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RECENT CASES

Here are some of the most recent judicial developments of interest to franchisors:

ARBITRATION

AMERICAN ARBITRATION ASSOCIATION ENFORCES CONTRACTUAL REQUIREMENT THAT ARBITRATION BE CONDUCTED ON AN INDIVIDUAL BASIS

In a decision of interest to franchisors and their counsel, a franchisor represented by Gray Plant Mooty recently obtained an important victory before the American Arbitration Association, which placed into abeyance a claim brought by a group of seven franchisees. In Bertuli et al v. Verlo Mattress Factory Stores, LLC, et al, Case No. 51 114 Y 00940 06, each franchisee had executed a franchise agreement that provided that:

> The Company and Franchisee agree that arbitration shall be conducted on an individual, not a class-wide, basis and that an arbitration proceeding between the Company and Franchisee shall not be consolidated with any other arbitration proceeding involving the Company and any other person, corporation, partnership or limited liability company.

Despite that language, the seven franchisees, represented by Dady & Garner, together commenced an arbitration proceeding against the franchisor challenging various system-wide practices. The franchisees argued that their agreements did not bar their joint action, as that action was not brought as a class action but was instead brought as related individual claims. The franchisees also denied that they had "consolidated" their claims because they had commenced their action jointly from the beginning and had not first filed individual claims then later asked that those claims be consolidated.

Upon a motion by the franchisor, the American Arbitration Association rejected the franchisees' claims and placed the matter into abeyance. The case administrator informed the franchisees that the AAA would not consider their claims until they were commenced individually as required by the franchise agreements. While the franchisees requested that this issue be submitted to the arbitrator for resolution, the AAA administratively found the claims to be barred by the plain language of the franchise agreements. This decision thus represents a powerful tool for franchisors seeking to prevent arbitration on a collective basis by a group of franchisees.

CONNECTICUT COURT HOLDS THAT IT HAS AUTHORITY TO ADMIT CALIFORNIA COUNSEL TO PRACTICE BEFORE A CONNECTICUT ARBITRATION PANEL

In Doctor's Associates, Inc. v. Jamieson, 2006 WL 2348849 (Conn. Super. Ct. July 19, 2006), the court addressed the issue of whether the representation of a client in an arbitration proceeding in Connecticut constitutes the practice of law. The issue arose after the franchisees sought admission of two California attorneys to represent them in an arbitration commenced by Doctor's Associates, Inc. ("DAI") in Connecticut. By statute, Connecticut prohibits the "unauthorized practice of law."

After concluding that the California attorneys would, in fact, be practicing law in Connecticut if they represented the franchisees in the arbitration, the court held that it had the authority to admit California counsel to practice before a Connecticut arbitration panel.

This case is a good reminder to franchise counsel that they either need to be a member of the bar in the state in which the arbitration is located or seek pro hac vice admission through the court (or, in some instances, comply with the specific statute or rule concerning the practice of law in private arbitration proceedings) before they can represent a franchise client in the arbitration proceeding. Failure to do so may result in sanctions or disciplinary action by the state bar in which the proceeding is located.

STATE FRANCHISE LAWS/VIOLATIONS/TERMINATIONS

COURT APPLIES CALIFORNIA FRANCHISE RELATIONS ACT TO NON-RESIDENT FRANCHISEE

In Gabana Gulf Distribution, Ltd. v. Gap International Sales, Inc., 2006 WL 2355092 (N.D. Cal. Aug. 14, 2006), the court considered a motion to dismiss brought by defendant Gap. Plaintiff signed a series of agreements with Gap whereby plaintiff was granted the right to serve as a distributor of Gap merchandise in defined territories. When Gap sought to terminate its agreement with plaintiff, plaintiff filed suit claiming that Gap's purported termination violated the California Franchise Relations Act. In response, Gap argued that the Act could not apply to plaintiff, as that company was not domiciled in California and did not do business within the state. Gap further argued that plaintiff's complaint failed to state a claim upon which relief could be granted as the parties' contract expressly disclaimed a franchise relationship.

The court denied Gap's motion to dismiss. The court agreed with Gap that plaintiff was not domiciled in California and did not conduct its allegedly franchised business in California. Because of those facts, the court agreed that the Act would not normally apply to plaintiff. The court found, however, that the Act did apply to plaintiff because the parties had contractually agreed to treat plaintiff as a California resident. Specifically, the parties' contract provided that their relationship would be governed by California law "as applied to agreements entered into and to be performed entirely within California between California residents." While an ordinary choice of law clause is insufficient to bring a party within the scope of the California Franchise Relations Act, the court found that the language employed here purposely agreed to treat plaintiff as a California resident entitled to the Act's protection.

The court also found that plaintiff had properly alleged it was a franchisee, despite the language of its contract disclaiming such a relationship. For that reason as well, the court denied Gap's motion to dismiss.

COURT REFUSES TO APPLY INDIANA FRANCHISE ACT TO FLORIDA FRANCHISEE

In Manufacturer Direct LLC v. DirectBuy, Inc., No. 2:05-CV-451, 2006 WL 2095247 (N.D. Ind. July 26, 2006), Plaintiff Manufacturer Direct operated a DirectBuy franchise in West Palm Beach, Florida. Defendant DirectBuy is the franchisor for the system and it served Plaintiff with a notice of termination after concluding that Plaintiff overcharged its customers for goods sold, in contravention of the express terms of the franchise agreement. Plaintiff then filed suit in Indiana for declaratory relief; wrongful termination in violation of the Indiana Franchise Act; tortious interference with contract and/or prospective economic advantage; breach of contract; and breach of the implied covenant of good faith and fair dealing. The subject of the Court's ruling was DirectBuy's motion for judgment on the pleadings, which the Court granted in part and denied in part.

The Court held that Plaintiff, a Florida company operating its business in West Palm Beach, Florida, was not entitled to the protections of the Indiana Franchise Act because, as the statutory languages makes plain, the Act applies only to "residents of Indiana" or those "who will be operating a business in Indiana." The Court was not persuaded by Plaintiff's argument that it conducted business in Indiana by virtue of the franchisor's location there. The Court further held that the franchise agreement's general choice of law provision did not create any rights under the Indiana Franchise Act. Consequently, the Court dismissed the claim.

The tortious interference claim, which was predicated on DirectBuy's refusal to approve a sale of the franchise, was also dismissed. Finding that the express terms of the franchise agreement provided DirectBuy with the discretion to approve any sale and to require that remodeling be completed as a term of a sale, the Court ruled that Plaintiff failed to assert any allegations sufficient to override the terms of the agreement or to conclude that DirectBuy's decision was without a business justification.

Plaintiff's claims for breach of contract and breach of the implied covenant of fair dealing survived the motion to dismiss. Unlike other jurisdictions, Indiana does not impute an implied duty of good faith and fair dealing into every contract.

However, Plaintiff argued that the Uniform Commercial Code's "good faith" requirement was applicable to the franchise agreement. In denying the motion, the Court seemingly agreed and stated that the franchise agreement's specific language may open the possibility that the UCC's covenant language would apply. Notably, the Court advised the parties that they could revisit the issue during summary judgment proceedings.

Finally, DirectBuy was not able to overcome its burden of proving that, at such an early stage and based on the pleadings alone, Plaintiff overcharged its customers for goods sold. Therefore, the Court did not dismiss Plaintiff's breach of contract claim or claim for declaratory relief.

WISCONSIN FEDERAL COURT DENIES MOTION FOR PRELIMINARY INJUNCTION UNDER WISCONSIN FAIR DEALERSHIP LAW

In S&S Sales Corp. v. Marvin Lumber & Cedar Co., No. 06C0354 (D. Wis. June 20, 2006), the United States District Court for the Eastern District of Wisconsin denied S&S Sales Corporation's motion for preliminary injunction based on Marvin Lumber & Cedar Company's alleged violation of the Wisconsin Fair Dealership Law.

Under the terms of a 1987 oral agreement between the parties, S&S served as a top-level distributor of Marvin windows, as part of Marvin's two-step distribution system. Claiming a need to respond to changing market conditions, however, Marvin notified S&S in May 2005 that Marvin would begin selling directly to larger dealers located in eastern Wisconsin. Despite initial resistance from S&S, and the parties' failure to reach a mutual settlement of their differences, in February 2006 Marvin ultimately notified S&S of its intent to move forward with the direct sales campaign effective June 2006. In reply, S&S filed suit claiming Marvin violated the Wisconsin Fair Dealership Law ("WFDL") by substantially changing the competitive circumstances of the parties' dealer agreement without good cause, and seeking a preliminary injunction. The WFDL is among the broadest of the various state relationship laws.

In reviewing S&S's motion to enjoin Marvin's direct sales initiative, the court considered whether, once a plaintiff establishes the likelihood of a WFDL violation, the law gives rise to a rebuttable or irrebuttable presumption of irreparable harm. Section 135.065 of the WFDL provides that "any violation of this chapter by the grantor is deemed an irreparable injury to the dealer for determining if a temporary injunction should be issued." Looking to the legislative history and applicable case law, the court found support for the proposition that the statute creates a rebuttable presumption of irreparable harm. The court was further persuaded by general principles of constitutional law, explaining that if § 135.065 were construed as creating an irrebuttable presumption of irreparable injury: (i) the law would unduly infringe upon the judiciary's power; and (ii) the law would violate due process by eliminating use of an otherwise manageable case-by-case analysis as to whether irreparable harm has actually occurred. Accordingly, finding that Marvin presented sufficient evidence to rebut the notion of irreparable harm, and that S&S failed to demonstrate that its damages would be difficult to calculate were its motion for preliminary injunction denied, the court held in favor of Marvin.

VENUE/CHOICE OF FORUM

FORUM SELECTION CLAUSE ENFORCEABLE POST TERMINATION

A recent decision from the District Court of Appeals of Florida, Third District, upheld a forum selection clause in a franchise agreement after that agreement was terminated. DVDPLAY, INC. v. DVD 123, LLC, 930 So.2d 816 (Fla. App. 2006). In this case, the franchisor, DVDPLAY, INC., required that all claims arising out of or related to the franchise agreement would be subject to non-binding mediation. The franchise agreement also had a forum selection clause that required all legal action to be brought in California, which was the franchisor's principal place of business.

A dispute arose between the franchisor and the franchisee. The franchisee alleged that the franchisor was in breach of the franchise agreement and requested mediation. The franchisor responded to the request for mediation by denying that it was in breach of the franchise agreement and claimed instead that the franchisee was in breach of the franchise agreement. The franchisor requested that an additional issue be added to the request for mediation and demanded that the franchisee immediately contact it to schedule the proceeding. After receiving no response, the franchisor sent a letter to the franchisee stating that it was terminating the franchise agreement. Upon receiving this letter, the franchisee responded by denying the allegations that it had breached the franchise agreement, and continue to request mediation.

The franchisor refused, stating that the franchise agreement had already been terminated, and therefore nothing was left to mediate. In response, the franchisee filed a lawsuit against the franchisor in Florida.

The franchisor moved to dismiss the lawsuit arguing that it violated the forum selection clause in the franchise agreement. The Florida district court denied the motion, stating that the franchisor's repudiation of the franchise agreement made the forum selection clause unenforceable. The franchisor appealed. On appeal, the court held that despite the franchisor's refusal to mediate, the forum selection clause was enforceable because the parties clearly intended the forum selection clause to survive the termination of the franchise agreement. The court stated that the only way for the franchisee to escape the forum selection clause was to argue that somehow the clause was unjust or unreasonable as a result of unequal bargaining power. The court noted that the franchisee did not argue that the forum selection clause was unjust or unreasonable, but instead relied upon the franchisor's repudiation of the franchise agreement.

BREACH OF CONTRACT

FRANCHISOR OBTAINS SUMMARY JUDGEMENT AGAINST TERMINATED FRANCHISEE FOR PAST DUE FEES AND LIQUIDATED DAMAGES

In Holiday Hospitality Franchising, Inc. v. 174 West Street Corp., No. 1:05-CV-1419-TWT, 2006 WL 2038550 (N.D. Ga. July 19, 2006), Plaintiff Franchisor sued defendant to recoup outstanding franchise fees in the amount of $45,115.71 and to recoup liquidated damages in the amount of $612,811.08. Defendant 174 West Street, a subsidiary of the Irish company The O'Callaghan Hotels Group, Ltd., entered into a franchise agreement with plaintiff Holiday Hospitality Franchising to operate a Holiday Inn in Annapolis, Maryland. After a few months of operation, defendant notified plaintiff that it was not satisfied with the franchise arrangement and that it was concerned with the poor perception of the quality of the Holiday Inn brand. Five months after entering into the franchise agreement with plaintiff, defendant discontinued operating as a Holiday Inn franchisee. Plaintiff terminated the franchise agreement and sued defendant.

On plaintiff's motion for summary judgment, defendant asserted that it was entitled to breach the contract, offering three defenses in support: (a) that it was fraudulently induced; (b) that plaintiff's two sales representatives made untrue earnings claims in violation of franchise laws, entitling defendant to rescind the contract; and (c) that plaintiff's breach of contract entitled defendant to discontinue paying royalty fees and that the liquidated damages clause was excessive.

As to the first defense, the court stated that this was just a "flimsy litigation-inspired excuse" and that these were sophisticated parties, each represented by counsel in negotiations of the franchise agreement. As to the second defense, the court found defendant's reading of the applicable statute was strained at best since the statute provided for two remedies, neither of which provided for rescission of the contract. In any event, defendant had waived any right to rescind the contract by waiting three years after the filing the lawsuit to make this argument while at the same time choosing to retain the benefits it reaped from its short operation as a Holiday Inn franchisee. Finally, as to defendant's last defense, the court disregarded defendant's argument that plaintiff had breached the agreement and found the liquidated damages reasonable. The court rejected all of defendant's defenses and granted plaintiff's motion for summary judgment.

JURY TRIAL WAIVER

JURY TRIAL WAIVER IN FRANCHISE AGREEMENT UPHELD

In a decision that provides a well-reasoned analysis that could be useful to franchisors in other cases, a federal district court in Pennsylvania granted a franchisor's motion to strike a jury demand in Bishop v. GNC Franchising, LLC, 2006 WL 2266251 (W.D. Pa. Jan. 13, 2006). The plaintiffs had signed franchise agreements that clearly provided that any trial "shall be to a court of competent jurisdiction and not to a jury. Franchisor and Franchisee hereby irrevocably waive any right either party may have to a trial by jury." Nonetheless, in a lawsuit in which they were represented by attorney Jeffrey M. Goldstein of Washington D.C., the plaintiffs demanded a jury trial. (The court trial resulted in a win by the franchisor on all remaining issues, with the plaintiffs subsequently being ordered to pay the franchisor $350,719.71 in attorney's fees and expenses pursuant to the "prevailing party" provisions of the franchise agreement.)

In striking the jury demand, the district court applied the test to determine if the waiver by the franchisees was "knowing and voluntary." First, the court found there was no gross disparity of bargaining power between the franchisor and franchisees. The rationale of the court that will be helpful to franchisors in similar cases focused on why the plaintiff franchisees were sufficiently "sophisticated" to understand the waiver provisions: one franchisee had pursued an undergraduate degree in business administration and had once had a job managing 170 employees in a $15 million dollar transportation company; the other franchisee had worked as an advertising sales representative. Those facts were sufficient to show sophistication, the court found. The waiver was also found to be "conspicuous," in large part because the provision was entitled "Jury Trial Waiver and Other Mutual Waivers." Finally, the court found that the franchise agreement was not a "contract of adhesion" even though a high-ranking executive of the franchisor had allegedly said the contract was "non-negotiable." The franchisees "were under no pressure to purchase the franchise at issue," the court concluded, so their acceptance of the jury trial waiver remained voluntary.

The court did not decide the issue of which party has the burden to prove that the waiver was voluntary, knowing, and intelligent, but held that the franchisor could clearly show those factors even if it had to carry that burden.

VICARIOUS LIABILITY

NEW HAMPSHIRE SUPREME COURT HOLDS THAT FRANCHISOR HAS NO DUTY TO ENSURE THE SAFETY OF ITS FRANCHISEES' EMPLOYEES

In VanDeMark v. McDonald's Corp., 2006 WL 2034071 (N.H. July 21, 2006), the New Hampshire Supreme Court addressed, for the first time, the issue of whether a franchisor has a duty to ensure the safety of a franchisee's employees. The court concluded that no such duty existed for at least four reasons. First, the franchisor's operations and training manuals encouraged the franchisee to adopt its own policies for its restaurant. Second, the franchise agreement specifically stated that the franchisee was an independent contractor and was not an agent of the franchisor. Third, the franchisee was not required to follow the franchisor's security policies. Finally, the franchisor made no affirmative attempt to provide security to the employees of the franchisee. Based upon these facts, the court held that the franchisor did not assume a duty to ensure the safety of the franchisee's employees.

As part of its holding, the New Hampshire Supreme Court noted that the weight of authority from other jurisdictions construes franchisor liability narrowly, finding that absent a showing of control over security measures employed by the franchisee, the franchisor cannot be vicariously liable for the security breach.

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