative relationship arguably does not qualify as a "franchise."

In an area representative relationship, the area representative (as the franchisor's agent) has a license to use the franchisor's trademark to solicit prospective franchisees, provide operational support to the franchisor's franchisees, and to otherwise further the franchisor's business. But does an area representative operate a separate business identified or associated with the franchisor's trademark? If the area representative agreement restricts the area representative's right and authority to independently offer or sell goods, services, or commodities, then, as a matter of law, can an area representative relationship be deemed a franchise?[15] If an area representative lacks the power and authority to negotiate and close on the sale of a franchise, then, as a matter of law, can an area representative relationship be deemed a franchise?[16]

Whether or not an "agent" has the power to effect a sale has been addressed by various courts in the context of franchise termination. In *DeLuca v. Allstate Insurance Company, Inc.*,[17] for example, three insurance agents, faced with imminent termination of their agency contracts, sought protection under the New Jersey Franchise Practices Act (NJFPA). After analyzing the agency relationship, the court concluded that the plaintiffs' New Jersey offices did not satisfy the $35,000 minimum "sales" component of the "place of business" requirement of the NJFPA[18] because, as mere insurance agents of Allstate, they buy nothing from the insurer and sell nothing to the public.[19]

14. MINN. STAT. § 80C.01 (2016).

15. *See* DeLuca v. Allstate Ins. Co., Nos. BER-C-185-11, BER-C-291-11, BER-C-299-11, 2011 N.J. Super. Unpub. LEXIS 3140 (N.J. Super. Ct. Ch. Div. Dec. 28, 2011), *aff'd*, 2014 N.J. Super. Unpub. LEXIS 1090 (N.J. Super. Ct. App. Div. May 13, 2014) (holding that insurance agents are not "franchises" under the New Jersey Franchise Practices Act and that insurance agents do not "sell" insurance; therefore, insurance agency fails to meet the "community of interest" element of a franchise and the NJFPA's place of business requirements because no insurance sales occur at the agent's offices).

16. Even if they had authority to sell franchises, franchises are general intangibles, according to I.R.C. § 197, and therefore are not goods, services, or commodities. *See* 26 U.S.C. § 197(d)(1)(F) (2016).

17. *DeLuca*, 2011 N.J. Super. Unpub. LEXIS 3140.

18. The NJFPA applies only

> to a franchise (1) the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey, (2) where gross sales of products or services between the franchisor and franchisee covered by such franchise shall have exceeded $35,000.00 for the 12-months next preceding the institution of the suit . . . , and (3) where more than 20% of the franchisee's gross sales are intended to be or are derived from such franchise.

N.J. STAT. ANN. § 56:10-4 (West 2016).

19. *DeLuca*, 2011 N.J. Super. Unpub. LEXIS 3140, at *83.

The court further concluded that the insurance agency plaintiffs lacked "community of interest" with its insurer.[20] To establish a "community-of-interest," for purposes of the NJFPA, "there are two basic requirements: '(1) The alleged franchisee must make substantial franchise specific investments and (2) must have been required to make these investments by agreement or by the nature of the business.'"[21] The requisite franchise-specific investments "are usually capital investments, such as a building designed to meet the style of the franchise, special equipment useful only to produce the franchise product, and franchise signs."[22] Under the Allstate agency relationship, the court found that plaintiffs had made no capital investment: they paid no fee to become agents, paid no ongoing franchise fees, their office space and fixtures, as well as their equipment, were nonspecific to Allstate, and Allstate had furnished their signage.[23]

Although not directly relevant to the issue of coverage, it also makes sense to consider the purpose of franchise sales legislation and how it benefits the consumer. The purpose of the FTC Rule is "to prevent deceptive and unfair practices in the sale of franchises and business opportunities and to correct consumers' misimpressions about franchise and business opportunity offerings."[24] To achieve this objective, federal and state franchise sales laws require delivery of a franchise disclosure document, containing the information prescribed by the Amended FTC Rule. This includes twenty-one categories (or Items) of information, specifically tailored to apply to the operation of a franchised business.

Because area representatives operate under a different business and compensation model, applying the franchise sales laws to the area representative relationship does not materially benefit a prospective area representative. For example, the Amended FTC Rule requires franchisor to disclose initial and continuing fees payable by the franchisee. In an area representative relationship, the area representative may pay an initial fee, but the true economics of the relationship lie in the details of the commission structure payable to the area representative.

Also, most important to a potential area representative is the number of franchisees in the system and average franchisee revenue and success rates because those are the numbers that help a prospective area representative understand the

20. *Id.* at *77.

21. *Id.* at *75 (citing Atl. City Coin & Slot Serv., Inc. v. IGT, 14 F. Supp. 2d 644, 659 (D.N.J. 1998) (quoting Cassidy Podell Lynch, Inc. v. Snydergeneral Corp., 944 F.2d 1131, 1143 (3d Cir. 1991))).

22. *Id.* at *75–76 (citing Instructional Sys., Inc. v. Comp. Curriculum Corp., 614 A.2d 124, 141 (N.J. 1992)).

23. *Id.* at *76. Although this holding may raise the question of whether the "community of interest" element is satisfied under New Jersey law, if the agent pays a substantial fee for acquiring agency rights under the Hawaii and Minnesota franchise sales laws, "community of interest" and payment of an initial fee are two separate elements which, presumably, must be independently met.

24. Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities, 72 Fed. Reg. 15,444 (Mar. 30, 2007) (codified at 16 C.F.R. pt. 436).

market and project his or her potential commissions. Because the Amended FTC Rule prohibits disclosure of materials or information other than those required or permitted by its disclosure requirements (or applicable state law requirements),[25] franchisors are prohibited from disclosing, explaining, or summarizing in the franchise disclosure document the economic terms of the area representative relationship or information about franchisee performance.

II. Application of Franchise Relationship Laws to an Area Representative Relationship Conflicts with Principles of Agency

In addition to franchise sales laws, a number of states have enacted so-called "franchise relationship" laws that prohibit a franchisor from terminating or failing to renew a franchise without "good cause," "just cause," or "reasonable cause."[26] Definitions of these terms vary from state to state and, in some states, the terms are not defined at all. Some relationship laws specifically state that some practices will be deemed to be "good cause," including the franchisee's voluntary abandonment of the franchised business, conviction of a crime, impairment of the franchisor's trademarks, bankruptcy, repetitive breaches of the same event, seizure or foreclosure by a government authority, and failure to pay monies owed.

Franchise relationship laws also typically protect a franchisee's right to transfer the franchised business. For example, the Hawaii Franchise Rights and Prohibitions Act prohibits a franchisor from refusing to permit a transfer of ownership of a franchise, except for good cause.[27] Similarly, the Iowa Franchise Act permits a franchisee to transfer the franchised business and franchise to a transferee provided that the transferee satisfies the reasonable current qualifications of the franchisor for new franchisees.[28] The Michigan Franchise Investment Law declares void any provision in a franchise agreement, thereby permitting a franchisor to refuse a transfer of ownership of a franchise, except for good cause.[29]

These laws may be necessary for franchisee protection because the franchise relationship generally is considered an arms' length relationship and a franchisor owes no fiduciary or special duty to a franchisee under the common law in most jurisdictions.[30] Absent the statutory protections afforded by

25. Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. § 436 (2016).

26. Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 Bus. Law. 289 (1989).

27. *See generally* Haw. Rev. Stat. § 482E-6 (2016).

28. Iowa Code § 537A.10(5) (2016).

29. Mich. Comp. Laws § 445.1527(g) (2016).

30. According to the Fifth Circuit, "A fiduciary duty will not be lightly created as it imposes 'extraordinary duties,' and requires the fiduciary to 'put the interests of the beneficiary ahead of its own if the need arises." Floors Unlimited, Inc. v. Fieldcrest Cannon, Inc., 55 F.3d 181 (5th Cir. 1995) (applying Texas law); *see also, e.g.*, Bishop v. GNC Franchising LLC, 403 F. Supp. 2d 411, 424 (W.D. Pa. 2005) (significant weight of authority holds that franchise agreements do not give rise to fiduciary or confidential relationships between the parties); O'Neal v. Burger Chef

state relationship laws, therefore, a franchisee (who typically has less bargaining power than the franchisor) may have little protection against the wrongful termination of his franchise or other types of action considered abusive by state legislation. Supplementing the common law to address certain types of actions in a franchise relationship, therefore, makes sense.

The area representative relationship, however, is an agency relationship, and application of the franchise relationships laws to the area representative relationship directly conflict with applicable agency principles.[31] According to the Restatement (Third) of Agency, these are the duties that an agent owes to his or her principal:

1. General Fiduciary Principle.

An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship.[32]

2. Duties of Loyalty

(a) Material Benefit Arising Out of Position. An agent has a duty not to acquire a material benefit from a third party in connection with transactions conducted or other actions taken on behalf of the principal or otherwise through the agent's use of the agent's position.[33]

(b) Acting as or on Behalf of an Adverse Party. An agent has a duty not to deal with the principal as or on behalf of an adverse party in a transaction connected with the agency relationship.[34]

(c) Competition. Throughout the duration of an agency relationship, an agent has a duty to refrain from competing with the principal and from taking action on behalf of or otherwise assisting the principal's competitors. During that time, an agent may take action, not otherwise wrongful, to prepare for competition following termination of the agency relationship.[35]

Sys., Inc., 860 F.2d 1341, 1349–50 (6th Cir. 1988) (applying Tennessee law); Premier Wine & Spirits v. E. & J. Gallo Winery, 846 F.2d 537, 540–41 (9th Cir. 1988) (applying South Dakota law); Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480, 484–85 (5th Cir. 1984) (applying Louisiana law); Murphy v. White Hen Pantry Co., 691 F.2d 350, 354–56 (7th Cir. 1982) (applying Wisconsin law); Picture Lake Campground, Inc. v. Holiday Inns, Inc., 497 F. Supp. 858, 869 (E.D. Va. 1980) (applying Virginia law); Layton v. AAMCO Transmissions, Inc., 717 F. Supp. 368, 371 (D. Md. 1989) (applying Maryland law); Bonfield v. AAMCO Transmissions, Inc., 708 F. Supp. 867, 883–84 (N.D. Ill. 1989) (applying Illinois law); *see also* AAMCO Transmissions, Inc. v. Marino, Nos. 88-5522 & 88-6197, 1991 U.S. Dist. LEXIS 18380, at *4–6 (E.D. Pa. Dec. 31, 1991) (applying Pennsylvania law); Fashion Boutique of Short Hills, Inc. v. Fendi USA, Inc., No. 91 Civ. 4544, 1992 U.S. Dist. LEXIS 9881, at *15–16 (S.D.N.Y. July 2, 1992) (applying New York law); Romacorp, Inc. v. TR Acquisition Corp., No. 93 Civ. 5394, 1993 U.S. Dist. LEXIS 16923, at *40–41 (S.D.N.Y. Dec. 1, 1993) (citing Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp., 823 S.W.2d 591, 595 n.5 (Tex. 1992) (applying Texas law)).

31. "As defined by the common law, the concept of agency posits a consensual relationship in which one person, to one degree or another or respect or another, acts as a representative of or otherwise acts on behalf of another person with power to affect the legal rights and duties of the other person. The person represented has a right to control the actions of the agent." RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. c (2006).

32. *Id.* § 8.01.

33. *Id.* § 8.02

34. *Id.* § 8.03.

35. *Id.* § 8.04.

(d) Use of Principal's Property; Use of Confidential Information. An agent has a duty

(i) not to use property of the principal for the agent's own purposes or those of a third party; and

(ii) not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party.[36]

3. Duties of Performance

(a) Duty Created by Contract. An agent has a duty to act in accordance with the express and implied terms of any contract between the agent and the principal.[37]

(b) Duties of Care, Competence and Diligence. Subject to any agreement with the principal, an agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances. Special skills or knowledge possessed by an agent are circumstances to be taken into account in determining whether the agent acted with due care and diligence. If an agent claims to possess special skills or knowledge, the agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents with such skills or knowledge.[38]

(c) Duty to Act Only Within the Scope of Actual Authority and to Comply with Principal's Lawful Instruction.

(i) An agent has a duty to take action only within the scope of the agent's actual authority.

(ii) An agent has a duty to comply with all lawful instructions received from the principal and persons designated by the principal concerning the agent's actions on behalf of the principal.[39]

(d) Duty of Good Conduct. An agent has a duty, within the scope of the agency relationship, to act reasonably and to refrain from conduct that is likely to damage the principal's enterprise.[40]

4. Duty to Provide Information. An agent has a duty to use reasonable effort to provide the principal with facts that the agent knows, has reason to know, or should know when

(a) subject to any manifestation by the principal, the agent knows or has reason to know that the principal would wish to have the facts or the facts are material to the agent's duties to the principal; and

(b) the facts can be provided to the principal without violating a superior duty owed by the agent to another person.[41]

5. Duties Regarding Principal's Property – Segregation, Record-Keeping, and Accounting. An agent has a duty, subject to any agreement with the principal:

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36. *Id.* § 8.05.
37. *Id.* § 8.07.
38. *Id.* § 8.08.
39. *Id.* § 8.09.
40. *Id.* § 8.10.
41. *Id.* § 8.11.

> (a) not to deal with the principal's property so that it appears to be the agent's property;
>
> (b) not to mingle the principal's property with anyone else's property; and
>
> (c) to keep and render accounts to the principal of money or other property received or paid out on the principal's account.[42]

On the principal's side of the relationship, the principal has a duty to act in accordance with the express and implied terms of any contract between the principal and the agent and has a duty to indemnify the agent in accordance with the terms of any contract between them; and, unless otherwise agreed (a) when the agent makes a payment within the scope of the agent's actual authority, or that is beneficial to the principal, unless the agent acts officiously in making the payment; or (b) when the agent suffers a loss that fairly should be borne by the principal in light of their relationship.[43]

Courts examining the application of franchise relationship statutes in the context of insurance sales generally have found them not to apply. For example, in *DeLuca*, the court held the New Jersey Franchise Practices Act (NJFPA) does not to apply because an insurance agency lacked the "fundamental component of exchange of products or services between insurer and agent, or the sale of product or services by the agent to the consumer" and therefore failed to satisfy the $35,000 minimum "sales" component of the NJFPA.[44]

Of particular interest in this case is that the court, in consultation with counsel, solicited the input of the New Jersey Department of Banking and Insurance, which weighed in on the issue of whether and to what extent application of the NJFPA would interfere with the Department's exclusive jurisdiction. In a letter dated December 19, 2011, the Department pointed to, among other things, the NJFPA prohibition against franchisee termination for anything other than "good cause," which is defined in the act as being "limited to the failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise."[45] According to the Department's letter:

> An insurer leaving the state of New Jersey is subject to extensive state regulation which could be frustrated and held hostage by an inability to cite to a franchisee's failure to properly perform as a franchise as managed by the Act. In addition, franchisors are barred by the NJFPA from imposing "unreasonable standards of performance upon the franchise" [citations omitted]. If the NJFPA is deemed applicable to insurance company-agent relations, an insurance agent could not be terminated by the franchisor unless he or she has violated the terms of a given franchise agreement. This conflicts directly with N.J.S.A. 17:22-6.14a(e), which gives the insurance company the right to terminate—immediately—an insurance agent for, among other reasons, "insolvency, abandonment, gross and willful mis-

42. *Id.* § 8.12.
43. *Id.* § 8.13.
44. *DeLuca*, 2011 N.J. Super. Unpub. LEXIS 3140, at *83.
45. N.J. Stat. Ann. § 56:10-5 (West 2016).

> conduct, or failure to pay" premiums. Agents violating their individual contracts—or not violating any specific provision of their contracts but say, having become insolvent, abandoned the agency, been guilty of gross or willful misconduct, or failed to pay premiums, could not, if the NJFPA applies, be terminated by the insurer for 60 days, unless the insurer had received written notice that the agent has been convicted of an indictable offense [citation omitted]. This is in conflict with N.J.S.A. 17:22-6.14a, which permits immediate termination in certain circumstances and terminations upon 90 days notice in others.[46]

On appeal, the New Jersey Appellate Court upheld the decision, but clarified that "[e]ven if there were no conflicts between the [NJFPA] and the regulated insurance industry, which is not the case, the relationship between Allstate and the [insurance agent plaintiffs] did not constitute a franchise under the Act because there was no 'community of interest,' and the plaintiffs did not maintain a 'place of business' [in New Jersey], as those terms are used under the Act."[47]

In the case of *Vitkauskas v. State Farm Mutual Automobile Insurance Co.*,[48] the court concluded that an insurance sales agent was not entitled to protection against termination under the Illinois Franchise Disclosure Act of 1987. Under Illinois law, "franchise" means

> a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which: (a) a franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services, under a marketing plan or system prescribed or suggested in substantial part by a franchisor; and (b) the operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate; and (c) the person granted the right to engage in such business is required to pay, directly or indirect, a franchise fee of $100 or more.[49]

In concluding that that the relationship failed to meet elements (a) and (c), the court stated:

> It is obvious that the plaintiff did not sell insurance. In the parlance of the industry, an employee is often referred to as an insurance salesman. The right to sell consists of an unqualified authorization to transfer a product at the point and moment of the agreement to sell or authority to commit a grantor to sell. The plaintiff did everything he could legally and responsibly do to effect a sale, but the sale could not be effective until approval of the defendant was forthcoming. Plaintiff could not commit the defendant to a binding contract of insurance. He could solicit an application for insurance, but he could not sell within the meaning of the IFDA.[50]

Similar to the *Vitkauskas* opinion, in the case of *Keeney v. Kember National Insurance Co.*, the New York Franchise Sales Law was held not to apply to an insurance agency agreement. There, the contract at issue authorized the

46. *DeLuca*, 2011 N.J. Super. Unpub. LEXIS 3140, at *81–82.
47. *Id.*
48. 509 N.E.2d 1385 (Ill. App. Ct. 1987).
49. 815 Ill. Comp. Stat. 705/3, ch. 121-1/2, ¶ 1703, § 3(18) (1985).
50. *Vitkauskas*, 509 N.E.2d at 326.

agent to solicit several types of insurance and to bind the insurer only to the extent specific authority was granted by the insurer.[51] In its ruling, the court characterized the agency agreement as a "garden variety" commercial contract, stating that "[I]n the Court's view, there is nothing about the contract that would enable the Court to categorized [sic] it as a franchise agreement."[52]

Application of franchise relationship laws also has been addressed in the context of whether a gasoline commission agent was entitled to protection against termination under the Connecticut General Franchise Act, which requires that the franchisee be "granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system . . ."[53] In *Getty Petroleum Marketing, Inc. v. Ahmad*,[54] the Connecticut Supreme Court concluded that commission agents were not covered under the act because they neither "offered" nor "sold" gasoline. Because Getty was selling its own gasoline "with the defendants acting as commission agents to facilitate the exchange," the court concluded that "there was insufficient evidence to establish that the commission agents had any entrepreneurial responsibility as to the sale of gasoline or the gasoline itself."[55]

Applying franchise relationship laws to the area representative relationship (specifically, applying the termination restrictions and pro-transfer provisions to the area representative relationship)[56] directly conflicts with agency principles.

Under agency law, the principal is privileged to terminate or discharge an agent on account of violation of the agent's implied duties, even if termination occurs prior to the stated term of the appointment.[57] Most franchise relationship statutes, however, prohibit termination without "good cause" or "just cause" and go on to define that term to mean a material breach of the franchise agreement.[58] Under this definition, bad acts such as abusive behavior toward

51. Keeney v. Kemper Nat'l Ins. Co., 960 F. Supp. 617 (E.D.N.Y. 1997).
52. *Id.* at 625.
53. Conn. Gen. Stat. § 42-133e (2016).
54. 757 A.2d 494, 497–98 (Conn. 2000).
55. *Id.* at 500.
56. *See, e.g.*, Conn. Gen. Stat. § 42-133f(a) (2016); Neb. Rev. Stat. § 87-404(1) (2016); N.J. Stat. Ann. § 56:10-5 (2016) (requiring 60 days' advance notice of intent to terminate, cancel, or not renew); Ark. Code Ann. § 4-72-204(b) (2016); Del. Code Ann. tit. 6, § 2555 (2016); Minn. Stat. § 80C.14 (2016); Miss. Code Ann. § 75-24-53 (2016); Mo. Rev. Stat. § 407.405 (2016) (requiring 90 days' advance notice of intent to terminate, cancel, or not renew). *See generally* Charles S. Modell, *The Accidental Franchise*, Bus. L. Today, Jan./Feb. 2004, at 45, 47 (noting franchise relationship laws may "require good cause for termination or nonrenewal of the relationship, and may require advance notice, typically varying from 30 to 90 days, with an opportunity for cure as enunciated in the individual state statute").
57. Restatement (Third) of Agency § 8.10 cmt. b (2006).
58. *See, e.g.*, Conn. Gen. Stat. § 42-133f(a) (2016) (defining good cause "to include, but not limited, to the franchisee's refusal or failure to comply substantially with any material and reasonable obligation of the franchise agreement"); Neb. Rev. Stat. § 87-402(8) (2016) (limiting good cause to "failure by the franchisee to substantially comply with the requirements imposed upon him or her by the franchise"); N.J. Stat. Ann. § 56:10-5 (2016) (limiting good cause to "failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise"); Ark. Code Ann. § 4-72-202(7)(C)-(H) (2016) (defining good cause in include

franchisees, accepting bribes from contractors, or soliciting for employment a franchisee's employees may not necessarily be addressed in the area representative agreement and therefore may not meet the "good cause" standard. Moreover, repeated breaches of an area representative's obligations—which may not be "material" as a single event but which, over time, are likely to injure a franchisor's reputation and/or relationship with its franchisees—may not rise to the level of a "material" breach justifying termination under the state relationship law standard. These same acts, however, may violate an agent's duty of good conduct, for which termination may be privileged under agency law.

Moreover, with respect to assignment, franchise agreements are governed by general contract law, which permits assignment except as restricted by the terms of the contract (which may be superseded by UCC provisions). Agency agreements, on the other hand, generally are not assignable by either party except to the extent permitted by the agreement. State relationship laws that prohibit a franchisor from unreasonably withholding consent to a transfer therefore fail to take into account the presumption against transferability and the subjective considerations involved in the assignment of an agency contract.

III. Conclusion

Because the area representative and franchise relationships are different—with different duties, different business models, and different compensation structures—courts should not be quick to apply franchise sales and relationship laws to the area representative relationship.

At the same time, however, practitioners should respect the differences between these relationships when drafting area representative agreements and choose words that achieve the desired results. For example, if the intent to create an agency relationship, the agreement should identify the area representative as the franchisor's "agent" and clearly state that the area representative is neither authorized nor empowered to offer, sell, or distribute

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"voluntary abandonment of the franchise; conviction of the franchisee punishable by a term of imprisonment in excess of one year, substantially related to the business conducted pursuant to the franchise; any act by the franchisee which substantially impairs the franchisor's trademark or trade name; the institution of insolvency or bankruptcy proceedings by or against a franchisee, or any assignment or attempted assignment by franchisee of the franchise or the assets of the franchise for benefit of the creditors; loss of the franchisor's or franchisee's right to occupy the premises from which the franchise business is operated; or failure of the franchisee to pay the franchisor within ten days after receipt of notice of any sums past due to the franchisor and relating to the franchise"); DEL. CODE ANN. tit. 6, § 2552 (2016) (no definition of "good cause" or "bad faith," but the provision in the statute which deems termination of a franchise as "unjust" if done "without good cause or in bad faith" is not unconstitutional on vagueness grounds under Delaware ABC Comm'n v. B-F Spirits, Ltd., 429 A.2d 975 (Del. 1981)); MINN. STAT. § 80C.14(3)(b) (2016) (defining good cause as "failure by the franchisee to substantially comply with the material and reasonable franchise requirements imposed by the franchisor").

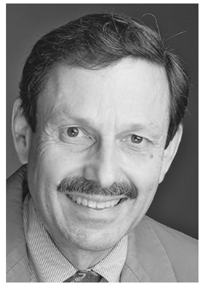
any goods or services. The agreement should recognize that, as the franchisor's agent, the area representative serves under the franchisor's direction and does not operate its business according to a marketing plan prescribed or suggested by the franchisor. The agreement also should state (and supported in practice) that the area representative is not required to make any franchise-specific investment. The practitioner also may want to consider identifying and incorporating into the agreement some or all of the implied duties of an agent.

Finally, if the area representative has other relationships with the franchisor, those relationships should be memorialized in a separate written agreement. For example, if the area representative also operates a franchised business, the franchisor/franchisee relationship should be governed by a separate franchise agreement. If the area representative also acts a supplier to the system, those rights should be memorialized in a separate supplier agreement.

Teaching Franchise Law in Law Schools: A Role for Experienced Franchise Lawyers

David C. Gurnick and Alexander M. Meiklejohn

Mr. Gurnick



Mr. Meiklejohn

The authors of this article write to encourage experienced franchise lawyers to propose franchise law courses to law schools and, if the proposals are successful, to teach the courses as adjunct professors. Both authors have taught franchise law, and both are happy to consult with any lawyer considering becoming an adjunct professor who has questions concerning the proposal process or the design or teaching of the course.

Part I of this article describes the role that adjunct professors have performed in law schools for decades and reasons for a school administration to have an adjunct teach franchise law. Part II highlights reasons that a lawyer can cite to persuade a law school that does not offer a course on franchise law to do so. Part III describes recent developments in legal education that affect law schools' interest in adding new courses and hiring new adjuncts—developments that may pose challenges but also offer opportunities for aspiring adjunct professors of franchise law. Part IV explains how the Forum's casebook, published in 2013, can be used in proposing, designing, and teaching a franchise-law course.

I. Adjunct Professors and Franchise Law

For decades, law schools have employed adjunct professors to teach courses after the first year. An adjunct may be well versed in a substantive legal area that is outside the areas of expertise of the school's full-time faculty members. Changes in law school curricula often lag behind developments in

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practice, and few law schools have enough full-time faculty members to teach all the courses that may be useful to their students. A particular course may require greater familiarity with practice than full-time faculty members possess. A lawyer who teaches as an adjunct can provide curricular enrichment in terms of course coverage and by introducing students to various aspects of legal practice. Moreover, adjunct teaching can powerfully reinforce traditional doctrinal instruction[1] by bringing home to students the connections between mastery of doctrine and effective practice.

Experienced franchise lawyers can offer law schools the benefit of their expertise in a specialized area of law and practice that is not covered in depth in Contracts or other traditional business-law courses. Franchising is subject to myriad statutes, regulations, and common law doctrines, including federal and state disclosure and relationship laws, some of which are highly complex.[2] The Federal Trade Commission (FTC) Rule, state disclosure laws, state relationship laws, and federal and state special industry laws all focus specifically on franchise sales and relationships. The numerous cases on inadvertent franchises offer cautionary examples of adverse business consequences that can result from either inadequate legal representation or none at all. Moreover, the ongoing activity on the Forum's list serve attests to the dynamism of franchise practice, as new legal issues and practical problems continually arise, challenging even seasoned practitioners.

To understand the purposes that those laws are designed to serve, students must become familiar with the transactions to which the laws apply and the claims of abuse that prompted their adoption. Franchise lawyers have a wealth of business knowledge that they can impart to students.[3]

1. In earlier decades, classroom discussion often took the form of Socratic questioning by a faculty member and responses by students. Some teachers provided few, if any, clear answers to students' questions. More recently, the pendulum has swung away from the "Kingsfield" model of teaching, summarized in Catharine W. Hantzis, *Kingsfield and Kennedy, Reappraising the Male Model of Law School Teaching*, 38 J. Legal Educ. 155, 156 (1988), toward a model in which teachers are more willing to provide clear answers. In addition, some teachers teach mainly by means of lectures.

2. The FTC regulates offers and sales of franchises pursuant to Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (West 2016) and a Trade Regulation Rule on Franchising, 16 C.F.R. § 436 (2016). The FTC also regulates offers and sales of business opportunity ventures. 16 C.F.R. § 437 (2016). Approximately fifteen states have adopted legislation regulating offers and sales of franchises. *See, e.g.*, California Franchise Investment Law, Cal. Corps. Code §§ 31000–31516 (West 2016). Numerous states have adopted legislation regulating the ongoing relationships between franchisors and their franchisees and restricting franchisors from terminating or refusing to renew a franchise in the absence of good cause. Congress and numerous states have also enacted legislation regulating franchising in particular industries. For example, Congress enacted legislation regulating franchising in the automobile dealer industry, 15 U.S.C. §§ 1221–1226 (West 2016), and the petroleum marketing industry, 15 U.S.C. §§ 2801–2807 (West 2016). States regulate franchising in the automobile, petroleum, farm, and equipment industries, among others, as well as beer and wine distribution.

3. Fellow faculty members may also gain useful knowledge and ideas from interaction with adjunct franchise law practitioners, although the practitioners may have few, if any, interactions with full-time faculty members. *See* Andrew F. Popper, *The Uneasy Integration of Adjunct Teachers into American Legal* Education, 47 J. Legal Educ. 83 (1997).

That knowledge will help students understand the context in which a particular franchise transaction took place, or a particular dispute arose, including at least some of the economic incentives and motives of the various actors who were involved. Contextual information can greatly increase students' interest in the law as well as their comprehension of legal issues.

II. Franchising: A Major Player in the Economy but an Orphan in Legal Education

A few statistics concerning franchising's economic role can help to convince a law school's administration, and perhaps also its faculty,[4] of the importance of franchise law. According to the U.S. Census Bureau, in 2007 there were 453,326 franchised establishments in the "top franchise sectors." Those establishments "accounted for 10.5 percent of businesses in the 295 industries covered by the census inquiry. . . ." The value of "sales, shipments, receipts, or revenue" from franchises was $1,288 billion, or 16.8 percent of the total for all businesses. Annual payroll was $154 billion, or 9.7 percent of the total for all businesses, and employment was 7,882,048, or 13.5 percent of the total for all businesses.[5]

To the extent that a subject generates news and controversy, it should be of heightened interest to law schools and their students. In recent years, labor-related litigation and administrative proceedings have brought franchising into the national discussion of income inequality.[6] News organizations and, no doubt, social media, have covered lawsuits in which plaintiffs sought to impose joint-employer liability on franchisors, including Domino's,[7] for actions by employees of their franchisees. The City of Seattle's decision to treat some franchised units as large employers for purposes of its minimum wage ordinance generated an unsuccessful but well-publicized challenge by the International Franchise Association, and the Ninth Circuit's

4. The faculty may need to vote to add the course to the curriculum. If so, the practitioner may need to begin the process by submitting a proposal to the faculty's Curriculum Committee. The office of the Dean should be able to identify the chair of that committee and provide his or her contact information.

5. U.S. Census Bureau, Economic Census: Industry Snapshot (2007), http://www.census.gov/econ/census/pdf/franchises_snapshot.pdf (last visited June 18, 2016). The International Franchise Association estimates that "[t]he output of franchise establishments in nominal dollars in 2016 will increase 5.8 percent from $892 billion to $944 billion. . . ." The IFA also estimates that "the number of franchise establishments will increase by 1.7 percent in 2016, from 782,573 to 795,932" and that "the number of direct jobs in franchise establishments will increase 3.1 percent in 2016 from 8,834 million to 9,112 million. . . ." Int'l Franchise Ass'n, 2016 Franchise Business Economic Outlook (Jan. 2016), http://www.franchise.org/sites/default/files/EconomicOutlookInfographic_January2016.pdf (last visited June 30, 2016).

6. *See e.g.*, Erin Conway & Caroline Fichter, *Surviving the Tempest: Franchisees in the Brave New World of Joint Employers and $15 Now*, 35:4 Franchise L.J. 509 (2016) ("Although both wage stagnation and the fissured workplace have concerned policymakers for decades, the Great Recession brought them to the attention of the general public. . . . Both issues could have a substantial effect on the franchise industry.").

7. Patterson v. Domino's Pizza, 333 P.3d 723 (Cal. 2014).

decision upholding the ordinance[8] may encourage other municipalities to emulate Seattle's example. The general counsel of the National Labor Relations Board has issued complaints alleging that McDonald's, as a joint employer of the employees of some of its franchisees, "violated the rights of employees [of those franchisees] by, among other things, making statements and taking actions against them for engaging in activities aimed at improving their wages and working conditions, including participating in nationwide fast food worker protests about their terms and conditions of employment. . . ."[9] And the U.S. Labor Department has sued a New Jersey company that allegedly misclassified its cleaning employees as franchisees, claiming that the misclassification led to violations of the Fair Labor Standards Act.[10]

The future may well bring more developments with regard to claims of labor law violations in franchise systems. David Weil, the Administrator of the Wage and Hour Division of the Labor Department, authored a 2014 book called *The Fissured Workplace: Why Work Became So Bad for So Many and What Can Be Done to Improve It.* The word "fissured" in the title refers to a workplace in which "lead" companies focus on their core competencies, using contracts to split off—delegate—the performance of non-core functions. In Weil's view, franchising is a form of fissuring which, at least in certain industries, can lead to wage and hour violations.[11]

Many franchise lawyers believe that these employment-related claims against franchisors are based on a fundamental misunderstanding of the franchise relationship. But regardless of their merit, the claims have brought attention to franchising that is likely to persist for some years to come.

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8. Int'l Franchise Ass'n v. City of Seattle, 803 F.3d 839 (9th Cir. 2015), *cert. denied*, 136 S. Ct. 1838 (2016).

9. Press Release, Nat'l Labor Relations Board, NLRB Office of the General Counsel Issues Consolidated Complaints Against McDonald's Franchisees and their Franchisor McDonald's USA, LLC, as Joint Employers (Dec. 19, 2014), https://www.nlrb.gov/news-outreach/news-story/nlrb-office-general-counsel-issues-consolidated-complaints-against (last visited July 2, 2016).

10. *See* News Release, U.S. Dep't of Labor, New Jersey Commercial Cleaning Company Sold "Franchises" to Low-Wage Custodial Workers to Avoid Paying Minimum Wage, Overtime (May 9, 2016), https://www.dol.gov/newsroom/releases/whd/whd20160509-0 (last visited July 2, 2016). The suit culminated in a consent judgment against the company. *Id.*

11. Weil summarizes his views concerning franchising as follows:

> Any effort to improve labor standards in franchised industries must recognize that organizational form's role in creating fissured workplaces. Traditional approaches to enforcement—focusing on the individual enterprise—may bring to light widespread violations of minimum wages, overtime pay, and off-the-clock work. But if not wedded to a larger strategy that attempts to change the forces that drive this behavior, enforcement will be effective only at the margin.

David Weil, The Fissured Workplace: Why Work Became So Bad for So Many and What Can Be Done to Improve It 158 (2014). Weil's views were embraced by a three-to-two majority of the National Labor Relations Board in *Browning-Ferris Industries of California, Inc.*, 362 NLRB 186 (2015). The NLRB is headed by a five-member board appointed by the president. Currently, the Board has two vacancies created by the departure of two members, including one of the members in the *Browning-Ferris* majority and one who dissented. The filling of both vacancies by President Trump may change the political and philosophical makeup of the board, resulting in a return to the joint employer definition, or something closer to the definition, that the Board employed prior to the *Browning-Ferris* decision.

Adding franchise law to the curriculum may also enable a school to augment its existing strengths. In a school that maintains an intellectual property concentration, for example, the administration or the faculty, or both, may believe that students should be able to study trademarks and trade secrets in action. A school that maintains a concentration in corporate, commercial, or workplace law may adopt the course in recognition of franchising's role in the economy.

Despite the importance of franchising and the complexity of franchise law, only a very small percentage of law schools have offered courses on the subject. There are more than 200 law schools in the United States.[12] Yet when one of the authors of this article conducted an informal survey of subscribers to the Forum's list serve in 2015, respondents identified only thirteen law schools in the country that have offered the course during the past twenty-five years.[13] There may be more, but the total number is undoubtedly small.

Today's law students have come of age in a world in which franchised outlets are ubiquitous. Reminding administrators of that fact and making them aware of the existence and complexity of franchise law may convince them to incorporate franchise law in their curricula and hire experienced lawyers as teachers.

III. Recent Developments in Legal Education: Lower Enrollments but More Interest in Practice-Oriented Courses

Two developments in legal education since 2010 have affected the hiring practices of many law schools. One development has probably made many schools less receptive to proposals for new courses or employment of new adjuncts, or both. But the other has increased schools' interest in practice-

12. The American Bar Association has granted full accreditation to 201 law schools in the United States and provisional accreditation to four more. ABA Section of Legal Education and Admissions to the Bar, Resources, ABA-Approved Law Schools, http://www.americanbar.org/groups/legal_education/resources/aba_approved_law_schools.html (last visited June 30, 2016). Moreover, some states have given degree-granting authority to law schools that lack even provisional ABA accreditation.

13. The survey asked for information concerning franchise law courses taught in law schools and any personal experience teaching such courses. The thirteen law schools are Emory University School of Law; Fordham University School of Law; Georgetown University Law Center; University of LaVerne College of Law; University of Memphis, Cecil C. Humphreys School of Law; University of Michigan Law School; Nova Southeastern University, Shepard Broad College of Law; Quinnipiac University School of Law; San Fernando Valley College of Law (now University of West Los Angeles School of Law); Southern Methodist University, Dedman School of Law; Temple University Beasley School of Law; University of Virginia School of Law; and Western New England University School of Law. After the completion of the survey, the law school at the University of Georgia added a course, which was taught for the first time in spring 2016, and the authors learned that a franchise law class has been taught at Creighton University School of Law. Survey respondents also identified courses outside the United States at Bond University in Australia, Western University Law School in Canada, University of Toronto in Canada, and University of Adelaide in Australia.

oriented courses, which experienced lawyers are well qualified to teach, either alone or in collaboration with full-time faculty members.

The first development is a substantial decline in the number of applicants to law schools.[14] That decline has led many law schools to reduce the number of students they admit. A school that does so while offering essentially the same curriculum will experience lower enrollments in many courses, leading the administration to consider reducing the number of electives, and perhaps the frequency with which certain electives are offered, and to reject proposals for new ones absent compelling arguments in their favor.

Smaller student bodies also mean reduced tuition revenue, which may increase interest in staffing courses with adjunct professors, who are relatively inexpensive.[15] But an American Bar Association accreditation standard limits the percentage of courses in a school's curriculum that adjunct faculty members can teach.[16]

14. In the fall of 2012, according to the Law School Admission Council, there were approximately 87,900 applicants to ABA-accredited law schools. The number declined every fall thereafter, reaching a low of 54,500 in the fall of 2015. Law School Admission Council, LSAC Resources, Data, End-of-Year Summary: ABA (Applicants, Applications, & Admissions), LSATS, Credential Assembly Service, http://www.lsac.org/lsacresources/data/lsac-volume-summary (last visited June 22, 2016). The number of people who took the LSAT in 2015–16 was 4.1 percent higher than it was in 2014–15, *id.*, suggesting that the number of applicants may have stabilized.

15. The nominal tuition per credit hour at a relatively expensive private law school is approximately $1,500 to $2,000. *See, e.g.*, Daniel Park, *A Nudge, Push, and a Shove: Where Duty Must Meet Deceptive Law School Marketing*, 27 Geo. J. Legal Ethics 785, 803 n.108 (2014). Writing in 2014, the author stated that Brooklyn Law School, which ranked 83 in the 2014 *U.S. News & World Report* rankings, charged $1,795 per credit, while New York University School of Law, which ranked 6, charged $54,678 per year. A full-time student generally takes 28 to 30 credits worth of courses per year. Both Brooklyn and NYU law schools are located in New York City.

At most, if not all, ABA-accredited law schools, most students receive some scholarship support and thus pay less than the nominal tuition. David Yellen, Dean and Professor of Law at Loyola University of Chicago School of Law, estimates that the average private law school tuition discount rate may be approaching 50 percent. *See* David Yellen, *Tuition Discounting on the Rise and Its Impact on Law Schools*, Law Deans on Legal Educ. Blog (June 19, 2016, 4:54 P.M.), http://lawprofessors.typepad.com/law_deans/2015/08/tuition-discounting-on-the-rise-and-its-impact-on-law-schools.html#. Assuming that Dean Yellen is correct and an adjunct faculty member receives $5,000 for teaching a two-credit franchise law course, an enrollment of five or six students may be necessary to cover the cost of the adjunct's compensation. *See* Popper, *supra note 3* (stating that in 1997 it was "fairly typical" for an adjunct to receive $4,000 to $5,000 for teaching a fourteen-week course that met once a week). The law school will probably also want compensation for its administrative expenses and overhead as well as any percentage of its revenue that it pays to its university unless it is one of the country's few free-standing law schools. For purely economic reasons, the law school administration may believe that the course needs a minimum enrollment of seven or eight students.

If a course is offered for one credit, it will meet for one academic hour per week; if it is offered for two credits, the meeting will be for two academic hours. An academic hour may be only fifty minutes long. Rates of compensation probably vary from one school to another. Given the time required for class preparation, grading, and any work with students outside of class, however, the adjunct's hourly rate is likely to be quite low.

16. The standard provides as follows:

> The full-time faculty shall teach substantially all of the first one-third of each student's coursework. The full-time faculty shall also teach during the academic year either (1) more than half of all of the credit hours actually offered by the law school, or (2) two-thirds of the student contact hours generated by student enrollment at the law school.

These and other factors may lead a school to decline to add franchise law to its elective offerings or to hire an adjunct faculty member to teach the course. Moreover, a school may add the course and hire an adjunct to teach it, only to drop the course from the schedule in a particular semester because of insufficient enrollment.

The second development, however, is an effort by many law schools to increase their offerings of practice-oriented, or "experiential," courses, or to add experiential components to existing doctrinal courses. The American Bar Association, which accredits law schools, recently mandated that schools require all their students to complete satisfactorily at least six credits of experiential courses. Live-client clinics, externships, and simulation courses can all qualify as experiential. A simulation course is one which

> provides substantial experience not involving an actual client, that (1) is reasonably similar to the experience of a lawyer advising or representing a client or engaging in other lawyering tasks in a set of facts or circumstances devised or adopted by a faculty member, and (2) includes the following:
>
> (i) direct supervision of the student's performance by the faculty member;
>
> (ii) opportunities for performance, feedback from a faculty member, and self-evaluation; and
>
> (iii) a classroom instructional component.[17]

In a simulation course that focuses on franchising, a lawyer can draw on his or her experience to craft any number of realistic exercises for students. Possible drafting assignments, for example, include a memo to a supervising lawyer, a comment letter or other communication to a regulatory agency, a letter or memo to a client, a portion of a disclosure document or a franchise agreement, a notice of breach or termination, and a court pleading asserting or defending a franchise law claim. Students can engage in mock negotiations, counseling sessions, or dispute resolution proceedings under the lawyer's supervision. The resulting curricular enrichment can assist the law school in meeting its accreditation requirements and its graduates in their transition to practice.

If a franchise lawyer knows a full-time faculty member who is willing to co-teach a franchise law course, the two teachers can collaborate. Students will then benefit from both the lawyer's experience in franchise practice and business and the full-time teacher's experience in teaching classes, giving assignments, and assessing students' work.[18]

American Bar Association, *2015-2016 Standards and Rules of Procedure for Approval of Law Schools*, Standard 403(a), http://www.americanbar.org/content/dam/aba/publications/misc/legal_education/Standards/2015_2016_aba_standards_for_approval_of_law_schools_final.authcheckdam.pdf (last visited June 22, 2016).

17. *ABA Standards and Rules of Procedure*, Standard 304(a), *supra* note 16.

18. For advocacy of collaboration between full-time and adjunct faculty members in teaching broad capstone courses, see R. Michael Cassidy, *Reforming the Law School Curriculum from the Top Down*, 64 J. LEGAL EDUC. 428 (2015). The authors of this article concur in Cassidy's advo-

IV. The Forum's Casebook Can Ease the Task of Creating and Teaching a Franchise Law Course

In 2013, the Forum published a casebook on franchise law.[19] Legal academics and practitioners worked together to create the book,[20] which includes numerous questions and problems for students. A teacher who adopts the book in his or her course can obtain a teachers' manual that includes the authors' thoughts concerning possible answers to the questions and problems. Moreover, the table of contents of the book should be sufficient to convince law school administrators and faculty members both that (1) franchise law is a distinct area of doctrine and practice and (2) there is sufficient material to justify a two-, three-, or even four-credit course. As published in 2013, the book did not include a chapter on the employment issues, but a supplement that focuses on those issues is available to teachers.[21]

Conclusion

The number of full-time faculty members who teach franchise law is probably even smaller than the number of schools that offer the course. As a consequence, the impetus for adoption of a course is likely to come from lawyers who emphasize the importance of the subject, their interest in teaching, and perhaps their willingness to include experiential components in their courses.

As every law teacher knows, teaching bright, motivated law students is challenging, thought-provoking, and thoroughly enjoyable. The authors of this article hope that, in the future, many more students will be able to benefit from the experience and the wisdom of experienced franchise lawyers.

cacy of full-time-adjunct collaboration but not with some of his other arguments. *See also* Alexander M. Meiklejohn, Lisa Oak & Robert A. White, *Teamwork in Teaching Transactional Law and Skills: Academic, Practitioner, and Business Contributions*, TRANSACTIONS: TENN. J. OF BUS. LAW (forthcoming).

19. FRANCHISING: CASES, MATERIALS & PROBLEMS (Alexander M. Meiklejohn ed. 2013).

20. The authors are among the twenty-nine contributors to the book, most of whom are practitioners. The Forum receives all proceeds of sales; none of the contributors has received or will receive any monetary compensation.

21. Alexander M. Meiklejohn, 2016 Supplement: Some Employment Issues (unpublished manuscript) (copy on file with author).

Franchising (& Distribution) Currents

Daniel J. Oates, Jan S. Gilbert, and William M. Bryner

ANTITRUST

Mr. Oates

Mr. Gilbert

Mr. Bryner

***Brentlinger Enters. v. Volvo Cars of N. Am., LLC*, Bus. Franchise Guide (CCH) ¶ 15,815, 2016 WL 4480343 (S.D. Ohio Aug. 25, 2016)**

The U.S. District Court for the Southern District of Ohio granted a motion for summary judgment in favor of Volvo Cars of North America, LLC, finding that its dealer incentive program did not constitute price discrimination in violation of the Robinson–Patman Act and the Ohio Motor Vehicle Franchise Act. The tiered incentive program offered dealers in the highest tier, which required an investment in certain facility remodeling, a higher per car sales bonus and increased access to high demand new models. Plaintiff, an Ohio automobile dealer, argued that access to the incentive program was not "functionally available" and was therefore unlawful because the requisite facility remodeling was both expensive and contravened local zoning requirements. The court held that neither of these justifications meant that the program was "functionally unavailable" because other buyers had been able to absorb the remodeling expense and because plaintiff did not seek a variance. The court noted that generally an incentive program is "functionally unavailable" when it is a secret or when the requirements are unknown. Based on this same analysis, the court also found that the program did not constitute constructive termination.

The court further found that the incentive program did not constitute a breach of Volvo's duty to act in good faith, in part, because Volvo launched the facility remodeling incentive to address a documented gap in

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customer satisfaction between the appearance Volvo's facilities and other brands. Similarly rejecting plaintiff's other ancillary claims, the court granted Volvo's motion for summary judgment.

ARBITRATION

Benihana, Inc. v. Benihana of Tokyo, LLC, Bus. Franchise Guide (CCH) ¶ 15,802, 2016 WL 3913599 (S.D.N.Y. July 15, 2016)

In 1995, Benihana, Inc. (BI) and Benihana of Tokyo, LLC (BOT) entered into a license agreement that gave BOT a perpetual, royalty-free license to operate Benihana restaurants in Hawaii. Among the pertinent terms of the license were that BOT was permitted to offer for sale only products that BI sold in its company stores or that BI pre-approved in writing. In addition, BI could terminate the agreement if (a) BOT violated any substantial term or condition of the agreement and did not cure the violation within thirty days after written notice from BI or (b) if BI gave three notices of default within any consecutive twelve-month period and such defaults remained uncured. The agreement also contained arbitration provisions, including a provision that, if the agreement was terminated by BI and BOT "dispute[d] [BI's] right of termination, *or the reasonableness thereof*" (emphasis added), the termination issue was to be decided by mandatory arbitration.

On May 6, 2013, BI notified BOT that BOT's sale of hamburgers in the Honolulu Benihana restaurant was not an authorized menu item and constituted a breach of the agreement. A second notice regarding this violation was sent on July 30, 2013, and eventually BI filed suit in the New York Supreme Court regarding this conduct. BOT removed the case to the U.S. District Court for the Southern District of New York (S.D.N.Y.). On December 13, 2013, BI notified BOT of a number of additional breaches of the agreement, including use of a number of unauthorized advertisements and BOT's failure to confirm compliance with the insurance requirement. When BI discovered the BOT continued to sell hamburgers at the Honolulu location, on February 5, 2014, BI issued a notice of termination, effective February 15, 2014. Two days later, BI filed a motion for preliminary injunction in the S.D.N.Y. case, in aid of arbitration (which had been commenced on January 13, 2014), seeking to prevent BOT from selling hamburgers at Benihana locations in Hawaii and to prevent additional unauthorized advertising conduct during the pendency of the arbitration. The court granted that motion.

Following an arbitration hearing on June 2–5, 2015, on September 18, 2015, the panel issued a two-to-one ruling in favor of BI. Although the majority found that BOT had committed three material breaches of the agreement and that there was good cause for BI to terminate the agreement, the majority held that the termination was nonetheless "unreasonable." The majority instead awarded BI a permanent injunction against the breaching practices and attorney fees. The dissenting panelist found that BI's termination was reasonable and would have awarded termination.

BI filed a petition in the S.D.N.Y. to vacate that portion of the arbitration award that refused to terminate the agreement. BOT filed a cross-petition, seeking to have the award confirmed in its entirety and requesting sanctions against BI on the ground that BI's petition for partial vacatur was frivolous. The court confirmed the award in its entirety and awarded BI its attorney fees in filing the petition, but refused to vacate the award in order to permit termination. The court also denied BOT's motion for sanctions.

The court was clear that it found the dissenting panelist's reasoning, which would have awarded termination, to be the more persuasive position. However, the court concluded that under the Federal Arbitration Act, it must confirm the award "if there is even barely a colorable justification for the outcome reached." The court found that the agreement's "supple reasonableness clause . . . for better or worse, entrusted the arbitral panel with unusually broad latitude to pass judgment on BI's termination decision." The court therefore concluded that the arbitration panel did not exceed its authority or rewrite the agreement, reasoning that if BI had "desired more predictability, it ought to have entered into an agreement that more tightly cabined the trier's discretion."

The court nonetheless determined that BI was entitled to an award of BI's reasonable attorney fees and costs in seeking to confirm the award. Moreover, the court denied BOT's request for sanctions, finding that BOT had failed to comport with the procedural prerequisites of Federal Rule of Civil Procedure 11 and also finding that BI's petition, and its support arguments, "were not—at all—frivolous."

***Capelli Enters., Inc. v. Fantastic Sams Salon Corp.*, Bus. Franchise Guide (CCH) ¶ 15,812, 2016 WL 4492588 (N.D. Cal. Aug. 26, 2016)**

The U.S. District Court for the Northern District of California upheld an arbitration provision in a franchise agreement and therefore denied a franchisee's request that the court enjoin franchisor Fantastic Sams Franchise Corp. from proceeding with a demand for arbitration. The parties' dispute arose when the franchisee closed its Fantastic Sams salon business less than halfway through the term of its salon license agreement. Fantastic Sams sought to collect monies from the franchisee purportedly due to the franchisee's breach, and the franchisee filed a claim before the court seeking a declaration that franchisee did not owe Fantastic Sams any money. Fantastic Sams responded by seeking a motion to compel arbitration and to dismiss or stay the franchisee's claim.

The court examined the language of the arbitration provision, which stated in part that "any controversy or claim arising out of or relating to [the] Agreement, or with regard to its interpretation, formation or breach of any other aspect of the relationship between [Plaintiffs] and [Defendants]" must be referred to arbitration. The court held that this language did not evince unmistakable intent by the parties for issues of arbitrability to be decided by an arbitrator. Rather, the court observed that an agreement conferring clear authority to determine "the validity or application of any provisions of" the arbitration clause to the arbitrator would have manifested the requisite intent. Regardless, the court held that the reference to the American Arbitration Association's (AAA) rules in the parties' agreement constituted clear and unmistakable evidence of the parties' intent for threshold issues of arbitrability to be resolved by an arbitrator. It rejected plaintiff's argument that its lack of sophistication meant that it did not appreciate the significance of the reference to the AAA rules, noting that the franchisee's owners are educated professionals with advanced degrees. The court further rejected the franchisee's argument that a provision permitting a court to enforce the agreement and/or confirm an arbitration award was contradictory. It therefore denied the franchisee's request for a restraining order and, in dicta, further opined that a motion to compel arbitration by Fantastic Sams would be successful.

***Roberts Irrigation Co. v. Hortau Corp.*, Bus. Franchise Guide (CCH) ¶ 15,787, 2016 WL 3440623 (W.D. Wis. June 20, 2016)**

The U.S. District Court for the Western District of Wisconsin denied a Federal Rule of Civil Procedure 12(b)(3) motion to dismiss or stay and to compel arbitration under the Federal Arbitration Act (FAA) filed by defendants Hortau, Inc. and its agent Hortau Corp. (together, Hortau) against dealer Roberts Irrigation Co.

In 2008, Roberts and Hortau, Inc. entered into a distribution agreement for the sale of agricultural goods. The distribution agreement provided for arbitration before the Canadian Commercial Arbitration Center under its commercial arbitration rules. The distribution agreement expired by its terms on April 30, 2009, after the parties failed to renew it, but the parties continued to do business with each other under an implied distributorship agreement. Six years later, Roberts sued Hortau in Wisconsin state court claiming that Hortau breached the implied distributorship agreement by failing to pay service commissions or repurchase inventory. Roberts also claimed that Hortau was unjustly enriched by Roberts' performance under the agreement. Hortau removed the case to the district court and moved to dismiss Roberts' complaint or stay the proceedings pending arbitration.

The court noted that for Hortau's motion to succeed, it needed to show that (1) a valid, written agreement to arbitrate existed, (2) the instant dispute fell within the agreement's scope, and (3) that Roberts has refused to arbitrate according to the agreement's terms. The court rejected Hortau's argument that the arbitration provision of the 2008 distribution agreement remained in force despite the fact the parties continued to do business with each other under essentially the same terms because Section 2 of the FAA explicitly requires that agreements to arbitrate be in writing. In sum, because Hortau failed to provide evidence that the parties had agreed in writing to arbitrate after the expiration of the 2008 distribution agreement, the court denied its motion.

***Rudd Equip. Co. v. John Deere Constr. & Forestry Co.*, Bus. Franchise Guide (CCH) ¶ 15,803, 834 F.3d 589 (6th Cir. 2016)**

John Deere Construction and Forestry Company is the exclusive wholesale supplier of Hitachi-branded products in North America. Rudd Equipment Company, Inc. is a long-time authorized dealer of Hitachi construction equipment. In October 2014, John Deere filed an arbitration seeking a declaration that it had the right to terminate its agreements with Rudd. In response to the confidential arbitration filing, Rudd filed an action in the U.S. District Court for the Western District of Kentucky, seeking an injunction to maintain the status quo between the parties pending resolution of the arbitration proceeding. At the same time, Rudd filed a motion seeking to have the entire case sealed pending the outcome of the arbitration, claiming that the very existence of the lawsuit and arbitration would likely result in loss of Rudd's existing and future customers, the layoff of employees, significant diminution in value of Rudd's financial investments, and loss of goodwill. Without waiting for a response from John Deere and without making any factual findings or conclusions, the district court granted the motion and sealed the entire case.

Thereafter, the parties proceeded to litigate the case in arbitration and mediate the lawsuit seeking injunctive relief. Eventually, the parties entered into an agreed order in the lawsuit. The arbitration panel learned of the agreed order in the civil case, and requested a copy, which John Deere provided without advance notice to Rudd. In response, Rudd filed a motion for contempt in the federal court action, alleging that John Deere had violated the seal by providing a copy of the agreed order to the arbitration panel. John Deere responded by filing a motion to unseal the lawsuit. The district court denied the motion for sanctions and granted the motion to unseal the case. Rudd then appealed the order unsealing the case.

On appeal, the Sixth Circuit noted that it had jurisdiction to review the order unsealing the case because an order to unseal is conclusive and final and ultimately determines that documents will not be protected from disclosure. The court then went on to note that the Sixth Circuit has long recognized a strong presumption in favor of openness of court records. The district court's initial order sealing the case was unsupported by factual findings, and therefore the district court acted appropriately in reversing its initial decision and unsealing the records. Moreover, the court noted that Rudd had produced no actual evidence of potential harm that would result from unsealing the case, other than Rudd's conclusory assertions that it would lose customers and employees.

The court also rejected two arguments raised by Rudd. First, Rudd argued that John Deere had waived its right to challenge the seal by acquiescing to the agreed order in the litigation. The Sixth Circuit noted that John Deere had no ability or right to waive the public's First Amendment and common law rights to access public court filings. Instead, the court has an independent obligation to keep its records open for public inspection that is not conditioned on an objection from anyone. Second, Rudd argued that it had relied on the order sealing the case to its detriment in the subsequent unsealing. The court rejected that argument as well, noting that Rudd's arguments carried little weight where Rudd itself had initiated the lawsuit. Moreover, although reliance is one factor that district courts may consider in reversing a decision to seal, it is not controlling, and the case did not present the type of extraordinary circumstances where reliance would outweigh the heavy public interest in accessing documents.

***Tigges v. AM Pizza, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,797, 2016 WL 4076829 (D. Mass. July 29, 2016)**
This case is discussed under the topic heading "Class Actions."

ATTORNEY FEES

***Schwartz v. Rent-A-Wreck of Am., Inc.*, Bus. Franchise Guide (CCH) ¶ 15,809, 2016 WL 3906581 (D. Md. July 12, 2016)**
After entry of a mandate following an appeal, plaintiff David Schwartz filed a bill of costs seeking $32,665.21 from defendant Rent-A-Wreck of America, Inc. The clerk of the U.S. District Court for the District of Maryland awarded costs in the amount of $13,405.11 Rent-A-Wreck filed a motion to review the order on the bill of costs, arguing that the clerk had erred because (1) Schwartz was not the prevailing party in the litigation because he had not prevailed on all claims and arguments raised in the case, (2) Schwartz had failed to differentiate costs between the claims he prevailed on, and those he had not, or (3) the cost bill should be reduced by $4,442.83 to take into account costs for five depositions of witnesses who did not testify at either of the two previous trials in the case.

Reviewing the order on the bill of costs, the court noted that the clerk must award fees to a party that prevails on any significant claim affording some relief sought. The two primary claims in the complaint were for declaratory judgment on Schwartz's right to operate a Rent-A-Wreck franchise and for specific performance directing Rent-A-Wreck to add Schwartz's franchise to its customer directories and webpage. Schwartz prevailed on both of these claims at trial and on appeal and therefore had prevailed on a significant claim, entitling him to an award of costs. The court also rejected Rent-A-Wreck's claim that Schwartz was required to differentiate costs on prevailing claims from those that it did not prevail on. The court noted that Rent-A-Wreck had cited no authority for this proposition and that it would be inconsistent with the standard of awarding costs to a party that prevails on any significant claim.

Lastly, the court also rejected Rent-A-Wreck's argument that Schwartz was not entitled to costs for depositions of witnesses who did not testify at trial. The court noted that the depositions were reasonably necessary at the time they were taken and therefore it did not matter that the witnesses ultimately did not testify at trial.

CHOICE OF FORUM

Carl's Jr. Rests. LLC v. 6Points Food Servs. Ltd., Bus. Franchise Guide (CCH) ¶ 15,796, 2016 WL 3671116 (C.D. Cal. July 7, 2016)

In 2013, Carl's Jr. Restaurants LLC (CJR), a Delaware corporation with its principal place of business in California, entered into a development agreement with 6Points Food Services Ltd., a limited liability company organized under the laws of Ontario, Canada, with its principal place of business in Saskatchewan. Pursuant to the development agreement, 6Points agreed to open thirty Carl's Jr. branded fast food restaurants in Canada by 2020. The development agreement contained a choice of law provision applying Ontario law to any dispute and a choice of forum provision that granted CJR the right to file suit in any state or federal court where its principal offices were then located, or alternatively, in any province of Canada where 6Points resided or did business.

The development agreement also required that 6Points' principal owners and operators sign guaranty agreements. 6Points' owners convinced CJR to accept a letter of credit from 6Points in lieu of the guaranty agreements.

After entering into franchise agreements to open four restaurants in Ontario, Canada, 6Points announced that it would cease operations and sent CJR a notice of rescission, demanding payment of $7 million. 6Points never provided CJR with the letter of credit, as promised by its owners.

Shortly after receiving the notice of rescission, CJR filed suit against 6Points in the U.S. District Court for the Central District of California. CJR also brought claims against CJR's principals arising out of their failure to obtain a letter of credit in lieu of signing the guaranty agreements. The following day, 6Points filed suit against CJR in the Ontario Superior Court of Justice. 6Points then filed a motion to dismiss CJR's lawsuit in California under the doctrine of forum non conveniens. The Canadian action was stayed pending resolution of the motion in California.

In addressing the forum non conveniens motion, CJR argued that the court must apply the modified standard applicable to cases where there is a valid forum selection clause. The court rejected this argument, noting that the modified forum non conveniens analysis applies only where the forum selection clause is mandatory. The forum selection clause between CJR and 6Points was not mandatory because it did not require that California be the exclusive forum for all disputes. Instead, the clauses were merely permissive because it identified areas where CJR could file an action if it chose to do so. Accordingly, the court applied the traditional test for forum non conveniens.

Under the traditional test, the court must determine whether an adequate alternative forum exists and whether the balance of private and public interests favor dismissal. The court first noted that there was no dispute that Ontario, Canada, represented an adequate alternative forum that offered a satisfactory remedy to whichever party would prevail. Next, the court evaluated the private factors, which include (1) the residence of the parties and the witnesses; (2) the forum's convenience for the litigants; (3) access to physical evidence and other sources of proof; (4) whether unwilling witnesses can be compelled to testify; (5) the cost of bringing witnesses to trial; (6) the enforceability of the judgment; and (7) all other practical problems that make trial of a case easy, expeditious, and inexpensive. Of principal importance to the court in evaluating these factors was the fact that CJR acknowledged that it was planning to move its corporate headquarters from California to Tennessee. As a result, factors (1)-(3), (5) and (7) weighed in favor of Canada because all of the principal witnesses were either in Canada or Tennessee, and Tennessee was closer to Ontario than California. The court noted that the other factors were at best neutral because regardless of the location of the litigation, the parties may face challenges gaining access to witnesses and evidence, and the prevailing party would face challenges to enforcing the judgment. The court also noted that, as a practical matter, there was nothing to stop the Canadian court from proceeding in parallel (and potentially to a different result), if the court did not grant the dismissal.

Finally, the court turned to the public factors, which include: (1) the local interest in the lawsuit, (2) the court's familiarity with the governing law, (3) the burden on local courts and juries, (4) congestion in the court, and (5) the costs of resolving the dispute unrelated to a particular forum. The court noted that, in light of CJR's intended move from California to Tennessee, California had no justifiable interest in trying the case, and as a result, the burden on the local courts and the court's docket was unjustified. Conversely, the Ontario court was much more familiar with the governing law because the contract called for application of Ontario law to any dispute.

Having reviewed all the factors, the court found that all of the public factors and most of the private factors weighed in favor of dismissal. All of the other private factors were at worst neutral. Accordingly, the court concluded that dismissal was the appropriate remedy, granted 6Points motion, and dismissed the case.

***DTV, Inc. v. Brunkswick Corp.*, Bus. Franchise Guide (CCH) ¶ 15,823, 2016 WL 4225556 (N.D. Ohio Aug. 11, 2016)**

DTV, Inc. entered into retail dealer agreements with Brunkswick Corp., a manufacturer of billiards tables and related products. The retail dealer agreements gave DTV the exclusive right to sell Brunkswick's products in Northeast Ohio and Milwaukee. The contracts also contained a venue provision that selected the U.S. District Court for the Northern District of Illinois as the exclusive venue for any disputes arising out of or in connection with the parties' agreements.

Shortly thereafter, Brunkswick terminated the agreements. DTV responded by filing suit against Brunkswick in the Northern District of Ohio, alleging breach of contract and violations of Ohio and Wisconsin law. Brunkswick then filed a motion to transfer venue, arguing that the provisions of the contracts controlled and that the case should be moved to the Northern District of Illinois. The trial court noted that the decision to transfer venue pursuant to 28 U.S.C. § 1404(a) requires that the court balance several private and public factors. Before evaluating the private factors, the court noted that under the U.S. Supreme Court's ruling in *Atlantic Marine Construction Co. v. U.S. District Court for the Western District of Texas*, 134 S. Ct. 568 (2013), a valid forum selection clause in a contract should be given controlling weight in all but the most exceptional circumstances. If a contract contains a valid forum selection clause, the court may evaluate only the public factors.

Concluding that the forum selection clause in the contract was valid and enforceable, the court held that venue transfer was appropriate, noting that all DTV's arguments related to the private factors for transferring venue. The contractual venue clause superseded those factors, and none of the public factors weighed against transfer. The court transferred the action to the Northern District of Illinois.

***Fraser v. BrightStar Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 15,821, 2016 WL 4269869 (N.D. Cal. Aug. 15, 2016)**

Plaintiffs, one a resident of Georgia and one a resident of California, were joint owners of a home health care services franchise in Buckhead, Georgia, operated by franchisor BrightStar Franchising, an Illinois limited liability company. On March 11, 2016, plaintiffs brought suit against BrightStar and against individuals who were current or former officers or directors of BrightStar in state court in California. The complaint alleged various state law causes of action arising from allegations that (a) BrightStar failed to disclose that its prior franchises in the Buckhead territory had failed, (b) BrightStar misrepresented the geographic area and potential client population of the franchise territory, and (c) BrightStar provided misleading financial information.

The case was removed to federal court on grounds of diversity of citizenship. All of the defendants moved to dismiss the action based on improper venue under Federal Rule of Civil Procedure 12(b)(3) or, in the alternative, to transfer venue to the Northern District of Illinois. The individual defendants also moved to dismiss for lack of personal jurisdiction and for insufficient service of process.

After finding complete diversity of citizenship and that the amount in controversy requirement had been satisfied, the court assessed the venue issue. Defendants did not argue that the Northern District of California failed to satisfy one of 28 U.S.C. § 1391(b)'s criteria for venue. Instead, defendants argued that the governing franchise agreement contained a forum-selection clause specifying federal court in Illinois as the venue for the dispute. Citing *Atlantic Marine Construction Co. v. U.S. District Court for the Western District of Texas*, 134 S. Ct. 568 (2013), the court held that the forum selection clause did not render venue in the Northern District of California "wrong" or "improper." As a result, the court declined to dismiss the case but, instead, analyzed the defendants' alternative motion to transfer venue under 28 U.S.C. § 1404(a) and did so separately as to BrightStar and to the individual defendants.

As to BrightStar, the court gave "controlling weight" to the agreement's forum selection clause and held that the plaintiffs did not carry "their heavy burden of establishing exceptional circumstances to warrant disregarding the parties' choice of forum." In particular, and contrary to the plaintiffs' arguments, the court held that the forum selection clause was not the result of fraud, undue influence, or overweening bargaining power; did not effectively deprive the plaintiffs of their day in court in Illinois; and did not contravene any strong public policy of California.

As to the individual defendants, who were not signatories to the franchise agreement and thus were not subject to the forum selection clause, the parties did not dispute that the case could have been brought in the first instance in the Northern District of Illinois. The court therefore analyzed whether the interests of justice and the convenience of the parties and the witnesses, favored a transfer of venue. Because the claims against the individual defendants were essentially the same as those against BrightStar, the court held that judicial economy would not be served by having litigation of the same claims proceeding in two different courts. In addition, the court found that overall convenience for the parties and the witnesses would be enhanced if the case proceeded in Illinois.

Finally, having transferred venue, the court denied without prejudice the individual defendants' motion to dismiss for lack of personal jurisdiction and for insufficient service of process.

***Get in Shape Franchise, Inc. v. Killingsworth*, Bus. Franchise Guide (CCH) ¶ 15,819, 2016 WL 4445230 (D. Mass. Aug. 17, 2016)**

Get in Shape Franchise, Inc. brought two cases against franchisees in the U.S. District Court for the District of Massachusetts alleging breaches of the franchise agreement. Both franchisees moved to dismiss the cases, alleging improper venue.

In the first case, the franchisee cited to a provision of the franchise agreement requiring that venue for all disputes be situated in Norfolk County, Massachusetts. As no federal courts are located in Norfolk County, the magistrate judge assigned to the case recommended dismissal of the case for improper venue, and the recommendation was adopted by the district court.

In the second case, with Killingsworth as the defendant, the motion to dismiss did not reference the forum selection clause in the franchise agreement, which was identical to the forum selection clause in the first case. Accordingly, the magistrate judge did not recommend dismissal. On review of the report and recommendation from the magistrate, the court concluded that it would work an injustice to treat the identical cases differently. Accordingly, the court rejected the report and recommendation and dismissed the claims against Killingsworth for the same reasons as the dismissal of the claims against the first franchisee.

CHOICE OF LAW

Rimrock Chrysler Grp., LLC v. Montana, Bus. Franchise Guide (CCH) ¶ 15,799, 375 P.3d 392 (July 12, 2016)

Following the bankruptcy filing of Chrysler, LLC (Old Chrysler) in 2009, Congress enacted a new law in 2010 designed to protect the interests of automobile dealerships that had their contracts with Chrysler rejected during the bankruptcy process. Specifically, Section 747 of the Consolidated Appropriations Act of 2010 established a disclosure and arbitration process to determine whether dealers that had their franchise agreements terminated by Chrysler (and any other bankrupt automobile manufacturer) could have their dealerships added to the networks of the manufacturers after they came out of bankruptcy. A dealer that prevailed in arbitration would receive a letter of intent from the manufacturer to enter into a new franchise agreement. In addition to the right to arbitration, Section 747 granted manufacturers and dealers the right to opt out of arbitration and voluntarily negotiate a new agreement.

Chrysler Group, LLC (New Chrysler) acquired Old Chrysler's assets out of the bankruptcy. Among other things, this included an arbitration claim made by a terminated franchisee, Rimrock Chrysler Group, LLC, which had previously operated a Chrysler dealership in Billings, Montana. Rimrock prevailed in the arbitration and received a letter of intent from New Chrysler for a new dealership in Billings.

After receiving the letter of intent, a then existing dealer located in Billings, Lithia Motors, Inc., filed an administrative complaint with the Montana Department of Justice, Motor Vehicle Division, pursuant to the Montana's dealer protest laws. The dealer protest laws allow existing franchisees to object to the establishment of a new or additional motor vehicle dealership of the same line-make by filing a written objection with the department. The department then conducts an administrative hearing to determine whether good cause exists for entering into an additional franchise of the same line-make.

Lithia prevailed in the administrative hearing, and the department entered an order in its favor over New Chrysler's and Rimrock's objections. Rimrock then appealed the decision to state superior court. New Chrysler did not appeal the decision. Instead, New Chrysler filed an action against Rimrock and a host of other dealers in U.S. District Court in Michigan, seeking a declaration that it had no obligation to offer defendants a new franchise agreement. Rimrock and New Chrysler ultimately settled the federal case. In exchange for the dismissal, Rimrock agreed not to assert in any forum that Section 747 generally preempts Montana state dealer laws.

After settling the case, but before resolution of the appeal of the administrative action in Montana, the Sixth Circuit ruled in the Michigan case that, as to the remaining defendants that had not settled with New Chrysler, Section 747 preempted state dealership laws. Rimrock then filed a motion to vacate the administrative proceedings in the Montana action, arguing that Section 747 preempted Montana's dealer protest laws and deprived the State of Montana of subject matter jurisdiction to hear the administrative claim. Rimrock's motion was denied because Rimrock had waived the right to argue preemption in its settlement agreement with New Chrysler, and because the action was not justiciable where New Chrysler had never appealed the Department's order. Rimrock appealed to the Supreme Court of Montana.

On appeal, the court first addressed the question of subject matter jurisdiction over the proceedings. Rimrock argued that the superior court did not have subject matter jurisdiction because Section 747 preempted any claim under the state dealer protest law and, as such, the court had no subject matter jurisdiction to hear the claim. Lithia and New Chrysler argued that Rimrock had waived that argument in its settlement agreement with New Chrysler in the Michigan case when it agreed not to argue preemption in any other jurisdiction. The court noted that preemption is an affirmative defense that may be waived if not raised, but only if it is federal preemption of choice of law. Federal preemption of forum cannot be waived. In evaluating Section 747, the court noted that the statute permits dealers and manufacturers to opt out of arbitration as the exclusive forum for resolving disputes and instead negotiate directly. As such, Section 747 did not preempt forum and instead only preempted choice of law, which could be waived. Accordingly, the court held that Rimrock had waived its right to argue that Section 747 preempted the state dealer protest law.

Next, the court addressed whether the appeal on the merits was justiciable even though Rimrock was not a party to the dispute between New Chrysler and Lithia and New Chrysler never appealed the department's administrative ruling. The court noted that Montana dealer protest law expressly provides that "any person . . . who is aggrieved" by a final decision by the department can appeal that decision to the superior court. Given that Rimrock lost its letter of intent by virtue of the department's ruling, it was an "aggrieved" party that had the right to appeal the decision. Accordingly, the court remanded the case for further proceedings in the superior court on the propriety of the department's ruling in the administrative hearings.

CLASS ACTIONS

***Martinez v. Stratus Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 15,788, 2016 WL 3402546 (Ind. Ct. App. June 21, 2016).**

This case is discussed under the topic heading "Fraud."

***Salazar v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 15,818, 2016 WL 4394165 (N.D. Cal. Aug. 16, 2016)**

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

***Tigges v. AM Pizza, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,797, 2016 WL 4076829 (D. Mass. July 29, 2016)**

Plaintiffs in this case, Atila Tigges and Tylor Reeves were pizza delivery drivers who worked for Domino's Pizza franchisees located in Massachusetts. Defendant franchisees paid their drivers a "tipped minimum wage," that is, a wage that is lower than the statutory minimum wage, but supplemented by tips. Tigges and Reeves each filed class action lawsuits in the U.S. District Court for the District of Massachusetts against their respective employers, alleging that the delivery surcharges assessed to consumers who purchased pizza for delivery were in fact "service charges" that the franchisees were required to pay to their delivery drivers under the Massachusetts Tips Act and the Massachusetts Wage Act. The prospective class representatives were not on identical footing, however, because Reeves had signed an arbitration agreement with the franchisees that included a class action waiver. Tigges did not sign a similar arbitration agreement.

The franchisees had already litigated a class action lawsuit brought by another delivery driver, Edione Lisandro. The *Lisandro* case alleged the same claims against the franchisees for violations of the Tips Act and the Minimum Wage Act. The court held an exemplar trial on the merits of Lisandro's claims, and the franchisee prevailed. As a result, Lisandro's motion to certify a class was denied, because he was deemed to be an inadequate class representative.

On March 23, 2016, Tigges and Reeves moved to certify their respective classes under Federal Rule of Civil Procedure 23(b). Shortly thereafter, the Reeves defendants moved to dismiss the claims, arguing that the claims were barred by the court's decision in *Lisandro*, or alternatively, the claims were precluded by the arbitration agreement signed by Reeves, which included the class action waiver. The court addressed all three of these motions in a consolidated order.

First, the court addressed whether the *Lisandro* case precluded re-litigation of the class action claims brought by Tigges and Reeves. The court noted that issue preclusion applies only in a subsequent action between the same parties. Although the attorneys representing Tigges and Reeves also represented Lisandro, Reeves was not a party to the *Lisandro* action; as such, issue preclusion did not apply to preclude the two new lawsuits.

The court next addressed the merits of the motions to certify the class actions. In order to certify a class under Rule 23(a), a plaintiff must show that (1) the class is so numerous that joinder of all members is impractical, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class. Rule 23(b)(3) also requires that the district court find that the questions of law or fact common to class members predominate over any questions affecting only individual members and that a class action is superior to other available methods for adjudicating the controversy.

Having set down the rules for certification, the court noted that the only disputed elements were commonality and typicality and whether common questions predominate over individual questions, such that a class action is the most appropriate vehicle for addressing the dispute.

Starting with the question of commonality, the franchisees argued that the questions at issue in the lawsuit are not common as between prospective class members because the charging of the service fee depended upon individualized assessments of such questions as the manner in which the pizza order was placed, whether the customer asked about the delivery charge, whether the driver offered information voluntarily about the delivery charge, the demographics of the area where the pizza was delivered, and other highly fact specific analyses. Conversely, plaintiffs argued that the common question in all the cases was simply whether the charging of a service charge was a violation of the Tips Act. The court agreed with plaintiffs, noting that any differences in underlying factual questions (i.e., whether the violation of the statute would benefit an individual class member) could be sorted out by separate subquestions submitted to the jury. In so holding, the court rejected a recent Eighth Circuit case that indicated that individual differences prevented a finding of commonality, noting that the differences could be sorted out after trial.

Next, the court addressed the typicality requirement of Rule 23(a)(3). To satisfy typicality, it suffices that the claims arise from the same event or practice or course of conduct that gives rise to claims of other class members and are based on the same legal theory. Defendants argued that plaintiffs could not satisfy typicality because some of the individual defenses at issue in the case made their factual circumstances too different from typical class members. For example, defendants cited to the arbitration agreements signed by the proposed members of the Reeves class as grounds for finding that Reeves was not typical of the class. With respect to Tigges, defendants argued that Tigges had not been a delivery driver in many years and the Tigges defendants changed their practices (such as disclosure of the surcharge policy to drivers and customers) over time. Thus, Tigges' claims were not typical of claims brought by later class members. The court rejected these arguments, noting that individual defenses threaten typicality only when they stand to become the focus of the litigation. According to the court, in a somewhat conclusory fashion, nothing cited by defendants arose to this level.

On the class certification question, the court last addressed the predominance requirements of Rule 23(b)(3). The court noted that predominance requires only that the individual questions not overwhelm common ones. Having already held that the claims of the class representatives satisfied the commonality requirement of Rule 23(a)(2), the court held that the claims were sufficiently common that they also satisfied Rule 23(b). Although there were some questions about variations in damages to different plaintiffs, those questions could be easily addressed after trial. The court also noted that a class action would be superior to all other methods of adjudicating the controversy because the amounts at issue (service charges) were relatively small and would not be well suited to individual claims by pizza delivery drivers.

Having concluded that all of the elements of Rule 23 were satisfied, the court granted the motion to certify both class action complaints.

Lastly, the court addressed the argument in the motion to dismiss that the arbitration agreements signed by Reeves and other class members precluded their claims. Plaintiffs argued that the class action waivers were unenforceable because they violated the National Labor Relations Act (NLRA). Specifically, they argued that the purpose of the NLRA is to encourage collective action by workers. This argument had previously been rejected by the Fifth, Eighth, and Second Circuits, but not by the First Circuit, where the district court was located. Moreover, a recent decision by the Seventh Circuit had concluded that a class action waiver in an arbitration agreement violated the NLRA and was therefore unenforceable. Siding with the reasoning in the Seventh Circuit, which was consistent with the NLRA's only policy guidance, the court held that the class action waiver violated the NLRA and was therefore unenforceable. To reach this conclusion, the court noted that the Federal Arbitration Act contained no specific language suggesting that it was intended to supersede the NLRA. Defendants argued that the Seventh Circuit's decision was distinguishable because, unlike the agreements signed by Reeves, the arbitration and class action waiver agreements in the other case contained no provision that allowed workers to opt out of arbitration. But the court noted that the National Labor Relations Board had previously ruled in administrative actions that arbitration agreements with employees that contain opt-out agreements still violate the NLRA. Deferring to the agency's interpretation of the statute, the court held that the opt-out provision did not save the arbitration agreement. Accordingly, the court denied defendants' motion to dismiss.

CONTRACT ISSUES

***Andrea Distrib., Inc. v. Dean Foods of Wis.*, LLC, Bus. Franchise Guide (CCH) ¶ 15,784, 2016 WL 3199544 (W.D. Wis. June 8, 2016)**

The U.S. District Court for the Western District of Wisconsin granted a summary judgment motion by dairy products supplier Dean Foods of Wisconsin, LLC against dairy hauler and distributor Andrea Distributing, Inc. on Andrea's claim under the Wisconsin Fair Dealership Law (WFDL) for unlawful termination of a hauling agreement and Dean Foods' counterclaim to recover a past due balance under a separate distribution agreement between the parties.

Dean Foods entered into a hauling agreement with Andrea, pursuant to which Dean Foods paid Andrea to transport dairy products to its customers in Wisconsin. The parties also entered into a distribution agreement pursuant to which Andrea purchased dairy products from Dean Foods for resale. Years later, Andrea began to have financial problems and accumulated a large past due balance on the products it purchased from Dean Foods under the distribution agreement. As part of a plan to pay down the arrearages, Andrea proposed to increase the "per stop" hauling rates it charged Dean Foods under the hauling agreement. After the parties failed to come to a longer-term agreement regarding the hauling rates, Dean Foods notified Andrea that it was terminating the hauling agreement. In turn, Andrea stopped making payments on its past due balance under the distribution agreement and sued Dean Foods in Wisconsin state court. Dean Foods subsequently decided to terminate the distribution agreement. It also removed the state court case to the federal district court and asserted a counterclaim for nonpayment under the distribution agreement.

The crux of Andrea's WFDL claim was that it had one omnibus dealership agreement with Dean Foods that the latter terminated without good cause. The court looked to the following four factors to determine whether the two agreements were distinct for the purposes of the WFDL: "(1) the language and history of the agreements, (2) the extent to which the grantor distinguished between the activities, (3) the extent to which the grantee distinguished between the activities, and (4) whether there were third parties performing the activities separately." The court agreed with Dean Foods' argument that there were two separate agreements covering Andrea's hauling and distribution activities. It noted some evidence that the activities under the agreements were comingled, but found that the remaining three out of four factors supported Dean Foods' claim. Having found that the two agreements were distinct, the court held that Dean Foods had cause good cause to terminate the distribution agreement for non-payment and that it complied with the requisite WFDL notice requirements. The court also found that the hauling agreement did not create a dealership between the parties under the WFDL because Andrea was not required to purchase equipment, build facilities, use Dean Foods' logos, or make other substantial investments in Dean Foods' business. Therefore, Dean Foods was entitled to terminate the hauling agreement at will.

***Bull Int'l, Inc. v. MTD Consumer Grp., Inc.*, Bus. Franchise Guide (CCH) ¶ 15,791, 2016 WL 3542249 (3rd Cir. June 29, 2016).**
This case is discussed under the topic heading "Statutory Claims."

***Caudill v. Keller Williams Realty, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,805, 828 F.3d 575 (7th Cir. 2016)**
In 2012, Jana Caudill and Keller Williams Realty settled a suit arising from Keller Williams's termination of Caudill's realty franchise. The settlement

agreement contained a confidentiality provision that prohibited the disclosure of the agreement's terms, but permitted disclosure to certain recipients, such as tax professionals and insurance carriers, as long as these recipients promised to keep the terms confidential. The agreement's confidentiality provisions also contained a liquidated damages clause, setting compensation at $10,000 for any violation of the confidentiality provisions.

Three months later, Keller Williams issued a franchise disclosure document to 2,000 of its franchisees, disclosing confidential terms of the agreement with Caudill. Caudill sued, seeking $20 million in liquidated damages, namely, $10,000 for each of the 2,000 violations of the agreement. The district court refused to grant relief, finding under Texas law that the liquidated damages clause was not a reasonable forecast of compensation to Caudill. The district court held that there was no evidence that the unauthorized disclosure in the FDD had caused $20 million in damages to Caudill, and Keller Williams had adduced evidence that any damage to Caudill did not approach anything close to an average of $10,000 per unauthorized recipient of the disclosure.

The Seventh Circuit, in short order, affirmed the district court's ruling, holding that although one could conceivably imagine serious damage to Caudill, the record reflected only speculation as to the amount of such damage.

***Choice Hotels Int'l, Inc. v. Frontier Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,817, 2016 WL 4367993 (S.D. Tex. Aug. 15, 2016)**
This case is discussed under the topic heading "Trademark Infringement."

***Get in Shape Franchise, Inc. v. Killingsworth*, Bus. Franchise Guide (CCH) ¶ 15,819, 2016 WL 4445230 (D. Mass. Aug. 17, 2016)**
This case is discussed under the topic heading "Choice of Forum."

***Howard Johnson Int'l, Inc. v. Tyler Texas Lodging, LLC*, Bus. Franchise Guide (CCH) ¶ 15,786, 2016 WL 3436402 (D.N.J. June 16, 2016)**
The U.S. District Court for the District of New Jersey granted a motion by Howard Johnson International, Inc. (HJI) for default judgment under Federal Rule of Civil Procedure 55(b)(2) against defendants franchisee Tyler Texas Lodging, LLC and guarantor Joseph Garrison where defendants failed to plead or otherwise defend HLJ's complaint for breach of the parties' franchise agreement and monetary damages exceeding $300,000.

HLJ, franchisor of Howard Johnson hotels, entered into a franchise agreement and related agreements with Texas Lodging for the operation of a ninety-one room Howard Johnson hotel in Tyler, Texas, in 2009. After Texas Lodging repeatedly failed to timely pay HJI, the latter terminated the franchise agreement and subsequently sued Texas Lodging in district court to recover recurring fees, including royalties, system assessments, reservation system user fees, annual conference fees, other fees, and taxes and interest. It also sued to recover liquidated damages for premature termination of the franchise agreement. After defendants failed to answer or otherwise respond to the complaint, the clerk of the district court entered default against both defendants and HLJ moved for default judgment. Noting that service of process was proper, default judgment was appropriate under the circumstances because defendants did not have a meritorious defense, HLJ would be prejudiced absent entry of the default judgment, and defendants acted culpably, the court also assessed HLJ's the damages sought by HLJ and found that HLJ had adequately proven its damages in the amount claimed.

***Jack In the Box Inc. v. Mehta*, Bus. Franchise Guide (CCH) ¶ 15,793, 2016 WL 3401988 (N.D. Cal. June 21, 2016)**

Beginning in 1992, plaintiff Jack In the Box Inc. (JIB) entered into a series of nineteen franchise agreements with various defendants. The parties also entered into a series of lease agreements in connection with the franchise agreements, in which JIB acted as landlord and defendants acted as tenants. Between September 1, 2011, and August 22, 2012, defendants failed to pay rent, royalties, marketing fees, and other charges pursuant to the agreements. In May 2013, defendants attempted to secure refinancing from a bank for their existing debts, but those efforts eventually failed due to significant differences between what defendants told the bank they owed JIB and the amount JIB told the bank defendants owed. Effective September 17, 2013, JIB terminated the agreements, but defendants continued to use JIB's trademarks following termination of the agreements.

Thereafter, JIB sued defendants for breach of contract and for trademark infringement and unfair competition under the Lanham Act. JIB then moved for partial summary judgment on its first claim under the contract; summary judgment on its Lanham Act claims; and summary judgment dismissing defendants' counterclaims for breach of contract, breach of the implied covenant of good faith and fair dealing, promissory estoppel, and negligent interference with contract and economic advantage.

In a near complete victory for JIB, the court granted, in its entirety, JIB's motion for partial summary judgment on its breach of contract claims as well as the JIB's summary judgment motion on its trademark infringement and unfair competition claims. The court also granted plaintiff's summary judgment motion seeking dismissal of all of defendants' counterclaims

Concerning JIB's breach of contract claim, the court found that there was no genuine issue of material fact that (1) the parties had a contract, (2) JIB had performed under the contract, (3) defendants breached, and (4) JIB was damaged thereby. In particular, the court rejected, due to lack of substantiating evidence, defendants' arguments that JIB improperly terminated the agreements and improperly interfered with their efforts to obtain refinancing that, according to defendants, would have cured the breaches. In particular, defendants failed to point to any provisions of the agreements that required JIB to undertake the obligations of which defendants complained, namely, the provision of monthly invoices and an accounting of the amount JIB had demanded from defendants' bank.

As to defendants' breaches, the court overruled various evidentiary objections and held that defendants did not create any genuine issue of material fact that they had breached the agreements in the ways asserted by JIB. These asserted breaches included failure to timely pay rent, marketing and other fees required by the agreements; failure to pay taxes, such that state and county tax liens were recorded; and failure to provide quarterly accounting statements. Defendants did not dispute that these breaches had occurred.

Regarding JIB's claims of trademark infringement and unfair competition, the court found that it was undisputed that, following termination of the agreements, defendants nonetheless continued to use JIB's Jack In the Box trademarks without permission as "holdover" franchisees. Because defendants did not dispute these facts, except for raising the same arguments that the court rejected in assessing the breach of contract claim, the court held that defendants were liable to JIB, as a matter of law, under the Lanham Act.

Finally, the court similarly granted JIB's motion for summary judgment seeking dismissal of defendants' counterclaims. In particular, defendants (1) failed to submit evidence of their own performance under the agreements and JIB's breach of the agreements in order to support their breach of contract claim; (2) failed to adduce evidence that JIB had made a clear and unambiguous promise not to terminate the agreements, which was necessary to support a counterclaim for promissory estoppel; and (3) did not sufficiently establish that JIB negligently interfered in defendants' refinancing efforts in order to support their counterclaims for negligent interference with contract.

***Midas Int'l Corp. v. Poulah Inv'rs, LLC*, Bus. Franchise Guide (CCH) ¶ 15,811, 2016 WL 4532033 (D. Md. Aug. 29, 2016)**

Midas International Corp. brought suit in the U.S. District Court for the District of Maryland against its former franchisee, Poulah Investors, LLC and its principal operators, alleging trademark infringement, breach of the franchise agreement, and breach of guarantee. The claims arose following expiration of the franchise agreement in November 2014. Prior to expiration, Midas sent Poulah a letter offering a renewal, provided that Poulah paid the delinquent amounts owing. At the time of expiration, Poulah owed Midas $13,587.10. Midas notified Poulah in writing of its obligations to de-identify its franchised location and to pay the outstanding delinquent amounts. Despite the warning, Poulah continued to use the Midas trademarks until August 15, 2015, when the company went out of business.

When Poulah failed to answer the complaint, Midas filed a motion for default judgment. At the same time, Midas brought a motion for summary judgment against the individual defendants (who had answered the complaint). The court reviewed the allegations in the complaint and concluded that Midas had stated claims against Poulah for breach of contract. The court awarded damages for the delinquent amounts owing, plus late fees, and liquidated damages for Poulah's use of the trademark following expiration of the franchise agreement.

Midas also prevailed on its claims for trademark infringement, which the court concluded were sufficient based on the allegations in the complaint that Midas owned the trademarks and that Poulah had continued to use them without permission after the franchise agreement expired. However, the court refused to award treble damages under the Lanham Act, noting that the Lanham Act allows only an award of "actual damages" incurred by reason of the infringement, which does not include contractually agreed-upon damages.

The court also granted in part the motion for summary judgment against the individual defendants. The court held that the guaranty agreements signed by Poulah's principals required that they pay any amounts due and owing to Midas by Poulah, including amounts due and owing under the contract or for trademark infringement. But because the court had already concluded that Midas established only contractual damages owing against Poulah and failed to present any evidence of actual damages for trademark infringement, the court limited the damages award against the individual defendants to the contractual damages against Poulah. In so holding, the court rejected the individual defendants' argument that they could setoff the amounts owed by Poulah to Midas under the franchise agreement. Specifically, the individual defendants claimed that Midas owed Poulah more money than Midas was seeking from Poulah, allegedly for warranty repair work that Midas had never credited to Poulah's account. The court noted that the individual defendants had presented no evidence of any offsets, and in any event, the franchise agreement specifically prohibited any offset by the franchisee absent the express written consent of Midas.

Finally, the court held that Midas failed to establish a claim for trademark infringement against the individual defendants, noting that there was no evidence that the individuals had personally participated in the company's trademark infringement.

***Mrs. Fields Franchising, LLC v. Bektrom Foods, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,810, 2016 WL 4051848 (D. Utah July 27, 2016)**

Mrs. Fields Franchising, LLC entered into a franchise agreement with Bektrom Foods, Inc., pursuant to which Bektrom agreed to make minimum annual guarantee payments as well as quarterly royalty payments. After making the first guarantee payment and all quarterly royalty payments, in September 2013, Bektrom failed to make the second payment in the amount of $150,000. Mrs. Fields sent Bektrom a notice of default for the missed payments, and the parties began negotiating a resolution to their dispute via email. The parties reached a tentative agreement, pursuant to which Bektrom agreed to continue making quarterly royalty payments and to make a payment of $75,000 in exchange for a release from its obligation to make the missed guarantee payment and future guarantee payments. Mrs. Fields prepared a draft agreement memorializing the terms of the parties' understanding, although it was never sent to Bektrom and never signed by either party.

Thereafter, Mrs. Fields filed suit, seeking damages for Bektrom's failure to make the $150,000 guarantee payment and other minimum guarantees up to $920,000. Bektrom argued that the parties had modified their contract when they agreed to waive the payment of the guarantees in exchange for a payment of $75,000. In support of this argument, Bektrom noted that Mrs. Fields had entered the terms of the parties' agreement into its accounting system, which internal records showed had forgiven the amount of the minimum guarantee payments in the company's records of accounts receivable.

The trial court agreed, noting that the email exchanges between the parties, the accounting notation, and the unsigned draft of the written agreement demonstrated sufficient evidence of Mrs. Fields' intentional waiver of a known right. In exchange for the waiver, Mrs. Fields was entitled to payment of the negotiated amount from Bektrom ($75,000). Accordingly, the court entered judgment in favor of Mrs. Fields in the amount of $75,000.

***Roadtrek Motorhomes, Inc. v. Calif. New Motor Vehicle Bd.*, Bus. Franchise Guide (CCH) ¶ 15,808, 2016 WL 3885006 (Cal. Ct. App. July 14, 2016)**

This case is discussed under the topic heading "Statutory Claims."

***Jade Grp., Inc. v. Cottman Transmission Ctrs., LLC*, Bus. Franchise Guide (CCH) ¶ 15,806, 2016 WL 3763024 (E.D. Pa. July 13, 2016)**

Plaintiffs in this case were four individual franchisees of Cottman Transmission Centers, an automotive transmission repair franchise. In 2006, Cottman's parent acquired Cottman's most significant competitor, AAMCO, and announced that it would be phasing out the Cottman brand. In the face of pushback from franchisees, Cottman continued to receive at least some support over the course of several years. However, in May 2014, it was announced at Cottman's annual convention that resources would be focused on growing the AAMCO brand and that no further resources would be invested into growing the Cottman brand.

Plaintiffs filed suit, alleging claims of breach of contract and breach of the implied covenant of good faith and fair dealing against Cottman. Plaintiffs also asserted claims of tortious interference against Cottman's parent. In addition, plaintiffs sought declaratory relief that the franchise agreements were terminated and, therefore, that the agreements' covenants not to compete were unenforceable. Defendants moved to dismiss all of these claims for failure to state a claim on which relief could be granted.

The court denied defendants' motion except as to the claim for a breach of the implied covenant of good faith and fair dealing. Concerning the breach of contract claims, the court held that the face of the complaint, viewed in the light most favorable to plaintiffs, plausibly alleged claims for various breaches of the agreement. In particular, plaintiffs plausibly stated a claim that Cottman failed to "develop, grow, and protect the company's goodwill" in violation of the agreement. The court also denied defendants' motion that the claims were barred by Pennsylvania's four-year statute of limitations, reasoning that the court could not determine, from the face of the complaint, whether the breaches were consummated at the May 2014 annual convention or at some earlier time.

Regarding the claim for breach of the implied covenant of good faith and fair dealing, the court granted defendants' motion. The court held that, because plaintiffs relied on the same facts to support both this claim and their breach of contract claims, they had an adequate remedy under the breach of contract claims and thus could not state a claim for breach of the implied covenant of good faith and fair dealing.

The court also denied defendants' motion to dismiss the tortious interference claims. Defendants argued that, because plaintiffs could not state a claim for the underlying breach of contract, the tortious interference claims must be dismissed. In light of the court's denial of the motion on the breach of contract claims, however, the court rejected this argument. Additionally, the court also refused to shield Cottman's parent from such a claim, holding that the parent's conduct "was not motivated by a desire to protect Cottman's assets. Rather, the allegations demonstrate that [the parent] was driven by an interest in aggrandizing itself through the growth of Cottman's corporate sibling."

Finally, the court held that declaratory relief may be available to plaintiffs. In particular, the court held that, when viewed in the light most favorable to plaintiffs, the asserted breaches of the agreement may have been sufficiently material to warrant rescission and, therefore, to warrant declaratory relief that the agreement had been terminated. Moreover, the court held that the applicability and reasonableness of the covenant not to compete was a fact-intensive inquiry that it was unwilling to resolve at the pleadings stage.

***Touch Holding Co. v. Copeland's Cheesecake Bistro, LLC*, Bus. Franchise Guide (CCH) ¶ 15,816, 2016 WL 4272908 (E.D. La. Aug. 12, 2016)**

Touch Holding Company approached Copeland's Cheesecake Bistro LLC about opening Copeland's branded restaurants in six countries. After some negotiations, Touch entered into a letter of interest with Copeland, pursuant to which it agreed to pay a "good faith deposit" of $100,000, with the "[b]alance of upfront fees to be paid upon execution of a Master Franchise Agreement." After the parties executed the agreement, Touch deposited the money and the parties began negotiating a master franchise agreement. During negotiations, Touch requested that Copeland begin modifying its menu to offer additional items, while Touch sought to secure a location for the first store. Copeland regularly reported progress on the changes to the menu and on purchasing and distribution issues. After several weeks, however, the parties were unable to reach agreement on the terms of a master franchise agreement. Accordingly, Touch demanded that Copeland return the deposit. When Copeland refused, Touch filed suit seeking return of the deposit in the U.S. District Court for the Eastern District of Louisiana. Copeland brought counterclaims for promissory estoppel, alleging that it had relied upon Touch's representations that it would be opening new restaurants when it agreed to modify its menu.

Touch moved for summary judgment, demanding return of the deposit, and dismissal of Copeland's promissory estoppel and detrimental reliance counterclaims. Touch argued that, under Louisiana law, a deposit of money that is not specifically denominated as "earnest money" is presumed to be refundable. The court rejected Touch's argument, noting that the "earnest money" statute applied to real estate transactions and not to commercial transactions. Looking at the plain language of the parties' agreement, the court held that it could not ascertain whether the parties intended that the deposit be refundable. Accordingly, the court turned to extrinsic evidence, noting that in various exchanges, the parties had noted that the money was referred to as a "down payment" on a future franchise fee. As a result, the court held that there was a genuine issue of material fact as to whether the deposit was intended to be refundable or instead the first part of several agreed-upon payments.

With respect to the promissory estoppel claim, the court held that the evidence in the record demonstrated that Copeland had relied upon Touch's statements by spending money to add items to its menu and address product distribution questions. As such, there were material issues of fact on the promissory estoppel claim. Given these issues of material fact, the court denied the motion for summary judgment.

CORPORATE VEIL PIERCING

***Uninsured Employer's Fund v. Crowder*, Bus. Franchise Guide (CCH) ¶ 15,794, 2016 WL 2605624 (Ky. May 5, 2016)**
This case is discussed under the topic heading "Statutory Claims."

DAMAGES

***Choice Hotels Int'l, Inc. v. Frontier Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,817, 2016 WL 4367993 (S.D. Tex. Aug. 15, 2016)**
This case is discussed under the topic heading "Trademark Infringement."

***Legacy Acad., Inc. v. Doles-Smith Enters. Inc.*, Bus. Franchise Guide (CCH) ¶ 15,781, 789 S.E.2d 194 (June 9, 2016)**
In an ongoing dispute between daycare center franchisor Legacy Academy, Inc. and franchisee Doles-Smith Enterprises, Inc. (DSE), the Georgia Court of Appeals found that the trial court erred in denying Legacy's motion

for a directed verdict and judgment notwithstanding the verdict (JNOV) on DSE's negligent misrepresentation claim but was correct in denying DSE's motion for directed verdict and JNOV on Legacy's breach of contract counterclaim seeking to recover lost royalties.

In 2006, Legacy entered into a franchise agreement with another entity owned by DSE's owners whereby DSE acquired the rights to operate a Legacy daycare center franchise in Fulton County. After opening in June 2008, DSE's center suffered yearly net losses. DSE stopped paying Legacy monthly royalties and advertising fees after March 2011. In August 2012, DSE terminated its relationship with Legacy and sued Legacy for, among other things, negligent misrepresentation and negligence under Georgia law. It also sued for rescission, but subsequently withdrew that claim. A jury found in favor of DSE on its claim for negligent misrepresentation and negligence, awarding it $350,000 and $40,000 respectively. It also found in favor of Legacy on its counterclaim for lost royalties and lost advertising fees, awarding Legacy $46,300.

The court reversed the award to DSE for negligent misrepresentation, noting that DSE had failed to provide proof of actual economic loss proximately resulting from the alleged negligent misrepresentation. It determined that DSE did not introduce any evidence at trial of the difference between the purchase price it paid for the Legacy daycare center franchise and the value of the franchise actually sold to them in light of the alleged misrepresentation. The fees DSE sought to recover, $40,000 for the franchise fee and $200,000 in personal debt obligations, were not recoverable as consequential damages as a matter of law for a negligent misrepresentation claim, but they would have been under the withdrawn rescission claim. The court affirmed the award of lost future royalties to Legacy noting that under Georgia law, a claim for lost royalties is treated in the same matter as a claim for lost profits. It determined that Legacy presented sufficient evidence of its lost gross revenue resulting from DSE's unpaid royalty fees. The court also determined that Legacy could use the advertising fee percentage to measure the value of DSE's broken promise to pay monthly advertising fees as a basis for its damages.

***Midas Int'l Corp. v. Poulah Inv'rs, LLC*, Bus. Franchise Guide (CCH) ¶ 15,811, 2016 WL 4532033 (D. Md. Aug. 29, 2016)**
This case is discussed under the topic heading "Contract Issues."

***Mrs. Fields Franchising, LLC v. Bektrom Foods, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,810, 2016 WL 4051848 (D. Utah July 27, 2016)**
This case is discussed under the topic heading "Contract Issues."

***Tri County Wholesale Distribs., Inc. v. Labatt USA Operating Co., LLC*, Bus. Franchise Guide (CCH) ¶ 15,807, 828 F.3d 421 (6th Cir. 2016)**
This case is discussed under the topic heading "Termination and Nonrenewal."

DEFINITION OF FRANCHISE

***Benson v. City of Madison*, Bus. Franchise Guide (CCH) ¶ 15,184, 2016 WL 4468411 (Wis. Ct. App. Aug. 25, 2016)**
This case is discussed under the topic heading "Definition of Franchise."

DISCRIMINATION

***Brentlinger Enters. v. Volvo Cars of N. Am., LLC*, Bus. Franchise Guide (CCH) ¶ 15,815, 2016 WL 4480343 (S.D. Ohio Aug. 25, 2016)**
This case is discussed under the topic heading "Antitrust."

ENCROACHMENT

***Rimrock Chrysler Grp., LLC v. Montana*, Bus. Franchise Guide (CCH) ¶ 15,799, 384 Mont. 76, 375 P.3d 392 (July 12, 2016)**
This case is discussed under the topic heading "Choice of Law."

***Roadtrek Motorhomes, Inc. v. Calif. New Motor Vehicle Bd.*, Bus. Franchise Guide (CCH) ¶ 15,808, 2016 WL 3885006 (Cal. Ct. App. July 14, 2016)**
This case is discussed under the topic heading "Statutory Claims."

***W. Colo. Motors, LLC v. Gen. Motors, LLC*, Bus. Franchise Guide (CCH) ¶ 15,792, 2016 WL 3600289 (Colo. App. June 30, 2016)**
This case is discussed under the topic heading "Statutory Claims."

FRAUD

***Devayatan LLC v. Travelodge Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,790, 2016 WL 3477205 (M.D. Fla. June 24, 2016)**
This case is discussed under the topic heading "Statutory Claims."

***Legacy Acad., Inc. v. Doles-Smith Enters. Inc.*, Bus. Franchise Guide (CCH) ¶ 15,781, 337 Ga. App. 575, 789 S.E.2d 194 (June 9, 2016)**
This case is discussed under the topic heading "Damages."

***Martinez v. Stratus Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 15,788, 2016 WL 3402546 (Ind. Ct. App. June 21, 2016).**
The Court of Appeals of Indiana affirmed a trial court judgment in favor of commercial cleaning franchisor, Stratus Franchising, L.L.C., against a class of franchisees of master franchisee Shamrock Building Services, Inc. d/b/a Stratus Building Solutions of Indianapolis (Shamrock), holding that the

trial court's findings of fact and conclusion of law that Stratus did not aid and abet franchise fraud were not clearly erroneous.

As a threshold matter, the class claimed that Stratus aided and abetted franchise fraud under Indiana law and the FTC Franchise Rule. It argued that because Section 23-2-2.5-13 of the Indiana Franchise Act referenced the FTC Franchise Rule, any deceptive act in violation of the FTC Franchise Rule constituted fraud under the Act. The court rejected that argument and reiterated long-standing precedent from the state supreme court that the Act does not provide a private right of action for violations of its disclosure provisions.

At trial, the members of the class claimed that they failed to receive customer accounts that generated the total income Shamrock had essentially guaranteed through its advertisements and sales presentations. In finding for Shamrock and Stratus on the fraud claims, the court noted that (1) the franchise disclosure document (FDD), unit franchise agreement (UFA) and sales presentations provided by Shamrock to the class contextualized any misleading statements in the sales presentation; (2) there was insufficient evidence that Shamrock and Stratus failed to act in good faith; and (3) the class could not justifiably rely on Shamrock's statements where the UFA contained a provision disclaiming reliance on any express or implied representations or guarantees.

Finally, the court noted that the record demonstrated that Stratus provided Shamrock with the FDD and UFA, which disclosed the franchise system in sufficient detail to allow prospective franchisees the opportunity to exercise independent judgment before purchasing a franchise. Therefore, the court affirmed the trial court's conclusion that Shamrock did not make material false statements concerning income guarantees in exchange for the individual class plaintiffs' payments of certain levels of franchise fees. Absent fraud on Shamrock's part, it also affirmed the entry of judgment in favor of Stratus on the aiding and abetting claim.

FTC FRANCHISING RULE

***Martinez v. Stratus Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 15,788, 2016 WL 3402546 (Ind. Ct. App. June 21, 2016).**
This case is discussed under the topic heading "Fraud."

GOOD FAITH AND FAIR DEALING

***Brentlinger Enters. v. Volvo Cars of N. Am., LLC*, Bus. Franchise Guide (CCH) ¶ 15,815, 2016 WL 4480343 (S.D. Ohio Aug. 25, 2016)**
This case is discussed under the topic heading "Antitrust."

***Devayatan LLC v. Travelodge Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,790, 2016 WL 3477205 (M.D. Fla. June 24, 2016)**
This case is discussed under the topic heading "Statutory Claims."

***Martinez v. Stratus Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 15,788, 2016 WL 3402546 (Ind. Ct. App. June 21, 2016).**
This case is discussed under the topic heading "Fraud."

***Jade Grp., Inc. v. Cottman Transmission Ctrs., LLC*, Bus. Franchise Guide (CCH) ¶ 15,806, 2016 WL 3763024 (E.D. Pa. July 13, 2016)**
This case is discussed under the topic heading "Contract Issues."

INJUNCTIVE RELIEF

***Choice Hotels Int'l, Inc. v. Frontier Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,817, 2016 WL 4367993 (S.D. Tex. Aug. 15, 2016)**
This case is discussed under the topic heading "Trademark Infringement."

JURISDICTION

***859 Boutique Fitness, LLC v. CycleBar Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 15,820, 2016 WL 4414786 (E.D. Ky. Aug. 18, 2016)**
859 Boutique Fitness, LLC filed a complaint against CycleBar Franchising LLC in Kentucky state circuit court alleging breach of a franchise agreement and seeking damages in excess of $2,500,000. Because there was complete diversity of citizenship between the two corporations and the amount in controversy exceeded $75,000, CycleBar removed the case to the U.S. District Court for the Eastern District of Kentucky. After removal, CycleBar moved to dismiss the claims asserted in the complaint and prevailed after a hearing on the motion. The court granted Boutique leave to amend its complaint to state a claim.

Boutique's amended complaint reduced the demand for damages to $74,383.79. After filing the amended complaint, Boutique filed a motion to remand the case to state court, arguing that the amount in controversy no longer satisfied the statutory minimum for diversity jurisdiction cases. The district court noted that when analyzing the amount in controversy for purposes of determining whether the court has subject matter jurisdiction over a removed matter, the court must examine the amount in controversy at the time of removal. Because the amount in controversy at the time of removal was $2,500,000, the court determined that the removal was proper, and denied the motion for remand.

***Jani-King Franchising, Inc. v. Falco Franchising, S.A.*, 2016 WL 2609314 (Tex. App. May 5, 2016)**
In 2004, plaintiff Jani-King Franchising, Inc., a commercial cleaning franchisor, was contacted by two shareholders of Belgian company Falco S.A. seeking to enter into franchising relationship. Jani-King and Falco subsequently entered into a franchise agreement, governed by Texas law, that granted

Falco an exclusive right to operate a Jani-King franchise in Belgium for a period of twenty years.

In November 2010, Falco defaulted on certain reporting obligations and began falling behind on payment obligations to Jani-King. In March 2014, Falco informed Jani-King that it no longer intended to pay royalties and gave notice of its intention to terminate the agreement. Following additional investigation, Jani-King learned that Falco had surreptitiously commenced a competing business in Belgium and had misused certain of Jani-King's personal property and confidential information. Jani-King brought suit in Texas state court against Falco, its three shareholders, and its branch manager, alleging claims of common law fraud and fraudulent concealment. Defendants filed special appearances, a procedure by which they challenged the Texas trial court's exercise of personal jurisdiction over them. The trial court granted those special appearances and found personal jurisdiction was lacking as to all of defendants, except Falco. Jani-King sought an interlocutory appeal, and Falco cross-appealed.

The Texas Court of Appeals refused to apply the fiduciary shield doctrine. That doctrine, if applicable, would have immunized the individual defendants from the exercise of jurisdiction because they could not be held individually liable for the claims asserted against them. However, because Jani-King had alleged torts against the individual defendants for which they could be held individually liable, the fiduciary shield doctrine did not preclude the exercise of personal jurisdiction over the individual defendants if such exercise was otherwise proper.

As to the individual defendants' substantive amenability to suit, the trial court had ruled that none of the individual defendants were subject to personal jurisdiction in Texas. The Texas Court of Appeals, however, reversed the trial court's rulings as to all of the individual defendants except Falco's branch manager. Regarding the branch manager, the court applied prior precedents to hold that, because the branch manager did not reside in Texas and communicated only by email regarding performance of the franchise agreement, his contacts with Texas were insufficient to support the exercise of personal jurisdiction. By contrast, the other individual defendants had traveled to Texas and had made statements and omissions, while in Texas, that were relevant to Jani-King's claims of fraud and fraudulent concealment. Consequently, and after determining that the exercise of personal jurisdiction by the Texas courts would not offend traditional notions of fair play and substantial justice, the court reversed the trial court and found that these individual defendants were subject to jurisdiction in Texas.

Similarly, on Falco's cross-appeal, the court held that Falco's contacts with Texas were sufficiently extensive that Falco could reasonable anticipate being sued there. In particular, under the agreement, Falco agreed to the jurisdiction of U.S. courts, and the only state in the United States in which Falco performed tasks under the contract was Texas (and did so for ten years). The agreement was also governed by Texas law. As a result, the court affirmed the trial court's denial of Falco's special appearance.

The significance of this decision is reflected in the court's efforts to draw lines concerning conduct that will or will not give rise to personal jurisdiction, at least under Texas law. Relatively innocuous emails or telephone calls in the day-to-day performance of a franchise agreement do not appear to give rise to personal jurisdiction in Texas. By contrast, visiting the state and engaging in conduct that give rise to the allegations of the lawsuit will result in the exercise of personal jurisdiction by Texas courts. Similarly, a foreign-based franchisee will be subject to personal jurisdiction in Texas if it enters into a franchise agreement that is governed by Texas law and if the parties assent to jurisdiction in the United States in circumstances in which Texas is the only U.S. state in which pertinent conduct occurs.

***Rimrock Chrysler Grp., LLC v. Montana*, Bus. Franchise Guide (CCH) ¶ 15,799, 375 P.3d 392 (July 12, 2016)**
This case is discussed under the topic heading "Choice of Law."

***Tigges v. AM Pizza, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,797, 2016 WL 4076829 (D. Mass. July 29, 2016)**
This case is discussed under the topic heading "Class Actions."

***Tilted Kilt Franchise Operating, LLC v. 1220, LLC*, Bus. Franchise Guide (CCH) ¶ 15,798, 2016 WL 463172 (N.D. Ill. July 29, 2016)**
This case is discussed under the topic heading "Termination and Renewal."

***W. Colo. Motors, LLC v. Gen. Motors, LLC*, Bus. Franchise Guide (CCH) ¶ 15,792, 2016 WL 3600289 (Colo. Ct. App. June 30, 2016)**
This case is discussed under the topic heading "Statutory Claims."

LABOR AND EMPLOYMENT

***Salazar v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 15,818, 2016 WL 4394165 (N.D. Cal. Aug. 16, 2016)**
In 2010, the defendants (collectively, McDonald's) entered into a franchise agreement with a franchisee (Haynes). Pursuant to that agreement, and in general terms, McDonald's possessed control over setting general operational standards and Haynes was in charge of personnel. Plaintiffs were crew members at Haynes-owned McDonald's restaurants in Oakland, California, and brought a putative class action suit against McDonald's, seeking to recover wages allegedly owed to them under California state law.

McDonald's moved for summary judgment, on the theory that it does not jointly employ the plaintiffs because McDonald's, as opposed to Haynes, does not exert direct or indirect control over the plaintiffs' hiring, firing, wages, or working conditions. The court granted a substantial portion of McDonald's motion, but denied that part of the motion that concerned plaintiffs' claims under an "ostensible agency" theory.

In ruling on the motion, the court initially recognized that California law imposes a duty to pay minimum wages only upon "employers" and, as such, McDonald's could only be liable if it "employed" the plaintiffs. Applying *Martinez v. Combs*, 49 Cal. 4th 35 (2010), and *Patterson v. Domino's Pizza, LLC*, 60 Cal. 4th 474 (2014), and with a lengthy and detailed analysis, the court found that there was no genuine issue of material fact that McDonald's was not the plaintiffs' employer on an actual agency theory. The court found it to be undisputed that McDonald's did not control the plaintiffs' wages, hours, or working conditions and held that McDonald's did not retain a contractual right to do so. Similarly, the court held that McDonald's did not "suffer or permit" the plaintiffs to work because Haynes alone possessed the ability "to hire and fire workers, to set their wages and hours, and to tell them when and where to report to work." Moreover, the court determined that McDonald's ability, as a franchisor, to exert some measure of economic pressure due to its operational oversight capabilities was insufficient, as a matter of law, to make it a joint employer under *Martinez* and *Patterson*.

The court denied summary judgment to McDonald's, however, on the plaintiffs' theory of "ostensible agency." The court reasoned that ostensible agency arises if "(1) the person dealing with the agent does so with reasonable belief in the agent's authority; (2) that belief is generated by some act or neglect of the principal sought to be charged; and (3) the relying party is not negligent." McDonald's argued that because, under *Patterson*, uniform workplace standards intended to protect the franchisor's brand did not establish actual agency, the fact that the plaintiffs wore McDonald's uniforms and logos and served food packaged with McDonald's trademarks was also insufficient to give rise to ostensible agency. The court rejected this argument, reasoning that California courts had previously permitted a finding of ostensible agency even when actual agency did not exist and finding a lack of legal authority that foreclosed a finding of ostensible agency under these facts. Of particular relevance were facts that the plaintiffs believed that they and Haynes were employed by McDonald's; that the plaintiffs were required to wear McDonald's uniforms; that the plaintiffs were required to prepare and serve McDonald's-branded food; that the plaintiffs applied for their jobs through a McDonald's website; that the plaintiffs regularly interacted directly with McDonald's consultants; and that no one ever told the plaintiffs that McDonald's was not their employer. Although the court conceded that this case was "a close call," it found that, when taken in the light most favorable to the plaintiffs, a jury could reasonably find McDonald's to be a joint employer under an ostensible agency theory.

Finally, the court granted summary judgment to McDonald's concerning the plaintiffs' negligence theory. The court found that the plaintiffs' negligence claim simply duplicated its claims under California's labor and employment statutes. Because the court found California's statutory scheme to be exclusive, it held that the negligence claims could not proceed as a matter of law.

***Tigges v. AM Pizza, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,797, 2016 WL 4076829 (D. Mass. July 29, 2016)**
This case is discussed under the topic heading "Class Actions."

***Uninsured Employer's Fund v. Crowder*, Bus. Franchise Guide (CCH) ¶ 15,794, 2016 WL 2605624 (Ky. May 5, 2016)**
This case is discussed under the topic heading "Statutory Claims."

NON-COMPETE AGREEMENTS

***ReBath, LLC v. New England Bath Inc.*, Bus. Franchise Guide (CCH) ¶ 15,801, 2016 U.S. Dist. LEXIS 93033 (D. Ariz. July 15, 2016)**
Following the expiration of three franchise agreements with New England Bath (NEB), ReBath twice notified NEB of its post-expiration obligations. These obligations included, among others, ceasing use of ReBath's marks and logos; turning over operations manuals and customer contracts; and refraining from operating a competing business within the franchise territory, or within fifty miles of the franchise territory, for a period of one year. When NEB did not comply, ReBath brought suit, asserting claims of trademark infringement, false advertising, breach of the non-compete agreement, and trade secret misappropriation. ReBath moved for a preliminary injunction.

While ReBath's motion was pending, NEB certified to the court that it had returned the operations manual, removed ReBath's logos from service vehicles, removed signage, ceased use of NEB's ReBath-associated website, and provided information regarding business leads and service calls. The court therefore found it unnecessary to assess whether ReBath was likely to succeed on its trademark infringement and trade secret misappropriation claims. Instead, the court focused its likelihood-of-success analysis on ReBath's claims for breach of the non-compete and false advertising.

With respect to the non-compete claims, the court first held that the scope of the agreement's non-compete was likely not overly broad. In particular, the court reasoned that the non-compete provisions prohibited NEB from only operating a bathroom remodeling business and did not prevent it from continuing to operate a kitchen remodeling business. In addition, the court found that the geographic scope of the covenant—a fifty-mile radius from the franchise territory—was also likely reasonable, citing other decisions that enforced non-compete agreements of similar geographic scope. The court therefore held that ReBath was likely to succeed on its claim for breach of the non-compete.

ReBath's false advertising claim was directed to NEB's continued posting on its new website of customer testimonials about work it had performed while a ReBath franchisee. The court held that continued display of those testimonials was likely to mislead consumers into believing the NEB was wholly responsible for these customers' satisfactory experience when, instead, the goodwill associated with NEB's performance while a ReBath franchisee belonged to ReBath. The court therefore held that ReBath was likely to succeed on its claim for false advertising.

The court also concluded that ReBath likely would suffer irreparable harm absent an injunction. In particular, the court determined that ReBath's goodwill would be harmed because NEB's "overnight switch" to a newly named business in the same location in which it had operated as a ReBath franchisee for seven years "may signal to potential customers that [NEB has] lost faith in the ReBath brand." The court also concluded that the balance of harms favored ReBath and that the public interest would be served by an injunction. Therefore, the court granted ReBath's motion and enjoined NEB from using ReBath's marks; suggesting that NEB was affiliated with ReBath; operating a competing bathroom remodeling business for a period of one year within a fifty-mile radius from the franchise territory; and maintaining, using, or disclosing ReBath's operations manual or other trade secret information.

STATE DISCLOSURE/REGISTRATION LAWS

***Tilted Kilt Franchise Operating, LLC v. 1220, LLC*, Bus. Franchise Guide (CCH) ¶ 15,798, 2016 WL 463172 (N.D. Ill. July 29, 2016)**
This case is discussed under the topic heading "Termination and Renewal."

STATUTE OF LIMITATIONS

***Jade Grp., Inc. v. Cottman Transmission Ctrs., LLC*, Bus. Franchise Guide (CCH) ¶ 15,806, 2016 WL 3763024 (E.D. Pa. July 13, 2016)**
This case is discussed under the topic heading "Contract Issues."

STATUTORY CLAIMS

***Andrea Distrib., Inc. v. Dean Foods of Wis.*, LLC, Bus. Franchise Guide (CCH) ¶ 15,784, 2016 WL 3199544 (W.D. Wis. June 8, 2016)**
This case is discussed under the topic heading "Contract Issues."

***Benson v. City of Madison*, Bus. Franchise Guide (CCH) ¶ 15,184, 2016 WL 4468411 (Wis. Ct. App. Aug. 25, 2016)**
The Wisconsin Court of Appeals held that the City of Madison, Wisconsin, did not grant a "dealership," as defined by the Wisconsin Fair Dealership

Law (WFDL), when it contracted with several professional golf services companies to operate and maintain city golf courses. The court observed that for a dealership to be formed under the WFDL, an agreement must grant a person the right to sell or distribute goods or services or the right to use a commercial symbol. The court noted that the parties' agreement expressly stated that the city did not grant any of these rights. Moreover, the court held that the services that the companies provided to the city, e.g., providing golf equipment for rental and managing concession stands, had no distribution component. Lastly, the companies' use of the city's trademark was minimal and consisted of a small pooled advertising budget and a single sign. Hence, the court found insufficient evidence that the parties' arrangement constituted a dealership and therefore dismissed the companies' suit against the city.

***Bull Int'l, Inc. v. MTD Consumer Grp., Inc.*, Bus. Franchise Guide (CCH) ¶ 15,791, 2016 WL 3542249 (3rd Cir. June 29, 2016).**
The Third Circuit affirmed in part and dismissed in part an order from the U.S. District Court for the Western District of Pennsylvania granting an equipment manufacturer's motion to dismiss claims asserted by an equipment dealer for wrongful termination under Ohio's farm equipment dealer law (OEDA) and for breach of an implied warranty of merchantability with respect to the products furnished by the manufacturer to the dealer.

Bull International, Inc. and Cub Cadet Corp. d/b/a as MTD Products, Inc. entered into a dealer wholesale finance agreement and a sales and service agreement on August 1, 1985. The dealer agreement provided that either party could terminate it at any time, with or without cause, upon thirty days' prior written notice. In 2013, MTD informed Bull that it was terminating the dealer agreement after expiration of the thirty-day notice period. When Bull asked for an explanation for the termination, MTD, citing the dealer agreement, stated that it did not have to provide cause for the termination. Bull sued MTD in a multicount complaint alleging, among other claims, that MTD failed to comply with certain requirements of the OEDA, including that a manufacturer have good cause to terminate a dealer agreement and provide 180 days' prior notice to do so, and that MTD breached the implied warranty of merchantability with respect to the parts sold by MTD. The district court granted MTD's motion to dismiss, concluding that applying the OEDA to the dealer agreement would violate the Ohio constitution by retroactively burdening MTD's substantive rights and that Bull had failed to state a claim for breach of the implied warranty of merchantability.

The Third Circuit agreed with the district court's holding as to the OEDA claim. It found that OEDA, enacted in 2001, was substantive and could not be applied retroactively to the dealer agreement because it would negate MTD's contractual rights that vested more than fifteen years prior to the OEDA's enactment and because it would impose additional burdens, duties, and obligations on MTD that the parties did not include in the dealer agreement. In contrast, the Third Circuit found that Bull's allegations that MTD breached the implied warranty of merchantability were sufficient to survive a motion to dismiss. Claims that Bull had made, including that several parts manufactured by MTD were not merchantable and fit for a particular purpose, satisfied the common law criteria to sufficiently allege such a claim.

***Choice Hotels Int'l, Inc. v. Frontier Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,817, 2016 WL 4367993 (S.D. Tex. Aug. 15, 2016)**
This case is discussed under the topic heading "Trademark Infringement."

***Devayatan LLC v. Travelodge Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,790, 2016 WL 3477205 (M.D. Fla. June 24, 2016)**
The U.S. District Court for the Middle District of Florida denied a summary judgment motion filed by plaintiff Devayatan, LLC and its guarantors (third party defendants) and granted in part and denied in part a summary judgment motion filed by defendant Travelodge Hotels, Inc. (THI). The court held that THI was entitled to judgment as a matter of law on Devayatan's claims of negligent misrepresentations and violations under the Florida Deceptive and Unfair Trade Practices Act (FDUTPA), but genuine issues of material fact existed on THI's counterclaims and third-party claims and related affirmative defenses.

THI and franchisee Devayatan executed a transfer franchise agreement and related agreements for Devayatan's operation of a 134-room Travelodge hotel. During negotiations for the hotel, two of Devayatan's representatives visited and stayed at the hotel but failed to request a more in-depth visit of the facility. Devayatan also engaged an architect to create proposals for suggested renovations but did not retain a property inspector to inspect the facility. Prior to the transfer, THI informed Devayatan that the hotel was not in compliance with THI brand standards, it was in default at the time of transfer, and the transferor had not cured all of the defaults. THI also stated in its FDD that estimated costs to convert the hotel ranging up to $1.4 million for a 100-room facility. Post-transfer problems quickly ensued as Devayatan failed to timely cure deficiencies identified by THI while it completed other renovations required to bring the hotel up to code. After several failed inspections, THI terminated the franchise agreement and sued for fees THI claimed Devayatan refused to pay post-termination.

In its motion for summary judgment, Devayatan claimed that THI negligently mispresented the scope of work required to bring the hotel into compliance with brand standards. The court rejected this argument, finding that certain presumptions Devayatan made were unreasonable in light of explicit statements made by THI concerning the condition of the hotel during negotiations, including a punch list THI attached to the franchise agreement identifying items for repair at the hotel. Although the parties' agreement was governed by New Jersey law, the court also considered and rejected Devayatan's FDUPTA argument, finding that Devayatan had failed to establish that THI's statements were likely to mislead and to offer any arguments that THI acted unethically in any manner other than making representations that Devayatan simply misunderstood.

Devayatan also argued that THI improperly terminated the franchise agreement through allegations the court viewed as constituting claims for violation of the covenant of good faith and fair dealing. In denying THI's motion for summary judgment on this claim, the court found persuasive evidence that Devayatan failed its last inspection by a small margin and would have passed the inspection within the thirty-day time frame provided by THI to do so, notwithstanding a technical issue that prevented Devayatan from uploading proof of the repairs to THI's web portal. There was also an issue of fact as to whether a representative of THI had led Devayatan to believe it was under an improvement plan that would be submitted for approval to THI prior to THI's termination of the franchise agreement.

***H.B. Auto. Grp., Inc. v. Kia Motors Am.*, Bus. Franchise Guide (CCH) ¶ 15,813, 2016 WL 4446333 (S.D.N.Y. Aug. 22, 2016)**

This case is discussed under the topic heading "Transfers."

***Martinez v. Stratus Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 15,788, 2016 WL 3402546 (Ind. Ct. App. June 21, 2016).**

This case is discussed under the topic heading "Fraud."

***Midas Int'l Corp. v. Poulah Inv'rs, LLC*, Bus. Franchise Guide (CCH) ¶ 15,811, 2016 WL 4532033 (D. Md. Aug. 29, 2016)**

This case is discussed under the topic heading "Contract Issues."

***Rimrock Chrysler Grp., LLC v. Montana*, Bus. Franchise Guide (CCH) ¶ 15,799, 375 P.3d 392 (July 12, 2016)**

This case is discussed under the topic heading "Choice of Law."

***Roadtrek Motorhomes, Inc. v. Calif. New Motor Vehicle Bd.*, Bus. Franchise Guide (CCH) ¶ 15,808, 2016 WL 3885006 (Cal. Ct. App. July 14, 2016)**

Roadtrek Motorhomes, Inc. is a manufacturer of recreational vehicles. Roadtrek entered into an agreement with Mega RV Corp. pursuant to which Mega would sell Roadtrek's vehicles at its RV dealerships in California. Mega's dealerships sold a variety of RV products from sixty different brands. Roadtrek assisted Mega in financing the vehicles by delivering them without charge. Mega would then pay Roadtrek for each vehicle as it was sold. The parties did not memorialize the agreement in writing, and although they discussed the obligation to pay interest on this arrangement, no invoices were ever sent to Mega for interest. Moreover, the parties never agreed on when Mega would pay Roadtrek for vehicles it sold. Eventually, in 2006 the parties did enter into a written dealership agreement for the three relevant locations (Colton, Irvine, and Scotts Valley). Pursuant to the three-year dealership agreements, Roadtrek granted Mega an exclusive territory for sixty miles surrounding each dealership location, provided that Mega remained "in good standing" under the dealership agreements. Among other things, Mega was required to stock and prominently display Roadtrek products at its dealerships. Mega was also obligated to purchase a set number of vehicles, perform warranty and service repairs on Roadtrek vehicles, and maintain adequate working capital to enable the company to fulfill its obligations under the dealership agreements.

The agreements also imposed an obligation on Roadtrek to reimburse Mega for labor and parts on warranty repairs. Roadtrek also promised not to terminate, cancel, or fail to renew the dealership agreement without good cause. Good cause was defined as including any material breaches of the dealership agreements.

Beginning in 2007, the recreational vehicle industry entered a downturn. Many manufacturers and dealers began filing for bankruptcy protection and going out of business. Around this time, Roadtrek demanded payment for interest owing on the vehicles delivered to Mega that it kept on its lot until sale. The parties reached an agreement on payment, but Mega was unable to make the regular payments required by that agreement. Over the next two years, the parties tried to negotiate a resolution to their dispute over unpaid interest, but when they could not reach a resolution, Roadtrek repossessed its vehicles from Mega's dealerships in 2009 and stopped sending new vehicles to Mega. Roadtrek sent a letter to Mega under the UCC, asking for adequate assurances that the parties could conduct any further business transactions, and Mega responded with "good luck."

Approximately one month after receiving the email from Mega, in January 2010, Roadtrek entered into a dealer agreement with Mike Thompson RV (MTRV), one of Mega's competitors. MTRV had four dealerships in the area, one located across the street from Mega's Colton location. In June 2010, Roadtrek sent Mega notice of its intent to terminate the Colton, Irvine, and Scotts Valley dealer agreements.

Between January and July 2010, Mega filed eighteen complaints with the California New Motor Vehicle Board alleging that Roadtrek violated provisions of the parties' dealer agreements and its statutory obligations under the New Motor Vehicle Board Act. These complaints were reduced down to eleven and consisted of the following complaints: (1) two alleging that Roadtrek unlawfully terminated the Colton, Irvine, and Scotts Valley dealer agreements; (2) two alleging Roadtrek unlawfully modified the Colton and Irvine franchises by establishing MTRV as a Roadtrek dealer within Mega's exclusive territory; (3) one alleging Roadtrek violated the statute by establishing MTRV as a Roadtrek dealer within Mega's exclusive Colton territory without notice; (4) three alleging that Roadtrek had violated the statute by not reimbursing Mega for warranty repairs; and (5) three alleging

Roadtrek violated the statute by not paying money owed to Mega under a franchisor incentive plan. After a hearing, the Board rejected the two complaints alleging unlawful termination of the franchise, but sustained all of the other objections. Mega appealed the rejection of the two termination complaints, and Roadtrek appealed the Board's nine other orders.

On appeal, the court first addressed Mega's appeal of the two termination protests. The court noted that the appeal was based on Mega's argument that Roadtrek improperly terminated the agreements constructively when it took actions in 2009 and 2010 to repossess its vehicles. Alternatively, Mega argued that Roadtrek terminated the contracts without sufficient advance written notice in violation of the parties' dealership agreement, which required 365 day advance written notice of termination. The court rejected both of these arguments, noting that the Board's jurisdiction is limited by statute and does not include adjudication of claims pertaining to parties' conduct under their contractual agreements. Accordingly, whether Roadtrek's claims constituted a de facto termination of the contract was something that was outside the Board's jurisdictional authority to adjudicate. Similarly, although the contract called for written notice of termination at least 365 days in advance, the statute itself required only sixty days advance notice. As Roadtrek had provided sixty days advance written notice of termination, the Board had concluded that Roadtrek satisfied the statutory prerequisites to termination, and any other claim for a violation of the contract must be brought in a civil action.

Next, the court addressed Roadtrek's appeal of the modification protest, with Roadtrek arguing that no modification of the dealership agreements occurred when it granted the new dealerships to MTRV because Mega's exclusive territory rights under the dealership applied only as long as Mega was "in good standing" under the dealer agreements. Roadtrek argued that Mega was not in good standing because it was not displaying Roadtrek vehicles prominently, as required by the dealer agreements, and Roadtrek therefore had the right to grant new dealerships in Mega's territorial area. The court rejected these arguments, noting that the reason that Mega was not in good standing was because Roadtrek had repossessed all of its vehicles. Nonetheless, the court noted that the trial court had exceeded its authority by approving the modification protest on grounds not addressed by the Board. Accordingly, the court reversed the trial court on this issue and rejected the protest.

The court then moved on to Mega's protest relating to the establishment of an MTRV dealership in Mega's Colton area. Mega contended that this violated the statute, which requires that franchisors give notice to existing franchisees when awarding new franchises within ten miles of an existing dealer. The franchisor must also have good cause for awarding the new franchise. Roadtrek argued that the statute applied only to dealerships that opened after 2004, and that MTRV's Colton dealership had been in existence since 1999. The court rejected this argument, noting that MTRV had not been a Roadtrek dealer since that time. Accordingly, the court sustained the protest.

Next, the court addressed the warranty reimbursement protests. Mega argued that the statute requires that a franchisor fulfill every warranty agreement by adequately and fairly compensating franchisees for labor and parts used. Mega argued that Roadtrek failed in its obligations to satisfy the statute when it refused to pay for warranty work. Roadtrek had refused to make the claimed payments for warranty work, instead withholding the amounts as an offset for amounts that Mega owed for missed interest payments. But Roadtrek never notified Mega of these policies. The court noted that the failure to notify Mega of this policy was fatal to its defense of the claims and sustained the protests.

Lastly, the court addressed the incentive protests. Mega argued that the statute requires that all claims made by a franchisee for payment under the terms of an incentive program must be approved or disapproved within thirty days. If the claim is disapproved, the franchisor must notify the franchisee in writing of the disapproval and explain the grounds for the decision. As with the warranty reimbursement claims, Roadtrek began withholding amounts due and owing under the incentive program as an offset, but never informed Mega of these policies. For the same reasons, the court held that the failure to notify Mega of the policy was fatal to the defense, and it sustained the protest.

***Tigges v. AM Pizza, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,797, 2016 WL 4076829 (D. Mass. July 29, 2016)**

This case is discussed under the topic heading "Class Actions."

***Uninsured Employer's Fund v. Crowder*, Bus. Franchise Guide (CCH) ¶ 15,794, 2016 WL 2605624 (Ky. May 5, 2016)**

The Supreme Court of Kentucky affirmed an appellate decision that QFA Royalties, LLC (Quiznos) and two individual owners of a franchised Quiznos sandwich shop were not liable for workers' compensation payment made to an injured shop employee.

In February 2009, Eugene Davis and James Dick purchased an existing Quiznos sandwich shop, signing a transfer agreement and franchise agreement with Quiznos in their individual capacities. Several days later, Davis and Dick created Pulaski Franchises Inc. to own and operate the franchise, but failed to formally transfer the franchise agreement and franchise assets to Pulaski. However, cash flow from the shop was placed into accounts held by Pulaski and employee wages, taxes, and royalty payments to Quiznos were paid from a Pulaski account.

On April 15, 2010, an employee severely injured her eye while working at the shop. At the time of her injury, the workers' compensation insurance policy held in Pulaski's name had lapsed. The employee filed a claim that joined Quiznos, Pulaski, Davis, Dick, and the Uninsured Employers Fund (UEF) as parties to the claim because the UEF had to pay the injured employee workers' compensation payments as a result of the lapsed policy. An administrative law judge rejected several arguments lodged by the UEF, including that Quiznos had "up-the-ladder" liability to pay the benefits as a contractor under the state workers' compensation law and that Davis and Dick were jointly and severally liable to pay the benefits because there were engaged in a joint venture with Pulaski. The Workers' Compensation Board and Kentucky Court of Appeals agreed with the ALJ in rejecting these arguments.

On appeal, the Kentucky Supreme Court determined that the ALJ's decision was supported by the evidence. It agreed that the record supported a finding that Quiznos was in the business of granting and overseeing franchise agreements, not making and selling sandwiches. Therefore, Quiznos could not have up-the-ladder liability to pay the workers' compensation benefits to the injured employee. As to the individual franchise owners, the court noted that the real underlying question was whether Pulaski was the employer of the injured employee because Davis and Dick never transferred the franchise agreement to Pulaski. It held that the evidence supported the fact that the employee was paid by Pulaski and would have been paid workers' compensation benefits from Pulaski had the insurance not lapsed. For this reason, only Pulaski was responsible to pay the UEF for workers' compensation to the injured employee.

***W. Colo. Motors, LLC v. Gen. Motors, LLC*, Bus. Franchise Guide (CCH) ¶ 15,792, 2016 WL 3600289 (Colo. Ct. App. June 30, 2016)**

The Colorado Court of Appeals affirmed the district court's dismissal of claims lodged by West Colorado Motors, LLC d/b/a Autonation Buick GMC Park Meadows against General Motors, LLC, GM franchisee Alpine Buick GMC, LLC, and the executive director of the Colorado Department of Revenue.

Park Meadows and Alpine are both GM dealers in Colorado. After GM sent Park Meadows a written letter of its intent to approve the relocation of Alpine's dealership to within Park Meadows' "relevant market area," Park Meadows sent a letter to the executive director which, among other things, protested the relocation, requested an investigation of the relocation and a hearing, and/or the issuance of a cease and desist order under Colorado's motor vehicle dealer law. The executive director issued two letters to Park Meadows stating that it failed to include any allegations that a violation of the motor vehicle dealer law had occurred. After Park Meadows' receipt of the second letter, it filed a complaint in district court alleging, among other things, that GM unreasonably approved Alpine's relocation in violation of the motor vehicle dealer law.

The executive director successfully dismissed Park Meadows' complaint for its failure to file a request for judicial review of the executive director's action directly to the Colorado Court of Appeals pursuant to express requirements of the motor vehicle dealer law. The court affirmed finding that the district court had no subject matter jurisdiction over Park Meadows' second claim for relief. It disagreed with Park Meadows' argument that the executive director's subsequent letter did not satisfy the requisite elements of a "final agency action" under Colorado law, finding that the executive director's letter was an order that served in whole or in part as a final agency disposition of the matter under Colorado's administrative procedure act.

TERMINATION AND NONRENEWAL

***Andrea Distrib., Inc. v. Dean Foods of Wis.*, LLC, Bus. Franchise Guide (CCH) ¶ 15,784, 2016 WL 3199544 (W.D. Wis. June 8, 2016)**
This case is discussed under the topic heading "Contract Issues."

***Brentlinger Enters. v. Volvo Cars of N. Am., LLC*, Bus. Franchise Guide (CCH) ¶ 15,815, 2016 WL 4480343 (S.D. Ohio Aug. 25, 2016)**
This case is discussed under the topic heading "Antitrust."

***Bull Int'l, Inc. v. MTD Consumer Grp., Inc.*, Bus. Franchise Guide (CCH) ¶ 15,791, 2016 WL 3542249 (3rd Cir. June 29, 2016).**
This case is discussed under the topic heading "Statutory Claims."

***Choice Hotels Int'l, Inc. v. Frontier Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,817, 2016 WL 4367993 (S.D. Tex. Aug. 15, 2016)**
This case is discussed under the topic heading "Trademark Infringement."

***Devayatan LLC v. Travelodge Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,790, 2016 WL 3477205 (M.D. Fla. June 24, 2016)**
This case is discussed under the topic heading "Statutory Claims."

***H.B. Auto. Grp., Inc. v. Kia Motors Am.*, Bus. Franchise Guide (CCH) ¶ 15,813, 2016 WL 4446333 (S.D.N.Y. Aug. 22, 2016)**
This case is discussed under the topic heading "Transfers."

***Howard Johnson Int'l, Inc. v. Tyler Texas Lodging, LLC*, Bus. Franchise Guide (CCH) ¶ 15,786, 2016 WL 3436402 (D.N.J. June 16, 2016)**
This case is discussed under the topic heading "Contract Issues."

***Midas Int'l Corp. v. Poulah Inv'rs, LLC*, Bus. Franchise Guide (CCH) ¶ 15,811, 2016 WL 4532033 (D. Md. Aug. 29, 2016)**
This case is discussed under the topic heading "Contract Issues."

***Roadtrek Motorhomes, Inc. v. Calif. New Motor Vehicle Bd.*, Bus. Franchise Guide (CCH) ¶ 15,808, 2016 WL 3885006 (Cal. Ct. App. July 14, 2016)**
This case is discussed under the topic heading "Statutory Claims."

Tilted Kilt Franchise Operating, LLC v. 1220, LLC, **Bus. Franchise Guide (CCH) ¶ 15,798, 2016 WL 463172 (N.D. Ill. July 29, 2016)**

Tilted Kilt Franchise Operating, LLC is a franchisor of a nationwide chain of restaurants. In 2007, Tilted Kilt engaged defendants, a limited liability company and its four owners, as an area developer pursuant to the terms of an area developer agreement between the parties. Thereafter, Tilted Kilt alleged that, from July 2009 until December 2012, defendants made a series of misleading financial performance representations to prospective Tilted Kilt franchisees in connection with defendants' efforts to sell franchises. Based on defendants' representations, certain third parties entered into franchise agreements with Tilted Kilt, only to discover that defendants' financial projections were significantly exaggerated. On May 11, 2015, an attorney for these third-party franchisees wrote to Tilted Kilt informing it of the alleged misrepresentations, demanding a refund of fees paid to Tilted Kilt, and seeking a release of their obligations under the franchise agreement.

As a result, Tilted Kilt sued defendants, seeking declaratory relief that (1) defendants had breached the area developer agreement, (2) such breaches constituted good cause for termination, and (3) defendants' conduct justified termination without providing defendants with a cure period. Defendants asserted counterclaims and filed a separate lawsuit asserting affirmative claims against Tilted Kilt that were identical to their counterclaims. Defendants then moved to dismiss Tilted Kilt's claims under Federal Rule of Civil Procedure 12(b)(1) (lack of subject matter jurisdiction) and 12(b)(6) (failure to state a claim). Defendants also moved to consolidate their separate lawsuit with the one filed by Tilted Kilt. Tilted Kilt moved to dismiss the counterclaims.

The court granted defendants' motion to consolidate the two cases and therefore also granted Tilted Kilt's motion to dismiss the counterclaims. However, the court denied defendants' motion to dismiss Tilted Kilt's claims.

With regard to subject matter jurisdiction, the court held that the $75,000 amount in controversy threshold for diversity jurisdiction had been met. Although Tilted Kilt's complaint did not specifically assert any amount in controversy, the court held that this was "quite different from arguing that Tilted Kilt *cannot* prove a set of facts in which it would recover over $75,000." (emphasis in original). Because the court could not say, with certainty, that Tilted Kilt's recovery, or defendants' cost of complying with the judgment, would be less than $75,000, the court found that the amount in controversy requirement had been met.

The court also held that Tilted Kilt had stated a claim for declaratory relief. In particular, the court found that its complaint pleaded an actual controversy because Tilted Kilt had alleged that defendants had breached the area developer agreement and that it was entitled to a declaration from the court that such a breach warranted termination without an opportunity for cure.

As to the substantive matter, defendants argued that Tilted Kilt was seeking relief that was contradicted by Section 19 of the Illinois Franchise Disclosure Act, 815 Ill. Comp. Stat. 705/19 (which sets forth the grounds upon which a franchise can be terminated for good cause but without the need for a cure period) and the terms of the area developer agreement (which specified eleven circumstances under which the agreement could be terminated without affording an opportunity to cure). Tilted Kilt replied that (1) the breaches were incurable and (2) they nonetheless fit within the categories specified in the Act and in the agreement. The court agreed with Tilted Kilt. The court ruled that the pleadings in the complaint, if believed, were adequate to establish that the breaches were incurable, and that defendants' conduct constituted a crime and reflected repeated violations of the law and the area developer agreement, such that Section 19(c)(4) would permit termination without the requirement of a cure period. The pleading of such facts, the court determined, was sufficient to deny defendants' motion to dismiss.

***Tri County Wholesale Distribs., Inc. v. Labatt USA Operating Co., LLC,* Bus. Franchise Guide (CCH) ¶ 15,807, 828 F.3d 421 (6th Cir. 2016)**
Plaintiffs Tri County Wholesale Distributors and Iron City Distributing were parties to franchise agreements with Labatt USA Operating Co. allowing the distribution of several prominent brands of beer. When the agreements were executed, and for a time thereafter, Labatt was 100 percent owned by North American Breweries Holdings (NAB), which was owned by several investors. On December 11, 2012, NAB's investors sold their interests in NAB in a complex transaction that resulted in CCR American Breweries owning 100 percent of NAB. In March 2013, CCR purported to terminate the franchise agreements pursuant to Ohio Rev. Code § 1333.85(D). That section permits a supplier to terminate a franchise agreement for the sale of alcoholic beverages without just cause if "a successor manufacturer acquires all or substantially all of the stock or assets of another manufacturer through merger or acquisition." In that instance, however, the successor manufacturer must repurchase the distributor's inventory of the products and "compensate the distributor for the diminished value of the distributor's business that is directly related to the sale of the product or brand terminated or not renewed by the successor manufacturer."

The distributors sued Labatt, NAB, and CCR (suppliers), alleging that CCR's termination did not qualify under § 1333.85(D) and was therefore improper. In the alternative, the distributors asserted that the termination, if proper, violated the Takings Clause of the federal and Ohio constitutions. Also in the alternative, if the termination was proper, the distributors sought recovery for the diminished value of their businesses. The district court granted the suppliers' judgment on the pleadings as to the Takings Clause claim and granted their motion for summary judgment that § 1333.85(D) was applicable. In addition, the district court held a bench trial and determined the diminution in value of the distributors' respective businesses resulting from the termination. The distributors appealed and the suppliers cross-appealed.

First, the Sixth Circuit affirmed the district court's granting of summary judgment, holding that § 1333.85(D) applied to CCR's purchase of NAB from NAB's prior investors. Both the district court and the Sixth Circuit rejected the distributors' argument that only Labatt could be a "manufacturer" for purposes of the statute. Instead, both the district court and the Sixth Circuit adopted a "functional, control-based" approach. The Sixth Circuit reasoned that "there was a 100% change in ownership, with a complete change in control of the business decisions relating to the brands." It found the distributors' reading of the statute, i.e., technically speaking, the only Labatt could be considered a "manufacturer" because it was the only entity registered with the Ohio Division of Liquor Control, to be "hyperliteral" and to exclude improperly all transactions at the parent company level. The court therefore held that CCR's termination of the distributors was permitted under the statute.

Second, the Sixth Circuit affirmed the district court's grant of judgment on the pleadings dismissing the Takings Clause claims. In particular, the Sixth Circuit held that, even assuming the franchises were considered to be "property," this case presented no government taking of property. Instead, the Sixth Circuit held that the suppliers were "private actors who were not exercising the power of eminent domain under a delegation of authority from the government."

Finally, the Sixth Circuit largely affirmed the district court's calculations of the distributors' diminished business value. In particular, the Sixth Circuit rejected the distributors' argument that they were entitled to recover net operating losses incurred while trying to acquire replacement brands. The district court and the Sixth Circuit held that this constituted an impermissible double recovery because the distributors were awarded the fair market value of the lost brands and this cost was included in that calculation. The Sixth Circuit also affirmed the district court's calculation of the discount rate associated with the value of the lost brands, holding that the parties' arguments were a factual "battle of the experts" in which the Sixth Circuit was not left with "a definite and firm conviction that a mistake had been committed." Lastly, the Sixth Circuit reversed the district court and held that the distributors' award must be reduced by the amount of profits they had earned under the brands during the pendency of the litigation while the franchise agreements effectively remained in force.

TORTIOUS INTERFERENCE

***Jade Grp., Inc. v. Cottman Transmission Ctrs., LLC*, Bus. Franchise Guide (CCH) ¶ 15,806, 2016 WL 3763024 (E.D. Pa. July 13, 2016)**

This case is discussed under the topic heading "Contract Issues."

TRADEMARK INFRINGEMENT

***Choice Hotels Int'l, Inc. v. Frontier Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,817, 2016 WL 4367993 (S.D. Tex. Aug. 15, 2016)**

On November 8, 2008, Choice Hotels International, Inc. entered into a franchise agreement with Frontier Hotels, Inc. pursuant to which Frontier was granted the right to operate a Comfort Inn branded hotel in Houston. In 2014, Choice sent Frontier multiple notices of default, noting Frontier's failure to comply with certain provisions of the franchise agreement between the parties. After several months, Frontier had failed to correct the deficiencies in the notice of default. Accordingly, on December 12, 2014, Choice sent Frontier a notice of termination, which directed it to immediately discontinue using the Comfort Inn trademarks in connection with the advertising and operation of Frontier's hotel.

Frontier failed to de-identify its hotel and continued using the Comfort Inn trademarks. Choice learned that Frontier was continuing to use its trademarks when one of its customers complained to Choice about the quality of his stay. After receiving the complaint, on April 21, 2015, Choice sent Frontier a cease-and-desist letter, demanding that Frontier immediately discontinue its use of Choice's trademarks. Over the course of the next several months, Choice documented Frontier's continued use of its trademarks without Choice's permission.

On August 13, 2015, Choice filed suit against Frontier in the U.S. District Court for the Southern District of Texas alleging federal trademark infringement and false designation of origin as well as common law claims for trademark infringement under Texas law. Following discovery, Choice filed a motion for summary judgment on its claims. Frontier failed to file any opposition to the motion.

Evaluating the motion, the court concluded that all of the different claims presented the same issues under both federal and state law. Accordingly, applying the standard for federal trademark infringement, the court concluded that Choice had presented satisfactory evidence that it owned the Comfort Inn trademark, that Frontier had used the trademark without Choice's permission, and that there had been actual confusion in the marketplace sufficient to establish the likelihood of confusion standard for trademark infringement claims. The court therefore granted summary judgment on Choice's claims.

Having concluded that Choice was entitled to summary judgment, the court went on to evaluate the merits of its request for a permanent injunction, using the four factor test for injunctive relief: (1) success on the merits, (2) whether the failure to grant an injunction will result in irreparable injury, (3) whether the injury to the plaintiff outweighs any damage that the injunction will cause the opposing party, and (4) whether the injunction serves the public interest. Applying the facts of the case, the court held that all of the factors weighed in favor of ordering a permanent injunction, noting that the evidence showed that Choice had prevailed on the merits of its claim, that the injury was causing irreparable harm (as evidenced by the confused consumers complaining about the quality of Frontier's hotel to Choice), and finally, that there was no harm to Frontier given that entry of an injunction would only require that Frontier comply with the law.

Conversely, the court declined to award any damages. Choice had asked for an award under the Lanham Act of damages calculated with reference to the liquidated damages provision in the franchise agreement. The court rejected this argument, noting that the Lanham Act allows an award of "actual damages" incurred by reason of the infringement, which does not include contractually agreed-upon damages. Accordingly, the court granted Choice leave to file supplemental briefing establishing its actual damages caused by Frontier's infringement.

***Jack In the Box Inc. v. Mehta*, Bus. Franchise Guide (CCH) ¶ 15,793, 2016 WL 3401988 (N.D. Cal. June 21, 2016)**
This case is discussed under the topic heading "Contract Issues."

***Midas Int'l Corp. v. Poulah Inv'rs, LLC*, Bus. Franchise Guide (CCH) ¶ 15,811, 2016 WL 4532033 (D. Md. Aug. 29, 2016)**
This case is discussed under the topic heading "Contract Issues."

***MPC Franchise, LLC v. Tarntino*, Bus. Franchise Guide (CCH) ¶ 15,789, 826 F.3d 653 (2d Cir. 2016)**
The Second Circuit affirmed a district court's award of summary judgment against the owner of a pizza parlor (Tarntino) in favor of his cousins (together, Clearys). In 2011, the Clearys sued Tarntino in U.S. District Court for the Western District of New York for various violations of the Lanham Act, including fraudulent procurement of registration of the mark "Pudgie's." The district court canceled Tarntino's registration and dismissed his counterclaim for federal trademark infringement. On appeal, Tarntino challenged the district court's grant of summary judgment to the Clearys on their fraud claim, arguing that he lacked fraudulent intent when he applied for the Pudgie's mark in his individual capacity and signed an oath attesting, among other things, that to the best of his knowledge and belief no other person or entity had the right to use the mark.

On a de novo review, the Second Circuit disagreed. Although it agreed with Tarntino on the degree of scienter required for a plaintiff to successfully allege fraudulent procurement of a trademark, it found no genuine issue of material fact that he had fraudulently obtained his mark in the underlying dispute. The court noted that there was abundant evidence on the record that Tarntino knew others had rights to use the mark that were at least equal, if not superior, to his own rights.

TRANSFERS

***Devayatan LLC v. Travelodge Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,790, 2016 WL 3477205 (M.D. Fla. June 24, 2016)**

This case is discussed under the topic heading "Statutory Claims."

***H.B. Auto. Grp., Inc. v. Kia Motors Am.*, Bus. Franchise Guide (CCH) ¶ 15,813, 2016 WL 4446333 (S.D.N.Y. Aug. 22, 2016)**

The plaintiffs H.B. Automotive Group (Bronx Kia) and Major Motors of Long Island City were dealerships associated with the defendant Kia Motors America (KMA), the exclusive distributor of Kia-brand motor vehicles, parts, and accessories in the United States.

In March 2012, KMA, Bronx Kia, Major LIC, and others entered into a master settlement agreement (MSA) that resolved various disputes among them. Under the MSA, Bronx Kia would voluntarily terminate its franchise on September 30, 2013, unless it transferred the franchise, with KMA's consent, before that date. Bronx Kia was given until September 1, 2013, to provide KMA with a fully executed asset purchase agreement and for any prospective buyer to submit a franchise application package. After KMA rejected Bronx Kia's two initial attempts to transfer the franchise, on August 27, 2013, Bronx Kia made a third attempt. However, this prospective buyer did not submit its franchise application package to KMA until September 11, 2013. KMA ultimately rejected this application as well, and Bronx Kia's dealership terminated on October 26, 2013, pursuant to the MSA's terms.

Major LIC also had obligations to KMA to renovate Major LIC's facility by November 5, 2013. Major LIC refused to do so and, consequently, on that date KMA issued a notice of termination. After mediation of this dispute, KMA entered into an interim settlement agreement (ISA) by which KMA would evaluate Major LIC's proposed transfer of its franchise to a potential purchaser. The ISA provided that complete information about the prospective purchaser was to be submitted by June 9, 2014. Although materials were submitted to KMA on June 6, 2014, KMA determined that the information was incomplete and therefore did not consent to Major LIC's transfer of the franchise to this purchaser.

Bronx KIA and Major LIC sued KMA for various causes of action. KMA filed a motion for summary judgment, seeking dismissal of the claims and, in response to the motion, Bronx KIA and Major LIC withdrew a number of claims. Consequently, on summary judgment the court assessed only whether KMA's refusal to accept the transfers of Bronx Kia's and Major LIC's dealerships violated the New York Motor Vehicle Dealer Act. That statute contains provisions that prohibit a franchisor from, among other things, "impos[ing] unreasonable restrictions on the franchised motor vehicle dealer relative to transfer, sale . . . or termination of a franchise."

In both instances, the court ruled in favor of KMA and granted summary judgment. In particular, the court found that there was no genuine issue of material fact that KMA's refusal to accept the proposed transfers was not unreasonable because, at the relevant time, Bronx Kia and Major LIC were each subject to termination and "a dealer properly subject to termination does not have a free and clear right to transfer." The court held that there was no factual dispute that, in each instance, the putative transferor did not fully comply with the terms under which KMA would consider the proposed transfer. As such, KMA was under no obligation under New York's statute to consent to either transfer and therefore did not violate the statute by withholding its consent.

***Uninsured Employer's Fund v. Crowder*, Bus. Franchise Guide (CCH) ¶ 15,794, 2016 WL 2605624 (Ky. May 5, 2016)**
This case is discussed under the topic heading "Statutory Claims."

UNFAIR COMPETITION/UNFAIR AND DECEPTIVE PRACTICES

***Devayatan LLC v. Travelodge Hotels, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,790, 2016 WL 3477205 (M.D. Fla. June 24, 2016)**
This case is discussed under the topic heading "Statutory Claims."

***Martinez v. Stratus Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 15,788, 2016 WL 3402546 (Ind. Ct. App. June 21, 2016).**
This case is discussed under the topic heading "Fraud."

VICARIOUS LIABILITY

***Johnson v. Seagle Pizza, Inc.*, Bus. Franchise Guide (CCH) ¶ 15,825, 2016 WL 4410705 (Ky. Ct. App. Aug. 19, 2016)**
In deciding a motion for summary judgment, the Kentucky Court of Appeals held that several entities affiliated with the Domino's Pizza franchisor (together, Domino's Pizza) could not be held vicariously liable for a fatal shooting that occurred outside of a franchised Domino's Pizza restaurant. The victim was killed when he approached a robber he observed fleeing the franchised restaurant after the apparent robbery (presumably in an attempt to apprehend him). The claim was brought by the son of the victim, who observed the shooting, on his own behalf and that of his deceased father.

Plaintiff claimed that Domino's Pizza controlled the security procedures, procedures for handling of cash, and the late night operating hours of the franchised restaurant, allegedly creating conditions that facilitated the robbery. The court acknowledged that Domino's Pizza's operations manual provided minimum standards related to these instrumentalities that lead to the harm. However, the court also observed that the franchisee—which had executed the agreement for the premises, set prices for the restaurant, maintained its own security, and was responsible for hiring and firing the employees who interacted directly with the robber—controlled the physical details of the implementation of the safety and security responsibilities of the store. Indeed, the court noted, "[t]he seminal question is not whether Domino's Pizza established ubiquitous franchise standards, but whether Domino's Pizza retained control over the implementation of those standards." It concluded that Domino's Pizza did not control the day-to-day operations of the store and therefore could not be held vicariously liable. Hence, the court granted Domino's Pizza's motion for summary judgment.

The court remanded for discovery the question of whether the franchisee could be held liable under theories of *respondeat superior*, negligent supervision, and negligent maintenance of premises security. The court noted unresolved questions regarding the franchisee's duty to the decedent and the foreseeability of the harm. It concluded that the lower court prematurely ruled on the summary judgment motion and therefore remanded the case for discovery.

***Salazar v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 15,818, 2016 WL 4394165 (N.D. Cal. Aug. 16, 2016)**

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