The GPMemorandum

TO: **OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS**

FROM: **GRAY PLANT MOOTY'S FRANCHISE AND DISTRIBUTION PRACTICE GROUP**

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In this issue of *The GPMemorandum*, we will continue with our series of retrospective articles in celebration of our 15th year of publication. We then will summarize recent decisions and laws of interest to franchisors.

RETROSPECTIVE

WHAT HAS FOLLOWED FROM *COLLINS V. IDQ*?

This is the fourth in our year-long series of articles reviewing the recent progeny of what we identified in our December 2007 ten-year anniversary edition as the most significant franchise case decisions summarized in Issues 1 through 100 of *The GPMemorandum*, which covered the period from late 1997 through 2007. The fourth of those key cases was actually a series of decisions in a class action named *Collins v. International Dairy Queen et al.*, which was venued in federal court in Macon, Georgia, from 1994 through 2000. Our firm represented IDQ and its subsidiary, franchisor American Dairy Queen Corporation, throughout the case and in various proceedings that have followed from it. In the end, the original *Collins* class-action case settled, but not before the Middle District of Georgia issued various important decisions. Those decisions covered topics ranging from antitrust to class action certification to arbitration, and more.

As we noted in our special anniversary issue in 2007, the antitrust aspects of *Collins* largely have been relegated to the footnotes of other cases and in legal writings. Particularly after the Third Circuit issued its seminal opinion in *Queen City*, and then the Eleventh Circuit (where *Collins* was on appeal when it settled) decided *Maris Distributing*, it seems that the Middle District of Georgia's opinion on the "relevant market" in franchising was an outlier. The district court had appeared to rule that a franchisee could proceed with antitrust tying and monopolization claims on the theory that a franchise system itself could be a relevant market, or at least that there could be a market limited to "soft-serve ice cream" franchises, specifically. Over the past five years, however, we have reported only around a dozen cases in which antitrust tying claims against franchisors have even been brought by franchisees, and in those all but four franchisee plaintiffs have had their claims dismissed.

But *Collins v. IDQ* went far beyond antitrust; it was in the arbitration field that the case may have had the most practical effect, as the district court eliminated thousands of franchisees (roughly half the proposed "class" of claimants) from participating in the action because they had agreed to arbitrate their claims. This led some franchisors to include arbitration clauses in their franchise agreements if for no other reason than to defeat class-wide treatment.

POST-TERMINATION INJUNCTIONS: NONCOMPETE COVENANTS

FEDERAL COURT GRANTS PRELIMINARY INJUNCTION ENFORCING COVENANT

In a case litigated by Gray Plant Mooty, the United States District Court for the Western District of North Carolina recently granted a franchisor's motion for a preliminary injunction to prevent a former franchisee from operating a competing business. In *Outdoor Lighting Perspectives Franchising, Inc. v. OLP-Pittsburgh, Inc.*, 2012 U.S. Dist. LEXIS 53583 (W.D.N.C. Apr. 17, 2012), Outdoor Lighting Perspectives Franchising ("OLP") sought a preliminary injunction to enforce the covenant against competition in the franchise agreement. The clause prevented the franchisee from operating a competing business within its or any other franchisee's territory, or within a 100-mile radius of those territories, for a period of two years following termination or expiration.

The court held that OLP was likely to succeed on the merits of its claim. The court found that the covenant was reasonably necessary for the protection of OLP's legitimate business interests because it protected OLP's ability to refranchise the former franchisee's territory and preserved the integrity of OLP's system by demonstrating to other franchisees that OLP would enforce the covenant. The court also found that the two-year restriction was reasonable and that enforcing a valid non-compete prevented consumer confusion and unfair competition, which served the public interest. The court found injunctive relief to be appropriate because OLP would suffer irreparable harm to its goodwill in the form of lost customers and to its franchise system as a result of its inability to refranchise the territory. Finally, the court decided that the balance of equities tipped in OLP's favor because the harm to the franchisee resulted from its decision to violate the covenant. While the court granted OLP's motion, it decided that the 100-mile radius was more than was necessary and "blue penciled" the agreement by striking the 100-mile buffer and enforcing the covenant only within the franchisee's former territory or another franchisee's territory.

The same court upheld the same covenant, with the same modification, in *OLP v. Home Amenities, Inc.*, 2012 U.S. Dist. LEXIS 5406 (W.D. N.C. Jan. 18, 2012) (appeal pending).

COURT DENIES PRELIMINARY ENFORCEMENT OF NONCOMPETE COVENANT BASED ON FAILURE TO SHOW IRREPARABLE INJURY

In *Dickey's Barbecue Restaurants, Inc. v. GEM Investment Group, LLC*, 2012 U.S. Dist. LEXIS 54448 (N.D. Tex. Apr. 18, 2012), a federal court in Texas denied a franchisor's motion for a preliminary injunction to enforce noncompetition covenants. The defendants had signed an agreement with Dickey's Barbecue to develop three franchised restaurants in the state of Washington. During the construction of their first restaurant, the defendants dropped out of training and established an independent restaurant at their formerly franchised location.

Despite a contractual provision in which the defendants had consented to the entry of preliminary injunctive relief, the court denied the franchisor's motion, finding that it had failed to establish a substantial threat of irreparable harm. The court found that the franchisor could not show harm to its established customer base or goodwill in Washington because it had only recently begun operating in the state. Moreover, the defendants never actually operated a Dickey's Barbecue Pit at the location of their new restaurant. Finally, notwithstanding the franchisor's argument that the defendants were in a position to misappropriate many of its trade secrets, including recipes and other proprietary information that they had acquired during their training, the court found that irreparable harm was not likely to occur because the defendants had returned their operations manual and were using their own recipes and techniques.

<u>POST-TERMINATION INJUNCTIONS: TRADEMARK/SERVICEMARK VIOLATIONS</u>

FRANCHISEE'S NOTICE TO CUSTOMERS REGARDING END OF FRANCHISE RELATIONSHIP DOES NOT CONSTITUTE TRADEMARK INFRINGEMENT

In *Anago Franchising, Inc. v. IMTN, Inc.*, 2012 U.S. App. LEXIS 8120 (7th Cir. Mar. 29, 2012), Anago Franchising terminated one of its subfranchisors, IMTN. After termination, Anago discovered that IMTN had sent a letter to many of its customers advising them that it would no longer be operating under the franchisor's name, but instead would operate under a competing trademark and software system. Anago commenced an action, claiming that IMTN's use of its trademarks in the letter would cause confusion regarding IMTN's continued affiliation with Anago. Specifically, Anago contended that IMTN's statement that it would continue servicing customers' accounts without interruption suggested that IMTN remained affiliated with Anago. The district court dismissed the claim, finding that IMTN's letter to its customers specifically stated that it would no longer be using the franchisor's trademark as of a set date and time. The Seventh Circuit affirmed, noting that there "is absolutely nothing in [the letter] to indicate that [the new mark] is related to [the franchisor's marks]."

TRADEMARKS

KEYWORD ADVERTISING CLAIMS AGAINST GOOGLE RESURRECTED

Last month, the United States Court of Appeals for the Fourth Circuit issued a highly anticipated ruling on the legality of the use of others' trademarks in Google's keyword ad/sponsored links program, AdWords. The case is *Rosetta Stone Ltd. v. Google, Inc.*, 2012 U.S. App. LEXIS 7082 (4th Cir. Apr. 9, 2012). The appellate court reversed most of a 2010 ruling by a federal district court in Virginia, which had granted summary judgment in Google's favor on all claims. The lawsuit claimed that the search giant committed direct and contributory trademark infringement and trademark dilution, and was unjustly enriched, by allowing purveyors of counterfeit software to purchase Rosetta Stone's trademarks as keyword search terms.

The decision implicitly acknowledges that keyword advertising programs are being used by some advertisers for deceptive purposes, including trademark infringement and counterfeiting. This is helpful to franchisors, who are both trademark owners and advertisers. The Fourth Circuit joins other courts that are not prepared to give Google and other search engine companies a free pass when it comes to trademark infringement and dilution claims. Additionally, damaging internal Google studies concerning trademark confusion that Rosetta Stone unearthed during discovery could be useful fodder for future plaintiffs.

Franchisors and franchisees alike should review their keyword advertising policies to be sure that they do not utilize competitors' trademarks as keywords in a manner that steps over the line from fair use to infringement. Besides being a sound business practice, legally defensible advertising will avoid an unclean hands defense should a competitor or anyone else cross the line in its use of another's trademark.

TERMINATIONS

COURT HOLDS FRANCHISE AGREEMENT NOT A PERSONAL SERVICES CONTRACT

In *Husain, et al. v. McDonald's Corp., et al.*, 2012 Cal. App. LEXIS 515 (Cal. Ct. App. Apr. 30, 2012), a California appellate court upheld the trial court's grant of a preliminary injunction allowing McDonald's franchisees to continue operating their franchises

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during the pendency of a lawsuit against the franchisor. The plaintiffs owned and operated multiple McDonald's franchises in Northern California. They brought suit and asked the trial court to force McDonald's to allow them to continue operating their franchises during the pendency of the litigation, which the court granted. McDonald's appealed, arguing that the trial court erred because the franchise agreements were personal service contracts which, as a matter of law, could not be specifically enforced.

In upholding the trial court's grant of a preliminary injunction, the appellate court held that the "close personal working relationship" between a franchisor and its franchisee does not automatically convert a franchise agreement into a personal services contract. The court found that the plaintiffs were not providing services to McDonald's; rather, they were providing a flow of income to the company. Thus, the appellate court rejected McDonald's argument that the injunction violated California law regarding the availability of specific performance of a personal services contract.

LIMITATION OF ACTIONS

GEORGIA DISTRICT COURT BARS CERTAIN CLAIMS ARISING FROM FRANCHISOR'S FAILURE TO DISCLOSE AN OWNER'S INTEREST IN DESIGNATED SUPPLIER

A U.S. District Court in Georgia granted a franchisor's motion to dismiss certain claims because of a contractual limitations period, but allowed the plaintiffs' RICO claims to move forward. In *Massey, Inc., et., al., v. Moe's Southwest Grill, LLC., et. al.*, 2012 U.S. Dist. LEXIS 53676 (N.D. Ga. April 17, 2012), Plaintiffs claimed that the franchisor failed to properly disclose to plaintiffs that its owner held an interest in a designated supplier. Although the owner held an interest in the supplier as early as 2001, the franchisor failed to disclose that interest until its 2004 Uniform Franchise Offering Circular.

Defendant moved to dismiss certain claims by arguing that they were barred by the one-year limitations period contained in the franchise agreements. Defendant argued that the plaintiffs received notice of the ownership interest through the franchisor's UFOC more than one year before they brought this action. The court agreed and rejected the plaintiffs' argument that because they were under no legal duty to read the UFOC provided to them, they should not be assumed to have read the information in the UFOC.

Defendant also moved to dismiss plaintiffs' RICO counts, arguing that plaintiffs failed to prove that there was theft by deception. The court disagreed, finding that because the franchisor failed to disclose the ownership interest until 2004, it suggested that its owner did not have an interest in the supply chain and that plaintiffs may have been harmed due to the additional surcharges on their products.

SETTLEMENT

COURT FINDS FORMER FRANCHISEE IN CONTEMPT

A Michigan federal court found a former franchisee in contempt of a court order after she failed to take affirmative steps to transfer the telephone number of her terminated franchise to the franchisor. In *Allegra Network LLC v. Bagnall*, 2012 U.S. Dist. LEXIS 48918 (E.D. Mich. Apr. 6, 2012), the franchisor filed a motion for preliminary injunction after learning that the franchisee was operating a competing printing business at the location at which it had previously operated its franchise. To settle that matter, the parties entered into a stipulated injunction in which the former franchisee agreed to "immediately" transfer the business' telephone number to the franchisor. In late December 2011, the former franchisee's counsel assured the franchisor that the transfer would happen within a week. However, the transfer did not occur until a few weeks later and without the franchisor's knowledge. When the franchisor finally learned of the transfer, the number had been claimed by another party. The franchisor then filed a motion to hold the former franchisee in contempt.

The court found the former franchisee in contempt because she had violated the stipulated injunction by failing to transfer the telephone number to the franchisor. Her admission that she waited two weeks to contact the telephone service provider and did not provide it with a copy of the injunction was clear and convincing evidence that she had violated the injunction. The court concluded that the franchisee should have taken affirmative steps to have her husband transfer the number in a timely fashion, including having him execute a legal instrument transferring his interest in the number and seeking the assistance of her attorney. As a result, the court directed the former franchisee to take all actions necessary to transfer the number to the franchisor and levied a civil penalty for each day the number was not transferred.

FRANCHISE SALES/TRANSACTIONS

CLOSING ADDENDUM AND INTEGRATION CLAUSE DEFEAT CLAIM OF UNLAWFUL FINANCIAL PERFORMANCE REPRESENTATION

In a recent decision, a federal district court in the Eastern District of Pennsylvania granted summary judgment to a franchisor on a terminated franchisee's counterclaim. In *Vino 100, LLC v. Smoke on the Water, LLC,* 2012 U.S. Dist. LEXIS 46465 (E.D. Penn. Mar. 30, 2012), a wine/tobacco store franchisee had been terminated for failure to pay royalties and for breaching its lease agreement for the franchised business premises due to nonpayment. As a defense and counterclaim to the franchisor's action for damages, the franchisee asserted that the franchisor had made an unlawful, undisclosed financial performance representation during the sales process, in violation of the FTC's Franchise

Rule. The franchisee argued that this violation rendered the franchise agreements at issue void as against the public policy of Pennsylvania.

The court noted that the Franchise Rule empowers the FTC (and not individual litigants) to enforce its provisions. Further, although Pennsylvania law states that courts will not enforce contracts that are opposed to the public interest, the franchisee's assertion that Pennsylvania law therefore incorporated the disclosure requirements of the FTC Franchise Rule was without merit. The court also held that the franchisee did not have a viable claim for fraudulent inducement of the franchise agreements. Given that the franchise agreements contained an integration clause and a separate closing addendum, both of which stated that no earnings information had been provided by the franchisor, the parol evidence rule prevented the franchisee from relying on the franchisor's alleged oral financial performance representations.

JURISDICTION AND PROCEDURE

MARYLAND DISTRICT COURT DISMISSES FRANCHISEE DEFENDANTS FROM CASE AFTER FINDING LACK OF PERSONAL JURISDICTION

In *Ohio Learning Centers, LLC et al. v. Sylvan Learning, Inc. et al.*, No. RDB-10-1932, 2012 U.S. Dist. LEXIS 57151 (D. Md. Apr. 24, 2012), the United States District Court for the District of Maryland granted an Ohio-based franchisee's motion to dismiss for lack of personal jurisdiction in a case brought against it and the franchisor by another Ohio-based franchisee, holding that the defendant franchisee did not have sufficient minimum contacts with the state of Maryland. The plaintiff franchisee had sued both the franchisor and defendant franchisee in Maryland alleging fraudulent inducement to purchase a franchise against the franchisor and tortious interference, antitrust, and conspiracy claims against the defendant franchisee.

Although the plaintiff franchisee argued that the defendant franchisee had sufficient minimum contacts with Maryland because he attended quarterly meetings and a week-long training session in Maryland and made monthly payments to and purchased supplies and promotional materials from the franchisor in Maryland, the court rejected those arguments. Instead, it held that the defendant franchisee's contacts were "isolated," "infrequent and negligible," and "can hardly be said to be 'continuous and systematic.'" The court also rejected the plaintiff's argument that jurisdiction was appropriate based on a conspiracy theory of personal jurisdiction. Under that theory, a court may exercise personal jurisdiction over a nonresident defendant without sufficient contacts with the forum if the nonresident defendant was part of a conspiracy that committed jurisdictionally sufficient acts within the forum. Here, the court held that the plaintiff had failed to make a prima facie showing of conspiracy because it had not sufficiently pled facts in the Complaint in support of the conspiracy claim.

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